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## Zimbabwe's hard sell

18<sup>th</sup> June 2009 | From *The Economist* print edition

*So far Morgan Tsvangirai's ground-breaking tour of America and Europe has brought plaudits rather than cash for Zimbabwe's battered economy*

IT IS Monday, so it must be Berlin. Or is it Stockholm? Morgan Tsvangirai may be forgiven for occasionally losing track, so crammed has his schedule been on his first official tour abroad as Zimbabwe's prime minister. On June 15th it was the turn of Germany's chancellor, Angela Merkel (pictured above), to meet him in Berlin, after he had spent a few days in Washington, DC, where he met President Barack Obama. Then he headed north to meet the Swedes, before flying across to Norway. He was also due to meet the leaders of Belgium, Denmark and France, plus officials from the European Union. Finally, on June 19th, he is to visit Britain for several days to hobnob with the prime minister, Gordon Brown, plus various other politicians and would-be investors.

Mr Tsvangirai always knew that this first official visit would be tricky. Tendai Biti, his finance minister, had already done the rounds of Western capitals with his begging-bowl and had come back empty-handed. So although the former opposition leader naturally hoped he would drum up a bit of extra cash for his shattered country, it was not the main aim of his trip. Rather it was to gain international support and recognition for himself and his Movement for Democratic Change (MDC) in their uneven power struggle with President Robert Mugabe and his Zanu-PF.

To that extent, the trip has already been a success. Anxious to boost Mr Tsvangirai at the expense of Mr Mugabe, foreign leaders have showered him with praise. Mr Obama talked about his "extraordinary admiration for the courage and the tenacity that the prime minister has shown in navigating through some very difficult political times." Ms Merkel said Mr Tsvangirai was a symbol of democracy and deserved support. He was also sure to get a warm reception in London, where successive British governments have led international opposition to Mr Mugabe's rule. In this respect, Mr Brown is as fiercely anti-Mugabe as his predecessors.

However, it is no surprise that the man who was beaten up, jailed and threatened with death by Mr Mugabe and his security forces is finding it hard to persuade his foreign hosts that the "period of acrimony" between himself and the despotic president is "over" and that Zimbabwe is now "on an irreversible transition to democracy". Few seem convinced. Some have even accused him of trying to deceive his interlocutors by painting too rosy a picture of the new Zimbabwe, perhaps out of a misplaced sense of patriotism.



Yes, there have been some improvements. The hyperinflation of recent years, for instance, has been brought under control. But Zanu-PF is already warning its people to prepare for a snap election, perhaps as early as next March, in an apparent attempt by Mr Mugabe to block the introduction of a planned new constitution, with clear limits on executive power and strict rules for elections. Four months after the unity government was set up, Mr Mugabe still completely controls the armed forces, the police, the intelligence service, the media and criminal justice. Political opponents and human-rights campaigners are still arrested and thrown into the country's jails on trumped-up charges.

White-owned farms are still being seized and invaded. Gideon Gono, the central-bank governor who oversaw the hyperinflation that helped destroy the country's once-flourishing economy, is still in his job. And the 85-year-old Mr Mugabe continues to call the shots in what is supposed to be a partnership of equals.

So Mr Tsvangirai got little change when it came to winning direct financial support for his power-sharing government. Likely donors still fear that too much of their cash would be stolen and squandered by Mr Mugabe's entrenched cronies. Mr Obama pledged \$73m in humanitarian aid when he met Mr Tsvangirai. But most of this is not new money and the American president stressed that it would go "directly to the Zimbabwean people" and nowhere near the government.

### **Don't give it to the bad guy**

Mr Obama also refused to lift the personal sanctions imposed on Mr Mugabe and other members of his regime nine years ago. Ms Merkel promised €25m (\$35m), but this was also earmarked for education, health and farming. Zimbabwe already gets about \$1 billion a year in humanitarian aid, which bypasses the government. A little of this already does go on what could be termed development projects, but for the moment Western governments are keen to spend most of this money on basic help for people who need food, medicine and clean water.

Zimbabwe's government-controlled media are belittling Mr Tsvangirai's tour, first describing it as merely an MDC fund-raising mission, then claiming he was just "on assignment" at the president's behest to press for the removal of sanctions and the restoration of the country's lines of credit—both untrue. None of Mr Obama's praise for the prime minister was mentioned in the state media, which failed even to show pictures of their meeting.

That he has been welcomed by some of the world's most powerful leaders and given a red-carpet treatment wherever he goes is itself a notable advance for Zimbabwe.

But at this stage Mr Tsvangirai can hope for little more.

## What did Bermuda get for taking Guantanamo detainees?

19<sup>th</sup> June 2009 | By Sir Ronald Sanders



I had to read the words of the letter three times because I could not believe my eyes on either of the two previous readings. This is what the Chairman of the US Congress, Bill Delahunt, wrote to Bermuda Premier Ewart Brown when his government controversially agreed to give refuge to four Chinese Muslims, known as Uighurs, who had been detained by the US government at Guantanamo: "We commend you for your political courage for taking these men into your nation and providing them with a new start in life. It is our hope that the American people will come to learn of your humanitarian decency and the great service you have done our country. You as a moral leader have made the right decision and we applaud you for it."

Imagine the brazenness of Delahunt in commending Brown for his "political courage in taking these men" into his nation. It is political courage that neither Delahunt nor any of his fellow US congressmen showed. Not one of them wanted any of the Guantanamo detainees on their soil even though it is the US government that snatched them and detained them.

Delahunt went on to describe Brown's action as "humanitarian decency". He's right about that, and it is clear that it is "humanitarian decency" that neither Delahunt nor any of his fellow US congressmen can remotely claim for they were adamant that none of the Guantanamo detainees would be taken into the US.

Staggeringly, Delahunt then tells Brown that he is "a moral leader" who has made "the right decision" and that the US Congress applauds him for it. What a shameless statement. If we were to turn that statement around, Delahunt and his fellow congressmen who have refused to take these detainees on US soil, are not "moral" leaders; have not made "the right decision" and deserve to be jeered.

This characterisation would be especially true against the background of what Delahunt's patronising letter goes on to say. It reads: "Justice for the Uighur detainees is years overdue. Their right to remedy has been denied them for too long... It is incumbent on all parties to ensure that neither diplomatic friction nor domestic party politics - whether in the U.S.A., Bermuda, or elsewhere - interfere with the ability of the men to rebuild their lives peacefully and with all the support mechanisms they need to adapt to life after Guantánamo."

Everything Delahunt said about the four Uighurs is right. Since he knows it – and presumably so do the others in the US Congress on whose behalf he wrote – why did he not insist on their entry and settlement in the US which is responsible for them being detained in the first place?

Undoubtedly, some of the detainees at Guantanamo harbour ill-will toward the US because of perceived injuries by successive governments. Undoubtedly, some of them have committed hostile actions against the United States, and undoubtedly some of them would continue to take such actions if they could. As suspected terrorists under international law, they should be tried under international law and dealt with appropriately. But, other innocent countries and peoples ought not to be dragged into this.

And, if they are dragged in as Bermuda has been, gratitude to them should not be an afterthought. Witness US President Barack Obama at a press conference at which he thanked Silvio Berlusconi, the prime minister of Italy, for agreeing to take Guantanamo detainees. He adds to his Berlusconi thanks: "I have to say, by the way, that Bermuda has done us a great service, as well, on that front, and I'm grateful to them." By the way? By the way thanks to a little island that has risked the anger of the Peoples Republic of China, done the "moral" thing, showed "humanitarian decency" and made "the right decision"? Surely, Bermuda deserved better than that?

And they deserve better more particularly because the reason that the US State Department gave for not involving the British government in its discussions with Bermuda (a British Overseas Territory) is that it wanted to spare Britain the anger of the Chinese government. It should be recalled that the Chinese wanted the Uighurs sent to China, and that the US government had actually allowed Chinese intelligence personnel to question the Uighurs while they were in detention at Guantanamo. So the US saves Britain from Chinese anger, but leaves Bermuda exposed.

In all this, it is very puzzling that the US State Department had what amounts to secret discussions with the government of Bermuda without informing the British government. It is certainly within the knowledge of the US State Department that Bermuda is not a sovereign state; that it is a British Overseas Territory; and that the British government retains full responsibility for its external affairs, security and defence. Taking in the Uighurs is not simply a domestic immigration matter; it has significant foreign policy implications.

Are we to assume that the US State Department deliberately and intentionally ignored the authority of its closest ally in the "war against terror" in arranging the transfer of the four Guantanamo detainees to Bermuda? This simply does not make sense. We are, after all, talking about two countries with a long history of international diplomacy and, more especially, a long history of collaboration and cooperation.

The British government has certainly been adamant that Brown did not have the right to negotiate the transfer of the Uighurs from US custody without consulting Britain. Reportedly, there have been "angry telephone exchanges" with Brown. Significantly, there have been no reports of similar angry exchanges with the US State Department.

One British Newspaper has reported that "Britain's foreign secretary, David Miliband, is understood to have had an uneasy telephone conversation with the US secretary of state, Hillary Clinton, about why London was not told. Clinton reportedly said the US had assumed that Bermuda had agreed the move with Britain before agreeing to host the Uighurs."

In the fullness of time, who knew what and when about this entire episode will make interesting reading. In any event, the British Governor of Bermuda has said that, despite protests within Bermuda and calls for the resignation of Ewart Brown as Premier, the Uighurs will remain in Bermuda and they will not be returned either to Guantanamo or to China. The deal then has been sealed.

What has to be asked about this now is: what will Bermuda get for taking in the Uighurs? Whatever it is, it should be more than just a verbal expression of thanks. Premier Brown should demand more on behalf of all Bermudians.

## East Africa gets broadband

18<sup>th</sup> June 2009 | From *The Economist* print edition



THE Horn of Africa is one of the last populated bits of the planet without a proper connection to the world wide web. Instead of fibre-optic cable, which provides for cheap phone calls and YouTube-friendly surfing, its 200m or so people have had to rely on satellite links. This has kept international phone calls horribly overpriced and internet access equally extortionate and maddeningly slow.

But last week, in the Kenyan port of Mombasa, a regional communications revolution belatedly got under way when Kenya's president, Mwai Kibaki, plugged in the first of three fibre-optic submarine cables due to make landfall in Kenya in the next few months. They should speed up the connection of Burundi, Rwanda, Tanzania and Uganda, as well as bits of Somalia, Ethiopia and Sudan, to the online world. Laying the cable cost \$130m, mostly at the Kenyan government's expense; Mr Kibaki hailed the event for bringing "digital citizenship" to his countrymen.

The new cable will compete with the other two to be welcomed onshore, perhaps later this year. The hope is that the high bandwidth and fierce competition between the three cables will slash costs and help create new business. With a mass of young English-speakers only an hour or two ahead of Europe's time zones, east Africa should, with luck, be well-placed to compete with India and Sri Lanka for back-office work for Western companies. Broadband, say its promoters, will transform the lives of millions in countries such as Kenya and Sudan, almost as dramatically as mobile telephones have done—all the more so because of the parlous state of east Africa's more old-fashioned infrastructure, especially roads and railways.

A few call centres have already got a toehold in the market and expect to expand fast when the cables arrive. Security experts say cybercrime and junk mail may increase too. Still, mobile telephones, not internet cafés, will continue to grow the fastest. The number and quality of handsets should rise. In a couple of years even fairly poor east Africans may be getting knowledge, news and entertainment on robust versions of existing Apple iPhone and Palm Pre models. That, in turn, may prove to be a political as well as economic boon, as information gets shared "horizontally", among people rather than "vertically" via media outlets run by the political and commercial elites.

Rwanda may emerge as a winner. Its president, Paul Kagame, has long identified the internet as a key to his country's development, offering concessions to software companies setting up there. But Kenya also wants to cash in. It has abolished sales tax on computers and in last week's budget ended the sales tax on new mobile phones. It has also let businesses write off bandwidth purchases in the hope of dominating the regional internet market. That may make other countries push companies to drop their prices.

This is all good news for the often embattled east African consumer. But there is a worry over whether the cables will be properly maintained. Some people fear that the wires may be dug up. But few mobile-phone masts have apparently been stolen, so maybe the cables will survive. One idea in Kenya is to recruit spear-carrying Masai herdsmen to graze their cattle and goats on top of the twittering fibre, just as they already guard the oil pipeline that runs across their pastures.

## Way Forward on IP Issues at the WTO Still Unclear

17<sup>th</sup> June 2009 | From Bridges Weekly



Last week's WTO Council for Trade-Related Aspects of Intellectual Property Rights saw very little, if any, progress towards resolving TRIPS issues in the context of the Doha negotiations.

The Council, which met on 8 June, 2009 has yet to see substantial progress in the discussions on the three intellectual property issues that have dominated the talks thus far: extension of 'geographical indication', or GI, protections to all products; the establishment of a GI register; and the adoption of an amendment of the TRIPS agreement to require that patent applicants disclose the origin of any genetic resources or traditional knowledge used in the inventions.

Technical cooperation and capacity-building also arose at last week's meeting. But the issue that dominated the session was the recent seizure of a shipment of the generic drug Amoxicillin, which was held up by German customs officials in Frankfurt en route from India to Vanuatu.

### Delayed Movement on Disclosure Requirement

Movement on the disclosure requirement continues to be delayed by deep divisions among Member states as to how to move forward the discussions on this issue. "Most countries support the full negotiation of the TRIPs agreement on biological resources, traditional knowledge and folklore. However there is continuing lack of consensus," Egypt told the TRIPS Council on behalf of the African group.

"It is difficult and costly for developing countries to fight for their rights on biological resources and/or traditional knowledge," the Egyptian delegate added. "The disclosure requirement is important for poor communities to protect their rights."

Brazil also noted that the disclosure requirement was important for its contribution to commercialising biological resources; increasing the accessibility of genetic resources, traditional knowledge and folklore for society; widening developing countries' participation in the system; and creating an international uniform legal framework.

India also lent its support in this regard, pointing out that there is no contradiction between the TRIPS Agreement and the Convention on Biological Diversity (CBD). It also volunteered to create a traditional knowledge database, but stressed that such a measure should be complementary to the disclosure requirement, not a substitute for it.

Since 2006 a number of developing countries have called for an amendment to the TRIPS Agreement to include a mandatory requirement for patent applicants to disclose the origin of any genetic resources and/or associated traditional knowledge involved in their inventions. In July 2008, an unprecedented coalition of developed and developing countries put forward a proposal to this effect, often referred to as the 'draft modalities text' on IP issues at the WTO.

Originally proposed by Brazil, China, Colombia, Cuba, India, Pakistan, Peru, Thailand and Tanzania, by last summer, the proposal had drawn the support of more than 100 WTO Members, including the EU and Switzerland.

At last week's meeting, these two developed members also reaffirmed their commitment to the proposal - document TN/C/W/52 - and expressed their readiness to address the developing countries' concerns. Although the EU has said it sees some merits in other proposals, such as the database approach favoured principally by Japan, it does not consider such alternatives to be as sufficient or as effective as the disclosure requirement.

The United States, joined by Argentina, Australia, Canada, Chile, Japan, New Zealand and Taiwan reaffirmed its opposition to the approach spelled out in the draft modalities. According to the US, the disclosure requirement is not essential and bringing CBD into the TRIPS Agreement would not make sense.

The draft modalities proposal calls for the inclusion of the IP issues "as part of the horizontal process" of the Doha round, advocating that the three controversial IP issues be included in the negotiations as part of the 'single-undertaking'.

The coalition that supports the 'draft modalities' includes more two-thirds of the WTO membership, but that stance has been met with strong opposition from Australia, Canada, Chile, Mexico, New Zealand, South Korea, Taiwan and the US, who have sponsored a competing initiative dubbed the 'joint proposal'. These countries hold that including intellectual property issues in the horizontal negotiations on modalities in the industrial and agricultural sectors would "substantially set back efforts to arrive at a viable way forward for the Doha negotiations."

#### **Outsourcing Discussions of TRIPS and the CBD?**

Australia, Canada, and New Zealand suggested the possibility of shifting discussions on the TRIPS Agreement and the CBD to another forum. According to sources, these countries proposed that discussions on this issue might be better placed in the World Intellectual Property Organisation, where there is a specific committee to address genetic resources issues.

But several developing-country Members opposed the suggestion to shift these discussions to WIPO. Given the urgency of halting the misappropriation of genetic resources, these countries say, the international community needs an amendment to the TRIPS Agreement, as such a measure would be binding and therefore stronger than an agreement outside the WTO.

#### **Technical Cooperation and Capacity-building**

Egypt suggested that all approaches to technical cooperation and capacity-building should be development-oriented, driven by demand, neutral and transparent. As many countries supported this suggestion, Uganda shared its experience on two capacity-building projects funded by the EU and expressed its need for more technical cooperation.

While noting the experience of Uganda, the Swiss delegate proposed that an assessment be undertaken by least developed countries in order to provide a basis for effective assistance. The delegate also offered that nations should coordinate to avoid repetition and ensure efficiency. Switzerland's proposal was welcomed by many countries.



### Special Session on GI Register

A special session of the TRIPS council met on 10 June under the chairmanship of Ambassador Trevor Clarke of Barbados. These special sessions are specifically mandated to discuss the creation of a multilateral register for geographical indications on wines and spirits.

During the session, several Members requested that the proponents of a mandatory, legally binding GI register draft a legal text detailing how such a mechanism would function. But this request was promptly refused, as the EU, one of the main supporters of the proposal, dismissed the request as an unnecessary diversion from the real issue at hand - the level of Member participation in the register and the consequences of such participation.

Other Members added that a legal text on the GI register section would be difficult to draft, considering that the document is a negotiated compromised text. They say it may prove difficult to reach consensus on further details.

The two other proposals for a GI register on the table are the 'joint proposal' advocated by the opponents to a mandatory and legally binding register and the 'Hong Kong proposal'. Both of the proposals have been drafted as legal texts.

Several member states, including China, Angola, Pakistan, and Peru, expressed their disappointment in the slow progress the TRIPS Council has made on these three main IP issues. According to Ambassador Clarke, progress in the special sessions will remain slow as some Members prefer to have the three IP issues move forward together in the broader context of the Doha Round.

The next session of the TRIPS council is scheduled for later this year.

### BRICs, emerging markets and the world economy

18<sup>th</sup> June 2009 | From *The Economist* print edition



The biggest emerging economies are rebounding, even without recovery in the West. The inaugural summit of the BRICs—Brazil, Russia, India, China—came and went in Yekaterinburg this week with more rhetoric than substance. Although Russia's president, Dmitry Medvedev, called it "the epicentre of world politics", this disparate quartet signally failed to rival the Group of Eight industrial countries as a forum for economic discussion.

But that should be no surprise: to realise how disparate they are, consider that Russia and Brazil are big commodity exporters, whereas China is a big commodity importer; China is a proponent of the Doha trade round, India a sceptic; India and China vie for influence in the Indian Ocean, Russia and China compete in Central Asia.

Instead, the really striking thing is that four countries first lumped together as a group by the chief economist of Goldman Sachs chose to convene at all, and in such a high-profile way. And that when they met, they discussed topics such as reforming the IMF; their demand for more say in global policy-making; and, in the case of China, Brazil and Russia, a plan to switch some of their foreign-currency reserves out of dollars and into IMF bonds.

All this reflects growing self-confidence. The largest emerging markets are recovering fast and starting to think the recession may mark another milestone in a worldwide shift of economic power away from the West. Estimates for their national incomes in the first quarter were better than expected. In the year to the end of March GDP rose by around 6% in China and India. The two accounted for no less than half the world's increase in wireless-technology subscriptions in that period. In Brazil gdp fell slightly in the first quarter but it is growing faster than the Latin American average and most economists think growth will return to its pre-crisis level as early as next year. In contrast, output in most large industrial economies is still falling. The exception in the BRICs is the host: dragged down by plunging oil prices last year, Russia's economy shrank by 9.5% in the first quarter, the worst performance in the G20 after Japan.

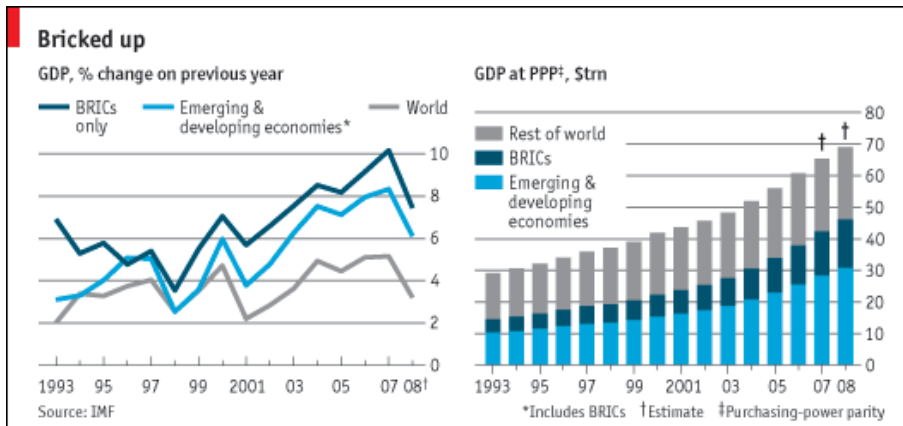
The fortunes of the others mark a sharp rebound since the turn of the year. Then, it seemed, the largest emerging markets faced being overwhelmed along with everyone else. Chinese exports in January were 18% lower than they had been a year earlier. Industrial growth fell by two-thirds in November and December. And around 20m migrant workers were wending their way back to their villages, jobless after the collapse of construction and export booms in coastal cities. The notion of "decoupling"—that emerging markets were no longer mere moons revolving around planet West—suffered a severe setback.

So what should one make of the turnaround? Might there be something to decoupling after all? Why are the BRICs recovering? And what are the implications for the rest of the world?

Decoupling means not simply that emerging markets tend to grow faster than rich industrial ones, although that is certainly true; it also implies that to some extent the two groups dance to different tunes, with emerging markets growing or shrinking autonomously, not just under the influence of rich ones. A study last year by Ayhan Kose of the IMF, Christopher Otrok of the University of Virginia and Eswar Prasad of Cornell University gave some support to this idea.

You would expect less decoupling as a result of globalisation. The cycles of output, consumption and investment should become more closely aligned in countries engaged in world trade. Yet when the authors looked at these indicators, they found something different. The cycles of output, consumption and investment did indeed become more closely aligned in rich countries. And the same thing happened in emerging markets. But when the authors compared the two groups, they found they were diverging. The business cycles of America and Europe converged. The business cycles of India and China converged. The business cycles of rich and emerging markets had decoupled.

When this study came out in mid-2008 the worldwide crash seemed to render it instantly obsolete. Yet the sheer size of the meltdown may temporarily have swamped deeper trends that are now reasserting themselves as the initial shock recedes. In 2000 developing countries accounted for 37% of world output (at purchasing power parities). Last year their share rose to 45%. The share of the BRICs leapt from 16% to 22%, a sharp rise in such a short period. Almost 60% of all the increase in world output that occurred in 2000-08 happened in developing countries; half of it took place in the BRICs alone (see chart).



If this pattern of growth were resuming, it would be good news: nearly half the world economy would be bouncing back. And there are one or two signs that the benefits of growth in the BRICs are being felt farther afield. Anecdotal evidence suggests “south-south” trade and investment by richer emerging markets in poorer ones continued to rise even as global capital and trade flows fell. One example of this is the “land grab” in which China and Gulf countries are

buying millions of acres of farmland in Africa and South-East Asia. China overtook America to become Brazil’s largest export market in March and April; it is also now the largest exporter to India. China is using its \$2 trillion of foreign reserves to invest in other emerging markets: for example, putting \$10 billion into Petrobras, Brazil’s state-run oil company.

China’s appetite for raw materials to fuel resurgent growth probably explains the 36% rise in industrial raw-material prices since the start of this year, benefiting exporters of things like copper—though how long this will last is an open question. If it comes from the boom in Chinese investment spending, then the boom could continue. If China is merely filling its stores temporarily after a period of destocking, then prices could fall again.

But the resilience of China, India and Brazil cannot offset the dire state of the rest of the world economy. While the three giants recover, developing countries as a whole are mired in recession. The giants seem to be decoupling not only from the West but from many of their smaller emerging brethren, too.

A series of reports confirms how badly things are going there. A review of ten poor countries by the Overseas Development Institute, a think-tank in London, concludes that they were worse hit than anyone expected, with sharp declines in remittances, employment and revenues and widespread balance-of-payments problems. As the study’s author, Dirk Willem te Velde, points out, the differences are often striking. In some countries—Indonesia, Kenya, Bangladesh—foreign direct investment has held up reasonably well; others—Ghana, Nigeria and Zambia—are facing sharp declines. Cambodian textile exports have been hit harder than Bangladeshi ones. But because import demand, capital flows and the need for foreign workers declined precipitously in the West, almost all developing countries are suffering.

In its most recent assessment, the United Nations says at least 60 poor and emerging markets will this year suffer falls in income per person. The UN’s forecasts for eastern Europe and sub-Saharan Africa are especially dark. For eastern Europe, Russia and its neighbours, the body predicts a fall in output of 5%. Arvind Subramanian, an economist at the Peterson Institute for International Economics, a think-tank in Washington, DC, argues that the recession in eastern Europe sounds the death knell for one of the two main growth strategies of the past 20 years—capital-account liberalisation (growth through exports is the other). The east European countries threw their financial sectors open to the world. In 11 of the region’s countries, foreign banks account for over 60% of bank assets. The flood of foreign-currency borrowing destabilised their economies and left them vulnerable when Western banks reduced lending.

In Africa, the UN predicts, output will now fall by 0.9%. That might not sound too bad but only two months ago the IMF was forecasting a rise of 1.7% and at the start of the year the UN had projected a 4.8% increase. To return to pre-crisis growth, says the African Development Bank (AFDB), would require the continent to attract \$50 billion of new money this year. Africa is nowhere near those levels because world capital flows are falling. The latest forecast by the Institute of International Finance says total net flows will collapse from \$890 billion in 2007 to just \$141 billion this year.

The AFDB fears that “a growth crisis” may be turning into a “development crisis”, leading to sharp increases in poverty and malnutrition. By the end of 2009, says the UN, there will be between 105m and 143m more people in poverty than if growth had continued at its pre-crisis levels. The main exception is in smaller East Asian countries, where industrial output is rebounding and GDP growth is likely to resume in the second quarter.

At the moment, then, recovery in the BRICs is coinciding with recession in the developing world as a whole. If this does not point to any change in global economic conditions, what does it reflect? Partly, that the BRICs depend less on exports than do many emerging markets. In Brazil and India exports are less than 15% of GDP. China, too, exports less than many people think. Though exports were 34% of GDP in 2008, these included “processing exports”—goods imported into China, processed and exported without much value having been added. All three were thus less affected by the slowdown in world trade than most.

The BRICs were cautious in liberalising their financial systems, so have been less affected than, say, eastern Europe, by the West’s financial heart attack. And their recoveries have been boosted by governments which have dramatically loosened monetary policy and increased government spending. But many other countries are relatively closed to trade and finance. Smaller ones like Chile and Taiwan have had a large fiscal stimulus. But few have done so well. Something more is needed to explain the recovery of the giants. A plausible explanation is size.

Size matters when world trade is falling because large economies have millions of domestic consumers to turn to when foreign markets fail. China is the best example. Small economies need trade to specialise, but the pressure of selling into a big domestic market helps companies in large economies remain competitive even without a lot of competition from imports. Big economies also tend to be diversified. India, for example, exports not just garments and cheap electronics—characteristic of many countries with similar levels of income per head—but ships, petrochemicals, steel and business services. Being diversified means little when markets all fail at once. But it is a big advantage when recovery begins since you are more likely to be in a business in which demand is rising.

Size and variety may also help the economic stimulus programmes of China, India and Brazil. In general, one of the commonest problems of government reflation is that the benefits leak out beyond your borders because the programme sucks in imports. Giant economies do not face this problem so acutely because even when trade has been liberalised, imports naturally tend to be a lower share of GDP.

The other challenge is to ensure that government stimulus programmes are broadly based. This could be more difficult in small economies which specialise in relatively fewer sectors. A handful of big companies may be able to use political clout to grab the benefits of spending for themselves. In principle, giant countries such as India or

China have more companies competing to manipulate the government for a share of the spoils. That is speculation, but the fact is that the stimulus programmes in the big emerging markets have been, mostly, large and effective.

China's stimulus package was the earliest and best-known example of fiscal shock and awe. But it is only part of the story. The government is using the state-owned banks to pump out loans at astonishing rates. According to Josh Felman, of the IMF's Asia research department, state banks and others issued 5.5 trillion yuan (\$800 billion) of new loans in the first quarter—more than in the whole of 2008. This is producing a spending splurge on steroids. Excluding SUVs, almost as many cars are being sold in China as in America. In 2006 Americans bought twice as many.

Brazil and India are following suit, albeit more modestly. Brazil reduced reserve requirements and gave banks and its deposit-insurance fund incentives to buy up the loan portfolios of smaller banks. These measures injected 135 billion reais (\$69 billion) into the domestic credit markets, according to Otaviano Canuto of the World Bank. Domestic credit rose sharply between September 2008 and January 2009 and consumer confidence is rebounding.

The source of India's resilience, argues Mr Subramanian, was "goldilocks globalisation": neither too dependent on foreign capital, like eastern Europe, nor too reliant on foreign customers, like parts of East Asia. Foreign capital dried up in the crisis, so India relied on domestic savings, which amounted to almost 38% of GDP in the year to March 2008. Companies thus turned for loans to India's unfashionable state banks, which hold almost 70% of bank assets, rather than borrowing overseas or raising money on the stockmarket.

India's growth was also shored up by government outlays, such as a generous pay rise for state employees, the cancellation of small farmers' debts, and the expansion of its rural-workfare scheme. Announced before the crisis struck, this spending was fortuitous. It left the public finances deep in the red, even as it helped the government to a decisive election victory. So far, this political triumph has boosted confidence in India more than the budget deficit has dampened it.

The question is whether such splurges are efficient and how long can they last. Consider China's investment. According to the IMF's Mr Felman, in early 2008 all the contribution of investment to growth came from non-state-owned enterprises, mostly the private sector; since December 2008, more than half has come from state-owned enterprises. Something similar is happening in Brazil. Between last September and this January credit from foreign-owned and domestic private banks rose by 3%; credit from public banks rose by 14%. The beneficiaries seem to be large firms, where loans are growing four times as quickly as at small ones.

It is not clear how far, in the long run, the BRICs will be affected by a big rise in the size of the government and large state-owned firms. But that rise is probably inevitable. China and, to a lesser extent, Brazil and India, benefited hugely from America's appetite for imports in 2000-08. That appetite has fallen and is likely to remain low for years, as American consumers adjust their spending and savings habits. The rise may also be difficult to reverse: the experience of the West has been that the public sector expands relentlessly until it reaches between 40% and 50% of GDP. But if the BRICs cannot export their way out of recession, the expansion of government is the main alternative to the slump being endured in those other big capital exporters, Germany and Japan. It is part of the price China and others are paying to clamber out of recession before everyone else.

## China Quarterly Update — June 2009

From the World Bank



**China's economy has continued to feel the brunt of the global crisis.** Global economic activity continued to decline in the first part of 2009, even as tentative signs of stabilization have emerged recently in several countries.

**However, very expansionary fiscal and monetary policies have kept the economy growing respectably.** Fiscal stimulus is centred on the infrastructure-oriented “RMB 4 trillion” stimulus plan and the monetary stimulus has led to a surge in new bank lending. Government-influenced investment has soared. Market-based investment has lagged, although positive signs have emerged in the real estate sector. Consumption has held up well. Very weak exports have continued to be the main drag on growth, but import volumes have recovered in the second quarter of 2009 as raw material imports rebounded.

**Global growth prospects remain subdued even as signs of stabilization have emerged.** Financial markets have become less strained and there are prospects for stabilization of activity. However, a rapid global recovery seems unlikely and uncertainty remains. The risk of global deflation seems low, although spare capacity will continue to put downward pressure on prices of manufactured goods. Monetary policymakers in major countries should in principle be able to prevent inflation from rising in the medium term, although risks remain, including political ones.

**Growth in China should remain respectable this year and next, although it is too early to say there is a sustained recovery.** Government influenced investment will strongly support growth in 2009. Nonetheless, there are limits to how much and how long China's growth can diverge from global growth based on government influenced spending, given that China's real economy is relatively integrated in the world economy. Meanwhile, market based investment is likely to continue to lag for a while because of the squeeze on margins amidst spare capacity in many manufacturing sectors. Prospects for real estate activity appear reasonably good, but consumption is unlikely to pick up speed. In all, China's growth is unlikely to rebound to very high single digit rates before the world economy recovers. We project GDP growth of 7.2 percent in 2009 and 7.7 percent in 2010.

**China can have the confidence to emphasize forward looking policies and structural reforms.** Based on our projections we think it is not necessary or appropriate to add more traditional stimulus in 2009. One reason is that the fiscal deficit is likely to be significantly higher than budgeted and additional stimulus now reduces the room for stimulus in 2010. Nonetheless, with subdued global demand and less export growth, China needs more growth from domestic demand—consumption in particular. Also, relative prices need to change, notably those of natural resources. The transition to more consumption-led, service sector-oriented, and labor-intensive growth requires policy adjustments that: (i) help channel resources to sectors that will grow in the new setting, instead of to sectors that have traditionally done well; and (ii) support thriving domestic markets and successful, permanent urbanization. Such reforms can be pursued more successfully if flanked by a well-functioning public finance system and social safety net.