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G-20 Meeting and Lessons for Pacific Island Countries

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The meeting of government leaders of 20 major economies of the world, known as G-20, was held in Russia last week. The G-20 includes 19 countries and the European Union. The 19 countries are from different continents: from Africa, Saudi Arabia and South Africa; from Asia: China, Japan, India, Indonesia and South Korea; from North America; Canada, Mexico and US; from South America: Argentina, Brazil; from Europe: France, Germany, Russia, Turkey and the UK; and from Oceania: Australia.

This year G-20 Meeting was looked forward to by developed countries and developing countries for two entirely different reasons. The concern of developed countries was with the Syrian crisis. The developing countries were more worried with economic impact of the likely scaling back of bond purchases by the US central bank. They wanted to be consulted.

Falling currencies

India is the most affected amongst the emerging economies, which are known as BRICS (Brazil, Russia, India, China and South Africa).

Except China's fixed *yuan*, floating currencies plunged when investors pulled out their funds in anticipation of rise in interest rates in America. South Africa's *rand* fell by 17 percent, Brazilian's *real* by 15 percent, and Russia's *rouble* 8 percent since May. Due to large current account and budget deficits, the Indian *rupee* fell nearly by 25 percent.

China's foreign reserves are at the highest (US$3.5 trillion), followed by Russia (US$ 572 billion); Brazil (US$ 372 billion); India (US$ 279 billion); and Indonesia (US$98 billion).

Although India's reserves are large unlike during its 1991 currency crisis, it did not intervene in the currency market to prop up the rupee. Brazil and Indonesia were buying up their currencies by selling American dollars, thereby pulling up the value of their currencies.

India was not in favour of a rise in the interest rate to stem the outflow of funds. Since elections are slated to be held in May, 2014, government was keen to please the electorate with more goodies, the latest being food subsidy scheme costing US$23 billion. India is not in favour of IMF loan because of the likely harsh conditionalities.

Decisions from G-20 Meeting

India's preference for softer options was obvious. With some exchange controls, India expects to stop the outflows and reverse the situation.

India looked forward to finalization of a proposal by BRICS in a sideline meeting at the summit for a reserve fund of US$100 billion.

The fund is for rescuing any BRICS country from foreign exchange shortage in the event of a balance of payments (BOP) crisis. The member country can obtain a loan from the fund which would be free from IMF conditionalities.

Russia announced that the reserve fund of US$100 billion fund would be set up with China's contribution of US$41 billion, with Brazil, India and Russia, US$18 billion each, and South Africa US$5 billion.

In another side line meeting, Japan and India agreed to expand their bilateral currency-swap arrangement from $15 billion to $50 billion. It will enable India to pay for imports in their currencies, rather than in dollars. Swap agreements will help reduce the demand for dollars in the short term and boost exports.

Lessons for Pacific Island countries

Pacific island counties would do well to consider similar initiatives: a reserve fund and currency swap arrangements as part of regional integration.

Once investment climate becomes favourable, one of the earliest procyclical developments would be rise in imports of capital and intermediate goods. Given the inelastic supply of exports in the short run, current account deficits would then emerge. A reserve fund would alleviate any temporary shortage of foreign reserves.

The idea of swap arrangements is not new.   I recall there was a similar swap arrangement in the early 1980s between Samoa and Fiji under which trade deficit of Samoa was funded by Fiji in bilateral currencies.

With substantial reserves built up in recent months (US$5.2 billion), PNG has started an aid programme: Tuvalu and Tonga received aid of about US$ 2 million each for climate change assistance and for cyclone relief; and Marshall Islands received US$1 million for drought relief assistance and for hosting of Pacific Islands Forum meeting, besides commitment of US$ 10 million to Fiji for the 2014 elections.

"PNG is able to do this because it has experienced enormous growth, averaging 6 percent per annum. That growth is expected to continue to grow in the medium term and we are expected to double our GDP in a couple of years. That has enabled us to have additional resources to help other Forum countries and communities throughout the region", said PNG Prime Minister.

PNG along with Fiji (record high foreign reserves of US $1.1billion), Solomon Islands (US$ 500 million) and Vanuatu (US$174 million) can pool some proportion of their reserves and set up a reserve fund of a required size.

These steps: reserve fund and swap arrangements will be a big support in a crisis time, which no one can predict in an uncertain world.