

Financial Crisis and the Developing Countries



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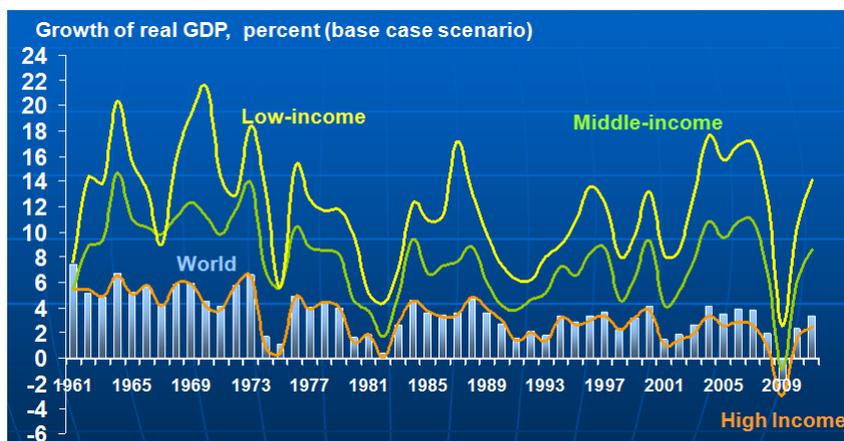
Outline of presentation

- **Global outlook**
- Impacts on employment, poverty and MDGs
- Policy responses

The Global Economic Crisis

- World economic growth is declining—by an estimated 1.7 percent in 2009
- GDP among developing economies will fall from 5.8 in 2008 to 2.2 percent .
- Volumes of world trade in goods and services expected to drop 6.1 percent in 2009
- Remittances to decline by 5-8 percent in 2009

Crisis Will Cause a Sharp Decline in Global Growth



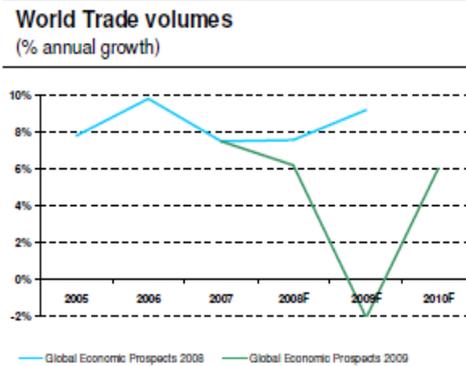
Source: DEC Prospects Group, World Bank

Trade volumes are falling...

In 2009 world trade is expected to contract for the first time since 1982

Decline in high-income countries import growth adversely affects developing countries' exports

Most African economies are export driven and will be affected by the slowdown in global demand



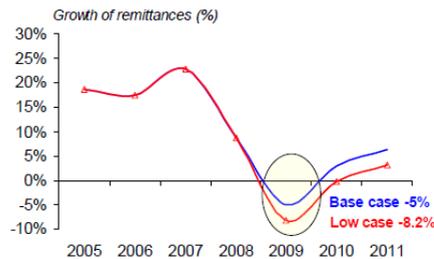
Remittance flows are also dropping

Remittance flows to developing countries began to slow down in Q3 2008 in response to the global financial crisis.

The slowdown expected to deepen in 2009.

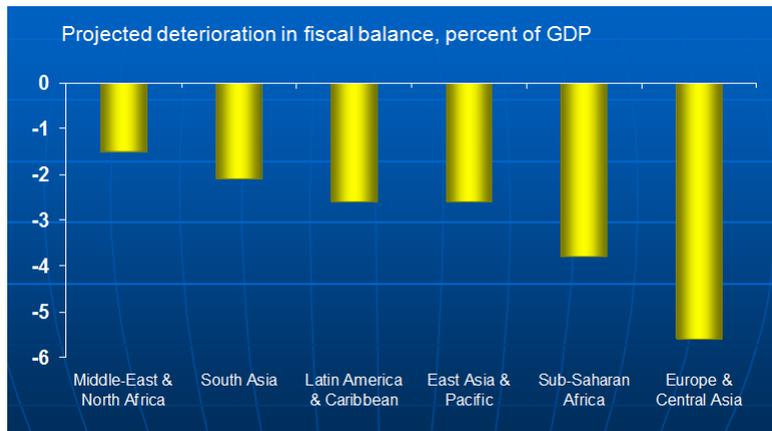
Recent estimates suggest a drop of between 5 (base case) and 8 (high case) percent.

Figure 1: Remittance flows will slow sharply in 2009 in US dollar terms



Source: DEC Prospects Group

Weaker Revenues will Soon Cause Fiscal Deficits to Deteriorate Sharply



Source: DEC Prospects Group

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Impacts on Employment, Poverty and MDGs

'Imported' demand crisis that affects households via:

- Changes in labor demand (↓ employment and earnings; ↓ remittances)
- Changes in the value of economic and financial assets
- Changes in prices
- Changes in public spending

Resulting income shock means fewer people escaping poverty

May have long-term impacts on capabilities (i.e. effects of malnutrition, schooling drop-outs, etc.).

Wage employment is contracting

- **Mine and smelter** closures have led to job losses: DRC (100,000), South Africa (40,000, nearly 10% of workforce), Zambia (3,000), Chile (2,000) and Mongolia (1,700), and to shorter working time in Armenia.
- In the **garment industry**: 30,000 workers laid off in Cambodia (10% of workforce and mainly women), large layoffs in Bangladesh.
- In **India** >500,000 job losses reported in last 3 months of 2008 in export-oriented sectors—i.e., gems and jewellery, autos, and textiles.
- In **China**, around 700,000 labor-intensive small- and medium-sized firms closed down in the cities of Guangzhou, Dongguan and Shenzhen, total job losses of up to 3 million.

Unemployment is rising and quality of jobs deteriorating:

ILO recent forecast (likely underestimation):

- **23 million more unemployed** workers (2009-07) in the **developing** world:
 - 11 million in East Asia (up 1 percentage point to 4.5%),
 - 4 million in South Asia (up 0.4 points) and
 - 3 million in Latin America (0.9 points);
- **93 million additional “working poor”** (\$1.25 a day):
 - 47 million in South Asia and
 - 24 million in Sub-Saharan Africa.

All of which adds-up to more people living in poverty...

- Growth slowdown means **53 million fewer people** will escape poverty in the developing world at the \$1.25/day line (65 more million people at the \$2/day line)
- In **Sub-Saharan Africa and South Asia** (except India) the growth slowdown essentially eliminates all progress in reducing the number of poor between 2008 and 2009
- In **Europe and Central Asia region**, larger growth slowdowns may lead to actual increases in the poverty rate of 0.5 to 2 percentage points, depending on the severity of the negative growth scenario
 - Armenia: increase of 1.9 percentage points 2009/2008
 - Bulgaria: increase of 0.5 to 1.1 percentage points
 - Turkey: increase of 1.5 percentage points

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Policy Challenges in responding to the Crisis

- Need to balance **short-term objectives**
 - Sustaining aggregate demand
 - Addressing declining private consumption
 - Closing or reducing the output gap
 - Mitigating crisis impacts
 - Supporting/restoring the financial sector
 - Assisting vulnerable groups
- with protecting **medium-term growth and development goals**

Scope for fiscal stimulus?

- Different countries have very different scope for carrying out counter-cyclical fiscal policy
- Some (mainly emerging markets that are members of G20) are implementing significant fiscal packages
 - About 2/3 focused on spending—Infrastructure, social protection; support for SMEs. 1/3 also contemplate tax rate cuts and investment incentives.
- But majority of developing countries, especially LICs, face weaker starting fiscal positions, and binding macro, financing and capacity constraints
 - *Bank estimates that only ¼ of vulnerable developing countries are in a position to undertake significant countercyclical spending*
 - *About 1/3 vulnerable developing countries are aid dependent and would need additional external support to finance increased spending*

What to spend on?

IMF fiscal guidance:

- Priority to spending (more effective than revenue measures)
 - Capital/infrastructure spending
 - Temporary boost to employment
 - Growth impacts (if well designed)
 - **Safety nets and labor programs**
 - Support for SMEs (credit/finance)
 - Biggest bang for the buck – but history may not be a guide
- In LICs, institutional constraints may be difficult to overcome
 - Quality of spending, extent of safety nets, capacity constraints

Safety nets and labor: lessons from previous crises

- Policy responses should match the nature of impacts of the crisis:
 - High open unemployment → public works or UI (Korea, Argentina)
 - Widespread fall in real wages → protection or expansion of social services, more widely targeted transfers (Mexico, Indonesia)
- Shape and quality of response depend on pre-existing capacity
 - In food and fuel crisis, Mexico, Brazil, Chile have efficient and effective response; Haiti less so
- Crisis can provide an opportunity to institutionalize SSN
 - Mexico started *PROGRESA/Oportunidades* after Tequila crisis; *Colombia Familias en Accion*, etc.

Policy Options:

- **Safety Nets**
 - unconditional or conditional cash transfers,
 - public works;
 - waivers for fees for essential services
- **Labor Programs**
 - expanding coverage or length of benefit for unemployment benefits;
 - training programs with income stipends
- **Additional possibilities?**
 - Temporary payroll tax holidays (including unemployment insurance contributions) or wage subsidies
 - Subsidized *short-time* agreements
 - Preferential access to credit (including trade-finance)
 - Programs targeted to 'at risk' youth