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The world economic crisis and its effects on developing countries

The crisis and the developing world – a statistical perspective

The financial crisis, whose symbolic beginning is commonly traced to the fall of the Lehman Brothers Bank in September 2008, hit developed countries first and spread very quickly afterwards throughout the world, eroding the foundations of the global economy, including the prevailing confidence in the supposed sound functioning of institutions. Hopes that developing countries (especially emerging markets) would be spared and that they would maintain their relatively rapid growth rate proved mistaken. The concept of "decoupling"[1], still popular in mid-2008, was quickly jettisoned. The consequences of disruptions in the world economy are still being felt and, thus, continue to affect the current economic situation and development perspectives in the poorer parts of the world.

The recent statistical data on the state of the world economy, released by the International Monetary Fund (IMF), give cause for cautious optimism: although the world economy is still far from being fully stabilised, it would seem that the greatest economic collapse since the Great Depression of the 1930s is gradually dissipating. Nevertheless, the recent data clearly show the extent of the crisis. While in 2007 the rate of world economic growth was 5,1% and dipped to 3,1% in 2008, in 2009 it will likely show negative values (– 1,4%), and for 2010 predictions call for the global GDP to rise by no more than 2,5%. There is a high probability that developing countries and emerging markets en bloc will be able to avoid recession. Their rate of growth, which reached 8,3% in 2007, and 6,0% in 2008, will remain around 1,5% for the current year, and rise to 4,7% in 2010. The following table presents details of growth rates in various parts of the developing world.

Region / Rok	2007	2008	2009	2010
World	5,1	3,1	-1,4	2,5
Developing countries and emerging markets	8,3	6,0	1,5	4,7
Africa	6,2	5,2	1,8	4,1
Asja	10,6	7,6	5,5	7,0
Latin America	5,7	4,2	-2,6	2,3
CIS	8,6	5,5	-5,8	2,0

Table 1. GDP growth dynamics in Global South regions for 2007-2010 (in %).

The presence of substantial regional differences is noteworthy. Even during the "crisis" year of 2009, developing countries in Asia have maintained a relatively high growth rate (due, in large measure, to China and India, whose governments implemented substantial economic stimulus packages). The countries of the former Soviet Union (i.e. Commonwealth of Independent States – CIS) are affected by a substantial recession. Africa, for its part, already the poorest continent, will not be able to maintain, for 2009 and 2010, the growth rates necessary for the realisation of the Millennium Development Goals adopted in 2000 (the necessary minimum growth rate is estimated at 5% annually). The IMF predicts that the rate of economic growth in developing countries will rise in the second half of the current year, although not in all regions of the developing world. This will most likely prove true, unless we encounter a second crisis wave – a scenario that we cannot yet rule out, at present.

Crisis transmission channels affecting development in Global South countries

The statistical data presented above is insufficient, on its own, to offer conclusions on the causes for an economic downturn of the degree that we have witnessed on a global scale. The economic literature has, however, identified several channels (or "transmission belts"), through which the effects of the present crisis reach developing countries. Key among them are:

1. **International trade and raw materials price fluctuations.** The current economic crisis has caused an unprecedented slowdown of the international trade turnover growth rate. In 2008, global exports fell for the first time since 1982; as recently as 2006, they had risen by 10%. The drop in the growth rate of raw material imports from developing countries undoubtedly played a part in slowing the growth rates of those countries' economies. At the same time, certain importer countries benefitted from the low raw material prices in 2009, which dropped by 40% from to the record highs of 2008. Simultaneously,

global food prices have remained high (due to the price inelasticity of demand for food products) which may result in the accentuation of problems linked with hunger and malnutrition. As for crude oil, the price dropped after the financial crisis erupted. However, we can already predict that the rise in the price of crude oil will be more dynamic than the overall post-crisis economic revitalisation. Predictions call for the price of crude oil to stabilise at approximately USD 75 per barrel in 2010. It is worthwhile to recall that sudden fluctuations – like those we have seen in the most recent period – in the price of articles constituting major components of developing countries' balance of trade (chiefly raw materials and food products), pose many difficulties for economic planning and placing investments aimed at combating poverty.

2. **Capital flows and the financial markets situation.** In 2008, total capital flows to developing countries fell to USD 686,4 billion (4,3% of those countries' GDP). This signifies the reversal of a tendency that began in 2003 and reached its climax in 2007, when developing countries' inflows reached USD 1,2 trillion (8,6% of their GDP)[2]. Foreign direct investments (FDI) have been highly affected as well, and we should not expect a repeat of the record levels registered in 2007. At the same time, drops in developing countries' stock markets and the "drying-up of investment portfolios" reduce their potential to finance important economic needs. Reduced credit lending by banks based in developed countries will have a negative effect on the economic prospects of developing countries. This is especially true of countries with high budget deficits, whose financing will become more difficult in the event that developed countries' debts also rise, and their safer debt securities "push" those of Global Southern countries out of international financial markets. This problem can only be resolved by raising interest rates, which in turn, for many developing countries, increases the risk of once again being caught in a spiral of foreign debt.
3. **Remittances.** The World Bank estimates that in 2009 remittance flows to developing countries will reach USD$304 billion; in 2008 the level was USD$328 billion USD (drop of 7,3%). This drop is smaller than the reduction in capital flows, because although the number of new migrants has fallen, this has not been accompanied by a comparable drop in the number of people working in either developed or developing countries. It is possible, however, that this will turn out to be a case of delayed reaction: in many developing countries, the effects of recession and rising unemployment were delayed until 2009, when they were reflected in the layoffs of migrant workers. We can thus expect to see the real decrease of these transfers only in late 2009 and in 2010.
4. **Development aid.** Because of the crisis, many of the world's poorest countries are increasingly dependent on development aid. Based on OECD data, Official Development Assistance (ODA) equalled USD 119,8 billion in 2008, which represents a real growth of 10,2% compared with 2007 levels. The 2008 ODA amounts were the highest in history, which – at least in theory – raises hopes for the realisation of resolutions adopted at the G7 summit in Gleneagles in 2005 (raise ODA to USD 130 billion by 2010)[3]. Nevertheless, unless developed countries' economies do not improve quickly, we may expect a repeat of the situation of the mid 1990s, when recession and budget problems in OECD countries contributed to the reduction of aid volume. We must also remember that the crisis has severely affected large enterprises, including multinational corporations, and this may well result in the limitation of development funds supplied by corporate foundations. According to World Bank calculations, even the present level of aid directed at low income countries is insufficient to fulfil their external financing needs already in 2009[4].

Implications for development

All the "transmission belts" pointed out above carry significant implications for the development of the Global South, although – due to the delayed reactions that characterise economic processes – their scale will only be measurable in 2010. At issue, is not only a drop in GDP in particular countries, but also its effects in the shape of turbulence within specific sectors of the world economy, which, in turn, places a dual pressure on the economies of developing countries:

- in terms of incomes – the drop in economic and export growth rates, coupled with the high prices of many imported goods, means lower budget incomes; at the same time,
- in terms of expenses – there are increasing needs to finance social welfare, healthcare, and entrepreneurship, in order to soften the social impacts of the reduction in GDP growth rates.

What is more, we must keep in mind that the drop of GDP growth rates in many developing countries results from the compounded effects of three distinct crises occurring during the last two years: the rise in food prices, the rise in crude oil prices, and the world economic crisis. In the opinion of the World Bank, the rise in food prices alone caused an estimated 190-230 million people to fall below the poverty line (USD 1,25 a day) in the period 2005-2008, while the number of people suffering from malnutrition increased by 44 million during the same period[5]. It should be noted here that every percentage point of reduced growth rate is estimated to translate into an additional 20 million people living on less than USD 1,25 USD a day[6]. For many developing countries, the necessity to devote more funds to the purchase of food and crude oil, in conjunction with the present economic situation, has also resulted in significant financial difficulties (as may be observed, for example, in budget deficits that surpass 10% of GDP).

We must also remember that – as demonstrated by African experiences – the implications of reduced economic growth rates for social development are far more asymmetrical than those of accelerated GDP growth rates, and result in even greater social stratification and increased poverty. Moreover, developing countries exhibit varied levels of resistance to crises, and this is particularly true of the present economic crisis. While large and relatively affluent developing countries (China and India, for example) can afford to release significant stimulus packages, thereby limiting the effects of the global breakdown on their internal economies, smaller countries, and those with the smallest incomes (African countries, in particular) are practically-speaking economically defenceless in the present situation.

For developing countries, therefore, the consequences of the current confusion in the world economy are multifaceted and still elude cohesive analysis. They must, therefore, be assessed in the larger context of various countries' development levels, the gap that separates them from highly developed countries, and the progress of the worldwide program to combat poverty. There is a serious risk that the progress made during the last decade on the road towards a more prosperous, just and stable world, will be stopped and even reversed. According to World Bank data, 1,4 billion people worldwide were living below the poverty line in 2005, although this figure was smaller than that calculated in 1981, when 1,9 billion people lived below the line. When these data were released in August 2008, the World Bank's chief economist, J. Lin, could still argue that real progress had been made in reducing world poverty, and that the realisation of the first Millennium Development Goal (to cut the 1990 scale of poverty by half by 2015) was possible[7]. Less than a year later, in April 2009, the World Bank released further data, which showed that although in the period 1999-2009 as many as 90 million people were raised out of poverty in Eastern Europe and Central Asia alone, the global crisis had pushed 35 million people in the region back into poverty[8].

The economic crisis is diminishing the chances of achieving the Millennium Development Goals on schedule. The world economic breakdown has hit at the halfway point of the Goals' realisation schedule. Already before the crisis had materialised, many experts doubted whether the goals could be reached by 2015. The crisis has only deepened those doubts. Certainly, the crisis will also raise additional difficulties for the realisation of other ambitious plans, including the liberalisation of world trade to answer the needs of poorer countries, adopted at Doha in 2001. On the other hand, it has provided opportunities to extend multilateralism beyond issues of trade and finance, and for wider global cooperation on questions of: climate change, energy supplies, development and the problems of "fragile states". World Bank president R. Zoellick has been among those calling for such a wider cooperation. In fact, the crisis has already resulted in a certain reshuffling of global governance: the role of the G20 has increased as the principal (and more representative than the G7/8) forum of agreement on strategies and methods to fight against the crisis on the global scale, which signifies that the influence of developing countries (at least the largest among them, including the BRIC countries, that is: Brazil, Russia, India, and China) on the future shape of the global economy's architecture is greater today than at any time in the past. The crisis is also an opportunity to accelerate the snail-paced reforms of international financial institutions (IMF, the World Bank, and regional development banks).

The world economic crisis also presents significant challenges for macroeconomic policy, broadly conceived, and its principal orientations. The last few years have witnessed what may be termed as a "destabilisation" of the assumptions of economic and development policy-making, and the disappearance of reference points that once seemed permanent. Three consecutive (indeed, overlapping) crises have left the governments of developing countries to face new challenges every few months – challenges that must be met with varied, often mutually opposed monetary and fiscal mechanisms. A psychological factor has also been added to the process: over the last decade, many countries in the South reformed their economies according to the principles of the West, yet now they face a crisis that they feel is none of their own doing. This goes some way to explain why certain among them have attempted a return to old models, such as protectionism and etatism, among others.

Lessons for the immediate future

In light of the above, what can be done to soften the negative effects of the crisis on developing countries, especially the poorest among them, and avoid the catastrophe that would be the collapse of the development agenda set out in the Millennium Development Goals?

Evidently, a fundamental concern must be to avoid a long-term, global recession and the complete collapse of the world economy and the network of financial institutions, which would have disastrous consequences for global development. Thanks to the coordinated actions of the G20 countries (and, in particular, the constructive approaches of developing countries) it would seem that the danger is behind us, but we cannot rule out further, although weaker, crisis waves. Key, also, are the rebounding of the world's great economies (US, EU, and Japan) and sustained high levels of economic growth in China, among other countries, which will prompt increased demand worldwide, and will subsequently stimulate trade and capital flows to developing countries. In the long term, of great importance is the elimination of the so-called global imbalance between countries disposing of enormous surpluses (such as China) and countries with enormous deficits (such as the US), and the redirection of the world economy towards a more equitable model of growth (which the administration of president Barack Obama has called for, at the G20 forum). Finally, it is essential to combat protectionist tendencies, which have cropped up in the US and the EU, as well as in developing countries. In the present situation, it seems a very difficult prospect for the Doha round of trade negotiations to arrive at a conclusion favourable to developing countries, but a successful finalisation would provide an important development impulse on the global scale.

The crisis situation presents enormous challenges for the leaders of developing countries. The economic breakdown may be an enticing occasion to return to a state-steered economy and authoritarian models of government, and there are fears that certain governments may choose this path. But the crisis is also, and perhaps the only, chance to implement or to complete necessary reforms where they are truly indispensable. This means such actions as reforming banking systems – if not building them from the foundations, improving access to credit for the poor, and supporting entrepreneurship. In the longer term, it means wholesale changes in economic policy perspectives away from endemic, short-term salvaging of capital accounts and liquidity, towards supporting long-term, balanced economic growth.

In this context, support for efficient international institutions, including financial institutions, is exceedingly important. In order to carry out the tasks that have been newly set for them, they must be adequately capitalised and reformed. G20 decisions have set in motion the process of increasing these institutions' resources, thanks to which they have been able to initiate new aid programs aimed at the world's poorest countries. The International Monetary Fund's lending potential will have tripled in 2009, from USD 250 billion to USD 750 billion, thanks to which the Fund will be able to, at minimum, double its financing of the needs of low income countries. Multilateral development banks (MDBs), too, will receive additional resources totalling no less than USD$100 billion for operational activities in developing countries. The IMF and the MDBs are modifying their aid policies, so that they may be more effective in combating the crisis in the Global South. These changes consist in, among other measures, lowering (in some cases, to zero) the interest rates on accumulated loans, increasing access to specific credit lines, and implementing new financial instruments designed for the realisation of tasks related to infrastructure and social welfare (e.g. World Bank's Vulnerability Framework). These measures are coupled with actions aimed at providing developing countries with a stronger voice within these institutions and increased influence in the decision-making process.

Funds for international institutions' aid activities come out of donor countries' budgets, but this should not limit their willingness to increase bilateral aid for the poorest countries, especially those whose abilities to deal with the crisis are meagre. The idea floated by the World Bank, by which 0,7% of funds spent by developed countries on economic stimulus packages would be directed towards key investments in the most impoverished countries, has not met with positive responses. Nonetheless, the volume of ODA should remain at least at its present level, although this must be considered insufficient if one takes into account the fast approaching deadline for the Millennium Development Goals. The crisis cannot become an obstacle to financing the fight against

the effects of climate change because this will directly impact actions that are going to have lasting effects on the quality of life of future generations.
The inexorably approaching final negotiations on the fight against the effects of climate change "post-Kyoto", scheduled for December 2009, will likely prove to be more difficult than was supposed only a year ago, but they will serve as the true measure of the international community's authentic global responsibility.

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1. As late as mid-2008, the crisis was widely predicted to remain confined to the US and, perhaps, to other developed countries, sparing developing countries and emerging markets.
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4. World Development Report 2009: Reshaping Economic Geography. Ovreview. www.worldbank.org.
5. Global Monitoring Report 2009. Crisis, MDGs, and the Private Sector. Emerging Findings and Messages. World Bank, Washington D.C., 2009.
6. The Financial Crisis: Implications for Developing Countries. www.worldbank.org.
7. New Data Show 1.4 Billion Live On Less Than USD 1.25 A Day, But Progress Against Poverty Remains Strong. www.worldbank.org.
8. Global Crisis Pushing Almost 35 Million People Back Into Poverty And Vulnerability In Europe And Central Asia. www.worldbank.org.