The financial crisis and developing nations – Ramifications and responses

There are still many uncertainties about the duration, depth and ramifications of the financial crisis. But there is one thing that is certain: developing nations are massively affected by it. This article illustrates the differences between the different groups of countries and how they can respond to the crisis.

According to current forecasts, in 2009 the economic growth of developing nations will be cut in half compared with last year. For the first time since 1982 global trade will be on the decline. The crisis will affect developing nations in two ways: via the deterioration of external financing terms and via the global reduction in demand.

Emerging economies affected first

The crisis will initially have the greatest impact on newly industrialising ("emerging") nations. They have experienced a huge drop in exports and there has been a capital drain for several months. The financing conditions on the capital markets have deteriorated drastically for these countries, and their currencies are facing devaluation pressure. It is forecast that in 2009 their economic growth will be two to three percentage points lower than in previous years. This can be attributed in large part to the contagious effects of the global financial crisis. Most emerging nations – with the exception of Eastern Europe – have pursued solid economic policies in recent years. Through debt retirement, trade balance surpluses and high currency reserves they have created economic latitude that can be used to overcome the crisis. However, it will be nearly impossible to prevent public and private investments from declining, with adverse effects on growth and poverty reduction.

The impact on poor developing nations will be delayed somewhat because they are less integrated into the global financing system. Due to declining commodity prices, falling demand for exports, declining foreign direct investment and fewer money transfers from migrants, in 2009 economic growth in these countries will probably also decline by two to three percentage points. In sub-Saharan Africa in particular, which in recent years had achieved remarkably stable economic growth of around six percent, this can represent a painful setback.

Poverty mounting

Poverty will increase in developing nations. Due to the rising energy and food prices over the past two years, according to estimates by the World Bank the number of poor had gone up by around 100 million people even before the financial crisis. While energy and food prices have fallen due to the recession, they will probably remain at a higher level than two years ago. As a result, real incomes have already fallen and will continue to fall due to the downturn in growth. Likewise the deficits in public budgets, which were already burdened by rising food and energy subsidies, will grow due to declining tax revenues. Social welfare mitigation measures are necessary to limit an increase in absolute poverty. Moreover, the scope for fiscal stimulus measures in poor countries is very limited. While in some emerging economies (China, Brazil) specific social welfare mitigation measures have been introduced financed by their own budgets, most poor developing nations are dependent on support from donors.

The response to the crisis has basically been geared toward the needs of emerging economies and middle income countries. Central banks and the International

Declining remittances by migrants to their home countries are an expected outcome of the world economic crisis.

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Zusammenfassung

Die globale Finanzkrise trifft alle Entwicklungsländer massiv. Zeitraum, Dauer und Stärke der Auswirkungen variieren jedoch und hängen unter anderem davon ab, wie stark die einzelnen Länder in die Weltwirtschaft integriert sind. Unstrittig ist, dass die Armut in den Entwicklungsländern steigen wird. Der Beitrag analysiert die Bedingungen in den jeweiligen Ländern und zeigt auf, wie die Gebergemeinschaft bisher reagiert hat und welche Maßnahmen weiterhin nötig sind, um der Krise entgegenzuwirken.

Resumen

La crisis financiera global afecta dramáticamente a todos los países en desarrollo. Sin embargo, el período de afectación, la duración y la intensidad de las repercusiones varían y dependen – entre otros – de cuán integrados se hallan los distintos países en la economía mundial. Lo que es indiscutible es que la pobreza en los países en desarrollo aumentará. El aporte analiza las condiciones en los países respectivos. Asimismo, indica cómo ha reaccionado hasta ahora la comunidad de donantes y qué medidas siguen siendo necesarias para contrarrestar la crisis.

Monetary Fund (IMF) have responded quickly to the rising liquidity and credit need of those countries. The World Bank has announced a tripling of its IBRD (International Bank for Reconstruction and Development) loans in the next three years and has set up special credit programmes for trade financing, for recapitalising banks and for infrastructure financing. It makes good sense that the crisis response is initially being directed toward emerging economies – because of their systemic significance for the global economy, but also because of the social implications of the crisis in these countries. But what about poor countries?

Possible courses of action

For the least developed countries (LDCs) which are more dependent now than before the crisis on official development assistance (ODA) there is little room for additional funding. No pledges have been made for increasing ODA as compensation for the "collateral damage" of the financial crisis in developing nations. At the Financing for Development Conference in Doha in December 2008, existing pledges were confirmed, but nothing more. The World Bank has announced that of the IDA (International Development Association) funds available to it – 42 billion US dollars (USD) for three years – 2 billion USD will be pushed up for rapid allocation in 2009 without this increasing the total volume of IDA-15. So bilateral donors are being relied upon to actually keep their pledges and possibly, like the World Bank, to accelerate disbursement of part of the pledged funds to 2009 to make it possible for the poor developing nations to respond adequately to the crisis – a mixture of short-term social welfare mitigation measures and long-term investments. And all this keeping in mind that the promised increase in ODA under the EU graduated plan by 2010 can only be fulfilled if considerable supplements are added to the 2009 and 2010 budgets.

What else can be done? The global economic situation must be stabilised, both in the trade and finance sectors. It is urgent that the Doha trade round be concluded positively. The G20 global finance conference in April 2009 must result in a stabilisation of the financial markets, which will also benefit developing nations.

Lastly, developing nations' own resources need to be mobilised more uniformly than in the past to make them less dependent on external financing over the long term. In particular in Africa a serious effort has to be made to develop national and regional capital markets. The Making Finance Work for Africa initiative is a promising approach to doing this. Perhaps the crisis will give countries a reason to build more on their own strengths – not as a retreat from the global economy, but as a necessary complement to be better able to mitigate risks as they have now become evident.

Photo: J. Boethling