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# The Global Financial Crisis, Developing Countries and Policy Responses

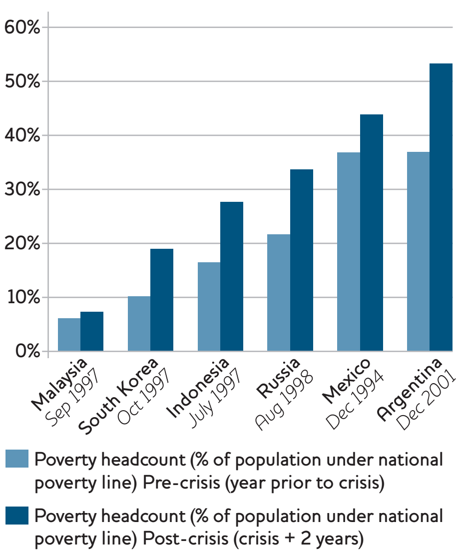
**How will the global financial crisis affect developing countries and what should policy responses be? To address the development dimensions of the current crisis, the Institute of Development Studies (IDS) undertook a set of rapid research projects. This brief summarises the conclusions from those projects. See www.ids.ac.uk/go/infocus7**

## The impact of the crisis on poverty

***Previous financial crises have increased poverty – sometimes dramatically (see In Focus Policy Briefing 7.2)***

Sadly, the world has a lot of experience of financial crises. Figure 1 shows poverty rates before and after the major crises

*Figure 1:* Poverty impacts of selected financial crises




Source: Gottschalk (2004) – see *In Focus Policy Briefing 7.2*

that have occurred since 1990. In each case, the poverty headcount increased. Non-income measures of poverty, including malnutrition, schooling drop-outs, and infant mortality have also often worsened.

***Poor households are still reeling from the fuel and food price shocks of last year (see 7.3)***

To try and assess the impact of this crisis on poor households now, researchers in Bangladesh, Indonesia, Jamaica, Kenya and Zambia undertook a rapid appraisal of the impacts in one rural and one urban community in each country. Often, households are still suffering from the large increases in food and fuel prices during 2007/2008. Many have exhausted their assets and are already in a weaker position. Crime, violence and other forms of insecurity and social division also appear to be increasing. Food riots and violent protest occurred in all of the countries.

***The crisis represents an opportunity to expand the scope of social protection in many poor countries (see 7.4)***

Current systems of social protection in developing countries are often fragmented and incomplete. Yet a substantial body of evidence shows that social protection programmes can have a significant positive impact. For example, the Oportunidades Program in Mexico provides cash and in-kind transfers conditional on school attendance and regular visits to health centres. In rural areas, Oportunidades increased educational achievement by

### Policy recommendations on poverty impacts of the crisis

- Invest in better early warning poverty and vulnerability data systems for rapid release of quantitative and qualitative indicators of the impacts of the crisis on poor people.
- Seize on opportunities to strengthen and implement social protection systems and programmes and develop long-term programmes through global partnerships.
- Aid-led finance is urgently needed to expand social protection in poor countries lacking fiscal space.
- Support vulnerable businesses, particularly in rural areas coping with shortages of credit and reduced demand in export markets.

14 per cent and children on the scheme have higher growth on average and lower levels of anemia than children not on the scheme.

*Differences in fiscal space (see 7.5)*
Developing countries vary enormously in their ability to expand government spending on social protection or infrastructure to compensate for the negative impacts of the crisis on the real economy. Some have strong fiscal positions and substantial international reserves, others have high debt, low reserves and substantial current account deficits. For such countries, aid-led financial packages can have a critical role in avoiding severe hardship. To be effective, such resources need to be delivered quickly and with flexibility.

## The crisis impact on trade and investment

### Policy recommendations on trade and investment

- Reform the IFIs and regional development banks to give more funds, more flexible funds and new social protection financing mechanisms.
- Understand China's strategic interests and motivations in order to enhance collaboration in the goals of renewed but sustainable growth, poverty reduction and achievement of the MDGs.
- Identify and address shortages in trade credit where they exist.
- Account for changes in world prices when considering impact.
- Understand people's differing policy narratives on the causes of the crisis and responses to it, to create more sustainable solutions.

*Recession in the rich countries hurts developing countries' exports… but it also lowers the price of oil (see 7.7)*
The GLOBE model of the world economy was used to simulate the impact of major recession in the developed countries on world trade (a five per cent reduction in the GDP of the OECD was simulated). The results suggest that world trade will shrink by over five per cent and the prices of developing country exports will fall. However, the price of oil also falls significantly. Developing countries lose US$71 billion in export revenues, as the prices of their exports decline, but for oil importers, the losses are partially offset by the declining oil price.

*Access to trade credit is NOT a major problem for established horticulture and garment exporters in Africa … but exchange rate volatility and buyer power are (see 7.8)*
A rapid survey of 25 horticulture and garment exporters in sub-Saharan Africa showed that the capacity of these firms to continue exporting was not being affected by cutbacks in credit, either from their customers, the international banking system or domestic banks. This appears to be because established horticulture businesses remain a good risk for domestic banks and are operating in well-established value chains, whilst Asian-owned garment firms rely on credit from their parent companies. However, firms exporting to the UK are suffering from exchange rate changes when their inputs are priced in US dollars. Nevertheless, there are substantial problems with trade credit for horticulture firms in Latin America. The well-established businesses covered in the survey may still have access to domestic credit, but others – such as business start-ups and cooperatives – may be more vulnerable.

*China's state enterprises are using the crisis as an opportunity to increase investments in Africa, particularly in the energy sector (see 7.6)*
China's need for natural resources, combined with its infrastructure-focused stimulus package, should maintain demand for key commodities such as oil, cotton, and copper. This contrasts with some South East Asian countries who provide intermediate products for China's export manufacturing and are seeing falling demand. Moreover, intensifying competition between private sector firms in China may accelerate investment in Africa, as Chinese companies seek new markets to compensate for falling demand from Europe and America.

*Developed country policymakers need to understand the way in which the crisis is being viewed within developing countries (see 7.9)*
Efforts to put in place effective new mechanisms of global financial governance will require the participation and agreement of a range of developing country governments. Achieving such agreement will only be possible if policymakers understand the way in which the crisis is viewed in different parts of the world and how these perspectives shape the types of solutions which are likely to be acceptable. Tracking of national-level debates in a select set of emerging economies suggest that the crisis, while demonstrating global economic interdependence, simultaneously increases distrust of Western models.

## Credits

This *In Focus Policy Briefing* was written by **Neil McCulloch**, **Anna Schmidt** and **Andy Sumner** at the Institute of Development Studies. The series editor is **Clare Gorman**. For other briefs on the crisis see: **www.ids.ac.uk/go/infocus7**

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