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](http://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

![Poverty impacts of selected financial crises](chart.png)

Figure 1: Poverty impacts of selected financial crises

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.