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**The global recession and developing
countries**

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Preface

The primary goal of the ILO is to contribute, with member States, to achieve full and productive employment and decent work for all, including women and young people, a goal embedded in the ILO Declaration 2008 on *Social Justice for a Fair Globalization*,¹ and which has now been widely adopted by the international community.

In order to support member States and the social partners to reach the goal, the ILO pursues a Decent Work Agenda which comprises four interrelated areas: Respect for fundamental worker's rights and international labour standards, employment promotion, social protection and social dialogue. Explanations of this integrated approach and related challenges are contained in a number of key documents: in those explaining and elaborating the concept of decent work,² in the Employment Policy Convention, 1964 (No. 122), and in the Global Employment Agenda.

The Global Employment Agenda was developed by the ILO through tripartite consensus of its Governing Body's Employment and Social Policy Committee. Since its adoption in 2003 it has been further articulated and made more operational and today it constitutes the basic framework through which the ILO pursues the objective of placing employment at the centre of economic and social policies.³

The Employment Sector is fully engaged in the implementation of the Global Employment Agenda, and is doing so through a large range of technical support and capacity building activities, advisory services and policy research. As part of its research and publications programme, the Employment Sector promotes knowledge-generation around key policy issues and topics conforming to the core elements of the Global Employment Agenda and the Decent Work Agenda. The Sector's publications consist of books, monographs, working papers, employment reports and policy briefs.⁴

The *Employment Working Papers* series is designed to disseminate the main findings of research initiatives undertaken by the various departments and programmes of the Sector. The working papers are intended to encourage exchange of ideas and to stimulate debate. The views expressed are the responsibility of the author(s) and do not necessarily represent those of the ILO.

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¹ See http://www.ilo.org/public/english/bureau/dgo/download/dg_announce_en.pdf

² See the successive Reports of the Director-General to the International Labour Conference: *Decent work* (1999); *Reducing the decent work deficit: A global challenge* (2001); *Working out of poverty* (2003).

³ See <http://www.ilo.org/gea>. And in particular: *Implementing the Global Employment Agenda: Employment strategies in support of decent work*, "Vision" document, ILO, 2006.

⁴ See <http://www.ilo.org/employment>.

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Foreword

This paper examines the effects of the global recession on developing countries. It argues that the majority of developing economies are in growth deceleration with positive as opposed to negative growth. Deceleration with positive growth has adverse consequences (especially for financing future economic development) but it is unambiguously better than deceleration with negative growth. This has implications on our expectations with regards to welfare loss in developing economies as well as on the international distribution of income. The three mechanisms identified through which the decline in growth will be affected in developing countries are capital flows, remittances and trade. The paper argues that higher future costs of international borrowing and the timeliness of its availability are likely to be generalised across the developing world. It also argues that the decline in official capital flows and falling remittances due to job losses and decreased demand for skilled migrant labour in advanced economies will impact the least developed economies relatively more than medium income developing economies. Lastly the paper argues that while trade contraction is universal across developing countries, the economies that are particularly affected by it are precisely those dominantly medium income economies that were at the forefront of last era of globalisation. Amongst these globaliser developing economies, those that have accumulated healthier reserves and have relatively larger domestic economies may have been able to withstand the shock from the recession better.

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1. Introduction

The aim of this paper is to make a general assessment of the impact of the 2008-2009 recession on the developing world. At the outset some basic qualifications would be in order. Taking an overview entails making defensible classifications of country groups whose underlying assumptions can be subject to discussion. It also entails selecting some indicators as broadly reflecting impact mechanisms that are deemed to be important. Taking an overview by definition also entails treating outliers to the emerging generalisation as exceptions that prove the “general” rule. We take the position that while deviations from the norm are essential for studying particular cases and formulating country specific policy, if there is a case for establishing an overview in the first place, which we think there is, then the average or norm needs to take categorical precedence over the exceptions.

The present recessionary shock to developing countries is circumscribed by the ways in which developing and advanced economies were economically connected to each other *prior* to the recession. In other words, if it is true that the source of the recession is located primarily in the advanced economies then it should follow that the short run limits of this crisis for the developing world are set by the very “integration” of the world during its last phase of globalisation. Thus the first round potential negative impacts ought to be from lost trade *from* the developing world to advanced economies; and capital inflows and remittances *to* the developing world¹ from the advanced economies. This is because in the last three decades there have been significant increases in South-North trade (especially in manufacturing exports from some developing countries to advanced economies²); increases in certain types of North-South capital flows³; and because of (skilled) migration from developing to advanced economies⁴ - increased remittances as well. Negative growth and

¹ As in all classifications there is a degree of arbitrariness in ours. For details of the rationale behind this classification and why it is preferable to a simple income based classification see reference below. In our classification system for the developing world, we exclude the richer developing and small economies (GDP per capita > \$ 10,000 in 2003, referred to as **other high income countries**) and high petroleum exporters (petroleum exports > 50 per cent of exports) from the developing country aggregates as the inclusion of these economies, tends to inject in to the aggregation special aspects of these economies. Developing economies excluding these high income and petroleum exporter developing countries are called *core* developing countries. **Core developing countries** constitute over 75 per cent of countries in developing world and cover 93 per cent of its population. Amongst core developing economies we construct two groups. First are the poorest of these economies and these are the **least developed**, as per the UN income based classification. The rest of the core developing economies, (i.e. countries that are not least developed and are also not in the other high income or petroleum exporting developing country category) are called **medium income** developing countries. Another sub-category that is amongst the core economies (from both least developed and medium income groups) but mostly from the medium income group is that of **High Manufacturing Exporters**. These are defined as countries whose manufacturing exports constitute over 50 per cent of their merchandising exports (average for 2000-2007). This category is taken to be a proxy for capturing the developing economy globalisers of the past decades. For details on classification of core countries see Ghose, Majid and Ernst (2008), this is referred to as GEC (2008) in the rest of this paper.

² See Ghose (2000); World Bank (2004). We do not examine the whole issue of commodity trade and terms of trade on which there is recent literature. The reason for this exclusion is simply that there is a cyclicity to commodity prices that is separate from the crisis. See World Bank (2009).

³ The literature on FDI flows is vast. For early reviews See De Mello (1997, 1999)

⁴ Data on skilled South North migration is available from the OECD database on immigrants and expatriates. For the year 2000, this data is also available by skill level.
http://www.oecd.org/document/51/0,3343,en_2649_33931_34063091_1_1_1_1,00.html

stagnation in advanced economies is likely to adversely affect these flows and produce contagion in developing countries⁵.

Given the limited availability of current data many of these expectations cannot be easily illustrated. However, it is not as if there is no data, and patterns on historical data cannot be used to speculate on likely impacts. From the point of view of the whole world developing countries are clearly less affected by this recession than advanced countries; from the point of view of the developing world the impact of the recession is more differentiated. This is because the expansionary process of globalisation of the last three decades did not impact the developing world uniformly. A few large and often highly populous (significantly though not exclusively Asian) countries have grown and taken advantage of the trade led integration of the world, while others have done so to a lesser extent⁶. The economies that have done well on trade led growth are on average also more affected by decreased demand from advanced economies but they are also perhaps more able to deal with the growth shocks partly because of their gains in the preceding period of globalisation. On the other hand, the developing economies that were relatively excluded from the globalisation process are also affected by this crisis, but in a different way. While these economies did not gain through the process of (manufacturing) trade-led growth like other parts of the developing world, they did receive significant (official) capital flows and remittances. Reversal of these flows, which are likely with the recession in advanced economies, could be adverse for the future development of these economies.

In the following sections we will first identify the growth impacts of the crisis. This is important because there may be some general misconceptions regarding this matter. We then go on to speculate on the welfare and employment effects of this crisis in developing countries. Then we proceed to examine each of the aforementioned mechanisms of contagion (capital flows, remittances and trade) through which this impact is likely to be felt. It will be argued that while these mechanisms are not exclusive, there is a hierarchy of relative importance with regards to each of these mechanisms in the developing world if we distinguish two parts of it, the poorest or the least developed part and the middle income part in which most emerging developing economies can be placed.

Based on past evidence and the limited information that is current and available, four stylised facts will be established about the impact of the recession in developing countries. First, that relative to the richer (industrialised, transition and high income developing) countries of the world, growth in the core developing world is decelerating but can be expected to be generally positive as opposed to negative. This is a crucial point and has implications for future employment and welfare in the developing world. Second, it is the medium income developing countries that will face a greater growth shock compared to least developed or poorest developing economies. This means that within the developing world the ability to deal with the shock will be relatively greater for those on whom the shock is greater. Third, the relatively more important transmission mechanism of the shock in medium income developing economies is going to come via loss in trade. Fourth, the

⁵ One way to see the difference between advanced and developing economies in this context concerns the financial sector and the banking system. Most developing country financial sectors were not complex enough to accommodate the type of instruments that were directly responsible for the reckless behaviour that led to the market failures that triggered the recession. See for example Stiglitz (2009) for details. Those developing countries that had more developed financial sectors perhaps learnt dearly from the Asian financial crisis (See Lee (1998) for an overview) in the 1990s to build regulatory firewalls around their banking sectors. In short, there is no banking or financial “market failure” in developing economies yet. In this sense the immediate source of the crisis in developing countries is in fact located in the mechanisms of contagion transmission in these countries from the advanced economies.

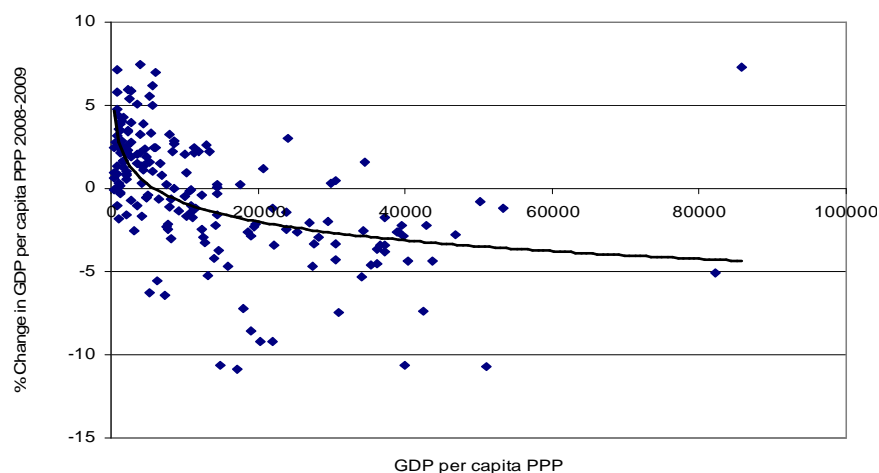
⁶ ILO (2004).

impact in the poorer developing economies will be driven more by a drying up of aid and declining remittances. Lastly based on these stylised facts pertaining to contractions in growth, trade, capital flows and remittances, we shall try and draw up some conclusions regarding general policy directions for meeting future challenges in the developing world.

2. The impact on growth in developing countries

The greatest impact of the global recession is in richer countries of the world, as that is where the crisis has originated. Figure 1 shows that the greater the GDP per capita of a country the greater were its chances of experiencing a low or negative growth in 2008-2009. The graph illustrates the effects of the recession in the developing world. While it is still early to say what will happen in developing countries in the future, it is important to base one's expectations on the illustration below.

Figure 1. The distribution of the impact of the crisis 2008-2009



Note: Data source IMF (2009)a. All data from this source is based on the information available in this data set at the time of downloading in July 2009. The regression equation is:
 $Y = -1.62^{***}\ln(x) + 14.03$; R-squared = 0.33. Number of observations = 181. The x-coefficient has greater than a 99 % confidence level.

As far as country group aggregates are concerned, Table 1 clearly shows a few things. First, comparing the numbers in the two columns it is obvious that there is universal *deceleration* in growth. Second, moving down the column for 2008-2009, we find that negative growth dominance turns in to positive growth dominance as we move from the richer to poorer economies. Per capita growth in 2008-2009 amongst core developing economies will be around 2.4 per cent for medium income countries group and 2.1 per cent for least developed group. The growth is a little better for the manufacturing exporters group. In contrast industrialised, transition and other high income countries are generally in negative growth.

Table 1. Percentage change in GDP per capita for country groups

	2007-2008	2008-2009
Industrialized	2.288	-3.351
Transition-CIS	7.741	-4.224
Transition-CEE	6.541	-1.797
Other high income	3.383	-4.753
Developing-petrol exporters	5.124	0.380
Core Developing Countries, of which		
Medium income	7.432	2.428
LDC	6.678	2.093
of which		
Manufacturing Exporters	7.555	2.703
All countries	4.099	-1.668

Calculations based on data from IMF (2009)a.
Note: See Footnote 1 for definitions.

While positive growth economies do dominate the developing world⁷, there are a significant minority of economies in the developing world that are also going in to negative growth. Table 2 gives a comparative count of economies going in to negative growth in 2008-2009. The 29 negative growth countries amongst the core developing economies are spread across the least developed and medium income country groups, but are proportionately greater in the medium income group.

Table 2. Frequency of countries with negative growth rates in GDP per capita (PPP)

	Year on Year Growth	
	2007-2008	2008-2009
Industrialized	1/23	22/23
Transition-CIS	0/12	6/12
Transition-CEE	2/16	14/16
Developing-Petro Exporters	1/17	5/17
Other High Income	1/20	14/20
Developing- Medium Income	0/44	19/44
Developing- LDC	1/48	10/49
Total	6/181	90/181

Calculations based on data from IMF (2009)a.
Growth Rates for Negative growth Core economies 2008-2009:
Least Developed Countries(LDC) : Guinea-Bissau -0.086; Lesotho -0.248; Comoros -0.313; Maldives -0.381; Eritrea -1.000; Belize -1.125; Cambodia -1.556; Madagascar -1.865; Angola -5.517; Equatorial Guinea -7.252;
Medium Income Countries: Dominican Republic -0.006; Costa Rica -0.138; Chile -0.338; South Africa -0.485; Guatemala -0.517; Paraguay-0.565; Namibia -0.636; Colombia -0.651; Nicaragua -0.738; Philippines -1.048; Argentina -1.561; Brazil -1.664; Jamaica -2.152; Ecuador -2.456; Thailand -3.036; Mexico -3.727; Malaysia -4.229; Turkey -5.268; Botswana 10.622.

⁷ In 64 out of 93 core developing countries in our sample we expect *positive growth* in 2008-2009. There is a near universal *deceleration* in growth even in these positive growth developing economies.

This completes the broad or general growth picture for the developing world. The *dominant form* of the crisis in developing countries is *growth deceleration with positive year on year growth* rather than *growth deceleration with negative year on year growth*. In contrast to industrialised, other high income and transition countries this is the central difference. The implications of the difference between growth deceleration that leaves change in GDP per capita positive and growth deceleration that leaves change in GDP per capita negative are obvious and considerable⁸. However this does not mean that there is reason to be complacent about the impact of the recession on the developing world. As noted, there is a universal deceleration in growth, and developing countries are adversely affected by this deceleration.

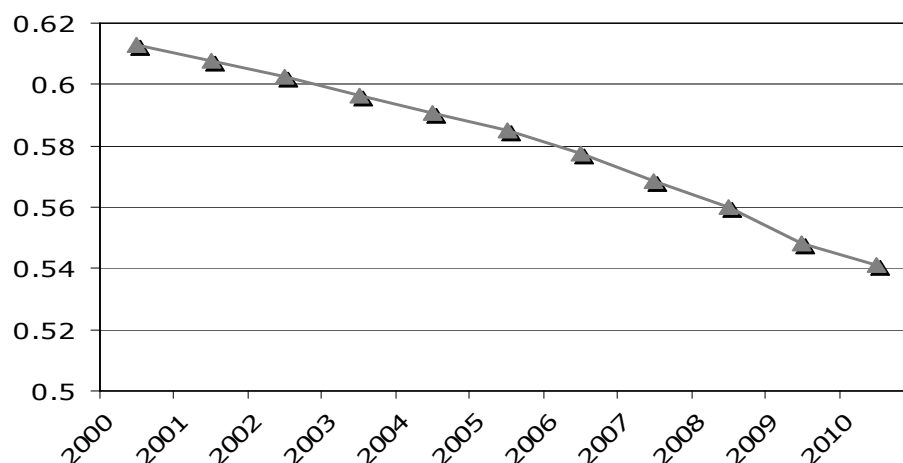
Care must also be taken to be clear on the implications of this recession on global integration. One feature of the growth process of the last few decades was a global convergence of per capita incomes across the nations of the world⁹. An obvious question to ask today is whether this recession is going to impact the process of global integration which preceded the crisis. We can see that on a standard measure of international inequality¹⁰, (using the projected growth rates by the IMF for 2009 and 2010) we still get a continued post crisis convergence in the world economies. Figure 2 shows that the population adjusted Gini coefficient across per capita incomes of the countries of the world is still declining, although it may be expected to do so at a slower rate after the crisis. It remains to be seen if a reversal comes about in the immediate future.

⁸ Unfortunately in emphasising the adversity of the crisis in the developing world, there has been a tendency to overstate (either unwittingly or knowingly) the case- by blurring the distinction between growth deceleration with negative growth and growth deceleration that still leaves growth positive. As is clear from Table 1, the change between the two change (growth) numbers (which is deceleration or acceleration) is universal. However the negative sign on this deceleration between two change numbers is not negative growth. It is quite alarming how often this is subject to confusion. There are other less obvious ways in which adversity can be exaggerated. For example it has almost become standard practice to assume a counterfactual as “true” and attribute the difference between the counterfactual and the obtaining (i.e. actual) situation as an increase in adversity! For example, if for country x the year on year growth in 2008-2009 is 3 per cent and in 2007-2008 it was 10 per cent, the question asked is what would be the case if growth continued on past trend of 10 per cent in 2008-2009 (i.e. there was no contraction) instead of the actual 3 per cent. The answer of course is that the poverty rate or the unemployment rate would decline more than what would be expected with the 3 per cent growth in 2008-2009. This is not an illegitimate exercise. However to calculate (1) the decrease in say the poverty rate on a 10 per cent (counterfactual) growth scenario for 2008-2009, and (2) the decrease in poverty rate on the obtaining 3 per cent growth for 2008-2009, and then proceed to subtract (1) from (2). i.e. the higher 10 per cent growth engendered poverty reduction figure from the 3 per cent growth engendered poverty reduction figure; and then present the result as an “increase” in poverty rate *due* to the growth contraction, is confusing and misleading. One cannot help but thinking that such exercises are perhaps designed to give the popular impression that the welfare number in question has somehow worsened, when in fact what has happened is that the improvement in the social indicator (e.g. the decline in poverty rate or the unemployment rate) can still be expected to continue albeit at a slower speed.

⁹ It is the case that if per capita incomes are not population weighted or the majority population developing countries (the globalisers) are excluded from the sample an increase in global inequality can be shown. The point is that not weighting GDP per capita numbers or successful globaliser country exclusions must be justifiable on grounds other than ones invoking the results they produce.

¹⁰ It is of course well known that international inequality measures do not take in to account national inequality because they assume the average income of a country is representative. However in this context it also needs to be pointed out, and this will be argued below, that the impact of growth on inequality in a national context may be contrary to what is often suggested and therefore expected. Moreover a contraction in per capita national income (that takes the economy in to negative growth) can in some instances (and we have reason to believe that it does so in many) impact the rich more adversely than the poor in a country thereby reducing inequality. It may well be the case that in a number of those economies where there has been negative growth (especially in the more advanced economies) income distribution measures will show improvements post crisis. One needs to look out for this as and when data from new surveys become available. See Milanovic (2009) for discussion of global inequality measures that take in to account national inequality.

Figure 2. Population weighted international inequality: Gini coefficients



Note: Data Source: IMF (2009). World Economic Outlook Database, April 2009
Population weighted Gini for All Countries Group has 148 countries (coverage 93% of the World population).

The upshot of our assessment of the impact of the global recession in developing countries is that it has slowed down growth in the developing world, just as it has done in the industrialised economies but on average per capita growth has not turned negative in most developing countries; at present the least developed economies are relatively less affected by the growth deceleration than are medium income developing economies, where most of the successful globalisers of the preceding decades can be placed. Moreover, while global integration or convergence of per capita incomes across all countries of the world has slowed down post crisis, it too has not reversed direction.

3. General expectations on poverty, income distribution and unemployment in developing countries

Given that there has been an initial tendency towards ambivalence in distinguishing between differences between growth deceleration with positive growth and growth deceleration with negative growth, expectations on poverty and inequality, as a consequence, have become subject to distortionary capture. The matters are further complicated because the dominant pre-crisis perspective on the relationship between growth, poverty and inequality was perhaps over simplified to start with.

Since social insurance systems are weak in most core developing economies, one important effect of a deceleration in growth may well be on the change in livelihoods of the labour force- for both the poor and non-poor parts of it. In fact the weakness of social insurance systems is precisely the reason why there exist workers in developing economies that live below the poverty line but are nonetheless in “employment” as a part of survival strategies¹¹. Actual survey data on poverty rates are however irregular and pre-date the crisis. For example, there were **no** comparable survey based estimates of poverty for any

¹¹ Majid (2001). This is also why in core developing economies unemployment rates are often much lower than poverty rates.

developing country for 2008 or 2009 in the World Bank's online POVCAL database on poverty at the time of writing this paper¹². Thus it is not possible to say on the basis of actual survey data as to what has happened, post-crisis, to poverty or to the working poor in any particular developing country. This means that estimates have to be based on extrapolating the past under simplifying assumptions. If we assume a robust growth-poverty reduction inverse relation - and this is where part of the problem lies¹³- then "on average" in positive growth developing countries (regardless of the fact that growth is decelerating over time), poverty rates should in principle still decline¹⁴. The reason why expectations on poverty rates by using growth rates are difficult to form is because the strength of the relationship between poverty reduction and economic growth, as the latter is and ought to be measured, is weak. The Figure below plots changes in GDP per capita (PPP) and changes in poverty rates for 60 episodes of changes in poverty from the latest World Bank data¹⁵.

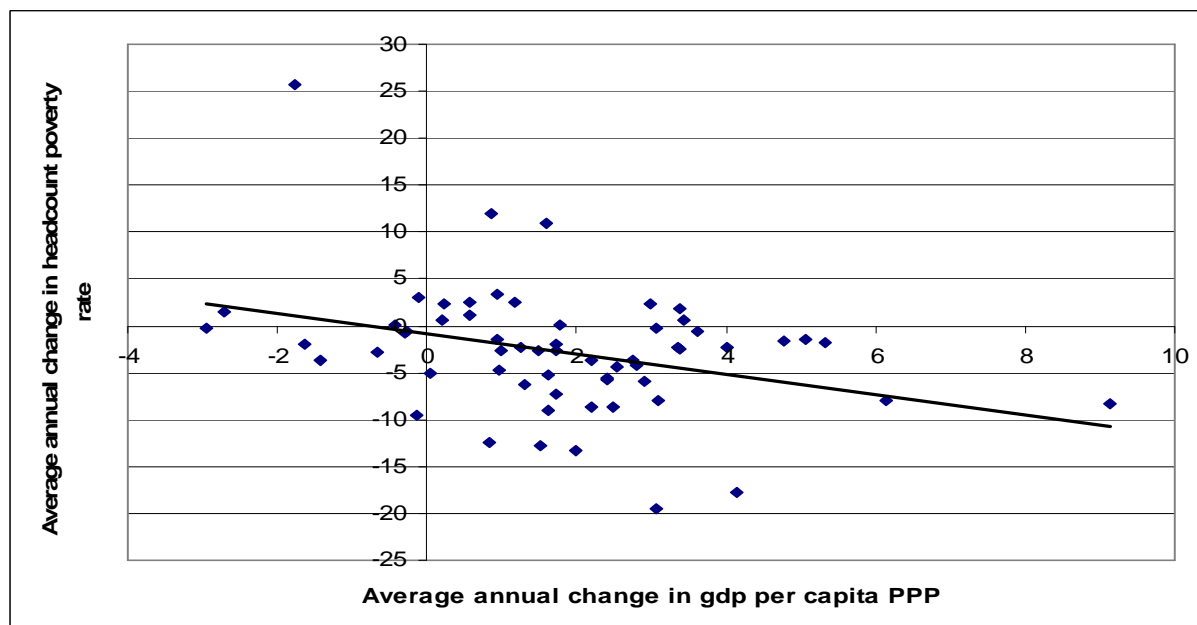
¹² <http://iresearch.worldbank.org/PovcalNet/povcalSvy.html>. Estimates of poverty impacts need to be taken caution. Once again there is a tendency on the part of some analysts to overstate the case by providing absolute numbers of estimated increases in poverty. Until the millennium goal is changed we need to first look at poverty rates as opposed to the population of the poor.

¹³ See GEC (2008), Chapter 5 and Majid (2010) forthcoming.

¹⁴ In reality the outcome is much more uncertain at a country level. At a country level we do not have sufficient observations to measure the growth-poverty relationship over the longer run. Moreover the cross country growth-poverty elasticity is statistically more reliable when the indicator of growth is the consumption or expenditure mean of the survey from which poverty is estimated and not GDP per capita. The elasticity of the poverty rate with respect to GDP per capita is a negative albeit much weaker empirical relationship. The reason for this weakness is of course that growth is essentially the movement of average income in the economy, while poverty rate is an exclusive measure of those who are poor. It is therefore possible for growth to take place in parts of the economy that do not impact the poor. A necessary condition of growth reducing poverty may well be that it should also increase the productivity of the poor as well as employment in the modern sector of the dual economy. See GEC(2008).

¹⁵ The selection of poverty episodes is from the new World Bank POVCAL data. We have selected episodes core developing economies by applying the following rules: (1) leaving out the cases where the gap between the initial and terminal periods is less than 4 years, (2) choosing, wherever data for more than two periods are available, initial and terminal periods in such a way as to minimize the possibility of deriving misleading trends, (3) choosing a single time-period or "spell" for each country¹⁵ even though multiple "spells" could have been chosen for many, and (4) leaving out the cases in which the incidence has been and remains very low (2 per cent or less). The resulting sample of is of 60 country episodes. The sample increases to 70 countries when we include non core economies, which are essentially transition economies that still meet the other selection criteria. For details on the data see Majid 2010 (forthcoming).

Figure 3: Episodes of change in poverty rate and change in GDP per capita for core developing countries



Note : Majid (2010) forthcoming. The regression equation is:
 $Y = -1.0855 * (x) - 0.8142$; Number of observations = 60 R-squared = .12
 The x-coefficient has greater than a 99 % confidence level.

The association is modest¹⁶, but the idea that poverty rate declines will slow down as the economy slows down are plausible. However and importantly there is little that can be said about the behaviour of the poverty rate when growth turns negative - (we have 10 historical cases of negative growth in the POVCAL database using our selection criteria for episodes) - the situation that obtains in 29 core developing countries today¹⁷. In short, while it is obvious is that even positive per capita income growth is only often and not always associated with declining poverty rates, what is also quite clear is that there are more recent historical episodes in the developing world with declining poverty rates and negative growth than those of increasing poverty rates and negative growth¹⁸. Consequently, speculating on the poverty impacts of growth deceleration with negative year on year growth in developing countries is even more problematic than doing the same for decelerating but positive growth economies. If one ignores most of these problems and goes with the inverse growth-poverty rule of thumb, then growth contractions in developing

¹⁶ In fact they get considerably weaker if we take the whole sample of 70 country episodes that include transition economies.

¹⁷ It is the case that poverty rates are based on consumption surveys and the change in the consumption mean of survey from which poverty rate is calculated if used as a proxy for growth (instead of GDP per capita from national income accounts), gives a much better result. But it is still a fact that the measure of economic growth is change in GDP per capita and not changes in household survey means. The problem admittedly is partly also in the labelling of “growth” because it were strictly claimed that increases in average consumption expenditures between two comparable surveys over time tends to reduce the headcount rate, it would not attract as much public attention as per capita growth reduces the poverty rate. And this is precisely because it is generally assumed that one is referring change in GDP per capita when one talking about growth.

¹⁸ Of the **eleven** core country episodes with negative GDP per capita growth in the POVCAL sample, selected on our aforementioned criteria, **seven** have shown a **decline** in poverty rates. In fact there is an asymmetry between the negative and positive growth economies. These are: Burundi (1992-2006), Malawi (1998-2004), Swaziland (1995-2001), Central African Republic (1993-2003), Niger (1992- 2005), Madagascar (1993-2005) and Mauritania ((1993-2000). See Majid (2010) forthcoming.

countries ought to slow down the achievement of poverty related Millennium Development Goals¹⁹.

As far as income distribution is concerned there are further complications that also have something to do received views on national level inequality and growth. If we accept the argument and supporting statistics, that growth in the past decades in developing economies has been distribution neutral²⁰ (as that is exactly what was needed to argue that growth is robustly poverty reducing) then whether there is a growth slowdown with positive growth or for that matter negative growth, we should have no systematic expectation on changes in inequality. In particular in negative growth economies (as in some developing countries today and in most advanced economies) we should not *necessarily* expect worsening income distribution. In fact the position on the basis of “received wisdom” ought to be an agnostic one²¹.

Now we can look at the data on the same 60 pre-crisis core developing country episodes from the World Bank POVCAL data set. Contrary to the view that growth is distribution neutral²², the simple association between change in GDP per capita and change in the Gini coefficient, which is the most standard measure used to measure income distribution²³- we get a positive relationship. It suggests that if one is to form an expectation, it is that inequality would on average increase with positive growth in developing countries²⁴. There is evidence to suggest that GDP per capita growth in developing countries in general tends to increase inequality as opposed to evidence which suggests that it does nothing systematic to it²⁵. Since most developing economies are in decelerating but positive growth, the expectation that inequality will increase will be appropriate but that is because the majority of developing economies are not in negative but still in positive growth! In other words, inequality can be expected to increase in most developing countries because they have been less affected by recession and not more!²⁶

¹⁹ Chen and Ravallion (2009) argue that global poverty rates will continue to fall (from 42 per cent to 39 per cent) in 2009, while the pre-crisis trend would have reduced poverty to 38 per cent. The numbers given for the “new poor” will be 64 million.

²⁰ World Development Report 2006. Actually here too, there is no relationship worthy of comment if the proxy for growth is the survey mean. See Majid (2010).

²¹ Having noted this, it is important to give the right reasons for the popular impression that growth deceleration which leaves growth positive taking place in developing countries today are somehow going to worsen income distribution. This as we shall see below is of course not incorrect because increased inequality ought to be expected for countries in positive growth. So it is because of the positive growth that we should expect increase in inequality and not because of decelerating growth!

²² Dollar and Kraay (2002).

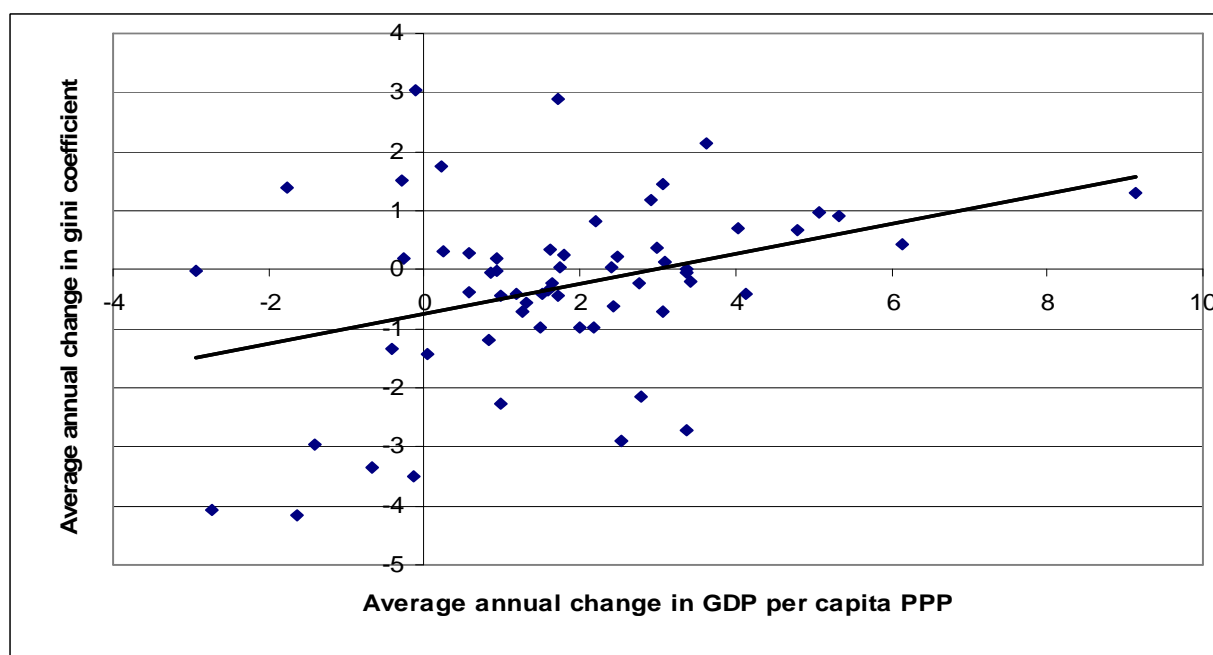
²³ If other measures of distribution are used then the preference for these ought to be explained without invoking the result their use produces. In other words, the choice of the inequality indicator that shows no relationship with growth (i.e. which confirms the distribution neutrality of growth assumption) must be shown to be superior to the one that shows a positive relationship (i.e. which rejects the distribution neutrality of growth assumption), on independent grounds.

²⁴ Interestingly the strength of this relationship is not any different from the one between growth and poverty in Figure 4.

²⁵ See Majid (2010) for reasons why the expectation that growth in developing countries increases inequality is plausible.

²⁶ The expectation with respect to negative growth countries also needs to be thought through. If there is some intuitive basis to the illustration in Figure 4, then to expect negative growth (in the minority of countries where it obtains in the developing world) to increase inequality or leave it unchanged also does not make sense. We have the same eleven core negative growth developing economy examples to draw on, and here too the effect is unlikely to be one that exacerbates inequality. Of the **eleven** core developing country episodes with negative GDP per capita growth in the POVCAL sample, selected on our aforementioned criteria, **seven** have shown a

Figure 4: Episodes of change in the Gini coefficient of income distribution and change in GDP per capita for core developing countries



Note : Majid (2010) forthcoming. The regression equation is:
 $Y = 0.255(x) - 0.746$; Number of observations= 60. R-squared = 0.12 *The x-coefficient has greater than a 99 % confidence level.

Reported data, at the time of writing of this paper, on unemployment rates in developing countries also precede the crisis in most cases²⁷. Amongst developing countries, we only had **17** countries for which unemployment rates extended in to a period in 2009. 16 countries are medium income countries and one is a petroleum exporter. There is no current unemployment data for the least developed economies. The limited evidence that we have on unemployment rates, shows adverse changes²⁸. Increasing unemployment rates are clearly more pronounced in countries that experienced negative growth in 2008-2009.

decline in gini coefficients of income distribution. This is of course consistent with the overall relationship and there is symmetry between the positive and negative growth economies.. These are: Burundi (1992-2006), Guinea-Bissau (1991-2002), Malawi (1998-2004), Swaziland (1995-2001), Central African Republic (1993-2003), Zambia (1991-2004) Mauritania (1993-2000) and Cote d'Ivoire (1993-2002). See Majid (2010) forthcoming.

²⁷ Data on unemployment rates does not extend to 2009 for most developing countries. All advanced economies for which we have data show increases in unemployment rates.

²⁸ It is important to point out that in the case of most developing economies where effective social insurance and automatic stabilisers are absent the employed by definition include the working poor. Therefore unlike the case of advanced economies, using the employment elasticity of growth to estimate impact of a slowdown in employment from a recession tells us little about improvements or adversity in the labour market. This is especially true for large developing countries like China, Brazil and India on which using such elasticities is a temptation. The only employment elasticity that makes sense in a developing economy context is one for manufacturing sector.

Table 3. Selected unemployment rates – Developing countries

Country	% Change in unemployment rates 2008-2009
Chile*	22.39
Turkey*	18.34
Ecuador*	18.33
Malaysia*	11.11
Sri Lanka	7.84
Colombia*	6.25
Egypt	4.11
Brazil*	3.83
Peru	3.28
South Africa*	1.07
Mauritius	-2.44
Venezuela*	-4.20
Morocco	-5.88
Uruguay	-6.04
Philippines*	-6.25

Notes:

A. Not all data is available for each country for all months. Only months with available data for both 2008 and 2009 were used for this estimate. The numbers below indicate the number of months used to calculate the average. The period of comparison always begins with January and does not skip any month, i.e. period of comparison=3 means that unemployment rates from January, February, and March are calculated in the averages for 2008 and 2009. The Philippines uses the months of February to April. Chile-6; Colombia-6; Ecuador-6; Egypt-3; Malaysia-3; Mauritius-3; Morocco-6; **Peru-6; **Philippines-3; Puerto Rico-4; **South Africa-6; **Sri Lanka-3; Turkey-2; Uruguay- 4; Venezuela-4.

B. Puerto Rico, Turkey, Uruguay and Venezuela are ILO verified data. The other countries are from country statistical official websites

C. * connotes negative growth economies in 2008-2009.

The *general* impact of this recession if it is prolonged, on workers in the developing world can only be speculated upon since there is little post 2008 information. However on the basis of taking a view on past relationships one can say that it is likely to be one that slows down the rate of poverty reduction. In some of those instances where countries are going in to prolonged negative per capita output growth perhaps there may be an increase poverty rates, but this is also not as obvious as it may appear, for reasons discussed above. As far inequality is concerned, again there is no new data but we should expect an *increase* in inequality in most developing countries because there is positive growth in the majority of developing countries, although this increase too, ought to slow down with growth deceleration. In any case there should be no expectation that inequality would increase *as a result* of the slowdown or negative growth (in the countries where there is negative growth). In fact, as we have argued, there may even be a basis to expect improving income distribution in countries that face negative growth. This, of course, only means that falling inequality measures in times of negative growth need to be qualified by the proviso that an absolute contraction leaves everyone worse off; and a decline in a relative measure such as inequality in such circumstances only means that the richer households are losing out more than the poorer ones²⁹. As far as the unemployment rate is concerned one can

²⁹ In fact in earlier sections, at a global level we have found that since richer nations are facing greater contractions than developing nations, global convergence of per capita incomes is continuing. The argument is similar at a national level.

expect adverse effects not only in negative growth economies but also in those economies that show export declines and decelerating (but positive) per capita growth³⁰.

4. Capital flows to developing countries and the crisis

One of the main fears stemming from the global recession pertains to capital flows, in particular the anticipated difficulties for open developing economies to access international capital for trade, development finance and balance of payments support. The argument is a general one, that if the recession entails, as it does, large scale borrowing by advanced economies -from what may have otherwise (theoretically) been the pool of internationally available funds for global lending, then it could well raise the future cost of finance in developing countries. It is too early to say how these constraints will pan out for developing economies in the future and to see in any detail how the recapitalization of parts of the financial sector by advanced economy governments and the size of stimulus packages in them, will impinge on the terms of developing country borrowing. Most developing countries face the prospect of an increasing cost of financing new loans and maintaining international obligations whose timeliness is critical, on the one hand, and emerging budgetary constraints due to tax and revenue losses on the other. Coupled with limited reserve capacities, these problems will definitely limit their ability to aggressively intervene in order to address the growth decelerations they face³¹.

The problems emerging from higher costs of borrowing in an environment of scarcer capital and growth deceleration will be important in the immediate future and it will also have an effect on monetary policy and revival strategies in developing world. This problem of terms and timeliness of credit access needs to be distinguished from the broader discussions on private capital flows in developing economies that have been taking place in last two decades, where the growth context was often a positive and expansionary one as opposed to a recessionary one. There is a vast literature on the subject of the costs and benefits of private capital flows (and especially FDI) in developing countries. However in **net terms** and as a percentage of national income (as opposed to individual inflow components in absolute terms), it is likely that the global recession is going to lead to a reduction in the **net inflow** of international capital to developing economies. In order to take a view on what this likely contraction in capital flows may do in developing countries

³⁰ The mechanism of increasing unemployment in successful globaliser medium income economies likely to be one in which exports losses initiate a reduction in demand in the formal parts of the economies that are connected to the exports sectors. These multipliers would vary across different economies, but it should be noted that direct employment effects on tradable parts of typical developing economies are in themselves low percentages of country labour forces. It will be shown below that trade loss is a central mechanism through which the recession is transmitted to developing countries.

³¹ It is not clear how this constraint will manifest itself but it may well end up in a situation where (unreformed) international lending institutions begin encouraging pro-cyclical financial conservatism in developing economies while encouraging counter cyclical monetary policy in advanced economies. Given that most developing countries have faced some growth deceleration, their ostensible stances on investment revival already suggest the possibility of other pressures. One indicator for which we have 2009 data for some developing countries is the discount rate (IMF, 2009a). The discount rate is an interest rate a central bank charges depository institutions (i.e. commercial banks) that borrow reserves from it. It is therefore a summary measure of the stance that government's monetary authority takes with respect to facilitating lending by commercial banks. In times of crisis, it can be taken as proxy to gauge government policy to encourage investment. Between January 2008 and January 2009, while 6 out of 7 advanced economies in the sample show a decline in discount rates, it is only 10 out of 43 core developing countries that show a decline in this rate. What is particularly noteworthy is that in the 20 negative-growth developing economies for which we have data, the discount rate is declining in only 4 cases. This is in sharp contrast to advanced countries, which are also negative growth economies, and where trends in discount rates suggest pro-cyclical stances.

we need to first have a realistic overview of its pre- crisis levels and distribution between official and private components, and bear in mind that the situation this data describes obtained in general conditions of buoyant growth expansion preceding the crisis. It is also important to bear in mind here that the question we are posing concerning the quantum of net inflows, is a separate one from the one concerning the growth effects of regulatory regimes that facilitate or control capital flows. It is true that in the decades preceding the crisis, there was very sharp growth of private capital flows globally, including to some developing countries, while official flows (bilateral and multilateral loans and grants) stagnated³². After the Asian financial crisis of the 1990s³³, there is little disagreement in developing countries that there are volatility risks associated with highly liberalised capital market regimes³⁴.

We first look at the least developed economies. The data presented in the Table 4 below shows that overall **net** foreign inflow of capital as a percentage of GDP was considerable in the case of the least developed countries in the period 2000-2007 (11.3 per cent of GDP) and that this inflow was significantly based on foreign aid (8.3 per cent). This is where effective declines can be expected. There has been a shift in the contribution of FDI, in the least developed economies from the 1990s, and this is in good part due to South-South investment (e.g. Chinese FDI in Africa)³⁵. Therefore one should not expect a significant impact of reduction in FDI in some of these poorer economies³⁶. In any event the main point here is that in many of these least developed economies where official flows were significant, savings rates were often lower than investment rates, and official flows despite the inefficiencies associated with them, are likely to have nurtured investment. In medium income developing countries on the other hand, the overall net inflow of foreign capital as a share of GDP was not so high and was also concentrated in a few countries. The fact is that pre-crisis net foreign capital flows to medium income economies have only been around 3 per cent of GDP on average for the period 2000-2007.

³² See, for example, GEC (2005).

³³ See Lee (1998).

³⁴ With hindsight the longer run question in developing countries in this regard concerns the growth benefits of a liberalised capital market regime versus growth losses due to its volatility. The circumspection regarding its so called unquestionable benefits began a few years ago. See Stiglitz (2009) and the references therein to shifting positions within the IMF.

³⁵ See UNCTAD (2007).

³⁶ Examining absolute growth figures for separated categories of capital flows (FDI, Portfolio, Private loans, Official flows) while helpful in analysing the *particular category* under examination and the assessing the relative merits and demerits of each "source" of capital, tends to obfuscate the actual importance of the overall phenomenon of net capital flows for growth in to developing economies. It is also a very different question from the theoretical one concerning of how open capital market regimes ought to perform in an ideal world under perfect markets and costless information assumptions. There is some firm level evidence in Tong and Wei (2009), for emerging economies based on pre crisis data of 2000-2006, that shows the volume of capital flows has *no* effect stock prices changes for manufacturing firms. The same research also shows that credit constrained firms that are more dependent on external capital flows are adversely affected by this exposure and are more vulnerable compared to those dependent on FDI investment. This is tantamount to showing that while the amount of capital inflow is of no consequence to change in stock prices, the composition of capital inflow matters. The strong version of the argument for economy wide growth benefits of FDI flows however requires the demonstration of more than its relative advantage vis a vis other private capital for credit constrained firms in emerging economies.

Table 4: Net foreign capital inflows as share of GDP for selected countries ^a, 2000–2007 (percentages)

	Foreign Direct Investment (FDI) ^b (1)	Portfolio equity ^c (2)	Private loan ^d (3)	Official flow ^e (4)	Total (5)
Medium-Income Developing	2.7	0.7	-0.3	- 0.1	3.0
Least Developed	3.1	0.1	0.2	8.3	11.5

Note

a Based on data for the following 86(core) developing countries:

Medium-income developing: Argentina, Bolivia, Botswana, Brazil, Cameroon, Chile, China, Colombia, Costa Rica, Cote d'Ivoire, Dominican Republic, Ecuador, Egypt, El Salvador, Ghana, Guatemala, Honduras, India, Indonesia, Jamaica, Jordan, Kenya, Lebanon, Malaysia, Mauritius, Mexico, Mongolia, Morocco, Nicaragua, Pakistan, Panama, Papua New Guinea, Paraguay, Peru, Philippines, South Africa, Sri Lanka, Swaziland, Thailand, Tunisia, Turkey, Uruguay, and Vietnam

Least developed: Angola, Bangladesh, Belize, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, Cape Verde, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Djibouti, Eritrea, Ethiopia, The Gambia, Guinea, Guinea-Bissau, Haiti, Lao PDR, Lesotho, Liberia, Madagascar, Malawi, Maldives, Mali, Mauritania, Mozambique, Nepal, Niger, Rwanda, Samoa, Senegal, Sierra Leone, Solomon Islands, Sudan, Tanzania, Togo, Uganda, Vanuatu, Republic of Yemen, and Zambia

b Net FDI inflow is defined as inflow minus outflow.

c Portfolio equity flow includes country funds, depository receipts and direct purchase of shares by foreign investors, inflow minus outflow.

d Net inflow of private loan is new public and publicly guaranteed debt and private non-guaranteed external debt to private creditors minus principal repayments and interest payments on past debt.

e Net official inflow is new debt from international organizations (multilateral loans) and loans from governments (bilateral loans) to official creditors plus official grants minus principal and interest payments on past debt to official creditors.

Source: Col. 1: UNCTAD, Foreign Direct Investment database

(<http://www.unctad.org/Templates/page.asp?intItemID=3199&lang=1>); Cols. 2, 3 and 4: World Bank, Global Development Finance database; data on GDP are from World Bank, World Development Indicators database.

So the rapid growth of cross-border capital flows in the recent pre-crisis high growth period for developing countries was *not* associated with astronomically high *net inflows* of foreign *private* capital (as a percentage of national income) into “developing countries”. Unlike private flows, official flows to least developed economies, on the other hand, have been much larger, and it is potential declines here that ought to be of priority concern.

In general, with regards to capital flows two points need to be made. First the difficulties in the cost of borrowing and timely access to short term capital for all core developing countries (medium income or least developed) may become very serious, whether the recession deepens or we get slow recovery in advanced economies. Second, the decline of official (disbursed) flows is to be expected, and despite all the inefficiency and transparency problems associated with aid, will be important particularly for least developed economies.

5. Migration and remittances

Widespread liberalization of international trade and capital flows since the mid-1980s have stood in contrast with the relative lack of liberalization of international migration. This was the situation prior to the crisis. The movement of people across national frontiers was and remains severely restricted. In fact general restrictions on the movement of persons were more severe during the period of “globalisation” preceding this crisis, than they were in the era of closed economies in the 1960s and the 1970s. While total migration from developing countries from the point of view of their own labour forces is low, there is a disproportionately high share of relatively skilled out migration from developing countries.³⁷

Table 5. Adult migrants from developing to developed countries as a share of adult population in developing countries, 2000 (percentages)

	All migrants	Migrants by level of education		
		Low	Medium	High
Medium-income developing	1.06	0.62	2.33	8.09
Least developed	0.59	0.25	4.19	14.80
Developing	1.01	0.57	2.40	8.38

Note: See GEC (2008) Developing countries refer to medium-income developing and least developed countries taken together. High level of education refers to “completed tertiary education”, medium refers to “completed upper secondary education” and low refers to “completed lower secondary education”.

Data Source: Derived from OECD Database on immigrants and expatriates (http://www.oecd.org/document/51/0,2340,en_2649_33931_34063091_1_1_1_1.00.html) and Barro and Lee (2000).

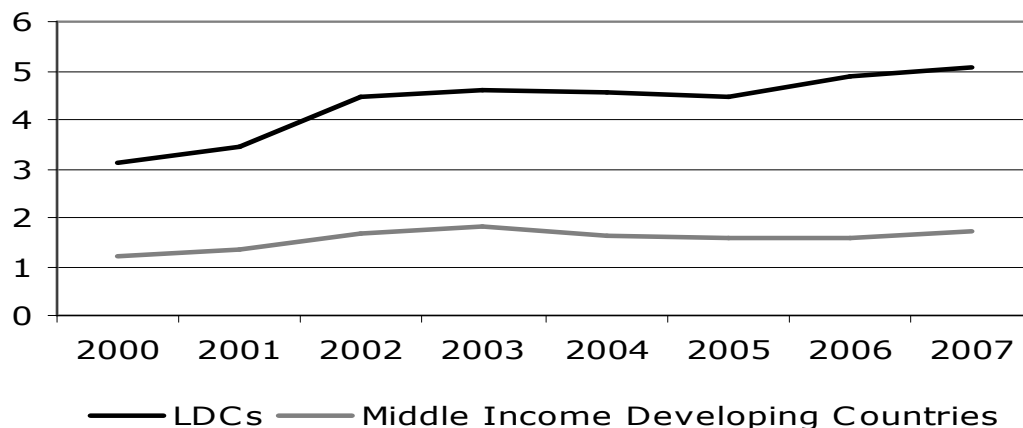
For most developing countries, while international migration has had no significant effect on the size of total labour forces, the migration of high-skilled workers from developing to developed countries has been very substantial, and may well have restrained the growth of skill-per-worker (and average labour productivity) in sending countries. This is special feature of migration from the developing to the advanced world during the recent decades. We estimate that in the case of medium-income developing countries, about 8 per cent of their adult population with tertiary education was working in developed countries in 2000. In the case of least developed countries, this percentage was higher, and we estimate that about 15 per cent of the adult population with tertiary education had migrated to developed countries. So essentially while total outmigration from developing countries has been limited, it has had a definite high skill bias. Clearly future skilled migration from the developing world is likely to be affected negatively as the recession deepens in advanced economies and this may affect remittances.

Figure 5 shows that it is specifically in the least developed economies that remittances were around 5 per cent of GDP in 2007. In the medium income country category (and the globaliser group of high manufacturing exporters) the percentage of remittances as a percentage of GDP is under 2 per cent of GDP. Therefore, like official foreign capital

³⁷ We have argued elsewhere that the argument that remittance gain compensates for the brain drain suffers from ignoring the likelihood that it is unskilled migrants who have a greater propensity to send remittances. GEC(2008). In the context of the recession it can be suggested that the greater a developing country has less-skilled out migration and the more it is to non industrialised economies, the lower may be its remittance loss. We also find that that the propensity to send remittances is higher for low skilled migrants than high skill migrants. So the loss in remittances from skilled migrants would be less than what would be the case with unskilled migrants. See GEC (2008).

flows, it is in the least developed economies, where dependence on remittances as a percentage of national income is high. Official flows and aid taken together, according to our estimates, constitute over 13 per cent of GDP in the poorest economies of the world

Figure 5. Remittances as a percentage of GDP



Source: Calculations and graph based World Bank data. The 2000 -2007 average on remittances as a % of GDP for all core developing countries is 1.7%, in which the LDCs are 4.5% and Medium income countries are 1.6%. For the High manufacturing exporters this average is also 1.6% of GDP. The graph is based on 59 countries of which 26 are least developed and 33 are middle income developing countries.

There are two implications of this that need to be looked at as new data becomes available. First as the impact of recession is felt by existing migrants in advanced economies, their remittances to home countries may be adversely affected, although for reasons noted above we don't expect this reduction to be as large as it may have been if the composition of the migrants was biased towards the unskilled. Second, if the recession or stagnation lasts long in advanced economies then in the longer run, this may even be the cause of some reversal in brain drain. Clearly countries from where the migration is of low skilled workers and in particular to other developing as opposed to industrialised economies remittances should be less adversely affected. This is as far as expectations go, based on the pre crisis situation.

We can now look at some new post crisis evidence now. The data for 11 economies that cover post crisis period tend to show on average that non-Asian economies are likely to face the remittance constraint more, but the evidence is limited.

Table 6. Average Remittances in selected economies (\$million)

	2008 Average	2009 Average	Change 2008-2009
Pakistan	564.2	695.2	131.08
Bangladesh	744.1	853.1	108.95
Nepal	191.6	228.0	36.33
Philippines	1'340.2	1'374.7	34.52
Kenya	57.9	49.1	-8.79
Honduras	218.4	200.6	-17.75
Dominican Republic	259.1	240.8	-18.33
El Salvador	323.1	302.0	-21.13
Jamaica	166.1	137.2	-28.93
Guatemala	356.8	322.9	-33.96
Mexico	2'063.2	1'831.2	-232.03

Notes: Data from the same months of 2008 and 2009 were averaged and then the difference between the two is reported in the column 2009-2008. Data for the first 6 months of 2008 and 2009 was available for: Guatemala, El Salvador, and Pakistan; the first 5 months: Bangladesh, Honduras, Mexico, and Nepal; the first 4 months: Kenya and the Philippines; the first 3 months: Dominican Republic and Jamaica. The actual data is from the data base of the Migration and Remittances Team, Development Prospects Group, World Bank, <http://www.worldbank.org/prospects/migrationandremittances>, <http://go.worldbank.org/G7EKFMM9B0>. July 2009

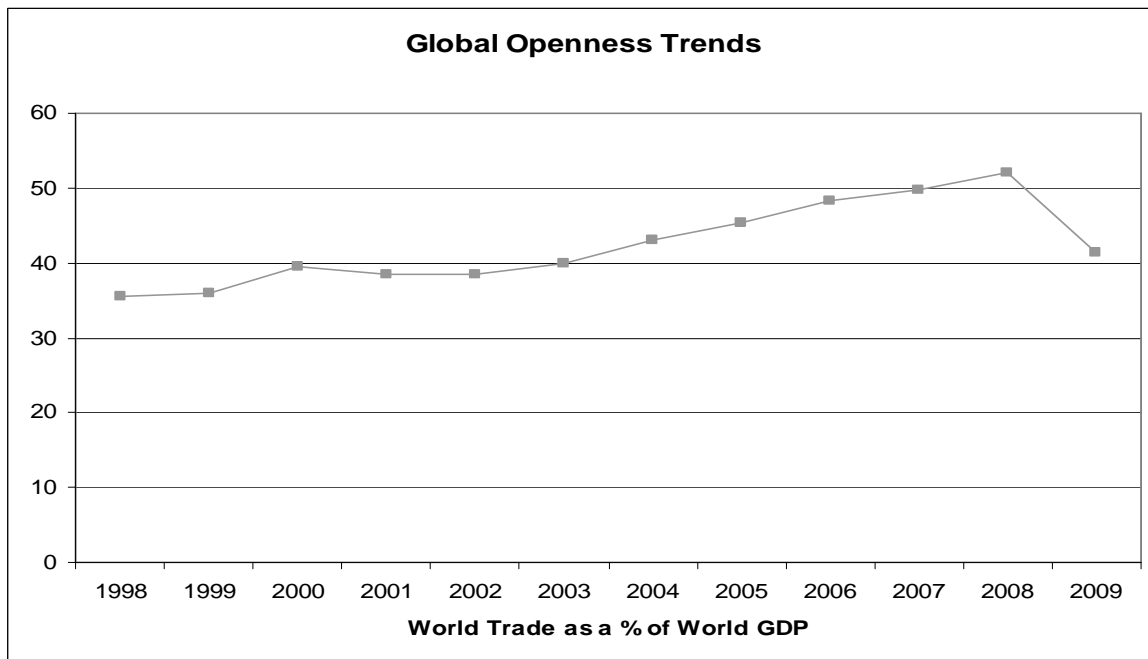
The data only includes two LDC economies, each of which shows an increase in remittances between 2008 and 2009. These are both Asian economies. In general we have a regional pattern where Asian economies are less while the Latin American economies are more adversely affected by remittance loss³⁸. While the initial post-crisis focus from a developing country perspective ought to concern job losses of skilled migrants in advanced economies and its effect on their home remittances, if the recession moves to those higher income (especially petroleum exporting) developing economies where unskilled labour migration from the South has taken place then remittances losses will be more wide spread.

³⁸ On a monthly trend while there seems to be a dip in latter part of 2008, most economies for which there is data seem to be recovering after that dip. However there are more countries with remittances lower in the most recent month for which data are available compared to September 2008. The picture does not change significantly if we examine these trends as a percentage of the 2008 GDP. We do not have enough data for the countries (LDCs) where we know remittances are a much higher percentage of GDP

6. Trade contraction and the crisis

A clear impact of the global crisis has been on global trade. The world is effectively less open after the crisis compared to what it was before it. Figure 6 shows that contraction quite dramatically for the whole world.

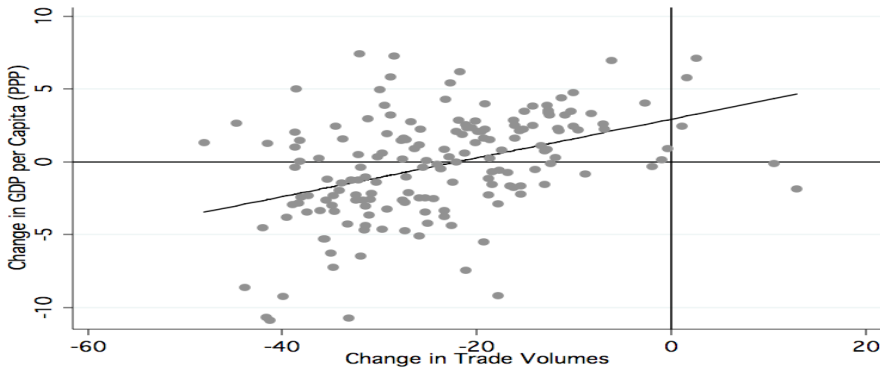
Figure 6. Global openness trends



Note: The graph is based on aggregates of 103 countries that covered 82 % of the world's population in 2008. The 2009 trade as % of GDP is a predicted value. This was calculated by summing the global trade volumes for 2008 Q1 and 2009 Q1 respectively and calculating the percent change. This percentage change number was multiplied by the total 2008 trade volume (for the sample) and then divided by the total 2009 GDP (predicted by WEO) to find the predicted trade as a percentage of GDP for . Data for trade is from DOTS database IMF and for GDP from IMF (2009).

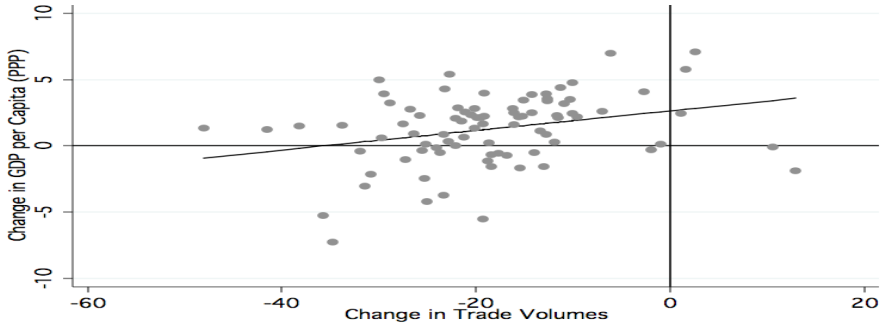
The period of 2008-2009 is therefore important to examine in more detail especially with a focus on core developing economies. In spite of the common deceleration in GDP per capita growth, the difference between advanced and developing countries has been the negative and positive growth rates of GDP per capita. Therefore examining change in trade as percentage of GDP in relation to change in GDP per capita is unlikely to reveal the true impact of trade loss in driving the recession. Examining change in absolute trade volumes and change in GDP per capita reveals this more clearly. Figure 7 shows that a change in GDP per capita in the recession period has indeed been associated with a change in total trade volumes with the world for each country. The figure also clearly shows that trade volumes have declined in the majority of countries across the world.

Figure 7. Change in trade volumes vs. change in GDP 2008-2009, All countries of the world



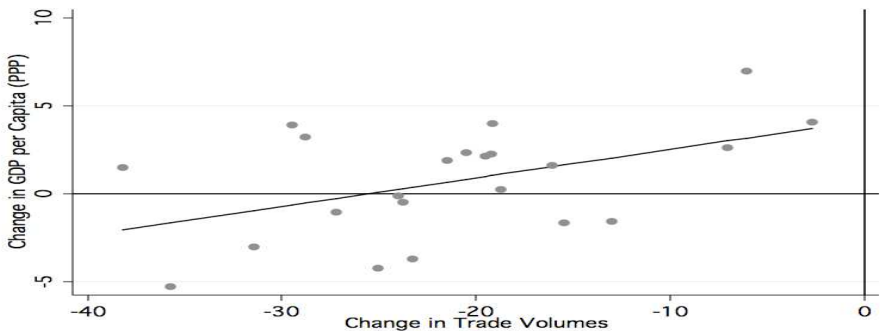
Note: Change in GDP per capita (PPP) = (2.938)**+ (0.133)** Change in Trade volumes.
 Number of observations = 170, R-square = 0.17

Figure 8. Change in trade volumes vs. change in GDP 2008-2009, Core developing countries (LDC and MIC)



Note: Change in GDP per capita (PPP) = 2.641)**+ (0.074)** Change in Trade volumes.
 Number of observations = 85, R-square = 0.09

Figure 9. Change in trade volumes vs. change in GDP 2008-2009, Core developing country manufacturing exporters only



Note : Change in GDP per capita (PPP) = 4.157)*+ (0.163)* Change in Trade volumes.
 Number of observations = 22, R-square = 0.22

*in front of the coefficient denotes that the coefficient is significant to the 99% level
 ** in front of the coefficient denotes that the coefficient is significant to the 95% level

As far as core developing economies are concerned the relationship is also as expected (Figure 8) but it differs from the global picture in that it is comparatively weaker. The third point that we need to make concerns the main globaliser developing countries that had increased their manufacturing exports in the last few decades. We find the relationship to be the strongest for high manufacturing exporter group of developing economies (Figure 9).

The trade based vulnerability to a growth shock in developing economies while generalised is clearly greater in those countries that are mostly medium income economies that had also been at the forefront of globalisation. It is also clear that some of these economies seem to have been able to adjust, while others have fallen in to both negative growth and a trade contraction.

Our analysis suggests that while all core developing economies are likely to be affected by the capital flow, remittance and trade mechanisms through which the recession is being transmitted, it is the specific trade effect that impacts the medium income economies (on average) more while it is the remittance and aid effect that is likely to impact the least developed economies (on average) more.

7. Responding to growth slowdown

We are yet to see in any detail how the recapitalization of parts of the financial sector by advanced economy governments and the size of stimulus packages in them will itself impinge on the terms of developing country borrowing. This matter will affect international financing in all developing economies in times to come. Disbursed grants and aid, as suggested, may also be lower and slower in materialising in many cases and this will affect the poorer developing economies more. The same is true for the relative impact of declining remittances. Least developed economies will be affected more in respect of aid and remittances because they are more dependent on these flows. There is little by way responses that the poorer economies affected by the crisis can do, and while their reliance on external assistance and support will be critical, it is unclear how this support can materialise and be maintained at earlier levels. The only saving grace here may be that the poorer economies are relatively less affected by the slowdown.

The situation in medium income economies is somewhat different than the least developed economies. These economies too will be affected by critical short run credit access problems. It is also the case that these countries will face separate foreign exchange constraints because of revenue loss through trade contractions. In this situation, the reserves that developing countries have at their disposal will circumscribe their ability to take action. The greater the reserves the greater will be the national policy space for response. Although information on reserves for 2009 is not available, it is quite clear that even prior to the onset of the crisis, very few developing countries were in reasonably strong financial positions to undertake large scale interventions. Generally the level of reserves in developing countries, barring a few, is low. Table 4 below shows the number of countries whose reserves were greater than a given number of months of imports before the crisis³⁹. It suggests that capacities to undertake prolonged interventions may be limited to a few countries only. In short many countries face the prospect of an increasing cost of financing international obligations on the one hand, and budgetary constraints due to tax and revenue losses on the

³⁹ The cut off of the number of months of imports is of course arbitrary.

other. Given limited reserve capacities, these problems will definitely limit their ability to aggressively intervene in order to address the crises they face⁴⁰.

Table 7. Core developing countries counts with total reserves in relation to months of imports: average of 2005, 2006 and 2007

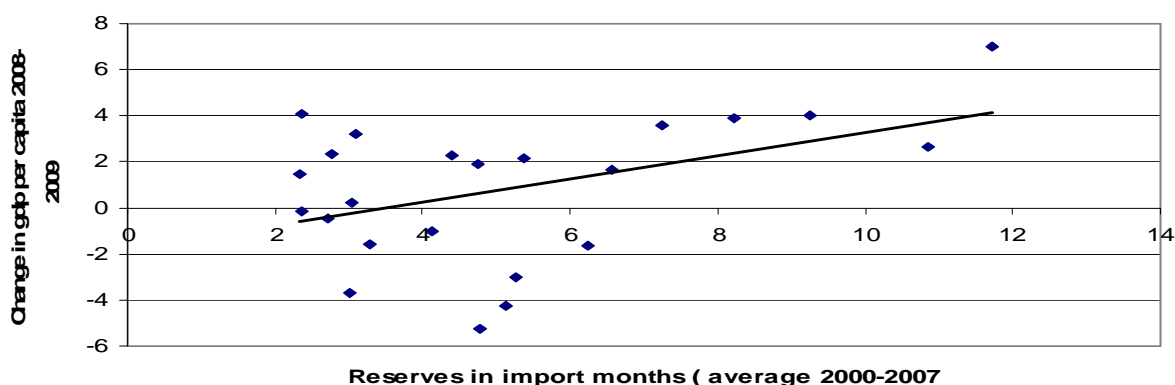
	Reserves greater than 7 months of imports	Reserves greater than 4 months of imports
Developing-Medium Income	10/44	23/44
Developing-LDC	2/34	20/34
Total	20/111	62/111

Source : Data is from IMF (2009)

It was suggested in the foregoing discussion that some economies, amongst the medium income economies may be in a better position to withstand the growth contractions compared to others in their group. We have also suggested above that it is the globaliser developing economies that are likely to be affected by trade contractions the most. However their abilities to respond to the slow down in growth will vary. While some of these economies are amongst the worst affected by trade losses, some of these are also economies that have accumulated reserves. In fact it would seem that a better reserves position in these economies is associated with smaller growth contractions. One can only illustrate these matters in cursory manner given severe data constraints. However it is interesting that Figure 10 below, for 23 globaliser economies for which there was data available, shows that the higher the reserves the greater the chances were that an economy had been in positive growth in 2008-2009. In fact it can be seen that countries that had more than 6 months reserves tended to avoid negative growth altogether.

⁴⁰ A stimulus in developing countries needs to be appropriate to conditions that obtain in them. Countries that do not have a significant potential for agricultural growth could face greater foreign exchange constraints. Developed-country-style fiscal stimulus and enhanced social safety infrastructure, that dominantly rely on increasing consumer purchasing power and demand, may be inflationary in some developing countries of today, because quick and adequate supply responses may not be there. The success of such packages, therefore, will depend on the countries' ability to import goods and services (including food), the demand for which will be stimulated as a result of the stimulus. Yet the context is one where the foreign exchange availability has fallen as a result of reduced exports, capital inflow and remittances. This is where foreign currency reserves assume great significance.

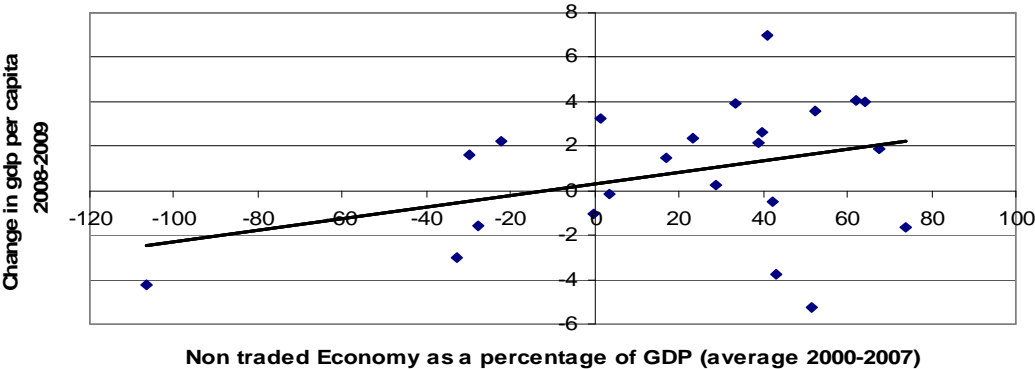
Figure 10. Developing country globalisers: low reserves on average may reduce ability to withstand the trade shock



Note: Change in GDP per Capita (PPP) = *(0.169) Average reserves in import months + ** (1.75);
 Number of observations = 23; R-squared = 0.20

The other cushion as far as the globaliser developing economies, who have been most affected by the trade loss, may have something to do with the size of their domestic markets. In other words there are those economies amongst the globalisers that have enhanced trade significantly but their domestic or non-tradable economy in comparison to the size of the tradable economy is still quite large. There are others where enhanced trade has altered the structure and orientation of the economy altogether making them much more trade-vulnerable in a literal sense. In times of growth loss it is the former type of economies that ought to have greater room to re-focus development efforts in the face contractions in their export markets. The share of trade in GDP is therefore not only an indicator of “openness” but its inverse is also a measure of the size on the non traded economy. Figure 11 below shows the relationship between the average level of the non traded economy as a percentage of GDP amongst high manufacturing exporters and their recent 2008-2009 change in GDP per capita. It is also plausible on this basis to suggest that on average larger non tradable sectors cushion the contraction. It goes without saying that over time one should be able say something more robust on what these associations suggest.

Figure 11. Developing country globalisers: Larger domestic economies on average may help respond to the crisis



Note: Change in GDP per Capita(PPP) = (.026)* Non traded economy as % of GDP Average + 0.303** ; Number of observations = 23; R-squared = 0.132. The proxy for the size of the non traded economy is the 100 – trade as a percentage of GDP averaged over 2000-2007. Economies with very high trade GDP ratios (more than 100%) would get negative values here.

8. Upshot and short run policy objectives

The basic point to underscore in this review is that we need to see clearly what the growth evidence of 2008-2009 tells us. The situation in developing countries is serious because in poor economies even a deceleration in growth which leaves growth positive in most countries can have adverse consequences. However overstating the adversity ultimately constitutes an obstacle to diagnostics as well as solutions. In general, our assessment of the impact of the crisis on the developing world is as follows:

- The majority of core developing economies are in growth deceleration with positive as opposed to negative year-on-year growth. Deceleration with positive growth has adverse consequences (especially for financing future economic development) but it is unambiguously better than deceleration with negative growth. This is a critical point because it has serious implications on our expectations with regards to welfare loss in these economies as well as on the international distribution of income. In a situation where current and actual survey based information on poverty and inequality is virtually non existent and on unemployment rates very limited, one must speculate with extreme care, and for that we need to get what is happening to growth right. This is because it is on the basis of growth that we form these expectations on welfare indicators, when actual data is absent.
- The impact of the crisis on the future costs of international borrowing is a cause for worry and this is likely to be a generalised concern across the developing world in the future. It is however clear that the likely decline in official capital flows due to debt pressures on advanced economy governments; and falling remittances due to job losses and decreased demand for skilled migrant labour in advanced economies will impact the least developed economies relatively more than medium income developing economies.
- Trade contraction is also universal in developing countries. However the economies that are particularly affected by this contraction are precisely those dominantly medium income economies that were at the forefront of last era of globalisation, some of whom may have more fiscal space to intervene than others. In other words, amongst these globaliser developing economies, those that have accumulated healthier reserves and

have relatively larger domestic economies may have been able to withstand the transmitted shock of the recession better than others.

As far as policy is concerned, we stated at the outset that the aim of this paper was to see if it was possible to make some empirically supportable generalisations with regards to the impact of this recession on the developing world. General policy prescriptions applicable at country level are a contradiction in terms. Typically at a general level all one can say is that effective policy can only be country specific.

Given that the specific transmission mechanisms must articulate themselves in terms of specific economic structures and markets of individual countries, many of the regular policies (e.g. pertaining to credit, training, social protection etc) that are prescribed to improve welfare and help development in normal times can be “re-dressed” as policies to deal with the slowdown. A call for investment in some activity “x” without addressing the question of finance or the implied reallocation of resources that it would entail without new finance- begs the original question- especially when the source of the problem is a growth slowdown. In any event even these types of prescriptions when made in a national context need to be properly shown to be feasible in the specific political economies of the countries in question. However, given that at this general level we have identified the differential nature of the impact of the recession, there is some scope for generalising *broad policy objectives* for the least developed and medium income developing economies respectively.

In terms of central policy objectives, the concentration for the least developed economies ought to be on evolving strategies that minimise remittance loss from advanced economies and as well as the loss in effective aid flows. In contrast, the central policy objective for medium income economies should be on minimising the loss from trade. These are clearly difficult objectives to pursue as they are tantamount to suggesting that policy objectives for developing economies ought to be those that reverse the very adverse impacts that the recession is having on them. But that is the point. Clearly the industrialised economies of the world, despite having been hit by the crisis more (because of regulatory and institutional failure in them) also have responsibility for redress towards those far poorer economies who shoulder no responsibility for the slowdowns in their growth.

It is also the case that within the developing world the relatively better off economies ought to evolve collective frameworks for recovery that include the poorest and least developed nations as well. For the least developed economies it is unclear how they will help themselves as their dependence on external (official) flows has historically been high. Clearly if there is a decline in disbursed aid then advanced economies will not exactly be increasing their help to the poorest in the world. The same is true to the extent that remittances of migrants originating from least developed economies contract, concerning which the space for policy action in advanced economies is more limited.

As far as trade is concerned, amongst developing countries there is an obvious danger of increased competition in shrinking global markets which can lead to beggar-thy neighbour consequences. There is consequently a need for market diversification and deepening on the part of developing economies. In particular, there is need to enhance South-South trade through regional and sub regional arrangements on the one hand, and taking measures to deepen domestic markets on the other.

The other trade policy focus is in the remit of advanced economies. Continued protectionism in advanced economies against imports from the South can only prolong adverse effects on unemployment as well as the working poor in the South. Dismantling

structures of protection would benefit both the least developed and medium income economies. While some trade offs between unemployment in advanced economies and trade growth in developing economies may obtain here⁴¹, a genuine attempt at a coordinated response to a fair global recovery requires this. Advanced economies are committed to a standstill on protection; ideally they need to have targets to reduce protection. However it is unlikely that we shall see too many advances on this front come about today, if they did not come about before the recession. The area in which advanced economies may still be expected to do something is on developing country trade facilitation including short term trade credits. From the point of view of developing countries, while there is no harm in hoping that the latter hopes will be met, depending on them to happen would perhaps be too optimistic.

⁴¹ Majid (2008) for references and a discussion on this topic.

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