Impact of the Financial Crisis on LDCs

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Section I

Introduction

• Initial impact less pronounced, as LDCs are not deeply integrated into global financial markets.

• Impact of crisis on LDCs is multifaceted and affects countries in different ways.

• LDCs have been more affected during the later phase of crisis, through a:
  - Sharp reduction in world trade and rapid decline in commodity prices.
  - Reduction of FDI flows.
  - Slowdown of worker remittances flows.
  - Potential decline of ODA.

• Global crisis is likely to have important implications for growth and poverty in LDCs.
Section II

Impact of the Financial Crisis on LDCs

1. TRADE

- Impact of trade shocks on LDCs is sharper and quicker than before.

- How LDCs are affected by the collapse of world trade depend on the nature of their trade specialization.

- Commodity price boom period is associated with faster growth in LDCs, but food and fuel price hikes are moderating the impact on rising standards of living and reducing poverty.

- Global recession has led to drastic fall in export volumes and prices.
Impact of the Financial Crisis on LDCs (cont.)

2. INVESTMENT

- The direct fallout of crisis on LDCs has been relatively limited in LDCs.
- However, they have found it difficult to mobilize funding in global financial markets.
- Premiums on trade credits have substantially increased.
- Global crisis likely to undermine FDI flows to LDCs, as MNCs lack access to funds.
- Decline of FDI inflows in the form of cross border mergers and acquisitions.
- However, FDI in greenfield investment in mineral and oil exporting countries may continue.
3. OFFICIAL DEVELOPMENT ASSISTANCE

- LDCs face a large resource gap.
- ODA flows play an important role in financing development in LDCs.
- LDCs rely heavily on ODA for financing a large part of their budget.
- During the crisis, as budgets of many donors governments have come under extreme pressure, it is likely that ODA flows may be curtailed (30% reduction projected, IMF 2009).
- This could endanger LDCs’ development prospects.
4. REMITTANCES

- Remittances have become an important source of development finance for LDCs.

- Remittances mainly come from other developing countries in the vicinity, hence the collapse in the commodity boom is likely to have a dramatic effect on remittance flows (around 5%, according to the WB, 2009).

- Adverse effects for poor households, where worker remittances often form a large part of their income.

- Collapse of remittances together with a slump in the domestic economy, resulting from negative trade and investment shocks, intensifies poverty and reduces the use of migration as a source of insurance to shocks.
Implications for Growth and Poverty

- The ongoing global financial crisis is having a significant impact on growth and poverty.

- The impact of the global economic crisis for growth and poverty varies across LDCs.

- Income growth in LDCs will likely stagnate as a result of the rapidly deteriorating external conditions.

- LDCs have their policy space limited due to generalized poverty.

- Low domestic resources available for finance (DRAF) rates in LDCs are due to extreme low productivity levels and lack of productive capacities.
Implications for Growth and Poverty (cont.)

- The crisis intensifies poverty in LDCs through a number of channels, direct and indirect.

- Directly, through its impact on economic growth, employment, wages and distributional changes.

- Indirectly, through its effect on government revenues, which may lead to a cut in government expenditure on social services.

- The crisis can lead to an increase in interest rates in LDCs, with negative effects on investment and employment, further hitting the poor.

- Decline in remittances and ODA could further exacerbate poverty.

- Conservative IMF estimates project that by 2010, as a result of the crisis, there will be 9.5 million of new poor in Africa and Asia.
Policy Responses
(i) National Level

- Fiscal Policies
  - Governments should use counter-cyclical policies, whenever possible.
  - Increment of investment in infrastructure, agricultural extension and in creation of jobs with low import content.
  - Planned investment for future years.
  - Protection of budgetary allocations to education, health and social welfare.
Section IV

Policy Responses (cont.)
(i) National Level

- Monetary Policies

  - Monetary policy should accommodate fiscal policy in stimulating aggregate demand.

  - Stimulation of private investment.

  - Provision of subsidized credit for investment in specific sectors.

  - Macroeconomic frameworks for poverty reduction should allow for access to sizable contingency funds to cope with negative shocks.

- Close monitoring of the domestic banking sector.
Policy Responses (cont.)
(ii) Regional Level

- Regional Development Banks are required to help LDCs to cope with the decline in government revenues.

- Recapitalization of the multilateral development agencies is necessary to deal with the scale of the current crisis.

- Transfers should be made with an unjustified conditionality and with respect to countries’ ownership of their policies and initiatives.

- Greater coordination, transparency, flexibility and democratic governance from all involved organizations is needed so that efforts become more fair and effective.
Policy Responses (cont.)

(ii) Global Level

- Official Development Aid
  - Honor commitments to increase aid to LDCs.
  - Improve the delivery of aid.

- Additional resources are required
  - Welcome global plan and reform adopted by the G20 at its recent London Summit.
  - Provide US$ 1.1 trillion dollar programme of support.
  - US$ 50 billion for LIC, NOT adequate.
  - Increase resources available to the IMF.
Policy Responses (cont.)
(ii) Global Level

- Multilateral Development Finance Institution (IMF) providing additional funds to DVCs
  - Overhauling IMF’s lending and conditionalities framework.
  - Flexible credit line and high access precautionary arrangement.
  - However, these facilities are unlikely to benefit LDCs given the strict eligibility criteria.

- No protectionism
  - Recomit to free trade.
  - Conclusion of the Doha Round of trade negotiations.
  - Duty and quota free market access to LDCs.
Thank you