

THE IMPACT OF THE GLOBAL FINANCIAL CRISIS ON DEVELOPING COUNTRIES

SUMMARY

'The debate in rich countries about the impact of the global financial crisis has largely ignored its impact on developing countries. But it is vital that policymakers from both North and South understand how this crisis may impact developing countries and the implications for development policy.' Neil McCulloch, IDS Fellow.

This report presents snapshots of the financial crisis as seen by 21 thinkers, academics and policymakers in 14 developing countries. IDS invited them to present their views on the likely impacts and possible responses to the crisis. Most importantly, results show that developing countries cannot be treated as a homogenous block – concerns vary significantly across countries, depending on their current economic situation, exposure to specific impacts and capacity to respond. Isolation from world financial markets will not protect the poorest countries, as the indirect impacts are likely to be severe.

Impacts

The report identifies six main pathways of impact:

1. Exports. Export growth is already slowing markedly in several developing countries. In Bangladesh, orders for ready-made garments from Europe and the US dropped 7 per cent in September. Year on year exports from the Philippines to the US are down by 15 per cent. In Kenya, the cut flower industry is suffering as European customers are hit by the crisis.
2. Foreign investment. Both portfolio and direct foreign investment have dropped dramatically in several countries as investors shy away from markets that are perceived to be riskier. The Ethiopian Electric Power Corporation has indicated that its investment plans will be severely affected due to the crisis.
3. Exchange rate. The sudden withdrawal of foreign capital from several developing countries has caused dramatic falls in their exchange rate. Companies and governments with substantial foreign currency denominated debts may contract or even collapse as a result. The Rand lost 35 per cent of its value between mid-September and mid-October. The Philippine peso was down 12.3 per cent over the year. The Indian rupee hit a record low to the dollar.
4. Interest rates. As foreign investors withdraw, risk premiums and interest rates have risen for developing countries on global capital markets. Philippine sovereign bond spreads and credit default swap spreads widened as of the end of September, the latter to 283.1 basis points from 265 basis points in June.
5. Remittances. A key concern for some countries (e.g. Philippines, Ethiopia) is the decline in remittances from workers in recession affected rich countries. Orders for *Mbuzi ya Jamii* (goat for the family) are down sharply at online stores that allow Kenyans abroad to pay for products and services for their families back home.
6. Foreign aid. Many countries expect that aid from rich countries will decline as governments reassess their fiscal priorities during a downturn. This could have particularly negative consequences for Africa. Private foundations are already scaling down their budget allocations, while contributors from Kenya, Ghana and Ethiopia all believe that there will be a decline in official aid.

Developing Policy Responses

Policy responses must take the following points into consideration:

- Countries will be affected differently by the pathways listed above. Developing a typography of countries will allow for heterogeneity of responses to address their specific needs.
- Within national economies some people will have more exposure to the affects than others.
- There are governance implications at international and national levels.

We propose three specific policies that should be pursued:

- Increase aid flows
- Enhance social protection
- Restructure International Financial Institutions