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on the
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**HOW RESILIENT HAVE DEVELOPING COUNTRIES BEEN
DURING THE GLOBAL CRISIS?**

Attached for the October 9, 2010, Development Committee Meeting is a background document entitled "How Resilient Have Developing Countries been during the Global Crisis?," prepared by the staff of the World Bank and the International Monetary Fund.

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HOW RESILIENT HAVE DEVELOPING COUNTRIES BEEN DURING THE GLOBAL CRISIS?¹

Summary

Developing countries, middle- and low-income alike, have displayed considerable resilience during the global crisis along two dimensions: ability to respond to the aggregate demand shock with countercyclical fiscal and monetary policy in order to maintain growth; and preservation of core spending on health, education and infrastructure. Such resilience is strongly correlated with macroeconomic policy buffers built up during the pre-crisis period, notably improved external positions (lower current account deficits and higher reserves), stronger fiscal positions (lower deficits and debt) and lower inflation.

On another crucial dimension of resilience, protecting vulnerable groups has proved a much bigger challenge because of weaknesses in administration and the dearth of readily-available social protection mechanisms which could easily be scaled up, especially in low-income countries.

Middle-income countries:

Output in middle-income countries (MICs) fell 4 percent on average between the third quarter of 2008 and the first quarter of 2009. Countries in the worst affected quartile—mostly classified as highly vulnerable at the outset of the crisis, many located in emerging Europe—saw output *contract* substantially while output *rose* slightly in the least affected quartile. Countries with stronger initial fiscal positions increased their primary deficits by substantially more than countries with weaker fiscal positions.

In terms of the longer-run impact, the most adverse effect is expected in Europe and Central Asia, where projected real GDP levels in 2010 and 2011 respectively are 15 percent and 17 percent below the levels obtained on the basis of the pre-crisis trend growth rate. But there is a high degree of heterogeneity, linked to pre-crisis macroeconomic policy buffers.

Low-income countries:

Low-income countries (LICs) were affected through a sharp contraction in export demand—the largest since at least the 1970s—as well as a decline in FDI and remittances. But the terms of trade improved slightly relative to 2008, except in oil exporters. Also, aid held up fairly well, contrary to initial fears of a substantial decline from the levels of recent years. In addition to higher pre-crisis growth and stronger macroeconomic policy buffers than in the past, LICs were helped by debt relief.

On average, LICs increased spending despite declining revenue and allowed fiscal deficits to widen in 2009 compared to 2008, especially in countries with higher initial policy buffers. Countercyclical fiscal policy helped reduce the impact of the crisis on growth and shielded core spending. Debt-to-GDP ratios have risen but are expected to resume a downward trend by 2011-12, and risk rating downgrades have been rare in post-crisis debt sustainability analyses.

Welfare:

The crisis could add 64 million people living below US\$1.25 a day by the end of this year compared to a situation where the growth trend of 2000-07 was maintained. Regarding the MDG of reducing extreme poverty, an additional 53 million people would have been lifted out of poverty by 2015 had the crisis not occurred. Based on the difference between actual and pre-crisis forecasts for growth in 2009, estimates suggests that 41 million people will be added to the undernourished,

¹ Prepared by World Bank and IMF staffs for the October 9, 2010 meeting of the Development Committee.

consistent with FAO's latest projection of the hungry crossing the one billion mark in 2009. In general, progress towards achieving the MDGs will be set back by the global crisis.

Role of international financial institutions:

The credit for the resilience of the developing countries during the global crisis goes largely to the countries themselves. The IMF and World Bank played a catalytic role through their policy dialogue and a big step-up in financing, which facilitated the unprecedented countercyclical response of the developing countries. The Global Food Crisis Response Program (GFRP) launched by the World Bank in 2008 helped low-income countries cope with the food crisis, which preceded the global crisis. The World Bank Group is stepping up its lending and policy advice in two critical areas: agriculture and food security; and social safety nets. Its private sector wing, IFC, launched several initiatives to help private enterprises in developing countries during the crisis.

Policy messages:

- Pre-crisis macroeconomic policy buffers helped shield MICs and LICs alike from the short-run impacts of the crisis. This demonstrates the importance of building policy buffers in good times and using them in bad ones. As the recovery takes hold, developing countries should start replenishing their buffers to prepare for future shocks. Policy buffers need to be replenished at a pace consistent with supporting the current economic recovery.
- The wave of food, fuel and financial crises has shown that many countries, particularly LICs, are wanting in terms of the development of safety net programs with adequate coverage. It is of prime importance to develop these programs and preserve the momentum once the global crisis is over.
- The number of hungry people has risen. Nutrition and food security need to be kept at the forefront of the development agenda. Efforts to meet the MDGs will need to be intensified.

I. THE BIGGEST ECONOMIC CRISIS SINCE WORLD WAR II²

1. The resilience of developing countries, low- and middle-income alike, during the global crisis is a topic of vital importance not only to the developing countries themselves, but also increasingly to the world economy. Global growth fell 6 percentage points from its pre-crisis peak to its trough in 2009, the biggest shock in the post-war era.³ Stock markets around the world fell over 30 percent between September and December 2008, wiping out US\$18 trillion in G-7 stock market capitalization. These developments marked the end of the boom years of the mid-2000s, with the world economy suddenly thrown into the Great Recession.

2. A crisis of this magnitude is bound to exact a heavy toll in terms of lost output and wealth but more importantly, in terms of human suffering. We would expect such effects to be more pronounced in developing countries than in the advanced economies because their shock-absorption capacity is likely to be much smaller, be it at the level of the government orchestrating a national response or the household. Therefore, an assessment of the resilience of developing countries is of considerable importance, as part of crisis-monitoring but also being better prepared in the future.

3. This paper, written jointly by Bank and Fund staffs for the October 2010 meeting of the Development Committee, conducts an initial stock-taking of the resilience of developing countries along three dimensions: mitigating the impact on economic growth via countercyclical policies; preserving core spending on health, education and infrastructure; and protecting vulnerable groups. In a nutshell, developing countries, especially those which built up macroeconomic policy buffers in the boom years before the crisis, have done well so far on the growth and core spending dimensions. But protecting vulnerable groups has proved a much bigger challenge in part because of fiscal constraints but mostly because of weaknesses in administration and the dearth of readily-available social protection mechanisms which could be easily scaled up, especially in low-income countries. As a result, the crisis has been a setback for the Millennium Development Goal (MDG) of reducing extreme poverty and improving other welfare indicators.

4. The robustness of the findings reported here will need to be revisited when more time has elapsed and more data collected. In addition, the considerable heterogeneity across regions and across countries within regions is worth stressing. But suffice it to say that the initial assessment reported here is an unambiguously strong endorsement of the sustained improvements in policies and institutions carried out by developing countries during the seven years or so prior to the crisis. It also stresses the urgency of speedily developing adequate social safety nets. Poverty alleviation has been set back and an estimated 41 million people were added to the list of the hungry in 2009.

5. The rest of this section outlines the impact of the crisis on economic growth in developing countries. Section II links the macroeconomic policy buffers built up in developing countries before the crisis to countries' space for appropriate countercyclical policy and growth resilience. Section III presents preliminary evidence indicating that core infrastructure and social spending by developing country governments has generally been protected. Section IV describes the welfare consequences based on microsimulations using available household survey data and captures the lessons emerging for social protection systems. Section V describes the role of the international financial institutions (IFIs), section VI concludes and section VII offers a list of issues for discussion by the Development Committee.

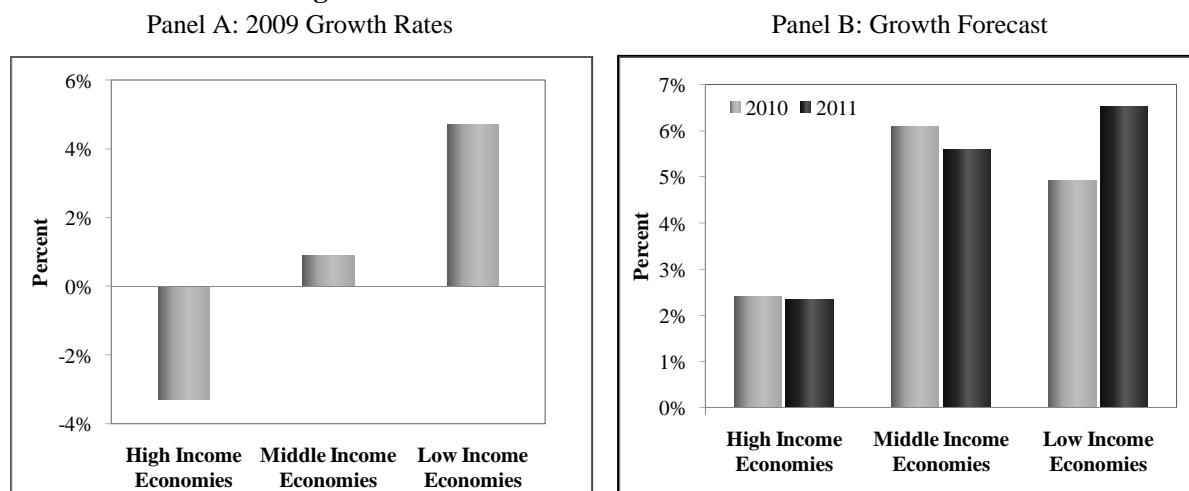
² Section I draws on T. Didier, C. Hevia and S. Schmukler, 2010, "How Resilient Were Developing Countries to the Global Crisis?" The World Bank, Washington.

³ Measured as the change in the growth rate of the global economy from its pre-crisis peak (5.2 percent in 2007) to its trough (-0.6 percent in 2009).

Economic growth collapses, then rebounds

6. During 2009, middle- and low-income countries grew 0.9 and 4.7 percent respectively, significantly higher than the -3.3 percent growth in high-income countries in 2009 (Figure 1, Panel A), leading to a half percent decline in world real GDP relative to 2008. In 2010, middle-income countries are currently projected to grow at 6.1 percent compared to 2.4 percent for high-income countries in 2010 (Figure 1, Panel B). The BRICs (Brazil, Russia, India, and China) account for a significant fraction of the projected growth in middle-income countries, around 45 percent. Current forecasts indicate that they will grow 8.4 percent in 2010.

Figure 1. Real GDP Growth in 2009 and Forecasts

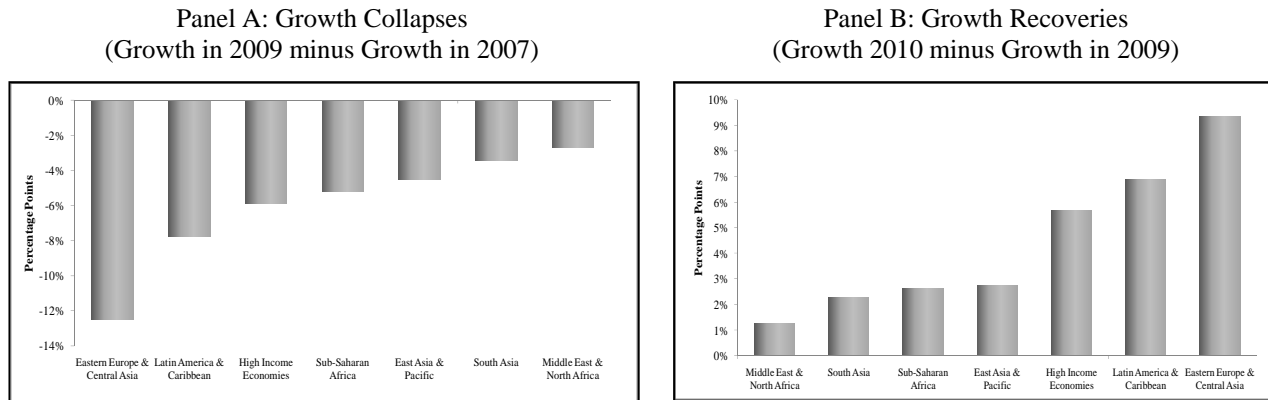


Source: Didier, Hevia and Schmukler (2010). Projections for 2010-2011 come from the most recent available statistics from Consensus Forecasts (June 2010), with the IMF's World Economic Outlook (April 2010) used for countries not covered by the Consensus Forecasts.

7. But the above description does not take growth rates before the crisis into account—for example, China and India grow on average faster than the U.S., so positive but lower growth rates for them still imply a significant relative contraction. Growth collapses across country income groups, defined as the difference in real GDP growth rates between 2007 and 2009, show that while high-income countries suffered a growth collapse of 5.9 percentage points, middle-income countries' real GDP growth declined by 7 percentage points. Moreover, during the recovery phase, the projected increase in real GDP growth rates between 2009 and 2010 in high-income countries (5.7 percentage points) is expected to be slightly larger than that for middle-income countries (5.2 percentage points). On the bright side, the decline in low-income countries was only 2 percentage points.

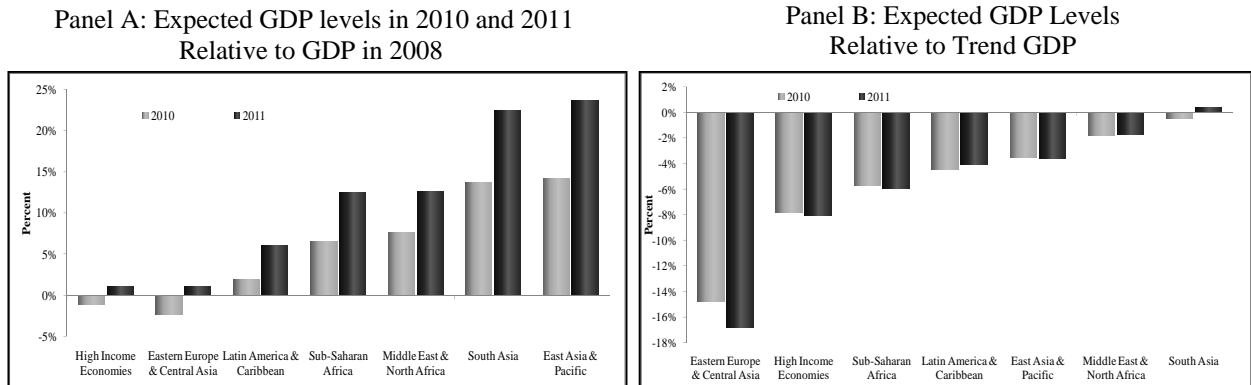
8. Figure 2 shows that no region was immune to the financial crisis. Developing countries in Eastern Europe and Central Asia (ECA) and Latin America and the Caribbean (LAC) experienced greater growth collapses than in high-income countries (Figure 2, Panel A) as well as developing countries in other regions. But these two regions are also expected to record the biggest growth recoveries in 2010 (Figure 2, Panel B).

Figure 2. GDP Growth Collapses and Recoveries across Regions



Source: Didier, Hevia and Schmukler (2010). Defining growth collapses as GDP growth in 2009 minus the average GDP growth in 2000-2007 gives similar results.

Figure 3. Real GDP Relative to 2008 and Historical Trend



Source: Didier, Hevia and Schmukler (2010).

9. Should the fact that larger collapses have led to bigger recoveries as shown in Figure 2 be taken as evidence that all developing regions were equally resilient? This would depend crucially on the extent to which the recovery compensates for the collapse preceding it. For example, panel A of Figure 3 shows that in 2010, the ECA region is expected to have a real GDP about 2.3 percentage points below its 2008 level; but ECA is expected to fully recover and slightly exceed its 2008 GDP level by 2011. Likewise, high-income countries are expected to fully recover by 2010. In contrast, the remaining developing regions will not experience an absolute decline in GDP at all. At one extreme, 2011 real GDP in the EAP and SA regions is expected to be more than 22 percentage points above its 2008 levels. Excluding China, the EAP region's performance is less spectacular but still impressive with 2011 real GDP projected at more than 11 percentage points above 2008 levels.

10. Another way of capturing resilience is to ask how countries are expected to fare relative to their pre-crisis growth trends. Panel B of Figure 3 reports projected real GDP relative to a counterfactual level obtained by assuming that all countries maintained their average growth rates over 2000 to 2007. The difference is a rough measure of the output cost of the global crisis. By far, the region most affected is ECA, where expected real GDP levels in 2010 and 2011 are respectively 15 percent and 17 percent below the levels obtained on the basis of the pre-crisis trend growth rate. But even within ECA there is a high degree of heterogeneity, linked to pre-crisis macroeconomic policy

buffers, as discussed in Section II. For instance, while Lithuania and Ukraine are projected to be around 30 percent below their extrapolated GDP trends, Poland’s forecast real GDP is only 3 percent below trend.

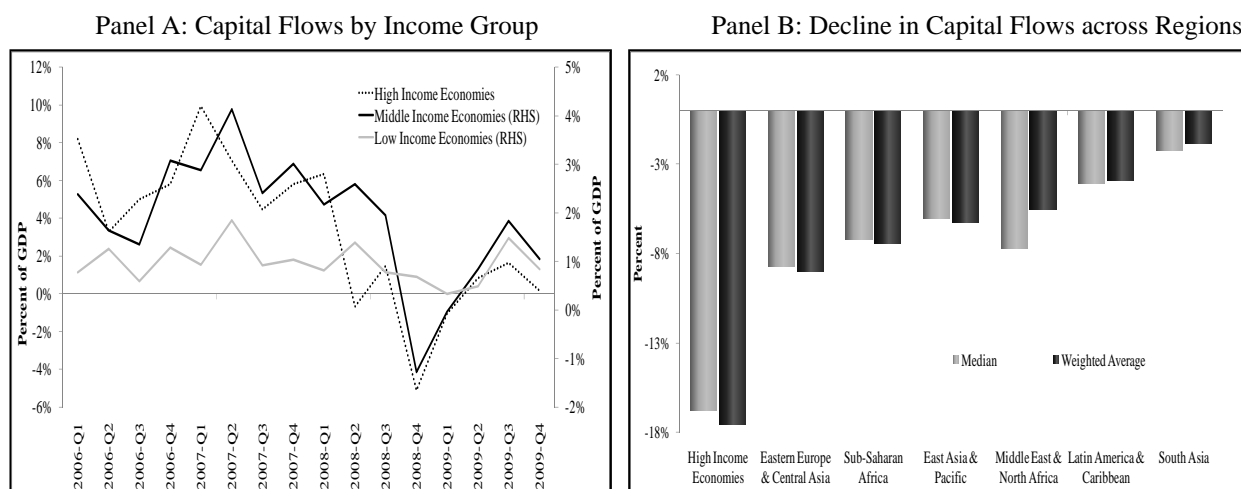
How the crisis was transmitted to developing countries

11. Not surprisingly, the crisis, which started in the center of the global financial and economic system, spread to developing countries via finance and trade linkages.

Finance-related transmission mechanisms

12. Figure 4 shows that a decline in capital inflows (from non-residents net of any withdrawals by them) did indeed occur. While most of the decline occurred in high-income countries, middle-income countries also suffered a significant decline in capital flows. Low-income countries suffered a relatively smaller decline because of their more limited external financial integration. The regional impact, displayed in Panel B of the figure, shows the heterogeneity of capital flow declines across regions. Among the developing regions, ECA suffered the largest decline in capital flows.

Figure 4. Capital Inflows



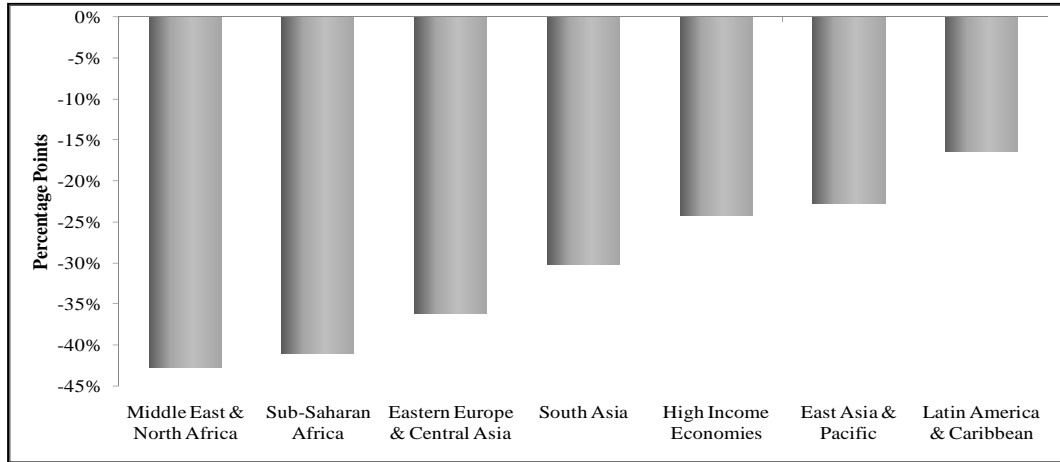
Source: Didier, Hevia and Schmukler (2010).

Trade-related transmission mechanisms

13. The aggregate demand shock in the advanced economies led to a large decline in global trade. The collapse in trade volumes, proxied by exports, is depicted in Figure 5. Global export volumes fell by around 25 percent between April 2008 and January 2009 but started to rebound thereafter, mirroring the movements in industrial production. Declines of more than 30 percent between peak and trough in export volumes were observed in economies in the ECA, MENA, SA, and SSA regions.

Figure 5. Trade Volumes

Declines in Export Volumes across Regions



Source: Didier, Hevia and Schmukler (2010).

14. Additional analysis shows that countries more financially integrated suffered greater growth collapses. Moreover, countries more open to trade and with higher shares of manufacturing goods in their exports also suffered larger growth collapses. This finding is not entirely surprising. From the perspective of developing countries, the global crisis was an exogenous shock transmitted from the center to the rest of the world via trade and finance. Therefore, it stands to reason that more integrated countries would be hit harder, an inevitable consequence of globalization. But even though this shock was much larger than the exogenous shocks developing countries are accustomed to, the eventual impact and therefore the resilience of developing countries would also depend upon how well-prepared they were, a point taken up in the next section.⁴ Indeed, the same factors—openness plus sounder fundamentals or macroeconomic policy buffers—are also associated with stronger expected recoveries.

Balance sheet effects

15. Since the late 1990s, many emerging market countries took steps to lower currency mismatches on public and private sector balance sheets (e.g., avoiding mortgages denominated in foreign currency funded by external borrowing). This was fundamental in allowing real exchange rates to depreciate without the fears of insolvency that would have arisen in the presence of liabilities in foreign currency with assets and earnings in local currency. In addition, self-insurance via the build-up of foreign exchange reserves meant speculators had less incentive to attack domestic currencies, thereby allowing interest rates to be cut.

16. In countries where currency mismatches were prevalent on private balance sheets and banks had high loan-to-deposit ratios as a result of borrowing externally and on-lending at home, the financial system took a big hit, amplifying the external shock. But in a notable accomplishment,

⁴ The question remains whether for individual regions or countries this crisis was more or less severe than shocks that were predominantly internally-driven, as with Latin America in the 1980s, East Asia in 1997-98 or Russia in 1998. Although this question is not addressed here, it is clear that developing countries were much better prepared this time, as section II demonstrates. On LICs, a forthcoming IMF paper titled “Global Shocks and their Impact on Low-Income Countries: Lessons from the Global Financial Crisis,” shows that while for many individual LICs this crisis was not the worst that they had faced, the unusual synchronization across countries made the growth decline for LICs notable.

emerging markets avoided a systemic banking crisis even though large individual banks were on occasion intervened.

II. STRONG MACROECONOMIC POLICIES HELPED DEVELOPING COUNTRIES

17. Compared to earlier crises, developing countries have so far displayed greater growth resilience during this most severe crisis in the post-war era. This is in large part thanks to crisis-mitigating macroeconomic policies. But there has been considerable heterogeneity in the ability to deploy such policies across countries. Countries that had built up policy buffers—notably improved external positions (lower current account deficits and higher reserves), stronger fiscal positions (lower deficits and lower debt) and lower inflation—were more easily able to expand fiscal deficits and cut interest rates. As a result, they experienced a smaller growth decline and are already seeing a quicker recovery than countries less successful at building such policy buffers.

Countercyclical Policies in Emerging Markets⁵

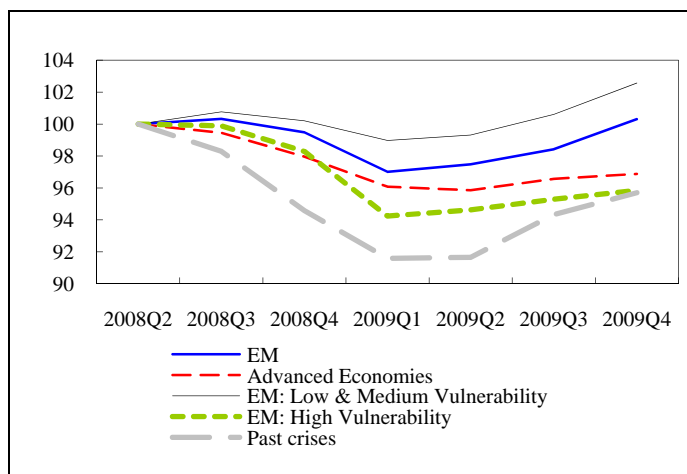
18. On average, output in EMs fell about 4 percent quarter on quarter (non-annualized, seasonally adjusted) between the third quarter of 2008 and the first quarter of 2009, the most intense period of the crisis (Figure 6).⁶ Those in the worst-affected quartile—mostly countries classified as highly vulnerable at the outset of the crisis, many located in emerging Europe—saw output contract by substantially more. In contrast, output rose slightly during the same period in the least affected quartile.

19. Controlling for factors such as trade and financial openness, countries that had better pre-crisis fundamentals and external vulnerability indicators experienced smaller output contractions.⁷ Higher international reserves relative to short-term external financing needs softened the impact of the global downturn. However, this effect was subject to diminishing returns. Countries that used reserves to moderate the impact of the crisis also allowed the exchange rate to bear part of the adjustment. Further, countries that had avoided pre-crisis credit booms experienced smaller output declines.

20. EMs reacted to the slump in external demand with an unprecedented policy response:

- Even accounting for stimulus measures already in place in 2008, EMs provided substantial fiscal accommodation—defined as a year-on-year increase in the primary fiscal deficit—averaging close to 2½ percent of GDP in 2009. This was in marked contrast to past EM

Figure 6. Emerging Markets: Real GDP (2008Q2=100, seasonally adjusted, medians)



Source: VEE Spring 2007; Haver; National authorities; Fund staff calculations

⁵ This section is based mainly on “How Did Emerging Markets Cope in the Crisis?” available at www.imf.org/external/np/pp/eng/2010/061510.pdf. “Emerging markets” corresponds closely to “middle-income countries” in the previous section.

⁶ All GDP growth data in section II are medians.

⁷ The terms “vulnerabilities” and “policy fundamentals” are used interchangeably, reflecting the fact that most vulnerabilities (mainly to external shocks) are determined by the strength of macroeconomic policy buffers.

- crises, where fiscal positions typically tightened in the year following the crisis.⁸ To achieve accommodation, EMs increased spending even as revenues fell.
- There was also significant monetary stimulus, with policy interest rates cut by 3 percentage points on average.

21. Countries that entered the crisis with better fundamentals were able to respond with more counter-cyclical policy easing. While most EMs kept fiscal policy accommodative during the crisis, some responded more aggressively than others, with higher pre-crisis primary balances and lower public debt levels permitting greater fiscal accommodation. These two factors accounted for most of the explained variation in fiscal accommodation across countries, with the change in the primary deficit varying from around 1 percentage point of GDP for the quartile with the least fiscal response to around 4 percentage points for the quartile with the greatest response. In addition, there is some evidence that fiscal accommodation was greater where growth fell the most.

22. Monetary policy responses to the crisis varied widely across EMs, reflecting differences in exchange rate regimes, external funding costs, and the level of pre-crisis policy rates. On average, EMs provided a similar-sized monetary response as advanced economies. Those in the Western Hemisphere (Latin America and the Caribbean) eased the most aggressively, while those in the Middle East—where inflation rates were higher and many countries have pegs—had less space for monetary easing.

23. Countries with better external vulnerability indicators on the eve of the crisis were not only the last to experience negative growth but also the first to start growing again. In general, faster recoveries have occurred in countries with stronger growth in trading partners, in those that sustained stronger public spending during 2009, and among those with flexible rather than pegged exchange rate regimes.

⁸ Previous crises in EMs are defined as Mexico (1994), Indonesia (1997), Korea (1997), Malaysia (1997), Philippines (1997), Thailand (1997), Brazil (1998), Colombia (1998), Ecuador (1998), Russia (1998), Turkey (2000), Argentina (2001), and Uruguay (2001). Dates in parentheses are those of crisis inception. Comparisons with past crises should be interpreted with caution, owing to differing external circumstances.

Countercyclical Policies in Low-Income Countries⁹

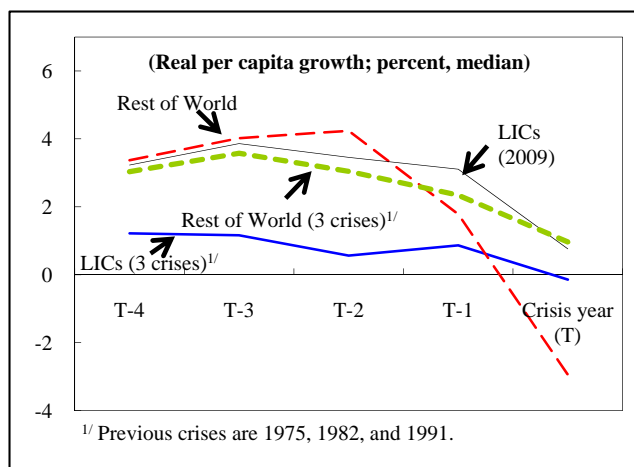
24. The crisis affected low-income countries (LICs) mainly through a sharp contraction in export demand, as well as a decline in FDI and remittances. For the typical LIC, the export demand shock was the largest since at least the 1970s.¹⁰ In contrast, the terms of trade of most LICs improved slightly relative to 2008, with the exception of oil exporters. Also, aid held up fairly well, contrary to initial fears of a big decline from the levels of recent years.

25. The drop in per capita real growth in LICs was significant, but, unlike in previous global downturns and in contrast to most EMs and advanced economies, growth in LICs remained positive on average (Figure 7).¹¹ Asian LICs saw the smallest decline in growth, thanks to their close trading ties to Asian emerging economies where growth held up well. SSA LICs experienced a somewhat stronger decline in growth, followed by LICs in Latin America and the Caribbean and LICs in the Middle East and Central Asia.

26. LICs' pre-crisis position was characterized not only by higher growth but also by stronger fiscal and external balances, higher international reserves and lower debt and inflation than in past crisis episodes. These policy buffers were built during the last decade (Figure 8). Debt relief, including through the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative, also helped.

27. Reflecting their accumulated policy buffers, three quarters of LICs were able to respond to the crisis with countercyclical fiscal policy. On average, LICs increased spending despite declining revenue and allowed fiscal deficits to widen by an average of 2½ percent of GDP in 2009 over 2008. There is preliminary evidence that, in line with the EMs' experience, LICs with higher initial buffers were more easily able to raise spending, and that countercyclical fiscal policy helped reduce the impact of the crisis on growth and protected core spending.

Figure 7. LICs: While the Fall in Growth was Steep, Per Capita Growth Remained Higher than in Previous Crises



Source: WEO, Fund staff calculations.

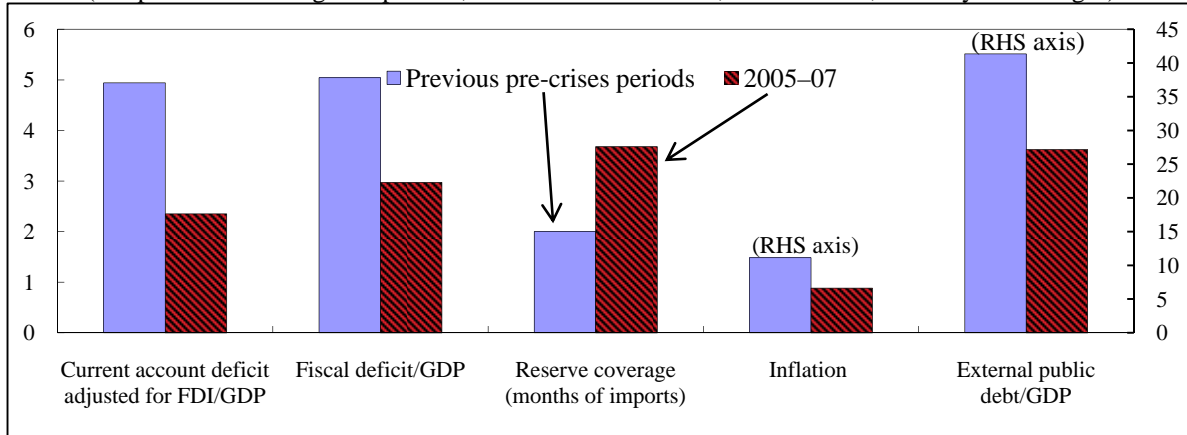
⁹ This section is based mainly on “Emerging from the Global Crisis: Macroeconomic Challenges Facing Low-Income Countries,” a forthcoming IMF paper, and “The Implications of the Global Financial Crisis for Low-Income Countries—An Update,” available at www.imf.org/external/np/pp/eng/2009/092809.pdf

¹⁰ Due to the absence of quarterly national accounts data for most LICs, the impact of the crisis on LICs is measured using data for 2009 and comparing them to data for earlier years, mainly 2008. Thus, 2009 is chosen as the year that the crisis affected LICs.

¹¹ Consistent with existing literature, past global downturns are defined across all LICs as the years 1975, 1982, and 1991.

Figure 8. LICs: The Pre-crisis Position was much Stronger

(Simple annual averages in percent, unless otherwise noted; for debt ratio, end-of-year averages)

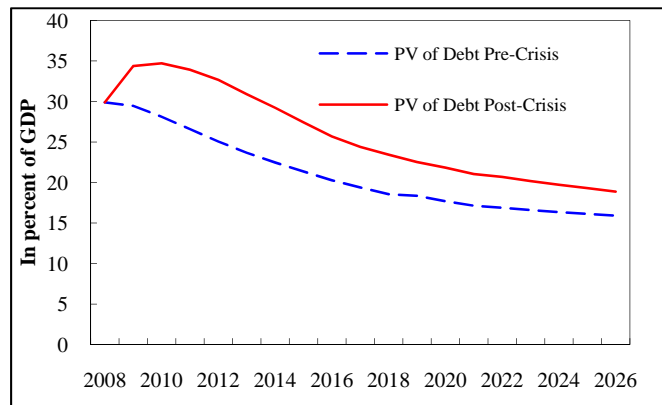


Sources: WEO, Fund staff calculations. Note: Previous pre-crisis periods: 1972-74; 1979-81; 1988-90.

28. With regard to monetary and exchange rate policies, almost two-thirds of the LICs for which data are available lowered the nominal policy rate, though possibly not to the full extent that the globally-driven fall in inflation allowed. Further, LICs that did not peg their exchange rates often reacted to downward exchange rate pressures by letting the exchange rate depreciate.

29. While debt remains manageable for most LICs, debt levels have increased somewhat as a result of the crisis.¹² The present value of the public debt-to-GDP ratio is expected to have risen by 5-7 percentage points in 2009 and 2010 as a result of the crisis (Figure 9). The expectation is that debt ratios will resume their pre-crisis downward trend provided expansionary fiscal policies are reined in as the growth recovery proceeds.

Figure 9. LICs: The Crisis has Left its Mark on Debt Levels



Source: WEO, Fund staff calculations.

III. PROTECTING CORE PUBLIC SPENDING DURING THE CRISIS

30. Developing country governments have traditionally adopted pro-cyclical fiscal policies, a history that did not bode well for the response to the present crisis. Besides, a widespread fear at the start of the crisis was that the governments of developing countries would be forced to cut core spending on health, education and infrastructure with two kinds of harmful consequences: (a) exacerbating the situation for vulnerable people already hit hard by the crisis; and (b) negative effects on long-run growth and the MDGs because of the setback to human capital and a worsening of the infrastructure deficit. These effects were expected to be more pronounced in low-income countries because of their thinner asset cushions as well as more limited access to capital markets to serve as shock absorbers.

¹² "Preserving Debt Sustainability in Low-Income Countries in the Wake of the Global Crisis." Prepared by the Staffs of the IMF and the World Bank, available at <http://www.imf.org/external/np/pp/eng/2010/040110.pdf>.

31. The previous section has already documented the welcome countercyclical policy response of developing countries to the global crisis. Simulations of spending trends suggest that the crisis has reduced the growth rate of core spending, but most likely not as severely as in previous crises--although these simulation results will need to be confirmed when actual data become available.¹³ Despite a slowdown in the growth of public social spending on health and education, such spending is likely to have increased on average in developing countries as a share of GDP and in per capita terms. In the 30 LICs for which data on outturns are available, median spending on health and education rose by 10 percent in real terms in 2009. Evidence also suggests that infrastructure spending did not drop severely, reflecting stimulus measures in a large number of developing countries. Still, adverse short and long term effects cannot be ruled out as momentum in achieving core development objectives such as the Millennium Development Goals (MDGs) was interrupted by the crisis. Box 1 sets out the implications for the MDGs.

Box 1: Resilience and the Millennium Development Goals (MDGs)

In spite of the unprecedented countercyclical response of developing countries to the global crisis, setbacks to the achievement of the MDGs are inevitable. Even before the global crisis—and partly due to the earlier food and fuel price shocks--progress in achieving some MDGs was lagging, particularly those related to lowering child and maternal mortality, primary school completion, combating hunger and improving sanitation. The situation is particularly dire in fragile and conflict-affected states, none of which has yet achieved a single MDG.

In addition to the poverty impact of the crisis discussed in section IV, from 2009 to the end of 2015, an estimated 1.2 million additional deaths may occur among children under five due to crisis-related causes and 350,000 more students may not complete primary school in 2015. About 25 million fewer people may have access to safe water supplies in 2015 as a result of the crisis (depending on the magnitude and effectiveness of investments implemented in many developing countries).

The impact of the crisis on progress in the MDGs has come through many channels, including slower economic growth.^{1/} While varying significantly among developing countries, growth fell from an average of 7 percent in the five years preceding the crisis to 1.6 percent in 2009, even with fiscal stimulus.^{2/} But even as developing country growth rebounds, high unemployment in many advanced countries could continue to exert downward pressure on workers' remittances and fiscal challenges faced by many advanced economies could threaten aid levels. These factors will make achievement of the MDGs even more challenging.

Therefore, advanced and emerging market economies must take measures to safeguard the global recovery, including actions to harness the power of international trade to act as an engine of development.^{3/} Macroeconomic buffers that foster resilience to economic shocks must be rebuilt so that countries can respond to future shocks to mitigate the growth costs and protect MDG progress. In scaling up investment to address the infrastructure growth bottleneck, low income countries need to strengthen their capacity to invest efficiently and borrow safely. At the same time, efforts are needed to improve the access of the poor to quality health and education services, affordable food, trade opportunities, finance and basic infrastructure.

^{1/} Global Monitoring Report 2010 (Chapter 2) (World Bank and IMF, 2010) has an extensive discussion of the relationship between growth and human development indicators.

^{2/} Unfinished Business: Mobilizing New Efforts to Achieve the 2015 Millennium Development Goals, World Bank, September 2010.

^{3/} Reaching the MDGs: Macroeconomic Prospects and Challenges in Low-Income Countries, International Monetary Fund, September 2010.

¹³ The simulations are based on the model in Lewis, Maureen and Marijn Verhoeven, 2010, "Financial Crises and Social Spending: The Impact of the 2008-2009 Crisis." The World Bank, June 2010. See also Figure 7 in "G20 and Global Development. Report prepared by Staff of the World Bank for G20 Growth Framework and Mutual Assessment Process" The World Bank. June 2010.

Regional Public Spending Impacts

*Africa*¹⁴

32. In a break from the past, preliminary data show that fiscal policy in most SSA countries has been countercyclical, with core spending protected or expanded. Fiscal deficits increased in two-thirds of SSA countries experiencing a slowdown. The key difference between fiscal stimulus countries (e.g., Kenya, Nigeria and Tanzania) and those which cut deficits (e.g., Ghana, Rwanda and Sudan) was the fiscal policy in the run-up to the crisis, and whether it allowed for fiscal space to expand deficits in response to revenue declines.

33. Capital expenditures increased in real terms in more than half the SSA countries in 2009 (median capital expenditure rose by about 1½ percentage points to 9.1 percent of GDP in 2009 compared with 2008). Again, the situation in stimulus countries sharply contrasts with that in countries where fiscal tightening was needed. In Kenya and Nigeria, capital expenditure rose by 1 and 2½ percent of GDP, respectively, in 2009, while current expenditure remained essentially flat. On the other hand, in Ghana and Rwanda, which tightened fiscal policy, capital spending fell by 1 and 3 percent of GDP, respectively, in 2009—again, with an unchanged level of current spending. So in all four countries, the change in spending was entirely accounted for by changed capital outlays.

34. Countries in SSA re-allocated current spending toward social spending needs—preliminary budget outturn numbers show that health and education spending increased in real terms in 20 of the 29 low-income countries in SSA. In addition, a growing number of countries have put in place cash transfers with targeting mechanisms; and a more developmental approach to social protection is being attempted via public works, with attempts to enhance food security through agricultural input subsidies. For example, Ghana further extended its cash transfer program (Livelihood Empowerment Against Poverty, LEAP) to new beneficiaries and initiated a Public Works program in its Northern region. In Tanzania, the government increased its allocation to the Social Fund TASAF which supports community based public works and has started pilot conditional cash transfers. In Kenya, the government introduced a youth workfare program, Kazi kwa Vijana, and a targeted food security scheme was developed, building on existing targeted programs. In Tanzania, the cotton and coffee sectors have been seriously affected by the sharp drop in world commodity prices. In response, the authorities put together a financing package equal to 0.5 percent of GDP. Smaller support packages for sectors affected by falling commodity prices were put in place in Burkina Faso and Mali. South Africa increased public sector wages and reprioritized spending toward social sectors (health, education, social protection, and housing in particular). The public works program was expanded in the FY11 budget with the aim of creating 4.5 million short-term jobs at a cost of R52 billion over FY11-13 (about 2 percent of FY11 GDP). Furthermore, the age bar for Child Support Grants was raised from 15 to 18, expanding the coverage from 9 million to 11 million children.

East Asia and Pacific

35. Most countries in the EAP region, including LICs, were able to introduce stimulus measures in response to the crisis. Stimulus packages were especially large in China (overall government expenditure went up from 18.7 percent of GDP in 2007 to 22.6 percent in 2009) and Vietnam (the fiscal deficit is estimated to have widened to about 9 percent of GDP in 2009 from about 1 percent of GDP in 2008). In Vietnam, the bulk of the stimulus measures focused on the expenditure side. This included an interest rate subsidy, acceleration of public investment (rural irrigation and infrastructure, additional off-budget projects in transportation, education and health), and boosting financial aid for

¹⁴ Based on World Bank Staff inputs and *Regional Economic Outlook Sub-Saharan Africa: Back to High Growth?* April 2010, International Monetary Fund, Washington. See also K. Krumm and C. Kularatne, 2010, “Fiscal Policy for Growth in Africa in Light of the Crisis,” The World Bank, Washington (forthcoming).

low-income earners and students. Core spending (defined for Vietnam as total spending minus interest payments, spending on defense and public security) increased by 5 percentage points of GDP in 2009 from the average level 2005-08. Thailand also implemented a stimulus package, which included new payments to community health volunteers, 15 years of free education, and pensions to the elderly not covered by social security. Increases in infrastructure spending were also planned, but weaknesses in public investment management have hindered timely implementation. The stimulus package was passed as an extra-budgetary measure to prevent conflict with Thailand's fiscal rule.

Eastern Europe and Central Asia¹⁵

36. With ECA being the hardest hit of the emerging market regions, countries there have been the first to cut all areas of public spending. Even with fiscal consolidation efforts, fiscal deficits rose in affected ECA countries. Of the 13 countries in ECA that experienced at least a five percentage point contraction in real GDP in 2009, the fiscal deficit increased by on average 4.1 percentage points of GDP in 2009 because of the decline in revenues.¹⁶ Fiscal consolidation occurred as a result largely of cutting expenditure in 2009. Russia—rich in hydrocarbon revenues—was an exception, continuing its fiscal expansion in 2009 and 2010.

37. Spending cuts came mainly through a reduction in the public sector wage and pension bill, and capital spending, while efforts were made to protect core social spending. Wage bills were reduced through wage cuts and freezes, and downsizing of the civil service (e.g., Bulgaria, Croatia, Estonia, Hungary, Latvia, Lithuania, Moldova, Montenegro, and Romania). Despite the need to cut spending, Romania sought to protect the most vulnerable by keeping the level of the minimum pension unchanged and minimizing cuts in targeted social assistance programs. Social assistance programs were protected or increased in a number of countries. For example, Armenia increased pensions, Family Benefit (FB) and unemployment insurance at a cost of 1.5 percent of GDP in 2009. In addition, Hungary and Latvia introduced new social safety nets while other countries increased spending on existing social protection programs (e.g., Moldova and Ukraine).

Latin America and the Caribbean

38. In Latin America, social spending remains strong. The largest economies were able to institute emergency social measures aimed at temporary employment financing and temporary transfers to the vulnerable. The exceptions to the benign growth outlook in the region are El Salvador and Mexico, where contractions of up to 8 percent in 2009 have created fiscal pressures. Despite the downturn, Mexico's structural reforms in education are slated to continue. Although education funding is expected to decline in 2009 and 2010 as a percentage of federal government spending, absolute funding will increase, maintaining the momentum of reform. Health spending will also decline as a percentage of total federal spending though by a smaller amount, but absolute spending will rise. Mexico also ramped up social protection programs—between late 2008 and early 2010 the coverage of the Oportunidades program expanded by 30 percent to about 18 million people. El Salvador is maintaining education funding, but the ratio of health spending is expected to decline slightly due in large part to reductions in the Social Security Institute's health expenditures.

South Asia

39. South Asian countries have not been affected as much by the crisis as some other regions. With the exception of India, large stimulus packages were not part of the fiscal response in the region. Some countries tightened fiscal policy and reduced core spending—in Sri Lanka, for

¹⁵ Based on M. I. Ajwad, 2010, "Coping Well or Barely Coping? Household and Government Responses to the Great Recession in Europe and Central Asia." Forthcoming.

¹⁶ Latvia, Ukraine, Lithuania, Armenia, Estonia, Russia, Slovenia, Romania, Montenegro, Moldova, Hungary, Croatia and Bulgaria – in order of GDP decline from largest to smallest.

example, public education and health spending dropped from 6.3 percent of GDP in 2007 to 5.5 percent of GDP in 2009. Over the same period, social spending in India rose from 4.7 percent of GDP to 5.9 percent, reflecting its fiscal stimulus package. Countries in South Asia also ramped up social protection programs. For instance, Bangladesh launched a 100 Day Employment Program in 2008 and an Employment Generation Program for the Poorest in 2009, which has contributed to an increase in social safety net spending from 2 percent of GDP in 2007/08 to 2½ percent in FY09/10.

Middle East and North Africa

40. Although the crisis impact was mild overall in the Middle East and North Africa, several countries in the region implemented stimulus measures. These have included new public investments in infrastructure, support to the private sector, and increased social spending. In Egypt, the government approved stimulus measures averaging 1½ percent of GDP for each of 2008 and 2009 for infrastructure investment projects, export subsidies and lower import tariffs on intermediate and capital goods.

41. Other fiscal stimulus programs across the region include increased infrastructure investment (Lebanon and Jordan), public wage increases (Lebanon, Morocco, Syria and Tunisia), increases in social subsidies (Algeria, Jordan and Lebanon), and small and medium sized enterprises support (Algeria, Morocco and Tunisia). In contrast, Iraq undertook a sharp fiscal adjustment in 2009, responding to a substantial decline in its oil revenues. The adjustment mostly focused on capital spending.

IV. MINIMIZING THE WELFARE IMPACTS

42. Notwithstanding output resilience and the determined efforts by developing country governments to protect core spending noted in Sections I-III, a crisis of this magnitude and the resulting--but hopefully temporary--slowdown in growth would be expected to lead to increased poverty and lower welfare along income and non-income dimensions. This section looks at the employment, poverty, hunger and distributional impacts of the crisis, as well as the social protection response. A caveat: the poverty and nutrition impacts discussed here are based on simulations and not actual data. They do not take into account policy responses and coping strategies of households. The results are therefore best seen as the 'worst case' welfare impact scenario for a given country.¹⁷

Labor market impacts – employment and earnings

43. In middle-income countries, the labor market impact appears to have fallen disproportionately on the quality of employment, rather than on the number of jobs. A study of 28 countries shows that the wage bill fell by an average of 8 percentage points between December 2007 and September 2009, with a particularly severe impact in middle-income countries and countries with fixed exchange rate regimes.¹⁸ With the number of jobs changing little, and employment even growing in 60 percent of the countries studied, three-quarters of the slowdown in the wage bill growth has been due to a loss in earnings.

44. This loss is driven by two factors. First, many employers have reduced working hours. In 4 of 14 countries for which data are available, hours worked fell by 5 percent or more. Second, a drop in developed country demand for imports has led to a shift in the labor market away from previously high-paying sectors. Qualitative rapid assessments from several East Asian countries confirm that jobs destroyed by the crisis have tended to be in the formal sector, whereas those created are most

¹⁷ The same caveat applies to results reported below from the Global Monitoring Report 2010.

¹⁸ G. Khanna, D. Newhouse, and P. Paci 2010. "Fewer Jobs or Smaller Paychecks? Labor Market Impacts of the Recent Crisis in Middle-Income Countries." Economic Premise Note 11, The World Bank, Washington. Fixed exchange-rate countries include Latvia, Lithuania (pegged to the Euro), and Venezuela (pegged to the US dollar).

often in the informal sector and in agriculture.¹⁹ The sectoral pattern of job losses depends on how the macroeconomic impacts are felt in a country. For example, while manufacturing faced the largest output shock in most countries, the services sector is projected to account for the highest share of employment losses in Mexico and the Philippines.²⁰

45. Similarly, the impact on international remittance inflows varies across countries. In Bangladesh, remittances are expected to grow by 12 percent between 2009 and 2010 in dollar terms—even though they are projected to be about 10 percent lower in 2010 relative to a no-crisis scenario. In contrast, about 40 percent of Armenian households suffered through loss of labor income, remittances or incomes from farm activities in 2009, with household consumption falling 12 percent in real terms relative to 2008. The impact on employment, labor earnings and remittances is likely to have translated into varying degrees of loss in household income across countries.

Poverty and inequality impacts

46. Although a rapid economic recovery could reverse some of the impact in the coming years, the crisis is nevertheless likely to impose a lasting impact on poverty reduction. By the end of this year, the crisis could add an estimated 64 million to the number of people living below US\$1.25 a day and 76 million to the number below US\$2 a day, compared to a scenario where the pre-crisis trend of economic growth (during 2000-2007) were to continue for developing countries.²¹ To show what the crisis could imply for the MDG of reducing extreme poverty, Table 1 presents three scenarios.²²

	Pre-crisis	Post-crisis	Low-growth
Europe and Central Asia	1.5	1.7	2.5
Middle East and North Africa	1.7	1.8	3.3
Latin America and the Caribbean	4.6	5.0	6.5
East Asia and Pacific	5.5	5.9	7.8
South Asia	21.5	22.8	28.6
Sub-Saharan Africa	35.9	38.0	43.8
Total	14.1	15.0	18.5

Source: Adapted from Global Monitoring Report 2010.

By 2015, the global poverty rate (percentage of the global population in poverty) is projected to be 15 percent compared to the 14.1 percent it would have been without the crisis, which implies that an additional 53 million people would have been lifted out of poverty by 2015 had there been no crisis. Moreover, if the recovery is slower than what is projected for the “post-crisis” scenario, the poverty rate would decline at a slower rate and fall to only 18.5 percent. South Asia and SSA appear to be the worst-affected regions, with poverty rate in 2015 being 1.3 and 2.1 percentage points higher as a

¹⁹ C. Turk and A. Mason, 2009, “Rapid, qualitative assessments of the impacts of the economic crisis: Overview of findings from eight countries,” draft report, The World Bank, Washington.

²⁰ B. Habib, A. Narayan, S. Olivieri, and C. Sanchez-Paramo, 2010, “The Impact of the Financial Crisis on Poverty and Income Distribution: Insights from Simulations in Selected Countries,” Economic Premise Note 7, The World Bank, Washington.

²¹ S. Chen and M. Ravallion, 2010, “Update to the impact of the Global Crisis on the World’s Poorest,” World Bank.

²² The pre-crisis trend gives the forecast path for poverty if developing countries had continued their performance during 2000-07. The post-crisis trend assumes a relatively rapid economic recovery in 2010, with strong growth continuing into the future. The low-growth trend assumes that recovery from the crisis will be delayed by 5 years, which has tended to be the pattern of past responses to severe external shocks to developing countries.

result of the crisis.²³ For SSA, this projection translates to 20 million fewer people being lifted out of extreme poverty by 2015, even under the more optimistic recovery scenario.

47. Country case studies, which use pre-crisis data to simulate the household level impacts of the crisis, provide useful examples of how the crisis is likely to have impacted poverty and income distribution within countries.²⁴ Such exercises show that although the level and depth of poverty are likely to increase as a result of the crisis relative to pre-crisis trends, there is considerable variation in how the impacts manifest themselves in each country.

48. In Bangladesh, the Philippines and Poland, lower GDP growth is expected to result in national poverty rates being 1.2, 1.5, and 0.4 percentage points higher in 2010, respectively, compared to what it would have been without the crisis.^{25, 26} Poland experienced a relatively large macro shock that has led to higher unemployment—the unemployment rate is expected to be higher by 2.5 and 3 percentage points in 2010 and 2011, respectively, than without the crisis. However, generous unemployment insurance benefits in Poland led to the poverty impact of the crisis being the smallest among the 3 countries.

49. In Mexico, Latvia and Turkey a contraction in GDP is likely to have led to an increase in poverty between pre- and post-crisis years.²⁷ In Mexico, GDP contracted by nearly 7 percent between 2008 and 2009, which is estimated to have raised the poverty rate by 3.4 percentage points. GDP is projected to return to pre-crisis levels by 2011, and even though poverty is expected to fall as growth resumes, more Mexicans will be poor in 2011 than in 2008. In Latvia, the poverty headcount rate is estimated to increase from around 14 percent to 20 percent between 2008 and 2009. In Turkey, where poverty is estimated to have increased by 4.3 percentage points between 2008 and 2010, the impacts are mainly due to lack of job creation in the face of a rapidly growing labor force. As unemployment insurance is likely to have protected the formal sector workers from falling into poverty, most of the losses are in the informal sector.

Impact on hunger

50. The impact of the global crisis on hunger is likely to have been significant, as found by a recent study which estimates the impact of growth slowdown in 2009 due to the financial crisis on undernourishment.²⁸ These estimates suggest that there are 41.3 million people more undernourished people than if the economic crisis had not occurred.²⁹ The estimates for the increase in hunger are

²³ World Bank and International Monetary Fund, 2010, “The MDGs After the Crisis.” Global Monitoring Report, 2010, Washington.

²⁴ With real-time household data unavailable in most countries, the assessment relies on extrapolations based on pre-crisis micro data. Therefore, the results are subject to important caveats (see Habib et al. 2010 for details).

²⁵ The poverty impacts for individual countries are with reference to the *national* poverty lines for each country, as opposed to the global poverty lines used for global and regional projections shown above.

²⁶ The projected real GDP levels (with crisis) in 2010 for Bangladesh, the Philippines and Poland were estimated to be 2.2, 4.9 and 5.3 percent lower than what it would have been had there been no crisis; the latest forecasts are generally more optimistic.

²⁷ For results on Latvia and Turkey, see Aran, M., M. Azam, M.I. Ajwad, and J. Hentschel. 2010. “A Methodology Note on the Employment and Welfare Impacts of the 2007-08 Financial Crisis.” Draft. The World Bank.

²⁸ The growth slowdown is measured as the difference between actual growth in 2009 and pre-crisis World Bank forecasts for 2009 growth. See S. Tiwari and H. Zaman, 2010, “The Impact of Economic Shocks on Global Undernourishment,” World Bank Policy Research Working Paper 5215.

²⁹ The estimates take into account not only the growth shock but also the decline in food prices, and hence is the net effect of these two factors (the growth shock leading to an increase in undernourishment outweighs the positive effect of the fall in food prices on undernourishment).

consistent with FAO's latest projection of the number of hungry crossing the one billion mark in 2009.

51. However, measures of nutritional status based on calorie sufficiency alone can understate the true long term impact of these crises. Households incur substantial long term costs when forced to compromise on dietary diversity, abandoning nutrient-rich food in favor of cheap sources of calories, and to cut back spending on health and education during periods of crises. Children born during droughts in Zimbabwe had significantly lower height during adolescence and enrolled into schools later than average. Early childhood nutritional status can have persistent effects through adulthood, including on wages in the labor market.³⁰ Furthermore, to the extent that these resultant shocks to human capital impinge on economic growth they weaken these countries' ability to mitigate the effects of future crises.

Impacts on income distribution: who is affected and how

52. The crisis appears to have had little impact on aggregate inequality indices in most of the countries that were studied. The aggregate numbers, however, do not tell the complete story of how impacts are distributed. Some regions and income groups within each country are estimated to have suffered more losses than others, depending on which sectors and income sources are more affected.

53. The impacts on income are relatively large among middle-income households, with the poor in some of the worst-affected countries being severely affected as well. In Mexico and the Philippines, nearly a fifth of households who can be described as "middle-class" (between 40th - 80th percentiles of per capita income) suffer losses that push them down to a lower income decile.³¹ In Mexico, where the crisis has been more severe, the poorest 20 percent of households are projected to suffer an 8 percent average loss in per capita income between 2008 and 2009, compared with 5 percent for the entire population. In Latvia, although the poorest 40 percent of the population is likely to have been hit the hardest, the rural poor may have been spared somewhat due to their isolation from the formal economy. In Mongolia, the poorest urban households suffer the largest impact, whereas the middle and upper income households are expected to achieve the largest income gains in the post-crisis recovery period.

54. In general, the impacts in the middle of the distribution can be attributed primarily to significant employment shocks to urban areas, and particularly to manufacturing and export sectors that employ a large number of workers from middle-income households. Compared to losses in labor income, losses resulting from lower remittances tend to be more concentrated among better-off households than losses in labor income, mainly because the initial (pre-crisis) distribution of remittances was skewed toward the better-off households.

55. The crisis also may have impacted women and men differently. Evidence from previous crises suggests that women bear a disproportionately heavy burden, as a consequence of a drop in the earnings of previously employed women, and an influx of low-paid female 'marginal workers' in the labor market. The second phenomenon, which was prevalent in the 1997 East Asian crisis and the Latin America debt crisis of the early 1980s and late 1990s,³² tends to be the strongest in the informal sector that typically pays much lower wages but absorbs women more readily. For example, case studies of mostly-female waste pickers, home-based workers and street vendors in 10 countries reveal

³⁰ J. Hoddinot, J. Maluccio, J. Behrman, R. Flores and R. Mortorell, 2008, "Effect of a Nutrition Intervention During Early Childhood on Economic Productivity in Guatemalan Adults," *Lancet* 371, pp 411-416.

³¹ Each decile is equivalent to 10 percent of the country's population, when households are ranked in terms of per capita income or consumption

³² See S. Sabarwal, N. Sinha, and M. Buvinic, 2009, "The Global Financial Crisis: Assessing Vulnerability for Women and Children." Policy Brief, World Bank Poverty Reduction and Economic Management Network, Gender and Development Group, Washington, D.C.

deteriorating working conditions and falling incomes as a result of the current crisis.³³ Some evidence suggests that men and women may have been affected differently in labor markets by the crisis, depending on the different natures of the sectors they are likely to be employed in. In Cambodia, among the two worst-affected sectors of garment manufacturing and construction, the male-dominated construction sector has adjusted mainly through layoffs while the female-dominated garment sector has primarily taken recourse to reducing working hours.

The “crisis vulnerable”: a new challenge

56. The “crisis vulnerable” refers to households who would not have been poor in the absence of the crisis. The characteristics of the crisis-vulnerable turn out to be quite different from those of the chronically poor (those who are poor with and without the crisis). For Poland, Bangladesh, the Philippines, Mexico and Mongolia, crisis-vulnerable households are estimated to comprise 0.4 to 3 percent of all households in 2010, and suffer much larger income losses than the average household of each country. In general, the crisis-vulnerable appear to be more urban, educated and economically active than the chronically poor. In Mexico, for example, the crisis-vulnerable are also more likely to be employed in the manufacturing sector and belong to households headed by women compared to the rest of the population, including the chronically poor.

57. As noted at the beginning of this section, the results reported here are based on simulations and not actual data from the crisis period. The little empirical evidence that is available, from household surveys conducted in 2009 in Armenia and Romania for example, suggest that poverty rates may not have increased by as much as originally predicted.³⁴ Besides, household coping strategies and policy responses may help alleviate the impact of the crisis on the vulnerable in some countries. Qualitative surveys from East Asia suggest that workers are most likely to cope with job losses or reduced hours by taking on multiple jobs. Expansion of social transfer programs in Poland and Mexico may have mitigated some of the poverty impacts, particularly on the poorest; and social assistance and pension programs may explain the relatively muted poverty impacts in Armenia and Romania as well. Finally, unemployment insurance has protected many in some countries, such as Poland and Turkey.

The social protection response

58. With the successive food, fuel and financial crises unfolding, developing countries have been compelled to act to stem the social consequences, and have done so with varying degrees of success. Prior to these crises, social protection was fragmented and inadequate, particularly so in SSA.³⁵ A survey of 120 countries during the food crisis showed that the bulk of SSA safety net programs were food-based programs, with school feeding and food-for-work being the most popular.³⁶ These programs are limited in their coverage, although (as Box 2 shows), the food crisis has served as an important catalyst for some expansion and innovation in these programs.

59. The bulk of developing countries does not, and still do not have adequate social protection mechanisms for the majority of the poor and vulnerable population. For many in this group of countries, the potential for expanding social protection coverage to assist those further impoverished and the “new poor” was limited because of declining fiscal space. As in the past, countries found it

³³ Z. E. Horn, 2009, “No Cushion to Fall Back On: The Global Economic Crisis and Informal Workers.” Women in Informal Employment: Globalising and Organising (WIEGO)/Inclusive Cities Project Report.

³⁴ See World Bank, 2010, “Armenia: The 2008–09 Global Economic Crisis, Policy Responses, and Household Coping Strategies”; and M. Azam and A. Isik-Dikmelik, 2010, “Technical Note on the Recent Trends in Poverty in Romania”, The World Bank, Washington.

³⁵ A. McCord, 2010, “The impact of the global financial crisis on social protection in developing countries.” *International Social Security Review*, Vol. 63, 2/2010.

³⁶ Q. Wodon and H. Zaman, 2010, “Higher food prices in Sub-Saharan Africa: Poverty Impact and Policy Responses” *World Bank Research Observer*, Vol. 25 (1).

difficult to introduce new schemes or ad hoc measures rapidly enough to mitigate the impacts of the crisis³⁷

60. MICs, which were generally more affected by the financial crisis than LICs, used their existing social protection systems effectively and introduced new programs. Argentina, Brazil, Chile, Korea, and Mexico used the lessons from earlier crises with large social fallout as a starting point for introducing new schemes offering income replacements for the unemployed or social assistance to the poor.³⁸ These countries were better prepared to cope with the consequences of the crisis in a systemic way. For example, the mainstay of the crisis response in Argentina involved scaling up programs like public works, a major transfer program for unemployed household heads, and child benefits to vulnerable families in the informal economy.

Box 2. The Food Crisis as a Catalyst for Better Social Protection

The food crisis, which was unfolding over 2007 and reached its peak during 2008 with soaring food prices, had its biggest impact on the poor. It has served as an important catalyst for alerting countries to the need for social protection mechanisms that could quickly help the most vulnerable in both LICs and MICs. The main problem in the context of the limited fiscal resources and administrative capacity was how to target households most in need of assistance, especially in LICs. Some country examples follow.

In Pakistan, BISP (Benazir Income Support Program) was introduced in the second half of 2008 on a pilot basis. In a space of 8 months the government expanded it to cover 2.2 million beneficiaries.

Motivated initially by the food crisis, Bangladesh introduced a new 100 Days Employment Generation Program to target about 2 million people in fiscal year 2009, making it the country's single-largest safety net program.

In some countries, due to large gaps in coverage of social protection programs, well targeted and less well targeted measures had to be combined to manage the food crisis. In Ethiopia, for example at the national level, the government suspended the value-added tax and turnover taxes on all cereals. In rural areas, the government expanded the benefit levels and coverage of the Productive Safety Net Program, a cash and food-for-work program and the mainstay of Ethiopia's safety net system.

In the Philippines there were over 60 different social protection programs implemented by over 20 government agencies. As a result of the food crisis, the government began to consolidate programs into a single, national social welfare strategy. In 2008 it launched a conditional cash transfer (CCT) pilot, which is gradually scaling up. In 2008 and further in 2009, the government increased its spending on social protection to assist those who have been affected by the global crises.

Whether scale ups have been sufficient to arrest poverty increases or not remains an open question. For example, Brazil responded swiftly to the food crisis by scaling up its main conditional cash transfer—Bolsa Família (expanding coverage from 11.1 in 2007-8 to 12.8 million families in 2009 and increasing amounts of transfers by 10 percent)—and increased benefits in the Benefício de Prestação Continuada (BPC), means-tested old age pension and disability grant program. Impact evaluations show that these measures were protective of the extremely poor, but too small to make any serious difference to the headline poverty and inequality increases.

61. In spite of these responses and the resilience of households through their own coping strategies, it appears that gains in poverty alleviation and reduction in hunger will be set back, and by a significant extent in some countries. The crisis underlines the need to implement poverty and hunger reduction strategies and have well-designed, fiscally affordable social safety nets in place as an urgent

³⁷ For example, some LAC countries were able to adjust benefit values or eligibility thresholds in their Conditional Cash Transfers to protect consumption for the poorest. But only six CCT programs (out of the 16 in the region) were able to do this; other programs had insufficient budgetary and administrative flexibility, see H. Ribe, D. A. Robalino and I. Walker, 2010, "Achieving Effective Social Protection for All in Latin America and the Caribbean: From Right to Reality," The World Bank, Washington.

³⁸ S. Freije-Rodriguez and E. Murrugarra, 2009, "Labor markets and the crisis in Latin America and the Caribbean (a preliminary review for selected countries)," in: Latin-America beyond the crisis: Impacts, policies and opportunities, The World Bank, Washington.

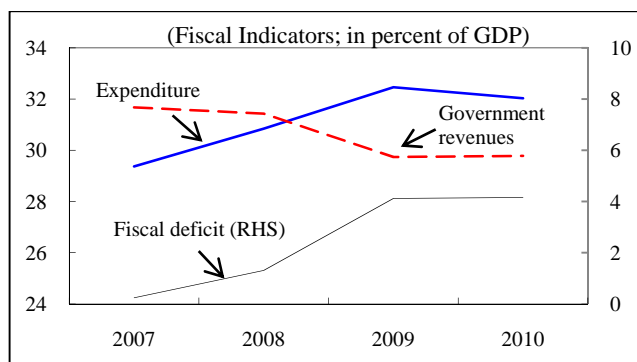
priority. Ideally these would need to be designed flexibly so that they can be expanded or deployed in the event of an economic shock. Momentum on this should not be allowed to flag as the crisis abates.

62. In this connection, an important lesson emerging from the global crisis is the need for combining two types of social protection mechanisms: income support to the unemployed; and targeted social assistance, which typically focuses on the chronic poor. Income support in the form of unemployment benefits helps laid-off workers and could also have macroeconomic benefits by stabilizing aggregate demand. Its main drawback is that most existing schemes cover only formal sector workers. Even in middle-income countries, over 50 percent of the labor force lacks access to ‘automatic’ unemployment benefits or labor-based protection.³⁹ This makes it important for developing countries to combine unemployment assistance with targeted social assistance programs. If well designed these can be expanded during the crisis, but may not be the ideal instrument to adequately cover all in need for temporary income support, given that the characteristics of those at the risk of becoming poor due to the crisis (the crisis-vulnerable) can be quite different from those of the chronic poor, as shown earlier.

V. ROLE OF THE INTERNATIONAL FINANCIAL INSTITUTIONS

63. The growth and core spending resilience displayed by developing countries during the global crisis is not an overnight phenomenon or a happy accident. Rather, it is a well-deserved payoff to the good macroeconomic and financial reforms implemented by developing countries over the past several years. For emerging market countries, the crises which began with East Asia in 1997 and then continued over the next few years, culminating with Argentina and Turkey in 2000-1, spurred fiscal and financial reform as well as self-insurance via foreign exchange reserve accumulation and better external asset-liability management. The resulting policy buffers served them well during this biggest crisis in the post-war era. For low-income countries, improvements in institutions and policies since the beginning of the new millennium, combined with debt relief, have been important factors in enabling resilience. Thus, the credit for the developing countries’ resilience goes largely to these countries themselves. Nevertheless, the IFIs, including the World Bank Group, the IMF and the Regional Development Banks, have played a valuable catalytic and supporting role, reflected in their policy dialogue and an unprecedented step-up in the financing provided.

Figure 10. EM: Countercyclical Fiscal Policy Response



Source: WEO, Fund staff calculations.

64. The international community supported Emerging Markets’ countercyclical policies, the fiscal component of which is captured in Figure 10. Together with other IFIs, the IMF and the World Bank quickly provided large amounts of financing to help countries smooth adjustment. In fiscal years 2008-09 and 2009-10, the IMF’s lending commitments under the General Resources Account

³⁹ ILO, 2010, World Social Security Report 2010/11. Providing coverage in times of crisis and beyond.

amounted to US\$217 billion, while disbursements amounted to US\$57 billion. The International Bank for Reconstruction and Development (IBRD)—which provides financing, risk management products and other financial services to EMs—delivered a record US\$33 billion in new commitments in FY09, almost tripling the previous year’s level, followed by an entirely unprecedented US\$44 billion during FY10 with total disbursements amounting to US\$48 billion during FY09-10, almost 5 times the level in FY08.

65. Low-income countries had to contend with the rise in food prices which began in 2007 and peaked in 2008. Box 3 describes the response led by the World Bank to this crisis, which preceded the global crisis and had a particularly pronounced impact on LICs. The IMF also provided additional support to address the food and fuel price shocks, through its concessional facilities.

Box 3. The Global Food Crisis Response Program (GFRP)

The Global Food Crisis Response Program (GFRP) was launched in record time in May 2008 to help LICs combat the effects of high and volatile food prices and adapt to the changes in the world food and fertilizer markets while avoiding distortive policies such as export bans or the forcible public procurement of grain. The two main foci were:

- Quick mitigation of the impacts on the vulnerable via social protection and budget support. And:
- Facilitating the longer-run food supply response through better supply chain and water management.

The total (approved and pipeline) amount for World Bank and externally-funded operations under GFRP stands at US\$1.46 billion, with actual disbursements so far at US\$976 million. Bank-funded operations are supporting 27 LICs while externally-funded operations under GFRP support another 12.

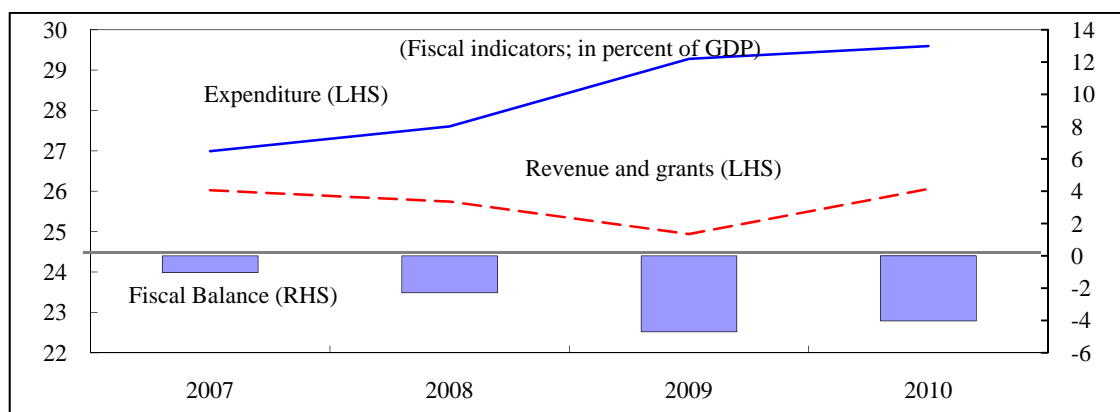
Impact on the ground has been substantial. Survey results from Niger indicate that rice yields in the GFRP project-supported areas for the 2009 off-season are 20 percent higher than yields recorded during the 2008 off-season. In Togo, 92 schools in poor and flood prone rural areas received funds to prepare meals, reaching more than 21,000 pupils. In Ethiopia, a total of 510,000 tons of fertilizer was procured with IDA funding for the 2009 production season through GFRP, narrowly averting what would otherwise have been a multi-year food disaster. An estimated 550,000 people in Ethiopia alone benefited from GFRP in 2009.

66. Food price volatility remains a threat and recent analysis suggests that domestic food price volatility has increased since the 2008 food price crisis.⁴⁰ Since mid-June 2010 global wheat prices have risen over 50 percent with knock-on impacts on rice, maize and sorghum. Fostering environmentally sustainable increases in agricultural output in low income countries is an essential part of the Bank’s food security agenda. The World Bank Group has been scaling up longer-term support for agriculture through implementation of its Agriculture Action Plan. In FY10, new projects in 50 countries were approved totaling US\$4.1 billion in new IDA/IBRD support to the sector and US\$2 billion in IFC support. Eighty one percent of this IDA/IBRD support has been focused on Africa and South and East Asia. The Agriculture Action Plan projects an increase in World Bank Group lending from US\$4.1 billion annually in FY06-08 to between US\$6.2 billion and US\$8.3 billion annually in FY10-12. In addition the Bank has also worked with other multilaterals to set up the Global Agriculture and Food Security Program (GAFSP) as a vehicle to invest in agriculture and food security in poor countries – current pledges stand at US\$914 million over three years. This was set up in response to a request from the G20 in Pittsburgh in September 2009 following pledges made by the G8++ at L’Aquila in July 2009.

⁴⁰ Food Price Watch May 2008, The World Bank

67. As with EMs, the international community also supported the countercyclical policy response of LICs. For example, many IMF-supported programs supported LICs' substantial fiscal accommodation (Figure 11). Reflecting debt sustainability considerations, programs for countries with moderate debt levels allowed for stronger fiscal expansion than programs for countries with high debt.⁴¹ Countries also benefited from record IMF and World Bank financial support. IMF concessional lending commitments to low-income countries during fiscal years 2008-09 and 2009-10 amounted to US\$5 billion, while disbursements reached US\$3 billion. In addition, under the 2009 US\$250 billion allocation of Special Drawing Rights, LICs received US\$18 billion to bolster their foreign reserves. Grants and interest-free, long-term credits from the International Development Association (IDA) to governments of the world's 79 poorest countries rose steeply to US\$29 billion during FY09-10, with disbursements amounting to close to US\$21 billion.

Figure 11. LICs: Countercyclical Fiscal Policy Response



Sources: WEO, Fund staff calculations.

68. During FY09-10, World Bank lending for safety nets reached more than US\$5.6 billion in 58 countries, almost seven times the pre-crisis average (FY06-08). Such lending helps governments maintain spending on programs to help poor people and other groups vulnerable to the crisis by boosting their incomes, increasing school attendance, improving nutrition, encouraging the use of health services, and providing job opportunities for the unemployed—including those thrown into poverty because of the financial crisis—and others living with disabilities or facing discrimination. Safety nets interventions supported by the Bank have included cash transfers, conditional and unconditional; public works programs; and in-kind transfers, e.g. school feeding programs. The Bank also established a Rapid Social Response (RSR) Program as part of its overall crisis response framework together with other donors to safeguard lives and livelihoods during the global crisis in middle and low-income countries. As of September 2010, the RSR Multi-Donor Trust Fund has allocated US\$37.6 million towards 34 activities of which 25 focus on social safety nets (70 percent of the allocated amount) and 16 focus on countries in Africa (58 percent of allocated amount).

69. Regarding support to the private sector during the crisis, IFC launched a targeted set of initiatives to complement its broader strategies and to help private enterprises in emerging markets navigate the unprecedented market conditions. Working with a wide range of partners, IFC launched initiatives to help ease bottlenecks in the flow of credit to micro, small, and medium enterprises; help companies manage troubled assets; and alleviate specific regional challenges. These initiatives included IFC's trade finance programs (Global Trade Finance Program, and Global Trade Liquidity

⁴¹ See "Creating Policy Space—Responsive Design and Streamlined Conditionality in Recent Low-Income Country Programs," available at www.imf.org/external/np/pp/eng/2009/091009A.pdf.

Program), Microfinance Enhancement Facility, Infrastructure Crisis Facility, Advisory Services - Access to Finance, and Debt and Asset Recovery Program. Together with partner governments and international financial institutions, support for these initiatives totaled over US\$11 billion, including over US\$6 billion for IFC's own account, US\$2 billion through partner governments and IFIs through IFC, and US\$3 billion in parallel financing arrangements. IFC has also launched coordinated action plans with other international financial institutions in Africa, Central and Eastern Europe, and Latin America and the Caribbean. These initiatives have been an important part of IFC's response to the global financial crisis, and continue to achieve significant development impact. Overall, IFC disbursements amounted to US\$12 billion during FY2009-10.

VI. CONCLUSIONS

70. A definitive assessment of the full impact of the global crisis on developing countries will require that more time elapse and more data be collected, especially on the household impacts. However, the evidence presented in this paper indicates an impressive degree of growth resilience for both middle- and low-income countries. By-and-large, developing countries were able to expand fiscal deficits and protect core spending. While there has been a rise in debt ratios in low-income countries, this does not pose a serious concern provided fiscal deficits are gradually reined in as the recovery takes hold.

71. In contrast to growth resilience and steps taken to protect core spending, protecting vulnerable groups in developing countries has proven to be a more difficult challenge because of relatively weak social protection mechanisms, especially in low-income countries, and in part because of fiscal constraints.

72. Looking ahead, safeguarding the global recovery to ensure strong and sustainable global growth is the most important precondition for higher growth in developing countries and restoring momentum in poverty reduction and improved living conditions. These countries need to begin rebuilding the policy buffers that were well-used during the crisis, in order to be prepared for future shocks. The pace of rebuilding buffers will depend on country circumstances and should be consistent with supporting the economic recovery. The establishment of effective and fiscally affordable social protection systems needs to be accorded top priority.

73. In low-income countries, fiscal consolidation could usefully focus on domestic revenue mobilization through improved tax policies and strengthened administration. Revenues were already low prior to the crisis and have declined further; besides, low-income countries will need to address their substantial infrastructure gap and preserve or even increase social spending in pursuit of their growth and poverty reduction goals. There is also a need to enhance expenditure efficiency and allocation. Another key to building resilience in low-income countries is the development of their financial systems, to enable households and firms to better smooth consumption and investment in the face of shocks.

VII. ISSUES FOR DISCUSSION BY THE DEVELOPMENT COMMITTEE

74. Members of the Development Committee may wish to discuss the following issues:
1. Is our assessment of the external environment generally correct? Are there additional risks or opportunities we should be considering?
 2. How can the WBG and the IMF best assist in reducing the risks to growth and increasing prospects for a sustainable recovery?
 3. Do shareholders have recommendations about added work the WBG should be pursuing on Agriculture and Food Security?