

Global Future

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THIS EDITION

The global financial crisis and the poor



FEATURING

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Letter

from the editor

Dear reader,

We want to share some good news. In December 2008, the United States Government passed the *Child Soldier Prevention Act*, a bill that the World Vision US advocacy team initiated, co-authored and led through a three-year passage.

While most of the world's estimated 250,000 child soldiers are enslaved by rebel or guerilla groups, eight national governments also use children as soldiers. Until now, the US Government has provided military assistance to six of those eight governments.

This bill restricts all forms of US military assistance to any government that uses child soldiers, until the children are removed from conflict and demobilised and the government policies are changed. This new law will compel these and other governments to stop using children in conflict, thereby saving the lives and childhoods of countless children.

Heather and Marina

what next?

in number 2, 2009

Health for the world's children

The second Global Future for 2009 revisits the critical issue of child health.

Globally, the under-5 death rate has fallen, from 11.1 million in 2000 to 9.2 million in 2007. Research and on-the-ground experience make clear that three in five of these children's lives can be saved with proven cost-effective interventions at family, community and district levels. Yet the Millennium Development Goals for child and maternal health lag behind other Goals, and 9.2 million children dying each year remains patently unacceptable.

So what will it take? This edition examines some of the key questions and issues surrounding the global commitment to ensuring that children, families and communities can claim their human right to health.

front cover image: This family lives on the streets of Cambodia: scavenging, weighing and selling cardboard, earning perhaps US\$0.75 a day. Scavenging keeps them busy until after dark, when they return to their "home": a small bamboo platform covered by a tarpaulin, on the grounds of the National Stadium.
photo: Jon Warren/World Vision

facing page background image: Children begging in a crowded city street in Georgia
photo: John Schenk/World Vision

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World Vision



MORE THAN FINANCIAL

The global financial crisis that engulfed the world in 2008 and continues to wreak havoc today is unique. Never before have so many people in so many countries been caught in an economic downturn. Never before have so many governments been forced to ease monetary policy and increase spending simultaneously – and by so much – in an attempt to stave off severe recession. And never before have the livelihoods of so many people in the world's poorest countries been so directly affected by circumstances in the richest. Indeed, there are justifiable fears that the rich world will lose sight of the Millennium Development Goals as it is consumed by its own economic turmoil.



The tumultuous events in financial markets over the past year, coming on top of the global food crisis, have forced practitioners and theorists alike to fundamentally re-assess how development can be achieved in a highly integrated world. This first edition of *Global Future* for 2009 contains a stimulating sample of new thinking about the impact of the financial crisis on developing countries, and the responsibilities of the developed world to mitigate its effects and prevent its recurrence.

Embracing this need to re-think the basics, Steve Keen tackles the debt mountain at the heart of the current crisis and suggests far-reaching structural changes to reduce the risk of history repeating itself. Ann Pettifor challenges the morality of the financial system, and invokes J M Keynes' idea of an international clearing agency as a first step to a more ethical and stable international financial architecture.

Of course, financial shocks in developing countries are not new. Roy Culpeper reminds us of successive shocks that left the poorest countries and their poorest citizens with debt burdens and growth deficits that have taken many years to erase. In this sense, the current crisis has historical precedents. But such crises in the past typically began in developing countries; the poor were largely able to avoid financial shocks from developed countries. This time, a much more integrated world has ensured that a crisis that started at the centre of the developed world quickly spread across the globe. Yet as Martin Ravallion makes clear, with intelligent application of existing policy ideas, developing countries could emerge from the crisis with stronger safety nets. The financial crisis may be unique, but we are not staring at a policy void.

The vulnerability of developing countries that embraced the global economy is notable. Simon Heliso shows how sub-Saharan Africa was quickly caught up in the financial "tsunami". Africa is clearly not isolated from the world economy nor from the effects of this crisis, despite early hopes to the contrary. Commodity-exporting countries well understand the market rollercoaster; less familiar is the collapse in demand for manufactured products now being experienced by some developing countries, most dramatically China. As World Vision staff report from the Philippines, Armenia and Albania, the crisis is directly affecting the lives of the poor.

World Vision's primary focus on children's welfare makes us acutely aware of the combined impact of the food and financial crises on children in developing countries. The food crisis exacerbated malnutrition, particularly for young children; the financial crisis has intensified the problem. As Rica Garde notes, the legacy of poor nutrition early in a child's life has life-long consequences.

Now is not the time for developed countries to turn inward and wind back the development agenda. As the contributors to this edition make clear, freezing or – worse still – cutting official aid is neither in the donors' interests, nor morally justifiable. Failing to achieve agreement in the Doha Round, or reverting to protectionist trade responses, harms developing and developed countries alike. The G20 meeting in April 2009 will be an early test of the developed world's response. It is a chance to commit to international equality and to signal that the essential re-design of the financial system will not penalise innocent bystanders in the crisis. ■

Dr David Lansley is Senior Economist for World Vision Australia.



AID IN THE TIME OF FINANCIAL MELTDOWN

Development efforts must be sustained, even increased, to confront this truly global crisis, argues Roy Culpeper.



Exporting local Thai produce, such as pomelos, to the European Union has made life much happier for Mr Chamrong Boodee and his family. Globally, many commodity and primary products exporters now face enormous uncertainty.
Photo: Somluck Khamtaen/World Vision

Financial crises have typically hit developing countries hard. Since the early 1980s, as the financial sector was increasingly deregulated and capital flows were liberalised, the world economy has careened from one financial crisis to the next.

A good number of these crises erupted in developing countries, which subsequently endured hardships lasting many years. For example, for Latin America the 1980s were a “lost decade” of economic decline; many of the poor in that region still have not recovered from the setbacks suffered two decades ago. The poorest countries, particularly in sub-Saharan Africa, languished for two decades under a debt burden due largely to loans and credits from international financial institutions, export credit agencies, and some official aid donors. This debt overhang was not adequately resolved until very recently.

Typically, the crises that erupted in the rich countries – including the US Savings and Loan crisis in the late 1980s and the European crises of the 1990s – did not significantly spill over to the developing world. But the current financial crisis, sparked off in the USA in August 2007 and in Europe soon after, will be different.

A CRISIS UNLIKE THE OTHERS

The transmission of the economic downturn from rich to poor countries will occur through a number of channels, including diminishing trade, investment, migrant remittances and aid flows. Already there are widespread lay-offs in China and other developing countries whose exports to the USA and other industrial countries are falling. Trade protectionism in the industrial countries will intensify these trends. Foreign direct investment, particularly in the resource extraction sector, will likely slow as a result of the sudden decline in commodity prices.

Official development assistance (ODA) is likely to be constrained. Donor countries will accord the highest priority in their fiscal stimulus measures to reviving their domestic economies and to containing the rise in unemployment. Although there is an acceptance that fiscal deficits will prevail for the next few years,

already there are concerns about their sustainability and future impact. Such concerns may lead to expenditure reductions in areas considered “discretionary” or of lower domestic priority in a time of recession. It is not yet clear whether aid will be cut, or simply flat-lined, as a result.

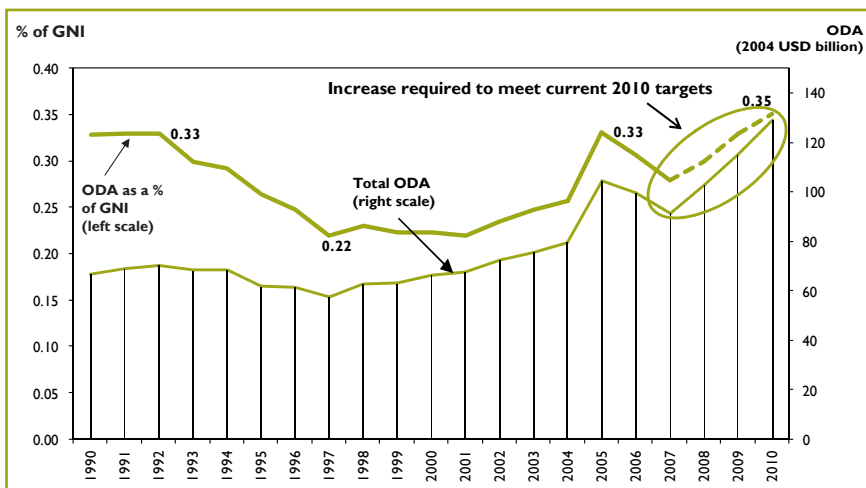
REAL COMMITMENT?

To their credit, when G20 leaders met in Washington in November 2008, they re-affirmed their development assistance commitments, consistent with their capacities and roles in the global economy. But looking back over the past two decades, the behaviour of most aid donors – the members of the OECD’s Development Assistance Committee (DAC) – is not reassuring, as the chart shows.

The 1990s were marked by recession in which absolute ODA levels stagnated in real terms (adjusted for inflation and exchange rate movements). Relative to gross national income (GNI), or ability to pay, average foreign aid levels fell significantly, from 0.33% to 0.22%. Aid levels only began to climb again after 1997. By 2005, aid from the DAC donors had crossed the \$100 billion threshold for the first time, but in relative terms it had simply returned to the level of 0.33% of GNI reached a decade and a half earlier – still far from the United Nations target of 0.7%.

Evils rooted in poverty do not respect international borders; sooner or later they come calling on rich countries

The spurt in DAC aid levels in the mid-2000s was a result of a number of factors. After the 9/11 attacks some donors felt that aid was an important dimension of the “war on terror”. Aid levels were also enhanced by exceptional debt relief accorded to Iraq and Nigeria. The Millennium Development Campaign with its eight goals also gained momentum around the 2005 Gleneagles G8 Summit, where countries promised to raise ODA levels by \$50 billion by the end of the decade. Western donors have clearly failed to meet this commitment. Instead there has been a drop in aid in absolute as well as relative terms, even



Development Assistance Committee members' net ODA 1990–2007 and DAC Secretariat simulations to 2010
Source: OECD, 4 April 2008

before the onset of the financial crisis in 2007.

ODA MORE CRITICAL NOW

There are compelling arguments for development efforts to be sustained, even increased, despite the crisis. First and foremost are the moral reasons. Poverty and deprivation, which afflict half of the world's population, are an affront to social justice (indeed, they represent widespread violation of human rights, and thus of international law).¹ It seems incredible that rich countries can quickly cobble together trillions of dollars for financial bail-outs and fiscal deficit spending, yet find difficulty in increasing annual aid levels by a mere \$50 billion over a five-year period.

If moral reasons are not enough, there is also self-interest. Rich countries will benefit from a world in which chronic poverty is vanquished and prosperity is more widely shared. A number of social and political disorders – disease, the drug trade, instability, civil war, mass migration – are at least partly rooted in poverty and economic disparities. None of these evils respect international boundaries, and sooner or later they come calling on the rich countries, no matter how much they try to insulate themselves.

The grim reality of climate change also must be factored into how we think about the challenges of development over the next few decades. Catastrophic weather and

a rise in sea levels will have greatest impact on the poorest countries and people, possibly triggering famine and other horrendous shocks to the human community.² For example, melting glaciers will increase flood risk and strongly reduce water supplies, threatening one sixth of the world's population, predominantly in the Indian sub-continent, parts of China, and in the South American Andes. And declining crop yields, particularly in Africa, could leave hundreds of millions without the ability to produce or purchase sufficient food.³ Even if the Gleneagles aid targets are achieved, which seems unlikely, aid flows will be under pressure to meet the needs of affected populations struggling to adapt to the changing environment.

PRACTICAL APPROACHES

However, there are practical ways that these formidable challenges can be confronted. First, existing aid programmes could be made much more effective; increasing the quality of aid is at least as important as increasing its quantity. For example, much technical assistance and food aid is tied to donor sources, increasing the cost of the aid considerably and depriving local consultants and farmers of the opportunity of providing the required services or food.

Second, recent research has shown that significant revenue can be raised through new and innovative measures. For example, the North-South Institute has estimated that

a tax levied at the rate of 0.005% on currency transactions can raise at least \$33.4 billion;⁴ if the proceeds were entirely allocated to international development, ODA would increase by a third or more.

That said, the onus to resolve these problems should not fall completely on foreign aid. Many other links between rich and poor countries, including trade, migration and investment, are much more important than aid. Improving access to the markets of industrial countries, by reducing subsidies and other barriers to developing countries' exports, would do far more to reduce poverty than the increases in aid currently contemplated. Rich countries also should eschew provisions in their stimulus programmes that shut out imports.

Finally, developing countries can do far more to help themselves through mobilising their domestic resources, partly through tax measures and partly by more effective financial intermediation. Developing countries should levy taxes on foreign investment at reasonable rates, rather than offering tax holidays and concessions. They should consider retaining some import tariffs, a main source of revenue for poor countries, or reducing them more gradually as part of a trade liberalisation policy. Not only would such measures help developing countries exit from chronic aid dependence; they would ensure greater national ownership and sustainability of development initiatives and reduce countries' vulnerability to future financial crises to and the unpredictability of foreign aid. ■

Dr Roy Culpeper is President and CEO of the North-South Institute, Ottawa, Canada. See: <http://www.nsi-ins.ca>

¹ Indeed, Article 2.1 of the *International Covenant on Economic, Social and Cultural Rights* sets up an international obligation to provide ODA. See http://www.unhchr.ch/html/menus3/b/a_cescr.htm

² The Intergovernmental Panel on Climate Change highlights the particular vulnerabilities of poor communities; see *Climate change 2007: Impacts, adaptation and vulnerability*, Contribution of Working Group II to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change, Cambridge University Press, 2007

³ N Stern, *Stern review on the economics of climate change*, Cambridge University Press, 2006

⁴ R Schmidt, *The currency transactions tax: Rate and revenue estimates*, Tokyo, New York, Paris: United Nations University Press, 2008



SMALL FISH: GLOBAL CRISES AND THE LATIN AMERICAN POOR

A history of economic dependence and inequality shapes the impact of this crisis on the poor in Latin American and the Caribbean; it is time for a new way forward, says Eduardo Nunes.

Once, while walking on the beach on a grey cloudy day, I encountered a fisherman fixing his nets. Trying to engage him in a chat, I said: “Ugly day, isn’t it?” Without taking his eyes from the net, he answered: “Depends on who is looking. The big predators, including myself, don’t see well on days like these, so the small fish are safer, and swimming in shoals they can find food even in dark waters. To the sardines it is a lovely day.”

It is easy to say how an economic crisis begins; harder to say how it will end. All economic models have variables that depend on the players’ choices. How markets and authorities react and relate to one another will determine future outcomes.

There is no easily predictable path. Are we in a so-called “V pattern” crisis (a sharp downturn, then a sharp upturn back to where we began), or a “U-shaped” recession (where economic activity is weak for an extended time)? Or is this an “L” crisis (down to a new lower economic level)? Most probably, the crisis will generate changes in wealth creation and distribution among companies, economic sectors and countries. New letters could be necessary to name it. But one thing is certain by now: we know that the poor will pay a higher price.

By definition, being poor is being more vulnerable to any shock. Crisis hits the poor first and more aggressively, and the poor are usually the last group to benefit from any economic recovery. First to be affected. Last to be saved.

DEPENDENCE AND INEQUALITY

Economic variables must be interpreted according to each region’s economic profile. Two aspects of the complex Latin American and Caribbean (LAC) regional economy will largely shape the impact of this crisis on the poor: dependence and inequality.

Being poor means being more vulnerable to any shock

For historical and political reasons, LAC has developed a high level of concentration of trade with just one country. The United States is the main trade partner for almost all countries in the region, despite some decrease in this dependency in the last decade. And LAC remains the most unequal region in the world: while this inequality is lower than in the 1980s, almost 40% of the region’s population, mainly from minorities (e.g. indigenous or of African descent), still have difficulty accessing opportunities of all sorts.¹ Dependence on the US economy ensured that LAC felt this crisis very quickly; the inequality will spread its consequences mostly amongst the poor, and will make the recovery more complex.

Based on these lenses, we can estimate the impact on the poor using a very simple equation with two variables: income (from employment, production, retail sales and gifts-in-kind) and expenditure.

INCOME

Several indicators can be used for income projection. Based on the simplest one, gross national product (GNP) growth, income projections for the LAC region dropped from 3.2% to 1.9% in 2009.² As population growth is faster than this, the forecast is that GNP per head will continue to fall for at least the next three years.³

Countries will be affected differently according to their economies, their size and their



Anna Cristina Alcantra, 37, and her son Ivon Elgardo, 10, help Santos Benjamin Muzum, 45, weigh the fish he just caught. They are part of a co-operative that looks after the fish farm; Anna and her children sell the fish in the market and to neighbours.

Photo: Andrew Goodwin/World Vision

portfolio of industries. We can group the region's economies into four non-exclusive categories:

1. Exporters of manufactured goods, who will experience estimated losses of 19–60%, depending on their degree of dependence on the US or other Northern markets
2. Exporters of agricultural and mineral commodities, who have already suffered losses of 15%–25% in export values (for exporters of energy commodities, the recent price adjustments will not make oil cheap again in the long term, but are enough to reduce investment in those countries)
3. Tourism-based economies, who will experience losses of 27–50%
4. Remittance-based economies, who already are being affected deeply, with their close dependence on US and European economies; their loss forecasts are about 30%

The foreign direct investment (FDI) upon which LAC relies for growth will drop dramatically. This will have a direct impact on the poor, mainly through decreased production, higher unemployment and higher inflation.

Estimates predict that in the next two years there will be a further 12 million unemployed in the region, including about 9 million who are already poor. New entrants to the labour market, mainly young people, will face greater difficulty. Unemployment will have two main collateral effects for the poor. First, nominal salaries will diminish. Second, even more poor people will be working in the informal (unregulated) economy (already this sector employs six out of 10 people living in poverty).⁴

EXPENDITURE

Alongside reduced incomes, there are signs that prices of the major expenditure items for poor people – food, housing, energy and transport – will rise.

To assess this “basic basket” inflation, the first variable to consider is the US dollar exchange rate. Most countries are very sensitive to currency fluctuations.

A higher dollar means higher prices for all imported goods (even in dollar-based economies), but food and energy are about the most sensitive to US dollar increases. Before the financial crisis, food prices had risen significantly for the past five years. But even though domestic prices for food and fuel have stopped rising, we can expect a worse situation in 2009 due to slower economic growth in the region in the wake of the global crisis.

POVERTY WILL INCREASE

Even in the most optimistic prognosis, poverty will increase in the next two years as a consequence of reduced income and higher living costs.

LAC benefited relatively little from the poverty reduction trends of the past 10 years. Poverty fell by 5.1% in LAC against 12.2% in South Asia and 20.1% in East Asia and the Pacific; sub-Saharan Africa's fell by 1.6%.⁵

Many are so close to poverty that any shock can push them back below the line

Even before this crisis, the relative incidence of poverty continued to decline in 2008, albeit at a slower pace than in previous years, but the absolute number of extremely poor still increased.⁶ The total poor population (living on less than US\$2 a day) could increase by more than 20 million in 2009–10.⁷ In a region with a young population, such as LAC, this means that about 14 million children (under 18 years old) will become poor.⁸

This large increase is partly explained by the volatility of the poverty index. About 70% of the total LAC population escaped from the “poverty cluster” in the past decade, but too many remain highly vulnerable – so close to poverty that any shock can push them back below the line.⁹ The number of people living in extreme poverty (less than US\$1 a day) could rise by 7 million by 2010; four million could go from poor to extremely poor, while two million could drop from being “non-poor” straight to extreme poverty.

With weaker economic growth, government capacity to respond to poverty will be reduced. Furthermore,

countries with a high dependence on aid stand to be impacted adversely by major donors' budget constraints.

A WAY FORWARD

At this critical juncture it is worth recalling the “pillars” upon which past growth in the LAC region has been based:

- the belief that markets would solve poverty
- social policies based on assistance rather than sustainable development
- intensive exploitation of natural resources (and labour) for low-value-added exports; and
- development led by the agendas of other regions or countries

This development model did not address the deep problems of dependence and inequality. Now there is an opportunity for the region to pursue its own roadmap to development and equality. The global financial crisis, with the concurrent environmental crisis, presents a clear opportunity for us to advance towards a new kind of regional politic – one based on the pillars of social and economic justice and respect for the environment. The conditions are right for the small fish. ■

Dr Eduardo Nunes is Operations and Integrated Ministry Director, World Vision Latin America and Caribbean Region.

¹ See United Nations ECLAC (Economic Commission for Latin America and the Caribbean), *Statistical yearbooks of 2006, 2007, 2008*

² See United Nations ECLAC, *Social panorama of Latin America, 2009* and International Monetary Fund, *World economic outlook: Financial stress, downturns, and recoveries, 2008*

³ United Nations IPC (International Poverty Centre), ECLAC, Brasília Symposium, 2009

⁴ Organización Mundial del Trabajo, *Panorama laboral, 2008*

⁵ *Desigualdade na América Latina e no Caribe: Relatório da Conferência, 2007*

⁶ A U Ahmed et al., *The world's most deprived: Characteristics and causes of extreme poverty and hunger*, International Food Policy Research Institute (IRPFI), 2007

⁷ United Nations IPC (International Poverty Centre), ECLAC, Brasília Symposium, 2009

⁸ Based on the UN Population chart, 2008

⁹ A U Ahmed, *ibid.*



AFRICA: TO INTEGRATE OR TO DE-LINK?

While rich countries must honour their aid and trade commitments, Africa needs to maintain domestic economic growth and social development, argues Simon Heliso.

Theorists and policy-makers in Africa have tended to think that the continent is ill-equipped to interact with global economic forces. As such, home-grown development solutions were earnestly pursued, effectively de-linking Africa from the rest of the world. A counter-ideology calling on Africa to adjust and to open up – to embrace globalisation – went too far, rendering Africa overly vulnerable to global economic vagaries while reducing spending on social services. Had it not been for sustained grassroots efforts, which in notable cases succeeded in improving basic services for the poor and reducing child mortality in spite of economic downturns, the human development picture would have been more grim than it is today.

A few countries, particularly in eastern and southern Africa, have drawn pertinent lessons from both extremes – de-linking and globalising. They noted that adjustment was necessary, but that so was increased and improved access to economic and social services. Prudent macro-economic and fiscal management was combined with policies that supported exports and attracted investment. These countries were not disappointed: growth finally came and, coupled with effectively targeted aid and

debt relief, growth increased optimism about poverty reduction.

UNFORESEEN EFFECTS

The thinking that Africa is a (fragmented) club of its own remains pervasive. While the financial crisis has kept Western nations on their toes, some African theorists, practitioners and even heads of state felt that the waves of the financial tsunami were too weak to reach “de-linked” Africa. None moved significantly, until November 2008, one year after the onset of the crisis, when African financial ministers met to harmonise thinking and develop a crisis response.¹

A case can be made for Africa to downplay the financial crisis. The continent’s place in the globalised economy is insignificant; the financial sector is shallow and capital markets, where they exist, are rigid. Only 17 African countries have a semblance of a stock market and, combined, they account for only 1.81% of the global portfolio.² Public debt securities and bank assets constitute only 0.31% and 0.15% respectively of the global total.³ Many countries still resist foreign ownership of banks and impose residual controls on capital accounts. The sophisticated evils unleashed by the sub-prime mortgage markets are simply absent.⁴

Yet the truth is that Africa’s recent decade of economic growth closely followed global trends.⁵ And the drastic share price meltdown experienced elsewhere between November 2007 and November 2008 was mirrored on the three main African stock markets: Johannesburg, Nigeria and Nairobi. In general, sub-Saharan African capital markets have fallen by 30–40% in the past 12 months.⁶ The added burden of withdrawals and meltdowns could literally kill these fledgling markets.

AID, TRADE AND CAPITAL INFLOWS

However, the impact of the crisis will be more significant in the three other areas that drive stability, economic growth and human development in Africa.

Aid. Two-thirds of all financial inflows to sub-Saharan Africa are in the form of aid.⁷ Although OECD⁸ countries on average gave only 0.46% of their national incomes in government aid in 2007,⁹ aid has been growing over the past 10 years.¹⁰

But the outlook is bleaker.¹¹ The massive bail-out packages, and the nationalisation of financial intermediaries and other assistance packages, reflect a re-prioritisation of government expenditure in rich countries toward salvaging their own economies. For Africa, reduced aid flows will worsen fiscal deficits, compromise capital expenditure projects and starve social services of funds for poverty reduction measures.

Trade. African growth was spurred, in part, by a modest rise in its international trade position, due to preferential treatment for African exports and the strong demand of growing economies in Asia.

Economic slowdown in advanced economies will subdue demand for African exports. The Baltic Dry Index (BDI), a commonly used indicator of international bulk shipping volumes, has plunged by 86% since May 2008 as China’s boom subsided.¹² Export revenues are falling rapidly in countries that are dependent on a small number of exports.¹³ Job losses or reduced job growth are immediate effects.

Capital inflows. Global economic decline will affect other forms of private financial inflows to Africa – mainly financing of current account deficits, foreign direct investment (FDI) and remittances. Total net private capital (debt and equity) flows are projected to decline from about US\$1 trillion to \$600 billion.¹⁴ Only half of the \$500 billion FDI inflows to developing countries will come in 2009.¹⁵ The risk is a return to net capital outflows; for example, Burundi already has a current account deficit of 40% of gross domestic product (GDP), while Uganda, Ethiopia, Tanzania and others have deficits in excess of 10–20%.¹⁶

Estimates suggest that Africa gets in excess of \$10 billion from citizens abroad.¹⁷ Remittances make up a significant portion of many countries’ GDP: from nearly 5% in Ethiopia to almost 40% in Eritrea.¹⁸ This source is being hit hard as the diaspora suffers from lost equity, jobs and investments.

WHICH WAY OUT?

African policy responses to the financial crisis take two main approaches.

One promotes Africa’s deeper integration with the world market.

This requires increased interaction within Africa itself, as seen in the recent move by eastern and southern African countries to harmonise three regional groupings into one large common market.¹⁹ Synchronising investments in infrastructure and economic systems enhances such efforts. For example, the Ethiopian Electric Light Corporation has ambitious expansion plans to include the Sudan, Kenya, Djibouti and Somaliland on the Ethiopian grid.²⁰ Unavoidably, donor money and global financing are important for the success of such projects, which should not be allowed to fail.

Africa ignores the crisis at its peril, for the crisis will not ignore Africa

For this path to succeed, African policy-makers need to focus on the opportunities that global integration provides, and skilfully use their countries' comparative advantages – relatively higher rates of return on investments and opportunities for diversification and growth²¹ – to gain new or sustained investment flows. After all, African GDP is projected to continue to grow, albeit at a lower rate than previously expected. Africa's attractiveness to the world must be ensured by continuing to improve the pre-conditions for growth: conflict management, macro-economic policy-making and governance.

The other, more de-linked, approach focuses on ensuring that domestic macro-economic and fiscal management nurtures growth and social protection. Social protection measures are needed immediately to reassure citizens, build resilience and safeguard human development achievements. They may take the form of expanding safety nets, protecting pro-poor spending (including health, nutrition, education and rural infrastructure), and improving targeted subsidies and transfers (such as food aid for work) that involve the poorest in economic activities that benefit communities.

A predictable and reliable economy builds business confidence

and creates jobs. African governments need to reassure strained financial intermediaries and businesses in the real sector, and wild inflationary pressure or wrong interest rates should not compromise their business drives. At the same time, financial sector reforms should enhance prudent controls, regional and global co-ordination, and the proper sequencing of liberalisation.

Africa ignores the global financial turmoil at its own peril, for the crisis will not ignore Africa. Yet improving the efficiency and accountability of domestic revenue generation and use should be a priority concern. Whichever approach they take, African countries will need to manage their image as prudent and pragmatic economic partners. To this end, bold actions are needed to empower citizens and ensure accountability of central governments. And enhancing productive use and ownership of Africa's vast economic resources, including land, clearly will bring greater social good. Unusual times may call for, and may bring forth, unusual measures. ■

Mr Simon Heliso is National Director, World Vision Burundi.

Despite the intense copper mining in Likasi Town, in the Democratic Republic of Congo, nearby communities have been ravaged by an economic crisis for decades. Problems are diverse and range from lack of clean water, schools and access to health care, as well as food insecurity. Funded by Japan, World Vision attends to the area's needs with agriculture, water and education interventions.

Photo: Horeb Bulambo/World Vision



¹ Africa Union (AU), United Nations Economic Commission for Africa (UNECA), Africa Development Bank (AfDB), and Africa Development Fund (ADF), *Briefing note 1: The current financial crisis – Impact on African economies*, Ministerial conference on the financial crisis, Tunis, November 2008

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⁸ Organisation for Economic Co-operation and Development ⁹ OECD, *Aid targets slipping out of reach?*, p 6, <http://www.oecd.org/dac/stats>

¹⁰ D Hostland, "The Impact of the global financial crisis on the development finance prospects of LDCs", *World Bank*, November 2008, p 16, see <http://www.unohrrls.org>

¹¹ *ibid.*, p 17 ¹² Y Mhango, "Real economy impact of global financial crisis in sub Saharan Africa", Standard Bank, 2004; L Kasekende, *op. cit.* ¹³ "Effects of the global financial crisis on developing countries and emerging markets", *Policy responses to the crisis INWENT/DIE/BMZ conference*, Conference note by D W te Velde, p 3, see <http://www.odi.org.uk/resources/projects/background-papers/2008/12/policy-responses-financial-crisis-developing-countries-emerging-markets.pdf>

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THE GLOBAL CRISIS AND DEVELOPING COUNTRIES: WHAT ROLE FOR THE G20?

Developing countries are already feeling the effects of the financial crisis and can expect worse, but G20 leaders have the opportunity to take immediate action, says Dirk Willem te Velde.

Who would have imagined a year ago that the day-to-day vocabulary of a development thinker would include the Baltic Dry Index, Capital Adequacy Ratios, letters of credit, counter-cyclical, fiscal stimulus and the like? Or who have predicted a reversal in development narratives, with developing countries now accusing the Western world of corruption and mismanagement of financial markets?

Commentators at the parliamentary session that I addressed in Cambodia in January 2009 suggested establishing a United Nations tribunal to bring to justice those who caused this financial crisis. I don't think we need to go that far, but it is now clear that poor developing countries are being hit hard along with the rest of the world.

There is a need to understand the actual and possible effects of the crisis and to implement appropriate policies to help developing countries. The G20 meeting that will be taking place in London on 2 April 2009 will be looking into the global financial crisis; that meeting should not forget development and the plight of the non-G20 countries.

A GLOOMY OUTLOOK

This global crisis has put pressure on all important sources of external revenues for developing countries – exports, remittances, foreign direct investment, portfolio equity flows, aid – with significant effects on the real economy, which has further feedbacks between the real and financial sectors. It is still too soon to understand the precise effects, as the news is still getting worse.

Growth revisions over the last half-year imply output losses of more than US\$60 billion in sub-Saharan Africa¹ – and US\$750 billion in developing countries – over 2008–9, as well as a drop of 3.5 percentage points in world output in 2009 alone. World income per head is expected to decline (see chart).

The Institute of International Finance estimates that global financial flows to developing countries will decline rapidly from roughly US\$1 trillion in 2007 to US\$165 billion this year. The International Labour Organization suggests that 18–30 million jobs could be lost between 2007 and the end of 2009, while the World Bank suggests that an additional 53 million people will be in poverty as a result of the financial crisis.²

EARLY SIGNS

The Overseas Development Institute is co-ordinating a large study of the effects of the global financial crisis in 10 developing countries. Conducted by local research institutes and think-tanks, this research has led to important preliminary findings.³

Asian countries such as Bangladesh, Cambodia and Indonesia already have experienced a sharp decline in manufacturing exports and industrial activity. In Bangladesh, export growth in the first six months of FY2008/9 (July–December 2008) was robust at 20% year on year (YoY), but in the second quarter exports

were down by 2%. This is the first time that negative export growth has been recorded in recent years. In Indonesia, growth in manufacturing has slowed in 2008, commodity prices started to fall from June 2008 and exports have been hard hit since November 2008. The non-oil and -gas trade balance has worsened.

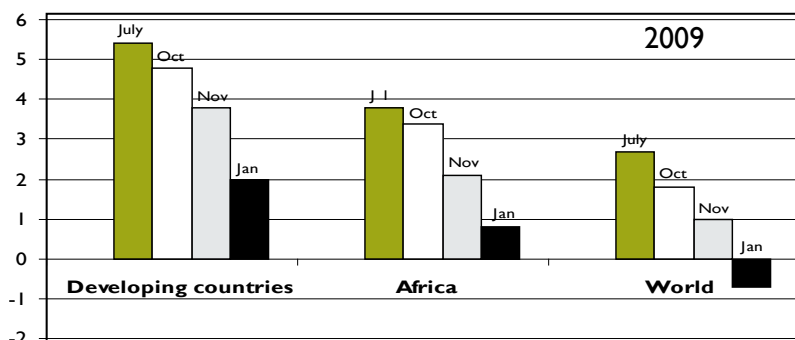
Commodity exporters such as Zambia (copper), Uganda (coffee), Kenya (tea), Nigeria (oil) and Bolivia (hydrocarbons) have seen recent declines in export revenues which also have affected government revenues negatively. In Zambia, where mining products account for around 80% of Zambia's exports, the copper price fell in 2008, from over US\$3 to just over \$US2 a pound. Copper mines are already closing and around 32,611 workers have lost their jobs – 15% of the total workforce of the copper industry. New projects have been put on hold and exploration projects have been affected due to difficulty in obtaining bank loans.

In Uganda, monthly trade data show a decline in value since September 2008 into 2009, with the value of exports falling towards the end of 2008. In Benin, cotton accounts for 34% of all exports – and cotton prices on the international market have fallen recently by nearly 40% YoY. The value of Kenyan tea exports has declined by 60% since September 2008. And Bolivia's government budget is highly dependent on hydrocarbon revenues, which are falling.

BEYOND TRADE

Several countries are also affected through migration and remittances. The number of workers leaving Bangladesh to find work elsewhere fell by 45% in January 2009 (YoY). Uganda has seen a slowdown in remittances.

Some of the case studies also reported large effects on their financial sector in 2008: the Indonesian stock exchange and equity market capitalisation nearly halved; in Zambia, the stock market index fell by 29%; and in Kenya, the NSE-20 Index fell by 25% since July, adversely affecting portfolio flows. The declines in the stock market



Forecasts for GDP per capita for 2009 (% annual growth)

Source: IMF forecasts and own calculations, scaled for expected population growth (1.3% for developing countries, 2.6% for Africa and 1.2% for the world)

index have made it more difficult to borrow from the capital market. Some countries have also reported exchange rate depreciations: Uganda's by 20% since October 2008; Kenya's by more than 20% since September 2008.

ORDER AND FAIRNESS

What should be done? Quite a lot, particularly by the G20 leaders. Their meeting on 2 April 2009 should explicitly include development and the plight of non-G20 countries, covering:

A "Global Poverty Alert" system. A network using "real time" updates to monitor the economic impact of declines in trade, financial flows, remittances and aid (as ODI is doing at the moment), and to monitor the impact on people's lives of lost work, lower incomes and falling investment in health and education.

Lending rules. More transparent and counter-cyclical rules could ensure stability of bank lending and other private financial flows to developing countries, so that banks lend less in good times and more in times when access to finance constrains growth.

Aid. Developed countries not only should stick to their aid commitments but should do more, as the case for aid now is stronger than before. They could encourage a fiscal stimulus world-wide, and much of it in poorer developing countries – because without a stimulus poor countries will fall further behind and because growth in Africa benefits others too. Consumers in poor countries are

more liquidity-constrained while developed countries, such as the UK and US, have had a period of over-consumption. Additional aid needs to address the worst-affected with early disbursements of funds this year, not later, and to examine the role of development finance institutions in a crisis.

Free trade. A commitment to free trade remains important and while a WTO package seems unlikely, it may help developing countries. More important is a commitment for all G20 countries to refrain from "beggar-thy-neighbour" economic nationalism, whether in the form of traditional tariffs or other protectionist measures which are more difficult to detect.

IFI reform. If the International Financial Institutions had had more legitimacy, (developed) countries might have acted on the macro-economic imbalances that have occurred over the last few years. Reform must correct this oversight.

The global financial crisis has already hit developing countries in a major way and worse is to come. The G20 leaders meeting in London need to take note, address this and implement a charter for development. ■

Dr Dirk Willem te Velde is Programme Leader, Investment and Growth, for the Overseas Development Institute. The views expressed are those of the author alone.

The author is grateful for discussions with ODI colleagues and the developing country researchers involved in the research project on the global financial crisis, co-ordinated by the ODI and funded by the UK Department for International Development and the Netherlands Ministry of Foreign Affairs.

¹ For all figures, except when otherwise specified, please refer to DW Velde, "Blue, green or red? A 'rainbow' stimulus to tackle global recession", *ODI Opinion 125*, Overseas Development Institute, 2009, <http://www.odi.org.uk/resources/odi-publications/opinions/125-fiscal-stimulus-global-recession-downturn.pdf>

² World Bank, "Crisis hitting poor hard in developing world", Press Release, 12 February 2009

³ For further details of the global monitoring project see: <http://www.odi.org.uk/events/details.asp?id=444&title=global-financial-crisis-developing-countries>

Do you know?



- In the 1990s, average foreign aid from DAC donors fell significantly (from 0.33% to 0.22%) relative to gross national income (GNI) and only began to increase again after 1997. By 2005, aid levels had crossed the \$100 billion threshold for the first time, but in relative terms it had simply returned to 0.33% of GNI – still far from the United Nations target of 0.7%. (OECD, April 2008)
- The Baltic Dry Index (BDI), a commonly used indicator of international bulk shipping volumes, has plunged by 86% since May 2008. ("Meanwhile, in the real economy...", *The Economist*, 16 October 2008)
- In some parts of the world, almost every family has one or more members living in other cities or abroad and sending money back regularly. Remittance flows to developing countries began slowing significantly in third quarter 2008, and could reach \$283 billion for the year, falling from 2.0% to 1.8% of recipient countries' GDP. ("Outlook for remittance flows 2008-2010", *Migration and Development Brief 8*, November 2008)
- During times of distress, poor households resort to borrowing, selling off productive assets, and withdrawing children from school or even putting them to work. (M Ravallion, *Bailing out the world's poorest*, World Bank, 2008)
- In early 2009, the World Bank called for the creation of a "Vulnerability Fund" to protect developing countries from the impact of the global financial meltdown. (The World Bank, "News and broadcast", 30 January 2009)

Families lose their main source of income

ARMENIA

“For many families of Alaverdi, Armenia, working in a copper foundry has been a tradition passed down for generations. The town’s largest industry has provided jobs for nearly 1,000 people for many years. At the beginning of 2009, however, the copper plant, which is the only functioning factory in town, started to slow down production due to reduced international demand. All indicators are that the factory will most likely shut down completely, leaving Alaverdi’s people without their main source of employment, stability and security.

“If the plant is closed, life in Alaverdi will stop,” says **Mr Arkady Yaralyan** of World Vision Armenia. World Vision is supporting some 500 Alaverdi children and their families with an Area Development Programme funded by child sponsorship.

DRAWING PEOPLE BACK HOME

Located inside a steep mountain gorge, the town itself began when the Alaverdi copper plant was established more than 200 years ago. During the Soviet period, Alaverdi – with a population of 25,000 – was the centre of metallurgic industry in the southern Caucasus, with the largest copper production facilities.

When the factory was closed with the collapse of the Soviet Union, many residents emigrated to Russia in search of work. Some years later the plant was privatised and re-opened, becoming part of the Vallex Group, the only producer of refined copper in the Caucasus. Production boomed, instilling in people new hope for a better future, and it wasn’t long before Alaverdians started returning and settling down in their hometown.

“Our people are dependent on the plant,” says **Mr Sasoon Khechumyan**, an official from Alaverdi Municipality. “The problem is that no other opportunities exist in the town. Alaverdi cannot rely on agriculture as land is scarce here; we have mostly ore mines.”

SLOWDOWN LEADS TO LOST SECURITY

Today, the global financial crisis is threatening the future of this town and its 17,000 inhabitants. The sense of security that the Vallex Group has tried hard to foster for its employees has been severely undermined.

The Tatoyan family of 10 is one of many families in Alaverdi that have lost their only permanent income. **Mr Mamvel Tatoyan** and his wife **Anahit** remember with deep sorrow their past years of relative welfare, when Mamvel worked as a carpenter in the Alaverdi foundry and could earn some extra money by working on demand in the construction field.

“We didn’t have serious financial problems before; my husband earned enough,” recalls Anahit, 54. “We could also improve our housing conditions, thanks to my husband’s skillful hands, to protect us from the cold winters.”

When strong competition in the construction field left no place for Mamvel, he was deprived of the extra income, but his stable job at the copper plant brought an income adequate to support the large Tatoyan family.



Global
VOICES OF LIFE FROM ARO

“the salary wasn’t high,
but I could at least
provide a decent life
for my family”

“Though the salary wasn’t high I could at least provide a decent life for my family,” says 55-year-old Mamvel. “Besides, the plant provided essential food products for its employees.”

The plant also carried out social projects, supporting local schools and kindergartens. People had a feeling of some safety; they had their stable wages. They could take out loans, as the plant provided a guarantee, and people were sure they could pay off their debts every month.

Mamvel is the sole breadwinner in his extended family of ten. He has been providing for his wife, son, daughter and five granddaughters (the youngest is only three years old). Moreover, his daughter has some serious health problems that have exacerbated the difficulties the family now faces.

“There is no job for my wife, no job for my son and me,” Mamvel explains. “Recently, my son left for Russia in the hope of earning some money there. I also am planning to leave, as I see no other opportunity to support my family. I live now on debts and I need to pay them back somehow.”

Sasoon Khechumyan says, “Most households have at least one person who has left the country in search of a job. People often see no choice but to leave their families for a long period. As a result, children grow up in incomplete families without a father or mother to take care of them.” However, the global financial crisis has affected Russia as well, and it has become difficult for seasonal job seekers to find gainful employment there.

ENTIRE TOWN IS SUFFERING

At the time of writing, officially 300–400 people in Alaverdi had lost their jobs since the beginning of 2009. However, the statistics do not give the complete picture. The numbers are much higher when considering the companies, enterprises and local entrepreneurs that have been providing the plant with supplies.

Also, Sasoon argues, the numbers do not take into account Armenians’ strong family bonds. “Every Armenian tries to financially support not only his immediate family but also his relatives. This means the numbers of people affected will increase. I am afraid that if the plant does not re-open in the near future the town will face a disaster.”

He adds that the people of Alaverdi are very hard-working and ready to do any job, but there is simply nowhere they can work. “The situation we are now in seems absurd to me. There is a healthy labour force but there are no job opportunities.”

Walking along the town’s narrow streets, one can see the worried and pensive faces of Alaverdians. Once proud and happy people, they rarely smile now. The only smiles are in the street posters bearing the faces of carefree Alaverdians with the logo of the Vallex Group and the slogan, “I love you, Alaverdi.” ■

Reported and photographed by Ms Gayane Ayyazyan, Public Relations and Communications Assistant, World Vision Armenia

Photos

Far left – The Tatoyan family in front of their house. Their family is one of many in Alaverdi who lost their only permanent income after the copper plant shut down.

Above left – Mamvel Tatoyan, 55, with his two granddaughters
This page – The copper-smelting plant was the only functioning factory in Alaverdi.

Global crisis affecting micro-enterprise

THE PHILIPPINES

“Fe Angeles, 52 years old, is a cook and owns a small restaurant in Hilongos, a poor community in Leyte, the Philippines. Every day, she prepares and cooks the food sold in the restaurant. She and her husband, **Fernando Angeles**, together manage the business, trying to earn a living and provide a better life for themselves and their children.

Fe is a client of Community Economic Ventures, Inc. (CEVI), a micro-finance institution tasked with managing World Vision's micro-finance programmes in the Philippines. With her strong entrepreneurial spirit, she has been a client for two years now.

In a recent interview with CEVI staff, Fe candidly confided the status of her business. Describing what life was like before a recent drop in sales, she said that people were coming to eat in her restaurant and buy her food. She was happy because the income she earned from the business enabled her to easily feed and clothe her family. She made a reasonable profit, earning at least 5,000 Philippines pesos (nearly US\$106) a day.

Life was much easier for her before. She still remembers herself saying, “If you just commit yourself to work hard, then there will be enough food to offer to your loved ones.” But now that economic recession is being felt in her country and her own community – from news of the closure of some financial institutions and rural banks, to people buying less from businesses like hers – Fe recognises that “more and more people are suffering even though they work very hard.”

FEELING THE DOWNTURN

The country's economy has been increasingly dependent on exports, foreign capital (investments, debt and aid) and remittances (some 9.2 million Filipinos working overseas remitted US\$14.5 billion in 2007, roughly 10% of gross domestic product). There are alarming trends of high and rising unemployment

(4.1 million unemployed and 6.8 million under-employed), falling incomes, increasing poverty and deteriorating welfare, which are expected to continue unabated in 2009.¹

A year ago, Fe saw that people were able to spend much more on food. Every day her restaurant was full: people came together for family gatherings and celebrations; travellers, waiting for their next ride, came in for a quick feed; young people whiled away their time eating and having fun. She was proud of the daily crowd in her restaurant, almost like fish teeming in the nets – a sure indication that people bought and loved her food.

However, in late 2008 Fe began noticing a gradual downturn in her sales. Some of her regular customers no longer appeared in the restaurant. Now, every day is a sad story and she wonders why this is happening when she continues to ensure good customer service and high-quality food. She points out that life is very hard these days; she has a declining number of customers, and those remaining have become more frugal when placing their orders.

Initially Fe's customers tried to avoid spending too much, many opting to buy cheaper food in other restaurants. In an effort to win back her customers, Fe adjusted the type of dishes she served, cooking more with vegetables and selling at a lower cost.



Global
VOICES OF LIFE FROM ARO

Now, she can no longer cook in volume because she anticipates that only a few will buy the food she sells.

Fe is really surprised and a bit devastated about the situation of her business and how it came to this sad point. "I worked so hard to sustain this business but people are pulling back from spending. I see that they now prefer cheaper food and they do it by limiting their orders. People now buy less of things they need to buy," she says. "So, I need to adjust. I can no longer earn the same income in the same ways. I need to be extra cautious."

As a micro-finance client, Fe worries because she still has loans to repay. The downsizing of her customer base greatly affects her income. Though she can still repay her loans, she wonders how she is going to recover all her losses.

"My friends and I were talking about our businesses and they, too, are experiencing the same declines. They said that the constant hike of basic commodity prices and the recent currency devaluation made these things worse. We are just lucky to have CEVI to partner with us in keeping our businesses and combating these challenges."

"Actually, prior to this, my husband and I had agreed to set up another restaurant. But because of the recent happenings, I think there will be changes. It might be that we will just wait until the whole situation becomes better and more stable." ■

Reported and photographed by
Mr Jonar Dorado and Mr Jonathan Neri
of Community Economic Ventures Inc.
with Ms Roni Oracion, Micro Enterprise
Development Adviser, World Vision Australia

¹ IBON Media, "Worsening storm for RP economy? RP poorly equipped to deal with global financial crisis", see <http://info.ibon.org>

"I worked so hard to sustain my business but people are pulling back from spending"

Photos

Right – Fe, standing in the entrance of her restaurant
Left – The family-owned restaurant



Remittances: the past and future for Albania's rural families

ALBANIA

The Gostima family relies on remittances, like hundreds of rural Albanian families. **Fadil Gostima**, 44, his wife **Razije**, 43, their two daughters **Irma**, 16, and **Alma**, 9, and their elderly grandmother share a two bedroom house in central Albania. The family struggles to get by, and Fadil has been in Greece since 2001 working to support his family.

Razije has tried her best to manage the little money Fadil has sent home, and works their small plot of land. "My husband spends most of his time working in Greece trying his best to provide for the family and pay our debts. But since last year he has not worked more than two months in total," she explains.

In fact, Fadil has returned to Albania and now is unemployed. "I can't stay in Greece any more because it is really hard now to find a job there," he says. "You have to wait for a month to find a job just for a short period. I don't know what is going to happen in the future if this situation continues."

"In the summer, I'm going to find a job to help my family in this difficult financial time," says 16-year-old **Kledisa Sollaku**.

Kledisa is in her second year of high school. She lives with her mother **Nazime**, 40, and her sisters **Leonora**, 15, **Anxhela**, 13, and **Bruna**, 8. Her father **Bujar**, 40, has been in Greece since 1991, working to support his family.

"If I find a job, I will save some money for my third year of school and my parents won't need to pay the entire amount on their own," says Kledisa.

Kledisa's family lives in a village in the Elbasan region, located about an hour south-east of the Albanian capital, Tirana. Their village is one of the largest supported by World Vision's Elbasan Area Development Programme (ADP) and reflects the income differentiations typically found among rural families.

HIGH COST OF RELYING ON REMITTANCES

According to residents, more than 70% of the village is dependent on remittances from abroad, which makes it like most rural areas in Albania.

A 2007 World Bank report stated that migration from Albania has been widespread – almost every family has one or more members living in other cities or abroad and sending money back on a regular basis.¹ The country has one of the world's highest rates of emigration, in proportion to its population.²

The study found that, in the Europe and Central Asia region, remittances benefit both the migrants' families and their home countries. For many of the poorest countries, remittances are "the largest source of outside income and have served as a cushion against the economic and political turbulence" of the past 15 years.³ According to the Albania Central Bank, remittances are critical for many sectors of Albania's economy and play an important role in bridging the country's widening trade deficit.

Significant remittances to Albania have helped reduce household poverty. Bujar Sollaku's family seem to enjoy good living conditions and comfortable housing thanks to the remittances he sends. "With the money he has sent us over the years, we have built this new house and have bought all the furniture in it," says mother Nazime.

Photos

Above – Fadil Gostima

Right – Razije Gostima and her daughters Irma and Alma

Global
VOICES OF LIFE FROM AROUND THE WORLD

But all this comes at a great price: this father has spent the last 18 years away from his family and has missed his daughters' childhoods in his efforts to secure their future.

FEELING THE GLOBAL CRISIS LOCALLY

Now, with the global financial crisis moving from the lending markets into the real economy, the recession is hitting neighbouring countries that host millions of Albanian migrants.

A study⁴ covering the first three quarters of 2008 showed that remittances had dropped 13% relative to the same period of 2007, from 947 million euros to 623 million euros.⁵

"My husband has had a good income in Greece, but last year he lost his job because the construction firm he worked for went bankrupt, since construction work has fallen dramatically," says Nazime. "Bujar used to send us an average of 700–800 euros each month, but he has sent a total of only 400 euros in the last six months."

The governor of the Bank of Albania warned that 2009 will be a difficult year for Albania's economy due to the global financial crisis, and attributed much of the pressure to slowing remittances and tighter financing conditions.⁶

"with the money
he sent us, we
built this house"

HOUSEHOLDS FORCED TO CUT BACK

Nazime explains that in recent times it has been especially difficult for her to meet the costs of her daughters' education, particularly for the new school year.

All four daughters continue to attend school, but it is more challenging for Kledisa. She has to travel to Elbasan city to attend high school, which means that her transport and study costs are far higher than her siblings'.

Being the eldest child, Kledisa understands her family's difficult situation. Showing admirable maturity, she often talks with her younger sisters about not asking for new things such as clothes or toys, knowing that these requests would only add to her parents' burdens.

"My parents don't tell us anything. They never talk in front of us, but when I have overheard their phone calls and I see them so sad, I feel so bad," says Kledisa. "I suspended my English language course because every time I asked my mother for the fees, I realised that it was very hard to pay. This course is so important for my future, but I decided to quit it (without my parents' permission) to help my family a little."

This family is one of hundreds of rural families that are struggling as the remittances they have relied upon and benefited from for so long are beginning to dwindle or even disappear.

"It is almost one year since my father lost his job," says Kledisa, "and if this situation continues it will be very hard for my family – especially for our education. University is coming up and it will be very challenging for my family to pay for it. But I really want to study medicine and, if necessary, I'm determined to work very hard for it." ” ■

Reported and photographed by Ms Bardha Prendi,
Communications Assistant, World Vision Albania

¹ A Mansoor & B Quillin (eds), *Migration and remittances: Eastern Europe and the former Soviet Union*, The World Bank Europe and Central Asia Region, 2007, p 79 ² *ibid.*, p 25 ³ *ibid.*, p 6 ⁴ Albanian Central Bank study "External sector developments in the Albanian economy during the period January–September 2008", p 6 ⁵ "External sector developments in the Albanian economy during 2007", p 5, see <http://www.albanianeconomy.com/news/2008/12/19/albania-cbank-warns-of-tough-09/> ⁶ Speech of the Governor of the Bank of Albania, Mr Ardian Fullani, at the Monetary Policy Statement for the second half of 2008, Press release, 29 January 2009





AVERTING A DEVELOPMENT CRISIS

Solutions to the financial crisis must deal with the immediate and long-term effects on the world's poorest, and introduce far-reaching, enduring change, says Rica Garde.



Sokchan was only six when he dropped out of school in Cambodia to work in a brick factory, helping his family to earn less than US\$25 a month. He now attends non-formal education classes at World Vision's drop-in centre. Children and families below the poverty line must not be abandoned during the global financial crisis.

Photo: Sopheak Kong/World Vision

The global financial crisis is arguably the biggest threat to development at the moment. As advanced economies slide into recession one after the other, the International Monetary Fund (IMF) predicts world economic growth will fall to 0.5% in 2009, the lowest rate since World War II.

Developing countries, especially those with significant economic ties to the West, find themselves at risk from economic troubles not of their doing. The World Bank projects that the crisis could result in 53 million more people falling into poverty, based on a daily income less than US\$2.¹ The economic downturn could potentially evolve into a severe development crisis affecting the poorest and most vulnerable populations world-wide.

DEVELOPING COUNTRIES

Already, declines in exports, foreign investments and international remittances are being felt by developing countries. Falling global demand for exports is exerting a downward pressure on commodity prices. A number of African countries have posted strong growth rates in recent years as commodity prices boomed, but these gains are now in danger.² International remittance flows provide a lifeline to numerous households in poor countries, and continue to grow as of December 2008³ – but this resilience is now uncertain. Low-income countries were initially thought to be insulated from the financial crisis because of their weak or almost non-existent links to the international financial market, but the secondary effects of the recession in the West are likely to severely affect the poorest communities in the world.

The global crisis could potentially result in large human and social costs which have long-lasting development impacts. Governments find it difficult to protect their populations from the blow of the economic downturn, coming on the heels of the food price crisis. The sharp rise in the prices of food commodities last year resulted in unrest and even violent protests in several countries.⁴ The crisis could well lead to social unrest. Economic downturn has the power to weaken social cohesion especially if this is weak in the first place.

As jobs and livelihoods are threatened, the poorest communities and those living just above the poverty line face dire consequences from any fall in income or support.

IMPACTS ON CHILDREN

Children are likely to disproportionately bear the burden of the crisis. Less government spending for social services, which already suffer from a lack of resources, means even lower quality education and health care for children.

Research shows that during times of distress poor households resort to borrowing, selling off productive assets, and withdrawing children from school or even putting them to work.⁵ During the 1997 Asian financial crisis, children's nutrition deteriorated in parts of Indonesia, while school drop-out rates increased in the Philippines.⁶ Such adverse coping measures may seem to affect children only temporarily, but in fact the consequences could be irreversible.

Family coping measures may have irreversible consequences for children

Malnutrition, prolonged absence from school and child labour have negative impacts on children's overall development. Evidence indicates that adults who were stunted as children earn less income than those who received proper nutrition.⁷ Overall, economic development is compromised by reduced human capital accumulation.

SAVING DEVELOPMENT

The global downturn will almost certainly slow down progress on future development outcomes, and potentially reverse previous hard-fought gains.

While rich countries bail out their financial sectors, concerns grow as to how much world leaders can commit to development during these tough times. Historically, aid drops during recessions.⁸

At the moment, very few developed countries are giving aid equivalent to the agreed target of 0.7% of GDP, and pledges made at the 2005 Gleneagles Summit are off-track. Many fear that aid budgets will receive less priority

as donor countries try to cushion the blow of the recession on their populations.

Yet these are crucial times for development. Poor countries will have to grapple with increasing poverty and hunger on top of existing human and social problems. Violent conflict, natural calamities and the spread of HIV will not stop because the world is in a recession. In fact, a deteriorating global economy will only exacerbate these events.

Conflict, HIV and natural disasters will not stop because of a recession

Despite the potential human costs of the crisis, high-level discussions such as the G20 meetings centre mostly on reforming the international financial architecture. There are fears that the plight of developing countries will disappear from the agenda at a time when support for development is needed so critically. While it is important for G20 leaders to restore order and confidence in the international financial architecture, the agenda should go beyond regulation and include broader development issues.

EXTRAORDINARY MEASURES

UK Prime Minister Gordon Brown has said more than once that these are extraordinary times which require extraordinary measures. Yet averting a development crisis does not require the extraordinary sums of money recently used to bail out the financial sector; it requires donor countries to keep their commitments to development goals, especially the Millennium Development Goals (MDGs), and to provide emergency funds to protect middle- and low-income countries from the brunt of the crisis.⁹

The Food and Agriculture Organization states that developing countries need about US\$30 billion annually to boost farm production¹⁰ – much less than the amounts given as a lifeline to various banks and financial institutions in 2008.

World leaders pledged US\$22 billion during the food summit

in Rome last year, yet much of this funding has not come through. It is unacceptable to withhold aid for the hungry, yet pour billions into propping up banks and financial firms. The consequences of poverty and under-development cross borders, so it is in the interest of developed countries to commit to these goals.

In working to restore order in the international financial sector, G20 countries should take things one step further: they should reform it into a more responsible sector that considers the needs of both developed and developing economies. Stricter supervision of the banking and financial sectors to improve transparency and accountability and to allow regulators to detect early signs of stress is just half the solution. It is more important to restrict incentives that fuel excessive but under-capitalised risk-taking which puts people's savings and homes at risk.

On a broader scale, cross-border financial practices that hurt developing countries must be reformed. The discussion on reform is neglecting the issues of tax havens and evasion which put legitimate tax revenues out of reach of developing-country governments. Tax revenues, an important source of development finance for both rich and poor economies, become even more important in times of downturn. Policy-makers must take the opportunity presented by the crisis to curb tax havens.

FREE AND FAIR TRADE

World leaders have been calling for the resolution of the Doha trade round as remedy to the global downturn. Trade has the potential to help developing countries to achieve economic growth, provided that the world economy recognises the need for a truly free and fair trading system.

While free access to rich markets is essential, it is important that developing countries are allowed to engage more effectively with the world trading system so that trade can harness inclusive development. Resolving the Doha round is only the first step. Building infrastructure, creating capacity to meet international standards and simplifying origin criteria to improve trade facilitation

are the more crucial steps to a free and fair trading system.

The trade system should consider the negative environmental effects of economic expansion and there should be multilateral efforts to mitigate them. Preservation of the environment is a global public good; the world economy should come up with ways to pay for sustainable energy and clean production.

The global economic crisis is indeed a threat to development, but it also presents an opportunity for world leaders to push the development agenda forward. Past crises always led to radical reforms, and the present one should be no different. Solving the global crisis must not end with restoring order in the financial system, but must lay the foundation for a more inclusive world economy that prioritises development outcomes. This sounds a tall order, but in these extraordinary times anything is possible. ■

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RE-THINKING FOOD SECURITY

The world has been shocked by two recent global crises and must reconsider the avenues to food security, argues David Lansley.



Every morning at the carrot market near Kurima town in the highlands of Papua province, Indonesia, buyers from Wamena city come to buy from the farmers. Around 2,000 farmers are reaping the long-term benefits of carrot farming.
Photo: Andrew Goodwin/World Vision

The year 2008 will be remembered for many things. One is how the acronym GFC morphed from being shorthand for a global food crisis to being common parlance for the global financial crisis. Re-using the same three letters is more than a commendable example of recycling; for the poorest people in the world the two crises have painfully similar effects.

Taken together, the food and subsequent financial/economic crises have jeopardised global food security to an unprecedented extent. The World Bank estimates that 130 million people or more were forced into poverty in 2008. In 2009, the combined impact of the GFCs could push an additional 46 million people into dire poverty with less than US\$1.25 a day, and a further 53 million to the edge of the abyss with less than US\$2 a day.¹ The occurrence of these two global crises came as a major shock; their combined effect is forcing a re-think of the very idea of food security.

Until recently, it was widely believed that achieving food security² was largely about improving distribution. World agricultural prices had been trending down for decades³ and it seemed clear that global food production was adequate to meet all needs. Food crises did occur, but they were the product of climatic, security or other events restricted to particular countries or regions.

Consequently, apart from the need for humanitarian assistance in response to short-term crises, the main food security challenges facing aid and development agencies centred on reducing structural supply constraints: improving infrastructure and market access, reducing post-harvest and other losses, and where necessary, increasing production. These were major undertakings that required significant resources. But the scale and scope of the problem of food security seemed manageable, both conceptually and in terms of programme design.

However, the food crisis and the financial markets meltdown have fundamentally challenged this view. The food crisis started the process. It was not just the scale and pace of rises in the prices of staple foodstuffs over the past two years – indeed, real

price rises in the first half of the 1970s were greater. The real shock was the **number** of short- and long-term forces that combined to rapidly reduce the availability and/or accessibility of food to hundreds of millions of people.

The threat to food security had become global rather than regional, demand- as well as supply-driven, chronic as well as acute. Indeed, the magnitude of the shock was such that the possibility of food insecurity has been contemplated in wealthy, developed countries free from widespread hunger for more than a century.⁴

Following on the heels of the food crisis, the financial and then economic crisis has exacerbated food insecurity by dampening domestic demand, depressing world trade, lowering incomes, increasing unemployment and reducing government revenues. In developing countries, this has occurred via three main channels:⁵

1. Export volumes and prices have fallen sharply, slowing what has been an important source of growth for many developing countries in recent years. Commodity-exporting low-income countries are particularly exposed to this development.
2. Private financial flows to developing countries are shrinking. Foreign direct investment is falling rapidly, and remittances from workers overseas stagnated in the second half of 2008 and are expected to contract in 2009.
3. Aid, while not declining yet, faces severe competition for funds from stimulus packages in the donor countries. The rapidly spreading global recession is quickly eroding whatever modest improvement in food security came from the lower food and energy prices in the second half of 2008.

The overlapping and reinforcing food and financial crises call for a re-think of at least three aspects of food security.

LONG-TERM INSECURITY

First, it is clear that food security will become increasingly hard to achieve over time. Some of the acute pressure on food and energy prices has eased as the global economic downturn begins to bite, but this relief is not permanent.⁶ Consider the main causes of the food crisis: demand pressures are likely to

re-surface when the world economy starts to recover; population and urbanisation will continue to increase; over time, oil prices will inevitably rise well above their current levels due to the interaction of rising demand, falling reserves and the market power of oil producers; the longer-term impact of bio-fuels is unclear, but US corn farmers are likely to lobby strongly for corn to maintain its place as an ethanol feedstock.

Food in the least developed countries must be seen as qualitatively different to other goods and services

Least amenable to quantification, but possibly the most significant of all, long-term climate change will increase the frequency of extreme weather events and intensify pressure on land and water resources. In short, food security still faces an unprecedented combination of powerful, complex and long-term pressures.

TRADE

Second, the role of trade in achieving food security needs to be re-assessed. Conventional economic analysis stresses that countries should specialise in the goods and services they produce most efficiently. If that results in a country exporting industrial crops or manufactured goods and importing most of its food, then so be it – the country will be better off following this strategy. The basic idea of free trade and specialisation remains powerful. But an abiding lesson from the food and financial crises must be that food in the least developed countries needs to be seen as qualitatively different to other goods and services.⁷

For poor countries that are significant net food importers, food security is fragile at best and can be dramatically disrupted by sudden adverse shifts in their terms of trade (the prices of their exports compared to the prices of their imports). A significant fall in export prices reduces the amount of imports that can be purchased.

If those imports make up a large part of a country's supply of staple food, the result can be civil disruption, hunger and child malnutrition, with its permanent impacts on physical and mental development.

Re-thinking the role of trade in food security is already occurring, but needs to gain momentum in the face of the global financial crisis. The FAO considered the connection between trade liberalisation and food security in its 2003 report *Trade reforms and food security: Conceptualizing the linkages*. The WTO has grappled with the issue in the Doha Round of trade negotiations through the commitment that "special and differential treatment for developing countries shall be an integral part of all elements of the [agricultural] negotiations". The vulnerability of developing countries, particularly the poorest net food importers, has been explicitly acknowledged in the negotiations on Special Products and Special Safeguard Mechanisms and in the continuation of the longer adjustment periods for developing countries carried over from the Uruguay Round.⁸

INCREASED PRODUCTION

Third, and most importantly, the global food crisis is forcing a re-assessment of the role of agriculture. In a world where food security is becoming more elusive, and where the greatest risk to food security is in the poorest countries heavily reliant on imported staples, there must be substantial and sustainable increases in food production within these countries. Increased agricultural productivity directly improves the food security of farmers and, through linkages with the rest of the economy (higher savings, investment and indirect consumption), of the wider community.⁹ And there is evidence that large percentage gains, albeit from low levels, can be achieved relatively easily in developing country agricultural productivity.¹⁰

For the poorest, most food-insecure countries, narrow specialisation and high levels of exposure to volatile commodity markets for basic food supplies are more likely to be part of the problem than part of the solution.¹¹ Accelerating developing country agricultural productivity must move to centre stage. The challenge for

development agencies is to ensure their programming reflects this new reality.

The double shock of a global food crisis followed by the greatest economic downturn since the depression of the 1930s must be seen as a watershed event. It has signalled that the world has entered a new phase in which food security will be more difficult to achieve. Many of the old problems remain, such as short-term supply disruptions and conflict. But these have been joined by new, tenacious and chronic pressures that will still be present when the developed and developing worlds finally emerge from the global recession. ■

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⁷ Concessions to the poorest countries, however, must not become the basis for renewed protection of agriculture in wealthy countries. Over-production, particularly in Europe, kept world food prices low for many years, encouraging developing country dependence on food imports and discouraging investment in agriculture.

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BAILING OUT THE WORLD'S POOREST

In a crisis, we need safety nets that offer hope for the future rather than purely a short-term financial fix, argues Martin Ravallion.

About 1.4 billion people, or one person in four in the developing world, live below the average poverty line of the world's poorest countries. Yet their total "poverty gap" – the annual sum of money that would bring everyone up to that poverty line – is barely one quarter of the \$800 billion fiscal stimulus plan just passed by the United States government.

The initial impacts of the global financial crisis on the world's poorest will tend to be in the urban economy, but will spill over in varying degrees to poorer rural areas, notably through reduced remittances and return migration. There are signs that this is happening already; an estimated 10 million (or 10%) of the rural-registered workers in urban China have already returned to their home villages.¹ Significant impacts on welfare can be expected, notably in countries, and regions within countries, that have benefited from market-oriented development (including through migration).

Naturally, many governments and citizens are asking what can be done to help protect the poorest. Unfortunately, the problem is a lot harder than simply filling all those "poverty gaps". The policy instruments are less than ideal and political economy constraints loom large. But there are some lessons from past experience that can help guide social policy responses to the current crisis.

EFFECTIVE SAFETY NETS

If an adequate safety net exists then of course it should be supported for protecting the poor. However, the starting point for many developing countries will be a weak safety net, with limited potential in an economy-wide crisis. There will be limited information concerning the likely profile of welfare impacts, though an effort still should be made to anticipate the types of households and places that will be most vulnerable, using the best available data and analytical tools.

Crises have given birth to some of the best social protection policies, but also some of the worst. Governments have sometimes been drawn into introducing generalised food and fuel subsidies that have come at a huge fiscal and economic cost, and are not easily reversed, yet have

had – at best – a modest impact on poverty. On the other hand, some developing countries have been able to turn a crisis into an opportunity for dismantling inefficient subsidies in favour of more effective safety net programmes. Crises have often presented opportunities for setting up better information systems for monitoring progress and for future preparedness.

CONDITIONAL CASH TRANSFERS

There is a risk that the political focus on responding to a severe crisis will come with a neglect of longer-term implications. A recently popular class of transfer programmes requires the children of recipient families to demonstrate adequate school attendance (and health care in some versions). Early influential examples were the Food for Education programme in Bangladesh, Mexico's PROGRESA programme (now called Oportunidades) and Bolsa Escola in Brazil. Impact evaluations have verified that such Conditional Cash Transfer (CCT) programmes bring both short-term relief through the extra cash and significant longer-term benefits to poor households through higher investments in child schooling and health care. Such programmes seek a balance between reducing current poverty and reducing future poverty.

Crises have given birth to some of the worst and best social policies

Concerns about distribution **within** households underlie the motivation for CCT programmes that ensure that children accrue relatively more of the gains. Targeting women in poor families in a fiscal stimulus plan tends to benefit children more – with improved nutrition, health and schooling.

In practice, a common drawback of CCTs and other targeted cash transfer schemes is that they are often unresponsive to changes in the need for assistance. A previously ineligible household that is hit by, say, unemployment of the main breadwinner may not find it easy to get help from such schemes. Temporary top-ups to the transfer payments to existing beneficiaries can help in a

crisis, but a temporary expansion in coverage will probably also be needed and this can be harder to achieve.

WORKFARE IN OR OUT OF CRISIS

One way to ensure that the safety net provides effective insurance – a genuine “safety net” – is to build in design features that encourage only those in need of help to seek out the programme, **and** that encourage them to drop out when they no longer need help due to better options in the rest of the economy. The classic example of such self-targeting is a “workfare” programme (variously called “relief work” or “public works”; “food for work” programmes also fall under this heading).

Workfare programmes have been widely used in crises and by countries at all stages of development. They were a key element of the Famine Codes introduced in British India around 1880 and have continued to play an important role there to this day; they have helped in responding to, and preventing, famines in sub-Saharan Africa; and were introduced at large scale during the East Asian financial crisis of the late 1990s, in both Indonesia and Korea. A well-designed and well-implemented workfare programme can be responsive to differences in need, both for many people at one time and for one person over an extended period.

A well-known example is the Employment Guarantee Scheme (EGS) in Maharashtra, India, which started in the early 1970s. This aims to ensure income support in rural areas by providing low-waged unskilled manual labour to anyone who wants it. The scheme is financed domestically, largely from taxes on the better-off segments of Maharashtra’s urban populations. In 2004, India introduced an ambitious national version of this scheme under the National Rural Employment Guarantee Act (NREGA). This promises to provide up to 100 days of unskilled manual labour per rural family per year, at the statutory minimum wage for agricultural labour, to anyone who wants it.

An ideal workfare scheme would guarantee low-wage work on community-initiated projects. The low wage rate ensures that the scheme is self-targeted, in that the “non-poor” will rarely want to participate, and it encourages participants to leave the programme when its help is no longer needed. The federal or state government could finance up to, say, 15 days a month of work on community projects at a wage rate no higher than the market rate for unskilled manual labour in a normal year. The work should be available to any adult at any time, crisis or not. This employment guarantee feature helps support the insurance function and also helps to empower poor people by relying very little on administrative discretion in determining access to the programme. As long as the guarantee is credible, it will help reduce the longer-term risks facing the poor, thereby fighting chronic poverty as well as transient poverty in a crisis.

It may not be feasible to fill all the poverty gaps exactly, but it is possible to protect a significant share of the poor in a crisis without damaging

longer-term prospects of escaping poverty. This will probably require a combination of relief work with transfers (in cash or food), targeted to specific groups who either cannot work (due to physical incapacity, including poor nutritional status) or should not be taken out of other activities – notably, school. ■

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For further information, see M Ravallion, Bailing out the world’s poorest, Policy Research Working Paper 4763, Washington DC: World Bank, 2008.

¹ This is an estimate based on surveys by National Bureau of Statistics of China, December 2008. A recent survey by the Ministry of Agriculture suggests that the figure may be closer to 20 million.

Supported by World Vision’s Food for Work Programme in Laos, villagers completed a gabion weir. By re-directing a nearby creek towards their rice fields, they enabled 64 households to grow rice twice a year, easing chronic food deficits that widely affected families.
Photo: Albert Yui/World Vision





RE-BUILDING THE WORLD'S FINANCIAL ARCHITECTURE

Economic reform must move us away from greed and personal gain and toward benefits for the whole of society, asserts Steve Keen.



Christine Ndugwa in her kiosk preparing chopped vegetables. As a small business owner participating in a Kenyan community bank, she is saving money and has yet to take a loan.

Photo: Cheryl Stock/World Vision

The world has an impressive array of economic institutions: the IMF,¹ the OECD,² the World Bank, central banks, and so on. Most were developed after the Great Depression with the goal of ensuring that such a cataclysmic event never happened again.

They have manifestly failed. We are now in what is widely acknowledged to be the greatest financial crisis since the Great Depression, and it may turn out to be the greatest financial crisis ever.

None of Wall Street's major merchant banks failed in the 1930s; all of them now have folded. Worst of all, the root cause of the Great Depression – an excessive level of private debt accumulated during a speculative boom – has been replicated at a far greater scale this time, and with more ludicrous assets as the focus of that now-failed speculation.

HOW DID WE GET HERE?

All this took place under the noses of the institutions that were supposed to prevent it. Clearly, the institutional approach to avoiding serious economic crises has failed. There are three main reasons why.

One is paradoxical: if such an institution actually succeeds in its aim, then it is left with nothing to do. When it comes to be run by those who did not experience the disasters that gave rise to it, those new managers can see it as obsolete and in need of reform – thus ending the policies that gave rise to the stability that was taken for granted.

A second is financial. The root cause of the Great Depression was the debt run up during the speculative bubble that preceded it – and that debt was taken on because, during the bubble, individuals were enticed by the possibility of enormous gains from leveraged speculation. Margin lending, for example, promised enormous gains from leverage: when shares could be bought with a 10% deposit, and shares purchased at \$10 could be sold for \$11, the speculator made a \$1 profit per share for a 100% return.

The third reason is intellectual. Though Keynes effectively took command of the economics profession during the Depression, the “neo-classical” economists he defeated re-grouped after it and spread once more the delusion that markets,

especially financial markets, are efficient and should not be regulated. The economic stability of the post-War period seemed to support the proposition of the innate stability of markets, yet that stability had more to do with the drastic fall in debt levels after the Great Depression and World War II than anything else. At the end of WWII, America's private debt to GDP ratio had fallen to an all-time low of 43%.

It has now hit 297%, which is 50% more than its Great Depression peak and almost twice the level of 1929. Economists ignored this rise because neo-classical theory asserts that debt has no impact on the real economy.

THE BURDEN ON SOCIETY

All three failures could easily recur if we once again go down the institutional route to economic reform. When the belief takes hold that capital gains can be made from speculation, there is a veritable stampede into debt that lenders are willing to fund, and that regulators are effectively impotent to stop. A bubble then forms in asset prices that sweeps resistance away while it grows and times remain good.

But while it is possible for individual speculators to get enormously rich by riding a bubble, the bubble grows only so long as debt levels rise even faster than prices. This increases the burden of debt on society as a whole, and when the price bubble bursts, prices collapse but society is still left with the debt. The process of de-leveraging – paying the debt down to sustainable levels – then causes a Depression.

SIMPLE, POWERFUL REFORMS

Since we cannot rely on either regulations or regulators to prevent a future crisis, we need instead to remove the temptation that leads to excessive debt. Two relatively simple reforms could achieve this: to set a maximum life for shares of 25 years; and to base lending for housing on the expected rental income of the house being bought.

The former reform would eliminate the possibility of outrageous share valuations, and hence outrageous profits from share speculation. If shares were issued for \$1, paid dividends and gave voting rights for 25 years, and were then re-purchased by the issuing company for \$1, share prices could

rise and fall over that 25 years, but could not reach ridiculous levels. The temptation to indulge in debt-leveraged speculation on share prices would be drastically diminished.

The latter reform would eliminate bubbles in house prices. At present, lenders can extend any amount they wish to a borrower, and purchasers compete with each other to buy properties with borrowed money. If instead the maximum loan that could be secured against a property was, say, 10 times the estimated annual rental income, then a buyer who wished to pay more than that to secure it would have to have more of his or her own money. A higher house price would then mean a **lower** level of leverage – the opposite of today's situation.

We need to remove the temptation that leads to excessive debt

These reforms are not glamorous – they may even appear pedestrian, compared to grandiose institutions. But grand institutions in economics have failed the test of time, over and over again. With these reforms, the only institutions needed to enforce them would be ones with a history of independence: the law courts.

Their impact on the world's poor would be mixed, but better by far than the false promise of a debt-driven road to riches. Some developing nations have done very well out of globalisation and export-oriented industrialisation. While some of those gains will be maintained – since they were translated into much higher levels of education, wages, and advanced manufacturing capital – the unwinding of the debt bubble will cause enormous pain as exports to the West collapse.

BEYOND THE DEBT BUBBLE

The debt bubble played a key role in financing the demand for the output of export-oriented industries. The West was able to maintain its demand for mass-produced consumer goods, even as its own industries declined, because

debt-financed spending maintained its ability to consume the output from Asia's factories.

Now that the bubble has burst, the first casualty has been American consumption of mass-produced goods – for example, South Korea's exports fell almost a third in the year to January 2009. Across Asia, workers who had risen above poverty on the back of export-oriented industrialisation may well find themselves back there via unemployment.

The export-oriented road to riches based solely on wage differentials with the West may therefore be over – especially if, in the aftermath of the crisis, America finds itself with massive unemployment. It will be unable to generate substantial employment again in finance and real estate, and it will definitely endeavour to re-build its industrial base. This will detract from the capacity of Third World economies to industrialise via exports alone.

Recent progress in alleviating poverty throughout the world may evaporate, with rising unemployment in both the Third World and in OECD countries eroding recent gains. If the last Depression is any guide, the poor will suffer badly during the one we appear to be entering.

The one light at the end of this tunnel is the knowledge that, after the last Depression, the greed and individual gain that dominated the Roaring Twenties gave way, for a time, to an ethos than promoted the interests of ordinary men and women over the wealth of the elite. It is time to re-build that ethos.

The grand institutions of the post-WWII world may play little or no role in that re-building – hardly surprising, since they were instrumental in deconstructing it over the last 40 years. The OECD would still exist as a talkfest between the governments of rich nations, but little more; the World Bank might return to its original role of providing some development funding, rather than giving and enforcing badly designed advice on economic policy.

The role of the IMF, however, could be increased if two of Keynes' pivotal reforms to international trade were finally implemented: generating

an international currency ("Special Drawing Rights") for trade, in place of using the US dollar; and requiring nations running a trade surplus to stimulate their demand for imports, as well as enforcing austerity on nations running a deficit as now. ■

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¹ International Monetary Fund

² Organisation for Economic Co-operation and Development

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- ▶ *Bailing out the world's poorest* (M Ravallion, World Bank, 2008)
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the Back Pages

...spiritually speaking

MORALS AND MONEY

"He made a whip out of cords, and drove all from the temple area... he scattered the coins of the money changers and overturned their tables." ¹

We are in the middle of the greatest economic catastrophe for generations. As with previous crises, it is the poor, those without buffers to weather the storm, who will fare worst – losing jobs and homes. In our inter-connected world, citizens of low-income countries suffer as demand falls for the goods they produce, protectionism rises, and finance flows that pay for basics such as water and medicines shrink. All this as the effects of climate change become ever more present.

As in the 1930s, this global crisis has been caused by deregulated financial markets lending excessive amounts of credit at high rates of interest.

From the 1970s, policy-makers were seduced by the argument that private bankers could be trusted to create and distribute credit almost without limit, and fuel economic growth and easy profits. So they lightened regulation on financiers, devolving to them the power to set the price of credit – interest rates.

The result was a tottering pile of unpayable debt that productive activity could not support. When rising real rates of interest made the cost and burden of the debt unpayable, the bubble burst.

A failure of ethics

"We have always known that heedless self-interest was bad morals; we know now that it is bad economics." — Franklin D Roosevelt

Since the 1970s, there has been a deliberate failure to recognise economics' true status as a sub-system both of the eco-system (which imposes natural, physical limits on available resources and on the capacity to cope with waste through environmental sinks), and of humanity's moral framework (commonly-held ideas of justice, fairness and harmony; a sense of right and wrong).

In driving the money-changers (money-lenders) from the temple, Christ asserted clearly that moral and spiritual considerations prevail over monetary ones.

The finance sector has, since the time of John Calvin (1509–64), successfully manipulated, evaded and discredited Christian moral and ethical standards – in particular the concept of usury – that placed limits on the capital gains made by money-lenders. The growing, secretive power of finance, not surprisingly, has required an increased deference to, and worship of the god of money.

With finance turned into the master of the global economy over the past 30 years, there have been historically unprecedented rates of usury. Western Christianity's failure to address the sin of usury contrasts with Islam's success in discrediting it.

And finance sector proponents did not stop at weakening religious ethics. They have successfully marginalised academics and intellectuals who questioned the dominance of finance.

Until very recently there was virtually no university department or journal of economics left that challenged "high finance". It was not even a subject of economic discourse.

Rebuilding ethical and economic architecture

My book, *The coming First World debt crisis*, published at the end of 2006 before the credit crunch unfolded, made the case that Western societies have to revive moral standards and set clear ethical benchmarks by which to regulate credit and debt, and rein in the finance sector.

The flimsy international financial system created in the early 1970s and consolidated thereafter has, on a grand scale, made the rich richer and the poor poorer.

While it can be argued that its responsible or ethical use has facilitated much worthy economic activity, it has been too easily and frequently abused, with wealth from the poorest countries being sucked up and transferred to the richest through various mechanisms including debt repayments, repatriation of profits and capital flight, rather than being spent domestically to reduce poverty.

We need a thoughtful re-design of the international financial system to ensure greater stability and fairness. John Maynard Keynes proposed an International Clearing Union (ICU) that would treat all nations more fairly, and help maintain balance in the international trading system.

The ICU would hold all international reserves and clear all international payments for trade in goods and services. Countries would be able to pay for imports in domestic currency rather than dollars, obviating the need to amass foreign currency. The ICU would also act as stabiliser by building up its own reserves and acting as lender of last resort.



Masters or servants?

Indebtedness is the concept of living beyond our means and beyond our environmental budgets, of mortgaging the future, of being in hock to creditors and usurers. Christian leaders should once again take up the cudgels against usury and emulate their leader, Christ, in chasing money-lenders from the temples.

Finance sector elites must be ousted from their role as masters of the global economy, and be returned to their proper role as servants to the productive economy. We do not have to live within the moral and ethical codes of a financial system designed by usurers. We can base a new system on values we hold dear: respect for the planet, and all life on it; our love for family and friends; our responsibility to future generations; our concern for neighbours and communities; our commitment to optimal scale, distributive justice and full employment.

The present crisis will bring increased hardship to billions globally – a crime of economic policy-making that refused to recognise the need for limits. But this financial crisis also gives us the chance to re-establish the ethical boundaries for all aspects our lives and the systems we create, for future generations. ■

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¹ John 2:15, *Holy Bible, New International Version*, Zondervan Bible Publishers, 1978

² See H E Daly, "Sustainable growth: An impossibility theorem", in H E Daly and K N Townsend (eds), *Valuing the earth: Economics, ecology and ethics*, pp 267–273

³ Islam prohibits the taking or giving of interest or *riba*. As Wilfred Hahn (2006) notes, *riba* "includes the whole notion of effortless profit or earnings that comes without work or value-addition production in commerce". In Islam money must only be used for facilitating trade and commerce.

While Islam recognises capital as a factor of production, it does not allow capital to make a claim on the productive surplus in the form of interest. Instead Islam views profit-sharing as permissible, and a viable alternative. The owner of capital can legitimately share in the gains (and losses) made by the entrepreneur. This mode of financing is called *mudaraba*. As Conrad Barwa (2005) writes: "investors in the Islamic order have no right to demand a fixed rate of return. No one is entitled to any addition to the principal sum if he does not share in the risks involved."

Another legitimate mode of financing recognized in Islam is based on equity participation (*musharaka*) in which partners use their capital jointly to generate a surplus. *Mudaraba* and *musharaka* constitute, at least in principle if not in practice, the twin pillars of Islamic banking.

⁴ A Pettifor, *The coming First World debt crisis*, Palgrave, 2006

World Vision is a Christian relief, development and advocacy organisation dedicated to working with children, families and their communities world-wide to reach their full potential by tackling the causes of poverty and injustice.

As followers of Jesus, World Vision is dedicated to working with the world's most vulnerable people. World Vision serves all people regardless of religion, race, ethnicity or gender.

Children are often most vulnerable to the effects of poverty. World Vision works with each partner community to ensure that children are able to enjoy improved nutrition, health and education. Where children live in especially difficult circumstances, surviving on the streets, suffering in exploitative labour, or exposed to the abuse and trauma of conflict, World Vision works to restore hope and to bring justice.

World Vision recognises that poverty is not inevitable. Our Mission Statement calls us to challenge those unjust structures that constrain the poor in a world of false priorities, gross inequalities and distorted values. World Vision desires that all people be able to reach their God-given potential, and thus works for a world that no longer tolerates poverty.

back cover image:

Children beg in a crowded city street in Georgia
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