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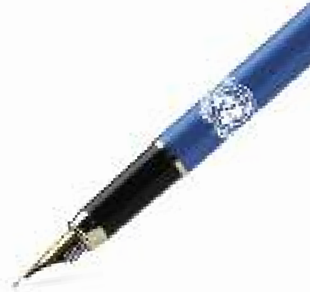

What does the credit crunch mean for development?

Alex Evans

It seems to be a cardinal rule that all global risks – whether climate change, HIV, food or energy price spikes, civil conflict or water scarcity – impact hardest on the world's poorest countries and most vulnerable people. As the credit crunch has moved from the financial sector to the real economy, it has become clear that the current global economic conflagration is no different.

At the top of the list of impacts is the collapse of global demand as the world's consumers batten down the hatches. The Organisation for Economic Co-operation & Development (OECD) projects that world trade will decline by as much as 13 per cent in 2009, the first fall in 25 years. Export-geared economies will feel the pinch harder than most: in China, for instance, coastal regions are already witnessing a major migration of workers back to rural areas as rising unemployment hits the country's manufacturing sector. In the background, the risk of a slide into tit-for-tat protectionism further clouds the medium-term outlook.

The fall in demand has caused keen headaches for countries dependent on exports of commodities and raw materials. Oil exporters have seen prices plummet from $147 a barrel to less than $45 within just six months, causing serious problems for governments with budgets predicated on much higher prices. Mineral exporters face similar problems: mass lay-offs of miners are already taking place in the Democratic Republic of the Congo and Botswana, for instance.

As emerging markets' prospects have dimmed in the eyes of investors, so has the availability of private sector money as a source of capital. With foreign direct investment and commercial lending collapsing as investors flee for safety, net private sector

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capital flows to developing countries are projected by the Institute of International Finance to fall from $929 billion in 2007 to $165 billion in 2009 – a staggering 82 per cent decline.

As private sector flows contract, the International Monetary Fund (IMF) – which appeared during the long boom to be heading for irrelevance – has found itself back at the centre of attention, with a lengthening list of countries in need of emergency bail-outs. April's G20 summit in London agreed a major new deal on IMF financing, which should help ensure it has the resources for the job – but development advocates are concerned that reform of the IMF to improve developing country representation may not be keeping up.

While the need for additional IMF finance is at the top of the global agenda, the same is unfortunately not true of other aid flows. Until recently, all the news had been positive: total official development assistance in 2008 reached $120 billion, the highest level ever, accounting for 0.3 per cent of OECD countries' gross national income. But with budgetary pressures rising in developed countries – and public support for development assistance falling – the outlook for aid spending now looks much less hopeful. The UN Millennium Campaign estimates that aid flows will fall by $4.5 billion in 2009 as a result of the credit crunch; UN Secretary-General Ban Ki-moon has called for a $1 trillion 'bail-out' to help developing countries cope.

The outlook is similarly dispiriting on remittances home from migrant workers, which have in recent years exploded as a de facto source of development finance. Before the credit crunch, remittances had come to be worth around $300 billion a year, according to the OECD fully three times as much as official development assistance. Now, though, remittances are projected to fall by $20 billion over the coming year: in Kenya, flows are already down by a third.

In all, then, the credit crunch and the global downturn present an almost uniformly negative set of changes for developing countries – changes which threaten to push 50 million more people into poverty, according to the UN. The *Economist Intelligence Unit*, meanwhile, has warned of the risk of conflict and civil unrest in many countries as a result of the downturn, noting that such risks are highly concentrated among the world's poorest countries.

Of course, the global downturn is not the only transboundary risk undermining prospects for development. While food prices have fallen since last summer's peak, the problem has not gone away: the Food & Agriculture Organization's (FAO) food price index is still only back at its May 2007 level, well above recent historical norms, and the FAO estimates that the global total of hungry people has risen from 850 million before the food price spike to over a billion today. Current low prices for oil, meanwhile, have led to a collapse in essential investment in new production – setting the stage for a new supply squeeze as the world emerges from the downturn. Worst of all, the credit crunch risks delaying action on climate change if policy-makers tackle the economy first and global warming second.

So how can policy-makers move towards a more positive approach? Two key areas for action stand out.

First, they urgently need to move towards a more integrated approach to managing global risks, one that starts from the recognition that economic and environmental recovery are two sides of the same coin. (To put it another way, as a senior IMF official recently said: 'The last thing we can afford now is another crisis creeping up on us.') Achieving greater integration will in turn depend on more effective multilateral decision-making structures. The growing role of the G20 is a step in the right direction – but only a step.

Second, international institutions must focus on building resilience in developing countries. Here, too, integration is the key challenge. Conflict prevention, peacekeeping, climate change adaptation, emergency relief and long-term development are all different facets of the same challenge – yet current institutional structures continue to treat them as though they were separate from one another. The problem of multilateral system coherence is hardly a new one; but rarely has it been more urgent.

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From financial crisis to human development catastrophe: a short step

For poor countries the global economic downturn could precipitate a crisis of human development in which the Millennium Development Goals (MDGs) become but a lost cause. Flows of aid and investment to developing countries are contracting; the prices of commodities, on which many developing countries' economies are heavily reliant, are plunging; and remittances – in recent years forming a prominent share of developing countries' GDPs – are drying up as the global economy sheds jobs in response to falling trade.

These trends will sink more people into extreme poverty. Reduced income and high food prices will combine to inflate the number of hungry and malnourished. For poor countries, these trends also mean likely cuts to MDG-related public spending – for example, on health and education. The effects will be devastating. Studies of past recessions show a particularly tight correlation with infant mortality, to take just one of the eight MDGs. The UN Development Programme says that during a recession:

- For every 3 per cent drop in a developing country's GDP, 47-120 more infant deaths can be expected per 1,000 live births.
- A poor child in a developing country is four times more likely to die than a child who is not poor but lives in the same country.
- Infant mortality among girls in some poor countries increases five-fold.

On the eve of the G20 summit, UN Secretary-General Ban Ki-moon issued this warning to world leaders:

In good times, economic and social development comes slowly. In bad times, things fall apart alarmingly fast. It is a short step from hunger to starvation, from disease to death, from peace and stability to conflict and wars that spill across borders and affect us all, near and far. Unless we can build a worldwide recovery we face a looming catastrophe in human development.