Presentation by Zia Qureishi

Discussion
Alice Sindzingre
Research Fellow, Centre National de la Recherche Scientifique (CNRS, Paris, University Paris-10, Economix);
Visiting Lecturer, School of Oriental and African Studies (SOAS, University of London), department of economics

The World Bank, Paris Office, 14 May 2009
Overview of the Report:
The Millennium Development goals (MDGs): Crisis Impact and Outlook

The Overview is fully right:
There is now, in 2009, a wide consensus: the impact of the financial crisis on developing countries is serious.
It is particularly devastating for countries that are on the “tipping point”, with their economic situation, their market and export structure being characterised by unstable equilibria.
These countries, typically low-income countries and ‘fragile states’, may fall back into deeper poverty.
They may be caught in “lower equilibria”, in poverty traps

This is an important progress for the World Bank –and the IMF- to recognise and focus on countries’ vulnerabilities (and therefore devise policy instruments such as, e.g. the WB Vulnerability Framework).
Same noticeable progress for the Bank, e.g. showing flexibility vis-à-vis countries affected by fiscal difficulties.
The poverty trap: the graph below shows the existence of two equilibria, a ‘low’ and a ‘high’ equilibrium.

**Figure 3. Welfare dynamics under the poverty traps hypothesis.**

Source: Christopher B. Barrett and Brent M. Swallow. 2006. Fractal Poverty Traps, World Development
1. The Global Financial Crisis and its Impact on Developing Countries

- **Report’s findings:** growth in developing countries expected to fall: 1.6% in 2009, vs. 8.1% in 2006-2007
- This means an increase in poverty, mainly in Sub-Saharan Africa (SSA), and a stop to recent progress in poverty reduction.
- From 55 to 90 millions additional people will be at risk of falling below the extreme poverty line
- One billion of people may experience chronic hunger in 2009

- **The Report** here underscores a particularly important point: the existence of irreversibilities, which may be created and reinforced by the current crisis.

- **For the Report:** “Experience suggests that growth collapses are costly for human development outcomes, which tend to deteriorate more quickly during growth decelerations than they improve during growth accelerations.” (overview)
Indeed, there may be debates on the duration of the crisis, on forecasts, etc.

**But there is a consensus** that even if the crisis does not last, it may be devastating in certain sectors: e.g., **education, health, and hence for long-term growth**

In situations of lower levels of provision of health or education, a whole generation may be affected: the country is threatened by a higher probability of falling in a poverty trap, of stabilising in a lower equilibrium.

This was shown by previous crises, such as the 1997 Asian crisis: e.g., in Indonesia, a reaction of households to the crisis was to reduce schooling expenditures (school attendance).

**Hence a risk of irreversible processes and microeconomic poverty traps.**

However, the existence of poverty traps is debated:

For some economists, countries are affected by sequences of periods of **decelerations and accelerations** (e.g., Ricardo Hausmann, Dani Rodrik, John Page, Jorge Saba Arbache)

**But in all cases, shocks have negative effects:** see B Jones and B Olken: ratchet effects when growth has a start-stop shape. See Paul Cashin on the asymmetries of booms and slumps.
However: some elements are missing in the Report

The crisis reveals the weaknesses of the model of growth of economies that are based **on the extraction and export of commodities**

I.e. typically low-income countries, and Sub-Saharan African (SSA) countries

Growth in SSA over 2005-2008 was based mostly on increases in the **price of commodities, and especially oil**, as shown by the IMF (World Economic Outlooks, SSA Regional Outlooks).

As shown by the *World Bank Global Economic Prospects* report of 2009 on commodities: **the demand for commodities is likely to slow**.
Figure 0.4 Technological progress has reduced the quantity of commodities used per unit of GDP

Therefore, it is crucial to address the **root causes of the greater impact** of crisis on the poorest countries and these countries’ vulnerability

- **I.e. the market structure that is common to these countries:**
- Weak industrial bases, with **little diversification**
- Dependence of revenues and fiscal balances on earnings - commodity prices - that are **intrinsically volatile**.

**The dependence of exports on commodity entails many detrimental consequences:**

- Commodity prices follow **cycles**
- See Jean-Marc Boussard: the modernisation of commodity sectors increases their **potential instability**
- Stabilising prices without controlling supply leads to overproduction

Beyond the irreversibilities created by the specific event of this crisis, there is a ‘structural’ problem stemming from the **inherent volatility of commodity prices, and the recent financialisation of commodity markets** (see Alfred Maizels, UNCTAD studies, Machiko Nissanke).
■ The commodity problem: not only price volatility, but long-term decline: the demand for commodities is often not elastic (to growth, or incomes).

■ This is mentioned in the Report, box 1.3, p. 36: but it is presented as manageable, not as a problem of market structure

■ The model of growth of commodity producing countries (middle- and low-income) => these countries are more exposed to risk

■ They are vulnerable to external shocks via many transmission channels (e.g., characteristics of commodity markets that shape commodity prices, linkages with financial markets, dependence of the fluctuations of global demand, etc)

■ These above issues seem overlooked in the Report, which rather focuses on a policy such as trade openness.

■ See in the Report: “The Importance of an Open International Trade and Exchange System”, p. 38; see “Pressing Ahead with Trade Openness” (chap 5). Openness is a relevant policy advice, as protectionism can be harmful.
The Report thus **rightly argues that market access** is crucial for reducing poverty in developing countries

However, it is a difficult recommendation in time of recession in developed countries, and in a context of firms that shift segments of their production in lower-wages countries

**It is not easily feasible in a context of unemployment:** e.g., US or UE countries agricultural sectors may fear further unemployment ….

In addition, **trade openness may not be a priority** for those developing countries characterised by vulnerable market structure, in particular **commodity-based ones**.

Especially **oil countries**: see IMF Outlooks: e.g., in SSA: half of exports are oil. Trade barriers are often low for the commodities used as inputs by industrialised countries, hence more trade openness is a not here a crucial policy.

Also, **trade openness** may not be a priority even in the perspective of the Report, i.e. **to cushion the social impact of the crisis**, fostering health, education, poverty reduction, securing temporary relief in order to avoid irreversible decisions to be taken.
Therefore, the Report should distinguish between:

* the **structural problems** of these countries (historical constraints, path dependence, initial conditions, endowments, export structures, etc);

* the **shock** of the 2009 global recession, one of the most serious in the last century, which reveals structural problems, create irreversible decisions and hence may lock individuals and households in chronic poverty.

In addition, the relationships trade openness-growth are not linear, which is recognised by the World Bank and the IMF (e.g., the World Development Report 2000 on poverty).

This is the same for the relationships **trade openness-poverty reduction** and **growth-poverty reduction**.

See François Bourguignon, IMF research, Dani Rodrik, Jeffrey Williamson in historical perspective, Francisco Rodriguez, etc...

Indeed, **history matters**: which **lessons from this crisis**? In the case of a rapid recovery (see *the Economist*, 2-8th May 2009: a V-shaped recovery soon....)
These vulnerabilities affect not only low-income countries, but emerging countries as well:

Emerging countries appear to be more resilient: e.g., Latin America, recent IMF survey: growth prospects in appearance better than expected.

However, the crisis questions the model of export-led growth, which fueled prosperity of emerging countries since the 1960s. Emerging countries’ - not only low-income countries- model of growth makes them vulnerable to external shocks.

See the policy shifts in China, which has a room of manoeuvre thanks to its market size: i.e. moving progressively towards a model of growth based on domestic markets and consumption.

Trade openness and financial openness facilitated the transmission of shocks. Countries are exposed to external constraints on which they have little control.

2. The Report recommends a particular attention to social protection programmes and services, targeting the poorest and vulnerable groups against the crisis’ immediate effects

- **The Report:** “The greatest concern pertains to the human development goals. Based on current trends, most human development goals are unlikely to be met at the global level” (overview)

- The Report supports a model of social protection based on appropriate safety nets for the vulnerable and the poorest: e.g. Conditional Cash Transfers (CTT)

- No doubts that many of these programmes have been very effective: see Martin Ravallion: positive impacts of the *Bolsa Escola* and *Bolsa Familia* programmes in Brazil, etc.

- **However:**
  - See Dani Rodrik: in a context of globalisation, ‘big government’ may be efficient: it is able to cope with social conflicts, with demands for social protection
  - => The state has a role to play
At low stages of development, social protection is often provided by private sources – families, firms-, as in Asian countries.

But when they grow, countries appear to aspire to welfare states systems. See China: e.g., *Le Monde*, 12 May 2009: health insurance for everyone before 2020 in China: the Chinese government invests 93 billion euros in its public health system. The previous retrenchment of the state had induced a significant decrease in the quality of health care and an increase in costs for patients.

The goal should be some basic universal coverage: non-universal, targeted, social protection includes many limitations: possible increase in inequalities, difficulties in targeting the appropriate groups, in drawing lines and boundaries between households.

This is, e.g., argued by the Institute of Development Studies (IDS) recent series *InFocus*, 2009: the crisis is an opportunity to rethink social protection in low-income countries.

France may be an example: despite many problems, its social protection system has reduced inequalities, more than, e.g., in the US: see Anthony Atkinson, Alberto Alesina, and many other economists. Publicly provided universal social protection is a desirable policy objective, even if an ideal one…
The Report, in its Chap 3: Leveraging the Private Sector Role in Human Development, focuses on mobilising the private sector in order to reach the MDGs in a context of crisis. This is a relevant objective, as states cannot do everything.

Indeed, since the 2000s, a large literature underscores the failures of Official Development Assistance (e.g. William Easterly, the Center for Global Development, etc.): strong arguments against aid and in favour of private finance (growing role of private donors, e.g. the M and B Gates Foundation).

The report is right that it should be tailored on a case by case basis.

However: countries differ regarding their history and the nature of their private sector: see Europe and the US, and within Europe. Traditions differ across countries regarding the respective roles of states and markets and definitions of public vs. private goods;

The Report advocates a greater role for the private sector in health and in education

However: such a role is confronted with problems of incentives and objectives: the private sector must have interests in this, as it is driven by profits and shareholders (in its broadest sense, including charities, etc)
This implies to think about what in the sectors of **health and education**, in developing countries, would be viewed as **public goods**: This is a difficult issue in developed countries: reducing the domain of public provision in health and education may increase **inequality**, as shown by the contrast **between the US and European welfare states**. These difficulties also apply to low-income countries.

**The Report: Redoubling Efforts toward Human Development Goals.**

“Governments are key actors in the financing and delivery of human development services, but the private sector (for-profit and non-profit) is playing an increasingly significant role. For example, one-half of health spending in many developing countries comes from private sources. Recent surveys in Sub-Saharan Africa and South Asia find that more than half of the MDG-related maternal, reproductive, and child health services used are privately provided.”

The Report here observes the role of the private sector but does not provide **arguments as to whether this role of the private sector is good or bad, a desirable state of affairs or not.**

**Involving the private sectors often implies problems of access, equity.** E.g., in the poorest countries, there is the well-known problem of users fees, which can exclude the poorest.
In addition, there are state failures, but state failures often imply private sector failures.

The capacities of local private sectors are limited in the poorest countries (they are developed in emerging countries, e.g., Brazil, South Africa).

In poor countries, private sectors are often represented by foreign investors, and foreign direct investment (FDIs) are often in the commodity sector, which often function as enclaves and with little “altruism”, or investment in infrastructure, e.g. via PPPs (often more supported by World Bank or other multilateral and regional banks projects than “pure” market forces).

However, PPP projects also entail problems, which is acknowledged by the World Bank (see the lessons drawn from privatisations in the 1980-90s by the World Bank).

Also, the banking system in low-income countries has been affected by the current financial crisis. The crisis (credit, trust) has reached SSA, even if SSA is “less globalised”, less exposed to “toxic assets”.

Finally, governments in low-income countries are often authoritarian and sometimes predatory: the predatory character of a government and low growth (or poverty) may even be endogenous (see Daron Acemoglu and James Robinson’s many studies). Such governments cannot provide the right incentives to domestic and international private sectors.
3. Which resources? The Report wants to accelerate the achievements of the objectives of human development

- Especially in the domain of health, where the MDGs cannot be reached.
- Indeed, it is important to focus on health and education

- But there are problems with the MDGs themselves:
- See the study by François Bourguignon et al. 2008. Millennium Development Goals at Midpoint: Where do we stand and where do we need to go?, Paris, CEPII: the MDGs are heterogeneous, they are weakly correlated: e.g., very little correlation between poverty reduction and changes in under-5 mortality, or between different non-income MDGs, e.g., between primary education and under-5 mortality.
- Bourguignon et al.: the correlation between GDP per capita growth and non-income MDGs is almost zero: the linkage found between those indicators and poverty reduction is limited.
- This limited correlation reflects some relative independence of the policy instruments governing progress towards MDGs from growth.
In addition, the problem of resources remains somewhat unclear. In many policy recommendations of the Report, financing is external financing:

Example (overview): Ensuring an Adequate Fiscal Response: “Additional financing, on appropriate terms, would help them support growth and protect the poor and vulnerable from the impact of the crisis. Enabling an adequate fiscal response in developing countries would be a win-win for all.”

“Supporting the Private Sector” (overview) includes a significant reliance on external finance, e.g. typically in the sector of infrastructure, e.g. via PPPs. “Fiscal stimulus will catalyze sustainable economic growth only if there is a vigorous private sector response. The private sector, in turn, will rebound only if supported by an appropriate enabling environment. Access to finance and infrastructure and the quality of business regulation are three key determinants of the private sector enabling environment”

This means access to private finance, but given the poor situation of savings, stock exchanges and the banking sector in low-income countries, it implies external financing driven by ODA, e.g. WB projects, particularly as the Report insists –rightly- on infrastructure: i.e. this means more aid, more concessional financing.
Recommending more aid to poor countries in times of crisis is important.

But it should not forget the problem of aid dependency, which is one of the key causes of the vulnerability of these countries.

As is well known, aid dependency may be a cause of slow growth. Also, there may be no relationship between aid and growth (see the IMF, Raghuram Rajan, Arvind Subramanian)

Hence the objectives of the Chapter 4, “Scaling Up Aid to Poor Countries” may be questionable.

The Chapter 4 shows well the limits of the HIPC and MDRI initiatives, and the problems of the DSA and DSF.

However: as early as 2005, IMF made many warnings regarding the scaling-up of aid and aid windfalls (e.g. for Tanzania, Ghana, Uganda, Ethiopia, etc).

Aid dependency is a key problem because of aid volatility, even more than revenues (see Ales Bulir and Javier Hammann).

Also, problems of absorption and spending of aid (see Sanjeev Gupta, IMF).
Where will this aid go: to the private sector? To budget support?

Moreover, in order to meet the MDGs, **aid must be very substantial.** Also, **aid must be supported by local structural changes in terms of savings and investment:** as argued by Carl-Johan Dalgaard (U. of Copenhagen) and Lennart Erickson (IMF). 2009. *Reasonable Expectations and the First Millennium Development Goal: How Much Can Aid Achieve?, World Development.*

The Report at the same time recommends a greater role for the private sector, which *per se* entails difficulties if the private sector is the only player,

But sometimes the Report seems to consider a private sector, especially in the key sector of infrastructure, which is supported by aid

And simultaneously the Report advocates more aid (*see Mobilizing Private Aid for Development*), even if a greater role for private actors in aid is recommended (p. 126, box 4.2)

Some recommended mechanisms are not new, e.g. IFC as seed money for FDI (*see p. 128, box 4.3, public funds leveraging private investment*).
4. Improving the Private Investment Climate for Recovery and Growth

This is a relevant recommendation. However, these indicators of the ‘business climate’ include many limitations.

Many criticisms in France (related to the criticisms of the conclusions of Andrei Shleifer et al. on the superiority of common law, vs. civil law) (see the website of the IDEF, on legal issues in developing countries).

The relationships between these indicators and growth are not firmly established. They are often based on cross country regressions that are often not robust.

Their weakness recognised in Box 2.1, p. 54 (the IEG evaluation of the “Doing Business” reports)

A key point of this chapter: infrastructure is a major problem

But it is also linked to institutional and political infrastructure

I.e. the problem is not only infrastructure per se, but governance, the objectives of rulers, as well as the management of infrastructures, their use by rulers, elites and politicians (this is recognised p. 78 on private participation in infrastructure/PPI).
5. The conclusion chapter of the Report: International Financial Institutions: Crisis Response and Support for the Private Sector

- Strengthening multilateralism and multilateral governance is an excellent objective, as well as channelling more funds in MDBs.
- The proposal of new instruments, different and more flexible conditionalities, is also most welcome: e.g., at the London summit in April 2009, the G-20 leaders’ commitments to the **WB Vulnerability Framework** through voluntary bilateral contributions.
- **However: this minimize the issue of political economy** (and IFI apolitical mandates): many countries are poor and cannot reach the MDGs because of their political regime, e.g. predatory regimes.

- See the Report’s Strategic Overview: Crisis Response and Medium-Term Strategies to Support the Private Sector: “As markets mature and demonstration effects take hold, the rationale for public intervention diminishes”. Hence a focus is on finance and knowledge.
- “The crisis has underlined the benefits of financing development in ways that do not create debt. Self-reliance echoes calls from many developing-country policy makers but is undermined by tax evasion and illicit capital flows” (from Yash Tandon, Ending aid dependence)

23
There may be some **tension between recommendations**: this chapter underscores that private investment is better than aid dependence, while another chapter recommends the scaling up of aid, and other sections advocate private aid.

**Finally:**
- The themes of the Report are unexpected
- Indeed, due to the crisis, states and so-called Keynesian policies are coming back at the forefront, the detrimental effects of markets left alone are widely acknowledged, and citizens expect rescue from their governments, which implement ‘big push’ policies, huge bailouts and more regulation.
- E.g., like in the US, where the recovery plan includes vast public projects – infrastructure, public works- and industrial policies (*International Herald Tribune, 8 Dec. 2008*).