PROTECTING PROGRESS:

THE CHALLENGE FACING LOW-INCOME COUNTRIES

IN THE GLOBAL RECESSION

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Background paper prepared by World Bank Group staff for the G-20 Leaders' Meeting, Pittsburgh, USA, September 24-25, 2009.

Contents

Protecting Progress:

The Challenge Facing Low-Income Countries in the Global Recession

Key Messages

- While the global economy is showing tentative signs of recovery, low-income countries (LICs) continue to suffer the consequences of the global recession which has left them with both external and fiscal financing gaps.
- Few LICs have the fiscal space to undertake counter-cyclical policy. With large portions of their populations clustered around the poverty line, even brief periods of economic slowdown can result in long-lasting impacts on poverty and longer-term economic growth. By end-2010, 89 million more people are expected to be living in extreme poverty, less than $1.25 per day, than would have been the case without the crisis.
- At the same time, many LICs have made significant progress over the last decade to improve macroeconomic policy, public-sector governance and the environment for private-sector investment. They are now better positioned to make effective use of incremental financial resources, when available.
- The World Bank estimates that financing shortfalls to cover at-risk core spending on health, education, safety nets, and infrastructure amount to about $11.6 billion for the poorest countries. Unless these shortfalls are covered, achievements to date in reducing poverty and establishing the foundations for longer-term development will be eroded. Even more will be needed if additional progress is to be made in reaching the MDGs.
- The World Bank Group, along with development partners, is working to help address the immediate needs of LICs through a broad range of instruments designed, among other things, to improve the efficiency and coverage of social safety nets, support trade flows, and sustain financing, particularly for critical infrastructure and SMEs.
- The current crisis highlights the pressing need for a Crisis Response Facility ready to promote quick and effective assistance to LICs following severe shocks. Such a facility would fill a critical gap in the global aid architecture which can jeopardize the gains made in many LICs based on recent strong reform efforts.

I. Introduction

With the world economy still fragile and signs of global recovery tentative, low-income countries (LICs) face a long and muted recovery. The nascent global economic recovery and improving financial market conditions have yet to provide the impetus needed to lift the economies of low-income countries (LICs)[*] from their deep economic downturn and dire financing challenge. While in many developed and emerging market countries, recovery is

[*] Unless otherwise indicated, low-income countries (LICs) in this paper include countries with GNI per capita (Atlas-method) in 2008 of $975 or less (see http://go.worldbank.org/D7SN0B8YU0).

underpinned by expansionary fiscal policy financed with large reserves or market borrowing, these options are out of reach for most LICs, which remain heavily dependent on commodity trade, remittance inflows, FDI and ODA. While there is considerable diversity in needs, as a group, low-income countries are expected to face large external financing needs this year estimated at around $59 billion.

Failure to address the crisis-related challenges facing LICs jeopardizes years of progress in combating poverty and improving the foundations for economic growth, thereby undermining progress toward the MDGs. Many LICs, particularly in Africa, have made significant progress over the last decade to improve macroeconomic policy, public-sector governance and the environment for private-sector investment. As a result, they are now better positioned to make effective use of incremental financial resources. However, large portions of the population remain clustered around the poverty line. Even mild downturns can have costly and long-lasting effects on human welfare, as families with few alternative employment opportunities and little or no access to credit are forced to reduce food intake, even for very young children, or pull children out of school. Evidence from past crises shows that children who experience short-term nutritional deprivation can suffer long-term harm. Such possible adverse outcomes highlight the importance of protecting core spending, including on health and education, in the face of sharply declining revenues. For the poorest countries without adequate fiscal space to respond to the crisis, core spending may face a funding gap of $11.6 billion in 2009 due to revenue shortfalls and increased demand for social protection.

Since the onset of the food and fuel crises nearly two years ago and the subsequent financial crisis and global recession, donors and development agencies have endeavored to mobilize additional resources for LICs and deploy them more quickly and effectively. The World Bank Group has intensified its efforts to cushion the impact on LICs, through a broad range of lending and advisory activities. But despite efforts to date, more is needed—without additional resources directed toward critical needs, many LICs will emerge from the current crisis further away from their development goals, with the impressive gains achieved in recent years largely eroded.

II. Impact of the Global Recession on Low-Income Countries

The Global Picture

The years preceding the global crisis were banner ones for low-income countries (LICs). Per capita income, which fell during the 1980s and 1990s, grew by 3.2 percent annually from 2001 to 2007. Financing conditions were favorable, as net private capital flows grew from 1.2 to 7.4 percent of GDP between 2000 and 2007. With current account and fiscal balances more sound than in previous periods, conditions for LICs by 2007 were fairly sound.

LICs were first hit by an unprecedented surge in fuel and food prices from 2007 through mid-2008. For many commodity-importing countries, high prices led to deteriorating external balances, rising inflation, and weaker incomes and household spending as they used up much of the economic cushion that they had developed during the preceding years of strong growth. The impact was most severe for the poor, for whom expenditures on food and fuel often represent more than 50 percent of spending.

When the financial crisis hit in the autumn of 2008, its epicenter was in the financial sectors of advanced economies. This quickly spread throughout the highly globalized financial system, impacting emerging markets around the world, even those with sound macroeconomic fundamentals. As the crisis spread from the financial sector to the real economy, policymakers rushed to respond through a combination of monetary easing and fiscal stimulus. The G-20 played a key role in the coordinated global response at their summits in Washington and London, at which restoration of financial stability took center stage.

Initial speculation by some was that the limited integration of LICs into the global financial system might insulate them from the worst effects of the crisis. But as the crisis spread to the real economy, with falling global demand, commodity prices and employment, LICs—many already reeling in the wake of the food and fuel crises—faced a deterioration in economic conditions, and initial hopes that the impact would be mild quickly dissipated. Research suggests that without a concerted effort to stimulate growth, recovery in LICs will lag recovery in the rest of the world. With most LICs lacking the means to undertake countercyclical fiscal policy, the resources necessary to return them to pre-crisis growth and poverty reduction trajectories will need to come from abroad.

The economic shock that hit LICs was not uniform, differing substantially across countries and regions, reflecting different economic structures, initial conditions, and the relative significance of different channels of impact. These differences, together with a shortage of high frequency data, complicate efforts to assess the impact of the crisis on the poor. But available evidence—however partial—confirms that the impact is real and large, and points to a clear erosion of recent hard-fought gains toward achieving the MDGs in many of these countries. Looking ahead, there is a risk that, without extraordinary efforts both domestically and by the international community, the achievements of recent years will be lost, with potentially long-term consequences for the economic and social development of LICs, and global security and prosperity, more broadly.

The initial financial crisis triggered a real-side crisis with surprising speed. Firms and individuals reacted to tighter borrowing conditions, rising borrowing costs, and increased uncertainty by delaying spending on investment and consumer durables. Private capital outlays across the world plummeted, and global production and trade of capital goods and consumer durables slumped. GDP losses across high-income countries surged during late 2008 and early 2009, and emerging markets were hit as well—20 of 25 middle-income countries experienced GDP declines during the final quarter of 2008 and 24 of 26 during the first quarter of 2009.

Developments at mid-2009 suggest that the global recession may be coming to an end, although the recovery of employment is expected to lag that of output. GDP declines have slowed or ended in many advanced countries, and looking ahead, growth is expected to strengthen, underpinned by substantial fiscal and monetary stimulus—notably in the United States and China. High frequency data suggest that the slowdown in global production and trade may be over, and leading indicators point to a strengthening recovery in output over the next few quarters. The driving force for the increase is trade, which is emerging from its trough in early 2009. While these signs offer hope for a gradual revival of world economic activity, uncertainties regarding recovery remain, including the durability of the "green shoots" emerging in major economies, and the health of the banking system across the OECD. Moreover, despite tentative signs of GDP growth recovery, the private-sector—hit by waves of uncertainty and constrained access to credit—is expected to resume hiring in earnest only with a lag, suggesting that unemployment and underemployment could rise further in the near term.

Channels of Impact

The impact of the crisis on low-income countries varies significantly across countries, reflecting differences in initial conditions and the relative significance of channels of impact. Understanding these differences is key to mounting an effective policy response.

Commodity prices

LICs have been challenged by unprecedented volatility in food and fuel prices. World fuel and food prices surged between 2005 and mid-2008, followed by a sharp price retreat for many commodities during the second half of 2008 and partial recovery so far in 2009. Oil prices dropped sharply from $133/barrel in July 2008 to $41/barrel in December 2008. They recovered to above $70/barrel by August 2009 in response to OPEC production restraint and expected demand increases as the global recovery began to take hold. The decline in world food prices was less pronounced, with increases over the past few years only partially reversed (see Box 6). Despite sharp declines in commodity prices more generally in the wake of the crisis, food prices in August 2009 are about 57.6 percent higher than in 2005, while energy prices are about 27.5 percent above their average in 2005.

The terms of trade for most LICs improved in the first eight months of 2009 relative to the same (pre-crisis) period in 2008. Sharply lower oil prices led to improvements in the terms of trade for low-income oil-importing countries that translated into an estimated net gain of 1.5 percent of GDP, with the largest gains recorded for European and Central Asian oil-importing countries. Oil exporters saw their incomes fall by 5.4 percent of GDP due to declines in their terms of trade. By contrast, the deterioration in terms of trade for all middle-income countries resulted in an estimated first-round net deterioration of close to 2 percent of GDP, due largely to sharp losses in oil-exporting countries.

Some LICs have suffered particularly large shocks. About one in five LICs experienced terms of trade losses in excess of three percent of 2008 GDP, with losses exceeding five percent for several countries (e.g., Chad, Guinea, Mozambique, Yemen and Zambia). Moreover, many LICs suffered large contractions in trade volumes, which in many cases have translated into lower export revenues and smaller tax bases. In Eastern Africa, evidence suggests a sharp reduction in agricultural earnings due to reduced exports of cotton from Tanzania and a drop of nearly 25 percent in the price of coffee in Rwanda. Mining industries have been particularly hard hit. Falling copper prices precipitated the layoff of one quarter of miners in Zambia in 2008.[1] The prices of Mongolia's main exports (e.g., copper, zinc, crude petroleum, cashmere) have been cut in half, and the resulting decrease in economic activity has led to a reduction in hours of 50 to 70 percent among workers at construction and cargo shipment sites.[2]

Trade

Exports from LICs fell during the first half of 2009, driven by several factors. Export market demand for LICs (calculated from trading partners' imports) is estimated to have fallen by between 5 and 10 percent in volume terms in 2009; coupled with falling commodity prices, the drop in the value of exports was even sharper. In dollar terms, merchandise exports are anticipated to drop by a steep 14.4 percent in 2009, compared to the 22.8 percent rise in 2008. Export developments have been particularly severe for LICs in South and East Asia, Sub-Saharan Africa, the Middle East and North Africa.

Combined, these terms-of-trade and trade volume developments contributed to a substantial deterioration in external balances for LICs since 2005. The aggregate deficit on LIC trade increased from $19.4 billion to $48.6 billion (2009 estimate) over this period, or from 6.3 to 9.2 percent of GDP. Taking into account net factor income, remittances and other current account items, the average deficit on LICs' current balances also deteriorated, from $10 billion to $40 billion or from 3.2 to 7.6 percent of GDP. LICs in East Asia, Sub-Saharan Africa, and Latin America experienced current account deficits averaging between 8.7 and 11.7 percent of GDP over 2008/2009. With limited domestic resources, the implication for many countries has been a steep increase in external financing requirements.

Capital markets

Net private capital flows to LICs declined significantly in 2008 to $21 billion from $30 billion in 2007 and are projected to drop further to $13 billion in 2009 (Table 1). Among private sources of finance for LICs, FDI has grown in importance in recent years, as a combination of rich natural resource endowments and market liberalization enhanced their attractiveness to transnational companies from both North and South. FDI inflows increased steadily between 2000 and 2007, to reach a level of $20 billion (5 percent of their aggregate GDP), accounting for 65 percent of total private flows to LICs. However, these flows remained concentrated—only 10 countries account for seventy percent of all FDI in LICs.

Table 1: Net Capital Flows to Low-income Countries

$ billions

	2000	2001	2002	2003	2004	2005	2006	2007	2008e	2009p
Current account balance	-3.6	-6.2	-7.0	-7.2	-7.4	-9.9	-8.7	-23.6	-36.9	-40.1
Financial flows:										
Net private inflows	2.6	3.6	4.7	5.6	8.6	8.9	14.9	30.6	21.4	13.0
Net equity inflows	4.3	4.5	5.3	6	7.1	8	12.8	26.4	14.0	11.2
Net FDI inflows	4.3	4.5	5.3	6.0	7.1	7.8	11.4	20.0	13.9	11.0
Net private debt flows	1.8	-0.9	-0.6	-0.4	1.5	0.9	2.1	4.2	7.4	1.8
Change in reserves (- = increase)	-0.5	-1.9	-4.3	-7.0	-5.1	-1.9	-9.7	-14.0	-1.0	3.2 (*)
Memorandum items										
Workers' remittances	5.7	8.1	10.4	11.5	13.2	16.1	20.2	24.5	30.7	28.5

(*) The change in reserves for 2009 accounts for only the first four months of the year, and for a sub-sample of 23 countries. Almost all of the net reserve depletion occurred in Vietnam.

Even in the best of times, LIC access to private debt markets has been marginal and uneven. Over the past decade, there have been only seven bond issuances by five low-income countries raising $2.3 billion, accounting for a miniscule share of total bond issuance by developing and emerging market countries. The last LIC bond issuance was in late 2007 when Ghana sold $750 million of dollar-denominated bonds, after which mounting risk aversion and prevailing unfavorable market conditions compelled potential issuers to postpone plans to go to market. Both Ghana and Kenya had planned to tap international capital markets to finance large infrastructure projects but instead postponed sovereign bond offerings worth over $800 million, delaying the construction of toll roads and gas pipelines. While the international bank loan market has remained more accessible, participation by LICs has been limited to occasional project finance deals, largely in extractive industries, and to short-term loans for trade financing.

Furthermore such cross-border flows tend to be highly concentrated in countries with natural resources and close proximity to larger developed and middle-income countries. Six countries account for 80 percent of foreign bank lending to LICs—Vietnam, Uzbekistan, Ghana, Liberia, Yemen, and Lao PDR.

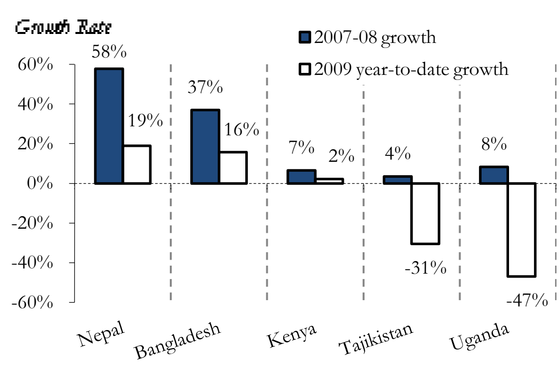
Initially less severely affected, equity markets in LICs have fallen along with those in the advanced and emerging markets over the course of 2009. Prior to the crisis, investor interest in African markets had been on the rise, with FDI, portfolio inflows and foreign lending having reached an all time high of $52 billion in 2007,[3] reflecting booming commodity markets, rising profitability of regional investments and an improved environment for local business. The increase in portfolio flows, in particular, underpinned the increase in the number of stock exchanges in Sub-Saharan Africa from five in 1989 to 16 today, including in Ghana, Malawi, Uganda and Zambia.[4] However, since the crisis began, inflows to equity markets have stalled or been reversed, resulting in significant reserve depletion in a number of countries.

Box 1: Zambia's Financial Sector

The drop in economic activity is affecting virtually all sectors of the Zambian economy via a sharp decline in copper prices which are now 30 percent below their peak in April 2008 (after bottoming out at more than 60 percent below their peak). While the Zambian banking system is currently stable and well capitalized, it faces significant risk in the context of the global slowdown. The copper mines, which largely fund themselves abroad, outsource the bulk of their ancillary activities domestically. As a result, the banks' direct exposure to the mining and quarrying sector (about 5 to 7 percent of total corporate lending in 2005 to 2008) vastly underestimates the banking sector's vulnerability to a sustained decline in copper prices. Moreover, with a high share of subsidiaries of international banks in the Zambian banking system, the financial sector is vulnerable to the global financial turmoil through parent-subsidiary relationships. As access to offshore funds through parent banks dries up, some locally operated banks may have their credit expansion plans restricted.

While largely insulated from the direct effects of contagion from advanced market financial crises, the banking sectors in many LICs have come under stress from real economy weakness. As the real sector slowdown feeds back to the financial sector, some banking systems in Africa are beginning to see several sources of weakness: (i) increases in non-performing loans from the slowdown in economic activity (e.g., 26 percent of Nigerian banks' portfolio is in the oil and gas sector); (ii) tightening liquidity due to reduced trade credit flows, which is even affecting commodities whose prices have not fallen drastically, such as cotton and cocoa in West Africa; (iii) withdrawal of liquidity from local subsidiaries of foreign banks to provide capital to headquarters (Box 1); and (iv) contagion risk from regional banks—South African banks own 24 percent of Africa's banking assets, and Nigerian banks had been expanding aggressively throughout the region.

Figure 1: Growth in Remittances to Selected LICs



Year-to-date growth is the growth up to mid-2009 compared to the same period in 2008. Data for all countries until June 2009; for Nepal until May 2009.

Remittances and migration

The sharp deterioration in economic conditions in countries which are key

destinations for overseas workers has led to a deterioration in workers' remittance flows to LICs, which are anticipated to fall by between five and seven percent in 2009 (Figure 1), recovering only modestly in 2010. Workers' remittances are relatively more important to LICs than to MICs (six versus two percent of GDP), so even a modest decline will cause significant hardship. And this average masks considerable variation, with some countries extremely dependent on remittance flows for foreign exchange and to augment household income. Particularly hard hit are migrants from Latin America working in the US construction industry and those from Central Asia working in Russia's oil and gas industry (Box 2).

Box 2: Moldova's Challenge

In Moldova, workers' remittances equivalent to about 30 percent of GDP in 2008 were more than enough to offset a current account deficit that would have reached 25 percent of GDP without them. With almost two thirds of these flows coming from Russia, Moldova was hit hard by the global crisis, and remittance inflows as a share of GDP are expected to fall by as much as half. Further compounding the economic shock, remittances are largely used to finance household consumption and fuel imports, on which the government depends heavily for tax revenue. As a result, in addition to the sharp contraction in external financing, last year's modest fiscal surplus is expected to turn into a sizeable deficit in 2009, perhaps as large as 10 percent of GDP.

Tourism

Many LICs, particularly small island states, depend heavily on tourism for foreign exchange and jobs, in both their formal and informal sectors. Rising unemployment, weak consumer confidence and sharp reductions in household wealth in advanced countries have led many potential tourists to either cancel or curtail their travel plans in 2009. Worldwide tourist arrivals declined by eight percent between January and April 2009, continuing the sharp falloff recorded during the second half of 2008.[5] South Asia registered one of the largest drops (12 percent), while Sub-Saharan Africa showed a marginal increase over the period.

In some tourism-dependent economies, the decline is particularly sharp. In Vietnam, where tourism accounts for 4.4 percent of GDP, foreign arrivals in the first half of 2009 were almost 20 percent below the same period last year. In the Maldives, arrivals were down 10.5 percent during the first five months of the year relative to 2008 and during the first four months of 2009, they were down by between 6 and 16 percent in Cambodia, Tanzania, and Senegal. Travel receipts for Tanzania, which account for 60 percent of total services exports, increased a minimal 2.4 percent in the year to May 2009, a significant slowdown from the 25.4 percent gains achieved in the same period in 2008. Namibia experienced a 17 percent decline in real value added by the hotel and restaurants sector in the first quarter of 2009. And in Kenya, tourism revenues dropped 20 percent in the first five months of 2009, as monthly tourist arrivals fell by 30 percent between January 2009 and May 2009.

Financing for SMEs

Lower net private capital flows and monetary tightening are translating into reduced liquidity for SMEs. Prior to the crisis, microfinance had been growing at a remarkable pace: total assets of microfinance institutions (MFIs) grew by 36 percent in 2006 and 51 percent in 2007.[6] Now, more than half of MFIs report that facing liquidity constraints and two-thirds expect increased liquidity pressures in the next six months. IFC estimates a potential refinancing gap for MFIs of \$1.8 billion over the next 18 months. Deteriorating loan portfolio quality is widespread, with 68 percent of MFIs reporting increases in portfolio-at-risk.

Some LIC SMEs are reporting substantial delays in receiving payment on invoices from retailers in OECD countries, putting significant financial pressure on their operations.[7] At the same time, SMEs are increasingly squeezed as banks become more risk averse and many governments are borrowing more to fund fiscal outlays. Data from a May 2009 survey of MFIs indicate a 15 percent decline in microenterprise profit margins due to higher costs of supplies (fuel, fertilizer, etc) and declining sales.[8] In a World Bank survey in early 2009 of 60 global buyers and suppliers, 40 percent of companies indicated that foreign sales have been delayed or cancelled due to a drop in new orders and 30 percent indicated that sales were down due to difficulties in obtaining trade finance. SMEs, particularly in LICs, reported being crowded out by larger, better integrated firms in accessing trade finance. Three-fifths of the managers surveyed indicated that their clients were having problems repaying their loans.

III. Impact on Poverty, Human Development and Vulnerable Groups

History demonstrates that the poor are at greatest risk from economic "shocks", whether due to conflict, natural disaster, or economic distress. In the current downturn, with the impact occurring through different (and often reinforcing) channels, the downside is particularly pervasive. Households are pushed into poverty, health conditions deteriorate, school attendance declines, and progress in other critical dimensions of development is stalled or reversed. Despite data shortcomings, the emerging evidence confirms concerns that the crisis could potentially reverse progress to date toward achieving the MDGs, and that these adverse outcomes could persist long after the global economy rebounds.

Poverty

The crisis is slowing dramatically the steady progress achieved in reducing global poverty. World Bank estimates suggest that the crisis will leave an additional 89 million people in extreme poverty (below $1.25 a day) at the end of 2010.[9]

The projected decrease in workers' remittances could have a serious impact on poverty, especially in countries and among households that are highly dependent on remittance flows. In the LAC region, the expected average decline of 4.4 percent in remittances will have particularly serious implications for Guatemala (125,000 additional poor) and Honduras (68,000 additional poor).[10] According to recent projections, if remittances to Tajikistan were cut in half, the national poverty headcount could rise from 53 to 60 percent.[11]

The collapse in global demand has led to layoffs from export-oriented industries in many LICs. Recent assessments undertaken in several LICs indicated work hour reductions to around 70 percent of regular hours for those still employed, and in some cases, as low as 50 percent.[12] Other countries witnessed widespread layoffs and job losses, with those displaced forced into an informal sector characterized by underemployment and high levels of income insecurity.[13] In Bangladesh, for example, employers in garment and

Box 3: Ripple Effects of Declining Exports

An estimated one to two percent of the urban population of the world makes a living collecting and recycling waste materials, generally paper, cardboard, plastic, glass and metal. Many are women and children. Recycled materials are used extensively for packing materials for exports. As global trade flows diminish, the demand for, and price of, recyclables falls, directly impacting the income of the poorest. Workers in this sector face reduced earnings: data from Delhi and Ahmadabad (India) show the price of scrap materials falling.

Source: "Women in Informal Employment: Globalizing and Organizing" (WIEGO), "Global Economic Crisis and the Informal Economy."

knitwear industries have responded to falling demand and prices by shutting factories and cutting wages. In reaction, thousands of workers have resorted to violence and burnt several factories and warehouses in June. While some laid off urban workers who had migrated from rural areas have returned to rural communities, others (particularly in East Asia) have tended to remain for several months in urban areas seeking new work, or switching to employment in the informal sector for reduced wages and with greater insecurity.[14] The inflow into the informal sector increases competition, eroding incomes more broadly (Box 3).

Human Development

Bank research estimates that the current downturn could result in 30 to 50 thousand additional infant deaths in Sub-Saharan Africa in 2009.[15] In the poorest developing countries, health and education outcomes move "with the cycle," and deteriorate during economic crisis.[16] Aggregate economic shocks have generally had much larger impacts on infant mortality among girls than among boys. These patterns have no "biological" explanation—girls are generally sturdier than boys, and there are no significant or substantive changes in the boy-girl birth ratio during crises. Rather, families appear to make greater efforts to protect boys than girls in dire economic times.

The severity of the current crisis threatens educational gains in many LICs. While basic education is mostly funded by government, secondary and higher education tend to be financed more by private spending. Economic shocks that reduce household income therefore constrain the ability of households to invest in education. Often, these adjustments exacerbate inequality. In Indonesia following the crisis in the late 1990s, spending reductions were biggest in poor households with more young children (10–14 years), while poor households with older children tended to protect education spending. One important factor is whether public expenditures can keep schools open. In many developing countries, teachers are the largest portion of the civil service, so deep public expenditure cuts that result in layoffs or deteriorating facilities are especially disruptive to the education sector.

The impact of the economic crisis on health depends on how well countries are able to protect critical spending. Experience from previous crises indicates that health budgets often suffer during times in which demand for public health services may go up and when prices for pharmaceuticals increase due to currency devaluation. While there is little quantitative evidence of significant budget cuts at this point in time, anecdotal evidence and press reports from some LICs suggests the crisis may limit the planned expansion of health programs, adversely affect the fight against HIV/AIDS and tuberculosis, and threaten the gains made over the last few years.

Women and the crisis

Women are often the first to suffer during an economic crisis. This is particularly true in the current crisis given that female employment in export-oriented industries has soared over recent decades and export sector layoffs in the current crisis are significant, including for high-value agricultural exports from many African countries. In Uganda, for example, the cut-flower industry employs a workforce that is 85 percent female. In Kenya, where cut flowers

Box 4: Employment and the Garment Sector in Cambodia

With 70 percent of its total garment exports going to the US market, Cambodia has been particularly hard hit by the global recession. Some 48 factories closed between September 2008 and May 2009. The garment sector has now shed some 18 percent of total jobs (62,000 out of 352,000 workers) and many workers are now working fewer hours (average earnings are down eight percent from the peak in mid-2008). The impact has been particularly hard on women who make up nearly 90 percent of garment industry workers.

are the second largest agricultural export, generating more than $200 million in foreign exchange, women comprise 70 percent of workers. In African countries with export-oriented textile factories, such as Kenya and Lesotho, more than three quarters of employees are women. Meanwhile, in Cambodia, where nearly 90 percent of garment industry workers are women (Box 4), garment exports dropped 30 percent in January 2009 (year-on-year) and layoffs have increased.[17] Shrinking product markets do not just impact the large-scale export sector. In India, self-employed women in the garment sector have seen their monthly earnings drop by 50 percent and days of work reduced by 69 percent since November 2008.

Women are also particularly vulnerable to any credit crunch in the microfinance sector where they comprise 85 percent of the poorest 93 million microfinance borrowers across the globe.[18] And women are less likely to have collateral and therefore more likely to be impacted as commercial banks tighten lending requirements for SMEs.

Box 5: Impact of the Crisis on Fragile and Conflict-Affected States (FCSs)

Like other LICS, many fragile states (FCS) are heavily dependent on commodity exports, remittances, ODA, and emergency and security assistance, all of which have come under intense pressure as a result of the global economic crisis. But FCS are doubly challenged, being defined by their weak institutions, ongoing and/or recent conflicts, and high poverty levels. This puts them in a highly disadvantageous position to cope with the effects of the crisis and to mediate its social impact. In FCS, political and reconciliation processes are already fragile and national capacities to consolidate peace are weak. Lower growth and higher unemployment rates, notably for youth, can further destabilize economies and increase the risk that conflicts will re-emerge, the development cost of which would be large, in both financial and human terms. For many FCSs, these problems are compounded by the fact that they have yet to complete the HIPC process, with several yet to even reach the decision point and become eligible for interim assistance (e.g., Comoros, Eritrea, Somalia, Sudan, and Kyrgyz Republic).

The financial position of virtually all FCSs is already constrained and is expected to get tighter as donors face their own fiscal challenges at the same time as the crisis exacerbates the financing constraints in previously well performing LICs, thereby increasing competition for scarce concessional resources. IDA support is constrained by the overall envelope and performance-based allocation rules. Without additional resources, and greater flexibility in allocation, it is doubtful whether IDA can mitigate the impact of the crisis on FCSs and help avoid deterioration and possible conflict relapses.

IV. Resource Implications and Policy Responses

Fiscal Impacts

LIC governments find themselves in a fiscal bind as the crisis unfolds, with fewer resources to meet growing needs. Revenues have declined and access to international capital markets, where it exists, has become more difficult. At the same time, more resources are needed to combat the impact of the crisis on economic growth and poverty—to provide fiscal stimulus to cushion the crisis impact on growth, finance social safety nets for vulnerable groups, and protect core expenditure. For virtually all LICs, the result has been a balancing act requiring efforts to mobilize additional resources in a difficult environment while striving to protect crucial spending priorities and simultaneously laying the groundwork for recovery.

Table 2: Central Government Revenues (in percent of GDP) 1/

	2007	2008	2009
Low-income countries	24.2	22.1	22.0
of which			
Fragile countries	25.3	21.1	22.5
Better performers	23.5	22.6	21.6
Oil Rich	28.2	29.9	22.4
Nonoil	22.6	21.2	21.5
Sub-Saharan Africa	26.3	23.3	23.9

Source: IMF World Economic Outlook, April 2009

1/ Includes grants, excludes debt stock relief under HIPC Initiative and MDRI.

Revenue pressures

Revenues and grants in LICs are projected to decline by an average of 2 percent of GDP between 2007 and 2009 (see Table 2). This reverses steady gains in revenue since 2000 in many LICs. Declines in revenue have been partially cushioned by rising foreign assistance—total net official development assistance (ODA) from OECD countries rose by 10.2 percent in real terms in 2008. Nevertheless, revenues and grants in fragile states are expected to decline sharply in 2008-09 from levels reached in 2007.

Revenues in countries that are dependent on commodity exports are especially hard hit by the crisis. Many LICs derive a significant share of their fiscal revenue—as much as 80 percent—from a few commodities, which exposes them to vulnerabilities due to the volatility of world commodity prices. In the run up to the current crisis, a number of LICs (largely oil and mineral exporters) had benefitted from high commodity prices. With improvements in fiscal management, many saved a significant portion of the revenue windfall, which helped cushion the impact of the crisis, at least temporarily. Others, particularly oil importers, entered the crisis already weakened.

Limited scope for counter-cyclical spending

For many countries affected by the economic recession, counter-cyclical fiscal stimulus is the preferred response. G-20 countries, for example, have adopted or plan to adopt fiscal stimulus measures averaging 0.5 percent of GDP in 2008, 2.0 percent in 2009 and 1.5 percent in 2010.[19] LICs, on the other hand, often lack the fiscal space for similar action. This makes it all the more important that policymakers are able to extract as much value out of the spending they are able to undertake in order to minimize the macroeconomic and social impact of the crisis.

LICs have generally reacted to the shrinking of fiscal resources through increased fiscal deficits. Commodity exporters have more scope to expand deficits than other countries, since many accumulated surpluses during the period of high commodity prices. As a result, they are able to temporarily expand their deficits significantly, by an average of over 8 percent of GDP between 2007 and 2009. Other LICs have also been able to allow fiscal deficits to expand, albeit by smaller amounts—about 2 percent of GDP on average during 2007-09. But within this group there are a number of LICs (including those in South Asia and many fragile states) with little fiscal space given high debt-to-GDP ratios. But thin domestic credit markets in many LICs raise concerns about government borrowing crowding out the private sector, especially when domestic banks prefer less risky assets, presenting a policy challenge going forward.

Incremental spending accounts for relatively little of the deficit increase in LICs. Bangladesh, Nigeria and Vietnam are among the few IDA countries that have announced stimulus packages. Bangladesh has a package equivalent to 1.6 percent of GDP. Nigeria's stimulus measures amount to about 0.3 percent of GDP, while Vietnam is undertaking a fiscal stimulus of about 12 percent of GDP including bringing forward already-planned expenditures, with almost half allocated to infrastructure and development projects and the remainder distributed among tax breaks and incentives, loan subsidies, and social welfare needs.

Protecting core spending

While widening fiscal deficits can help cushion the crisis impact, this is not an option for many LICs, which lack access to the resources needed to finance deficits. This makes it difficult to maintain core spending programs, without which key development objectives cannot be reached. While the specific composition of core spending varies by country, reflecting national circumstances and development priorities, it typically includes education and health spending, operations and maintenance of critical public infrastructure, and social protection (e.g., social safety nets).

Protecting core spending is essential to preserving progress towards development objectives. Core spending should be sustained and, if possible, expanded during economic downturns to secure the viability of public programs essential for meeting development goals (especially when households may be forced to curb their own spending on basic education and health services), maintaining existing public infrastructure to prevent a costly widening of infrastructure gaps, and ramping up of social protection to meet the increased demand during the crisis.

The global recession is estimated to have put at risk core spending of $11.6 billion (equivalent to about 1.1 percent of GDP) in the poorest countries in 2009 (Table 3). Just over two-thirds of this is for countries in Sub-Saharan Africa (SSA). Fragile states, including those in SSA and those emerging from conflict, account for 58 percent of the total. Just over one half of the cost represents the financing needs of IDA-only countries with relatively good institutions and which are not oil rich. For these countries, which have reformed their economies and public administrations, the shortfall places hard-won achievements at risk.

This core spending financing gap represents existing spending at risk in the poorest countries due to the decline in domestic revenue associated with the global recession as well as incremental demand for social protection. Filling the gap would enable these countries to maintain pre-crisis spending on health and education in real terms, avoid a widening of existing infrastructure gaps due to inadequate spending on the operation and maintenance of existing infrastructure, and prevent an increase in the poverty head count. It would not enable them to make further progress toward the MDGs or further inroads in poverty reduction. It represents the resources needed to simply stay in the same place—without these resources, progress to date in economic and human development and poverty reduction will be eroded.[20]

Table 3: Estimated Crisis Impact on Annual Core Spending

	Number of countries	Percent of GDP	Billions of U.S. Dollars
Education and health		0.4	3.6
Infrastructure		0.5	5.2
Social protection		0.3	2.7
Total	**60**	**1.1**	**11.6**
Country Groupings			
Fragile countries	20	1.1	5.1
Better performers	40	1.1	6.4
Oil rich	5	0.7	0.5
Non oil	35	1.2	5.9
Sub-Saharan Africa	36	1.2	8.1

Source: World Bank staff estimates for IDA-only countries for which data are available. "Fragile countries" are defined here as IDA-only countries with a CPIA score below 3.2; "better performers" are those with a score above 3.2.

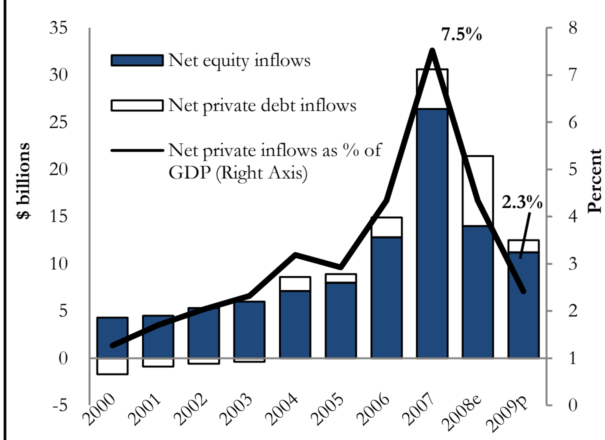
Mobilizing Additional Financial Resources

Faced with declining revenue, rising expenditure requirements, and limited capacity to finance larger fiscal deficits, LICs are striving to mobilize additional resources. But the options open to them are limited, pointing to the inescapable conclusion that maintaining core spending during the downturn will require supplemental support, largely from external sources.

Private flows

Prospects for private flows this year remain gloomy. With bank lending falling sharply through the first half of 2009, and FDI flows expected to reverse, total private flows are estimated to be in the order of $13 billion, almost one-third of the corresponding level of 2007 (Figure 2). In this environment, many LICs, already under strain due to earlier food and fuel crises, will have difficulty meeting their external financing needs, of which the major portion stems from current account deficits. This is in contrast with middle-income countries, for which private debt amortization, rather than current-account deficits, account for the bulk of estimated external financing needs.

Figure 2: Net private capital flows to low-income countries



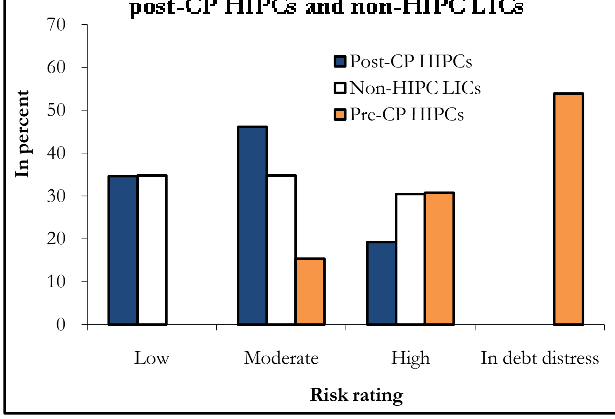
For most LICs, equity flows and disbursement of private debt falls significantly short of external financing needs, leading to aggregate financing needs of about $59 billion in 2009. Capital flows from official sources, along with drawdown of foreign exchange reserves, will help fill the gap in some countries. As of end-2008, LIC foreign exchange reserve holdings amounted to $69 billion, sufficient to cover less than four months of imports, down from an average import coverage ratio of 5 months at end-2007. The scope for further reserve drawdown is narrowing fast. About 16 of 27 LICs with data for 2009 have experienced a drop in reserves thus far this year, with noteworthy declines in Vietnam and Yemen (down by $3 billion and $0.9 billion, respectively).

Official development assistance

With only limited access to private capital markets, many LICs depend on official development assistance to finance much of their core spending and investment. Many LICs will therefore look to donors as a source of additional financing to offset the impact of the crisis. While some donors have been forthcoming (ODA from OECD members reached a record $120 billion in 2008), donors also face significant domestic fiscal pressures, threatening sustainability of this support. The latest OECD/DAC survey stresses that donors are lagging well behind their Gleneagles commitments and with a little over one year in which to deliver on their promises, they show "little sign yet of such raised levels of ambition."

Maintaining debt sustainability

Figure 3: Risk of debt distress in post-CP HIPCs and non-HIPC LICs



Concerns over debt sustainability could further hamper the capacity of a number of LICs to mobilize additional resources. Many LICs, especially those that have reached the completion point under the HIPC Initiative and other non-HIPC LICs, have low levels of debt and can afford to borrow to temporarily smooth the negative effects of the current crisis without substantially increasing the risk of debt distress. However, in some LICs, even if additional non-concessional funds were readily available, caution would be required to ensure that debt sustainability achieved in recent years was not discarded in a rush to fill short-term financing gaps (Figure 3). Despite substantial debt relief under various initiatives, maintaining debt sustainability in the face of growing fiscal pressures remains problematic for a number of LICs, which are at high or moderate risk of debt distress. Debt sustainability indicators will deteriorate in the short run for all countries as a result of the fall in exports, government revenues, lower remittances and a reduction in FDI. For those countries capable of pursuing a fiscal stimulus package, indicators can be expected to deteriorate even further. Looking ahead, a more protracted deterioration could occur if countries' growth prospects worsen due to sustained lower investment rates. LICs need to have in place sound borrowing policies and strengthen their capacity to manage their public debt, two areas where the Bank can provide valuable technical assistance to LICs.

The current recessionary environment, coupled with limited availability of concessional financing, poses tough choices for LICs. LICs should proceed cautiously before incurring additional non-concessional debt since they face a period of uncertainty and possible protracted stagnation in the global economy. Moreover, for those LICs already in—or facing increased risk of—debt distress as result of export declines or deteriorating global financial conditions, there may be little scope for increased borrowing in the short run. Indeed, what might be most valuable to countries in these circumstances is additional relief on borrowing costs, such as that provided through the IDA framework in which higher levels of debt distress trigger increased availability of grant financing. Unfortunately, the use of such mechanisms is limited by the availability of grant resources.

Deterring illicit flows and facilitating asset recovery

Even during normal times, the outflow of resources from developing countries as a result of corruption and illegal activity constitutes an enormous loss to developing countries, especially LICs. Estimates of the magnitude vary enormously but even the most conservative suggest the amount easily exceeds $120 billion, equal to the amount of ODA the OECD countries provided in 2008. Bribes paid to public officials in developing and transition countries, and almost always hidden abroad, are estimated to be between $20 to 40 billion per year. During periods of economic distress, the cost is even greater, as the missing resources translate directly into lives lost, literacy foregone, and infrastructure not built.

Recovering assets at the country level is a complex and time-consuming process. But progress is being made, as evident in the growing interest in the Stolen Asset Recovery (StAR) Initiative, jointly managed by the World Bank and the United Nations Office on Drugs and Corruption (UNODC), which seeks to support international efforts to deter illicit flows of the proceeds of corruption and facilitate asset recovery. More and more countries are taking advantage of the expertise and training available through StAR. The agreement recently reached in Mexico City on transparency and tax information exchange between OECD and G-20 countries and the Cayman Islands, Singapore, Liechtenstein, and other offshore financial centers is an important step forward.

Just as important as country-level recovery activities are efforts to address the public goods aspects of the issue. The proceeds of corruption in developing countries often find shelter in advanced country financial centers, implying that corruption can best be tackled through international cooperation and collective action. The wide-reaching evaluation and reform of global financial regulation and governance that is being undertaken as a consequence of the current crisis provides an unmatched opportunity to move this agenda forward by supporting partnerships between developed and developing countries and international institutions with an interest in these issues.

Prioritizing Expenditures

Given the heterogeneity of crisis impacts and country conditions, there is no one-size-fits-all policy response. In addressing the impact of the global economic crisis, policymakers in LICs are faced with the difficult task of minimizing job losses and other adverse short-run impacts on household welfare while encouraging economic recovery and setting the stage for the resumption of long-run sustainable growth. For most countries, this must be done within fiscal constraints that are very tight. Few LICs are able to undertake large-scale counter-cyclical fiscal stimulus including by instituting an ambitious program of new infrastructure. Many will need to focus their efforts on protecting core spending and maintaining existing critical infrastructure.

Protecting the most vulnerable

Even in more normal times, spending on social safety nets in LICs is insufficient to meet needs. In Bangladesh only about 18 percent of the poor were covered by some form of safety net program in 2005, when safety net expenditures were around 1 percent of GDP. In the Kyrgyz Republic, social assistance expenditures were less than 0.8 percent of GDP in 2007. Moreover benefits are low, having been raised from about $2/month to $3/month in response to the food price crisis.

Part of the crisis response is to support those who may not have been poor before, but suffer sharp declines of income, for example through loss of employment, drops in real wages or declines in remittances. Catering to the newly poor in the midst of a crisis is not easy though some programs do better than others. Access to formal unemployment benefits, for example, involves administrative costs to confirm eligibility before transfers can start. Few LICs have the capacity for this. On the other hand, self-selection based on wage rates for public works programs can attract new households rapidly, provided the institutional capacity to launch these on a large scale exists, as in Korea following the 1998 economic crisis.

Governments are using programs such as Conditional Cash Transfers (CCTs) and school grants to sustain or promote demand for education and stem increases in inequality in periods of crisis. A project in the Democratic Republic of Congo, for example, provides grants to finance emergency recovery support to address some of the near-term impacts of the crisis and sustain economic activities until the government's policy responses can take effect and medium-term donor support can be fully identified. The project will finance the short-term costs associated with teachers' salaries and water and electricity bills. CCTs can also support demand for health services as well by supporting basic consumption.

Taking gender into account

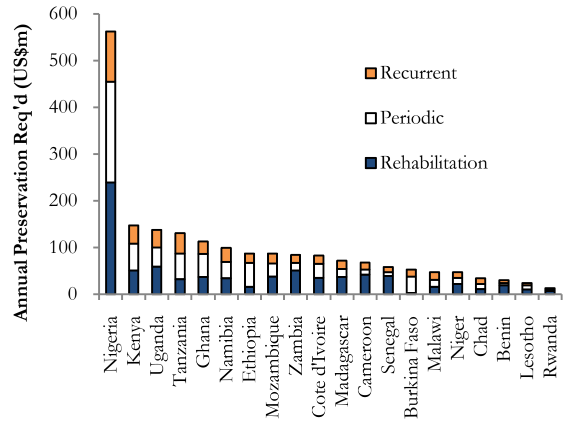
Given that women are often the first to suffer during economic crisis, there is a compelling argument for public spending to protect them. In addition, there is a strong microeconomic case for public spending on pro-poor programs that channel benefits through women: a large body of evidence indicates that women allocate a larger portion of their resources to household public goods (such as food and health, including on children) than do men, with beneficial effects for households and community well-being. Transfers to women is a smart way to spend aggregate fiscal stimulus effectively.[21] In countries that have to reduce aggregate public spending, safeguarding pro-poor programs that put resources in women's hands could therefore help protect children's health and schooling.[22]

Setting priorities on infrastructure spending

Labor-intensive public works projects may be a good way to create short-term employment during the crisis. The Bank estimates that one quarter of spending on public works in African LICs goes to local wages, and spending on public works has a multiplier of two for indirect jobs created. This translates into more than 600 person years for every US$1 million spent on public works.[23] In light of Africa's infrastructure needs, particularly in energy, transportation and water, sanitation and sewage systems (Figure 4 highlights needs for road maintenance, for example), this suggests considerable scope to efficiently and effectively respond to rising unemployment and under-employment in the wake of the global economic recession.

Experience from earlier crises points to the need to preserve existing infrastructure by protecting spending on operations and maintenance. If neglected, costs of replacement in the longer term can be considerably higher. World Bank estimates indicate that every dollar spent on road maintenance in Africa saves four dollars in rehabilitation. Annual preservation requirements (not including new roads) are estimated to be about $3 billion over the next 20 years.[24]

Figure 4: Road Sector Maintenance Needs in Africa



Source: Africa Infrastructure Country Diagnostic (June 2008), World Bank

Addressing food security

Even before the food crisis of 2008, one in every three persons in Sub-Saharan Africa suffered from chronic hunger. The situation has since grown worse (see Box 6). Hunger is also worsening in South Asia.[25] Not only is progress lagging on the MDG of cutting world hunger in half, but the situation is deteriorating. Addressing food security in LICs requires raising the productivity and incomes of the world's poor engaged in smallholder farming. Smallholders represent close to 75 percent of the world's poorest people, and account for 60 percent of the world's farmers[26].

But there is a growing realization of the consequences of complacency about food security and agricultural development over the past two decades, and commitments such as those made by the G-8 in L'Aquila offer hope. Public goods investment that facilitates private resource inflows into agriculture in LICs is essential and will be at the core of any viable follow up to the pledges made at L'Aquila. The Bank supports the efforts of the Comprehensive African Agricultural Development Program (CAADP) and similar activities to improve and scale-up public and private investment in agriculture in LICs.

Addressing food security also requires paying more attention to establishing sustainable food safety nets in LICs.[27] Mechanisms are needed to reduce vulnerability and improve social protection, such as early warning systems for drought and flood, targeted cash transfers, public works, community-based livelihood projects, and locally sourced nutrition programs. Many of the countries that most need these interventions do not have the pre-existing systems and institutional infrastructure to operate them, which require time and capacity to install. It is also not feasible to recreate this capacity each time an emergency hits, yet increases in capacity financed during an emergency are costly to maintain in normal times. Investment is needed in cost-effective institutional infrastructure and policies that improve capacities for ongoing needs assessment and targeting in food security, and to increase the capacity for rapid response.

V. World Bank Group Response to the Crisis

The World Bank Group has moved quickly to help countries respond to successive crises: first, by addressing the food crisis in early 2008 in coordination with UN partners, then the energy crisis in mid-2008, and now the current economic crisis. The Global Food Price Response Program, the Energy for the Poor Initiative, and the IDA Fast Track initiative, as well the IFC trade finance facilities, have been an important part of the World Bank Group's (WBG) rapid and immediate support to countries in need.

Box 6: The Food Crisis is Not Over…

World cereal prices have fallen rapidly since mid-2008, although they remain substantially above 2005 levels. Despite this decline, FAO now estimates that the ranks of the chronically malnourished exceed one billion due to income compression due to the global recession. Compounding income short-falls, staple food prices in many LICs have remained higher even as world prices have fallen, and in many cases, are higher than a year ago when world prices were at their peak. Reasons for the persistence of high domestic food prices differ across countries. In some countries, exchange rates have depreciated, and domestic prices for food have not fallen in step with the dollar-denominated world prices. In other countries, especially in Sub-Saharan Africa, high transfer costs, trade finance constraints, and market imperfections result in a wide band between import and export parity prices. As a result, staple foods behave more like non-tradable goods and are less directly affected by movements in world prices. Other reasons for high food prices include drought, pests, high transport costs, and demand in neighboring countries.

According to WFP, in 78 percent of the countries covered by their price monitoring bulletin, the cost of a basic food basket during April–June 2009 was higher than the same period in 2008 (WFP, July 2009):

- In Mali, the prices of millet and sorghum, which account for approximately one-third of calorie consumption, have increased by almost 50 percent since mid-2008. Maize and rice prices have also increased, and overall the cost of the basic food basket is 21 percent higher than a year ago.
- Prices of several major staples in Uganda have continued to climb, largely because of increased fuel costs due to supply disruptions. Overall, the basic food basket in Uganda is 27 percent higher than a year ago, led by increases in the prices of plantains, cassava, maize, and sweet potatoes ranging from 30 to 80 percent.
- Like Uganda, most staple foods in Rwanda are potatoes, sweet potatoes, cassava and plantains. Prices for these foods have continued to increase, and the cost of a basic food basket in Rwanda is 17 percent higher than a year ago.
- Maize provides approximately half the calories in the Zambian diet, and maize prices increased 37 percent between mid-2008 and mid-2009, which in turn increased the cost of the Zambian food basket by 21 percent.
- In Nepal the price of rice, which provides about one-third of calories, is 11 percent higher than last year and continues to climb because of drought and poor market access. Wheat, which accounts for 14 percent of calories, is up 54 percent over mid-2008 levels.

The World Bank Group has stepped up its financial assistance to help developing countries mitigate the impact of the crisis. The result has been record levels of activity—nearly $60 billion committed in FY09 from IBRD, IDA, IFC and MIGA to support countries hit by the global crisis, a 54 percent increase over the previous year, and a record high (see Box 7).

IDA commitments hit a record level of $14 billion in FY09, 25 percent above a year earlier. Results were driven by strong delivery to Africa (53 percent) and South Asia (33 percent). Development Policy Loans composed about 20 percent of the total. Following a record 15th replenishment of $42 billion for FY09-FY11, IDA can deliver $28 billion in additional financing over the next two years. Given the impact of the crisis on LICs, and the growing demand from partners, these resources may need to be augmented.

IDA front-loading and fast-tracking: In addition to increasing lending, the Bank has streamlined procedures and facilitated project restructuring and disbursement through the IDA Financial Crisis Response Fast-Track Facility. This Facility can fast track up to $2 billion of financial assistance, with the potential to increase the amount in the future depending on need.

Box 7: Financial Capacity Augmentation and IBRD and IFC Assistance to LICs

IBRD and IFC also provide substantial assistance to its poorest members in the forms of income transfers to IDA, enclave lending and guarantees, and knowledge work and research. In spite of the impact of the crisis on IFC's resources and the resulting deferment of $200 million of IFC's planned IDA transfers for a year, the WBG still fulfilled its overall FY09 group contributions by front-loading part of IBRD's contribution, highlighting its commitment to supporting the poorest that have been hit the hardest by the global crisis. However, in the absence of capital augmentation, the future ability to continue or expand this assistance would be constrained. Historically in times of capital shortage, IBRD has had to lower or even suspend its IDA transfers until there were new injections of capital or until its financial conditions gradually improved. Capital increases would enhance IBRD's risk-taking ability and hence allow the institution to scale up its assistance to LICs with limited creditworthiness, such as through expanded enclave lending program and other innovative approaches. Additional income generation from the capital increase would also enhance the capacity to make income transfers to IDA.

Box 8: IFC is Focusing on LICs

IDA Focus: IFC has been focusing on IDA countries, with a special emphasis on Sub-Saharan Africa. The number of countries in the region in which IFC is active with investment and advisory services increased from 21 in FY02 to 37 in FY09. IFC's volume in the region reached $1.8 billion in 92 projects.

Development Results: IFC's development results also underscore its growing reach to those most in need: in 2008, IFC portfolio clients provided 2.1 million jobs, served 5.5 million health patients, helped educate 1.2 million students, reached 200 million water, power and gas customers and provided 9.8 million MSME loans totaling $100 billion.

Crisis Initiatives: Recognizing that a strong private sector is vital for job creation, IFC launched a series of initiatives to help private enterprises cope with the crisis. These initiatives are expected to provide significant financing over the next three years—especially in LICs—by combining IFC funds with contributions mobilized from other sources.

- Trade: IFC has expanded its Global Trade Finance Program, tripling the size to $3 billion. In addition, IFC launched the Global Trade Liquidity Program, bringing together governments, development finance institutions and commercial banks to support up to $50 billion in trade in the developing world over the next three years.
- Infrastructure: IFC launched the Infrastructure Crisis Facility, which will include debt and equity components providing short-to medium-term financing for infrastructure projects, and will also include advisory services for governments.
- Microfinance: IFC's Microfinance Enhancement Facility is designed to address the challenges faced by microfinance institutions encountering difficulty in refinancing their debt. It is expected to provide refinancing to more than 100 microfinance institutions in up to 40 countries, including 20 of the world's poorest countries.
- Bank capitalization: The IFC Capitalization Fund is designed to support banks considered vital to financial systems in emerging market economies. $2 billion has already been raised in addition to IFC's $1 billion, and IFC is exploring expanding the reach of the Fund by developing parallel funds dedicated to investment in banks in Africa and Eastern Europe.
- Other initiatives are under development, including finding ways to facilitate distressed-asset recovery for regions and countries—especially LICs—that have been significantly affected by the crisis.

IDA will also be adjusting the implementation of its Non-Concessional Borrowing Policy (NCBP) to further enhance its flexibility and ensure consistency with the new Fund guidelines on debt limits in Fund supported programs.

IFC provided $12.9 billion in financing for private sector development in FY09 in addition to the funds mobilized for crisis initiatives. As a result of IFC's strategic focus on IDA countries over recent years, over half of the projects financed were in IDA-eligible countries in FY09, representing a tripling since FY05. The number of IDA countries covered by IFC investments increased from 29 to 61 over the same period. To increase development impact further and better leverage resources, IFC has launched a number of new crisis response facilities in both investment and advisory services with a special focus on LICs, combining IFC funds with externally mobilized resources (see Box 8).

MIGA issued $1.4 billion in guarantees in FY09 and is increasing its support to systemically important financial institutions seeking political risk insurance (PRI) for cross-border investments in subsidiaries in emerging markets.

Protecting the Poor: The World Bank Group's Vulnerability Framework

The WBG's operational crisis response includes targeted initiatives to protect the most vulnerable from fallout from the crisis. Crisis response initiatives focus on three themes: (i) protecting the most vulnerable from the fallout of the crisis; (ii) maintaining long-term infrastructure investment programs; and (iii) sustaining the potential for private sector-led economic growth and employment creation, particularly through SMEs and microfinance. The themes are being addressed through three operational platforms—the *Vulnerability Financing Facility (VFF),* the *Infrastructure Recovery and Assets (INFRA) platform,* and the *IFC-led private sector platform* (see above). Together these initiatives have mobilized $8.3 billion in *additional* resources from donors to mitigate the crisis impact on developing countries, especially LICs.

The Vulnerability Financing Facility is a dedicated facility to streamline crisis support to the poor and vulnerable. To leverage its resources, the WBG sought additional grant assistance for LICs and poor and vulnerable groups under the VFF which organizes under one umbrella the Global Food Crisis Response Program and the Rapid Social Response Program. The VFF programs address two specific areas of crisis vulnerability: (i) agriculture, the main livelihood of over 75 percent of the world's poor; and (ii) employment, safety nets and protection of basic social services to help the poor and vulnerable cope with crisis.

- **Global Food Crisis Response Program (GFRP):** Focusing on social protection and priority food policy interventions, the GFRP encompasses the Food Price Crisis Response (FPCR) Trust Fund of $200 million from IBRD surplus, as well as $1.8 billion in IDA/IBRD resources. Disbursements in 8 months totaled $790 million for 31 countries. In response to high demand, the Board raised the ceiling to $2 billion from $1.2 billion in April 2009. Total Bank-funded GFRP project commitments currently amount to almost $1.2 billion. The GFRP is supported by three externally-funded trust funds with resources from Australia (AUD 50 million), Russia ($15 million), and the EU (euro 110.8 million).

- **Rapid Social Response (RSR):** WBG support for safety nets and other social protection programs totaled $6.2 billion this year. The RSR is designed to help countries build the institutional capacity necessary to address urgent social needs stemming from the crisis by financing immediate interventions to improve access to basic social services (emphasizing services for maternal/infant health and nutrition and school feeding programs). It also supports building, or scaling up, pre-existing targeted safety net programs; and providing income support to the unemployed. To date, donor pledges to the RSR Trust Fund for Capacity Building have totaled over $80 million.

Infrastructure Recovery and Assets Platform (INFRA): INFRA is a multi-donor platform designed to focus attention and resources of the Bank Group and its development partners on the critical needs of infrastructure during the downturn, while helping to lay the groundwork for future growth and poverty reduction. WBG lending for infrastructure-related projects rose to $20.7 billion during fiscal year 2009, exceeding the $15 billion committed under the INFRA platform. IBRD/IDA committed $17.6 billion for infrastructure, a 48 percent increase over FY08 commitments. Of this, $4.6 billion was committed for IDA and within IDA, $2.7 billion was committed for Africa.

In addition to maintaining a strong pace of IDA lending this fiscal year, the Bank continues with efforts to stretch its balance sheet to help create the conditions for a reestablishment of private capital flows to developing countries and LICs in particular. Collaboration with the IMF is continuing to ensure that additional resources available for LICs are deployed effectively. The WBG is leveraging its own resources with financial support from public and private sources to match the needs of developing countries with the interests and capacities of donors. To help tap the considerable potential for commercially-viable and fiscally-attractive foreign exchange-earning projects in many IDA countries, the Bank is expanding the use of IBRD resources for specific projects in IDA countries based on the IBRD enclave framework for loans and/or partial risk guarantees for critical infrastructure and natural resource projects. The Bank is also working with major underwriters of emerging market bond issuance and liability management experts to identify innovative cofinancing opportunities. Despite these efforts, the crisis highlights gaps in the aid architecture that hamper quick and effective responses to LIC needs following severe and widespread shocks.

VI. What More Is Needed: Elements of an Effective Global Response

As the impact of the current global crisis has spread worldwide, it is evident that earlier hopes that low-income countries would be spared the worst were not realized. While the relative significance of particular channels of impact differ enormously across LICs, and high frequency data are elusive, available evidence confirms that the impact is both real and large, potentially threatening gains in jobs, poverty reduction, and human development.

In response to the series of crises (beginning with the food and fuel price shocks), many in the development community have stepped up their efforts to assist LICs by increasing resources, expanding existing programs, and introducing new initiatives. Despite tight domestic fiscal pressures, many donors have sought to mobilize additional resources, and development agencies (including the MDBs) have pursued creative means to "lean forward" to channel more resources more quickly to affected countries.

While mobilizing more resources is important, there are other priorities as well. Much attention understandably has been focused on identifying and addressing policy and regulatory failures that contributed to the crisis, and there remain other areas in which coordinated policy actions by the G-20 and others could make a difference to LICs. These include:

Trade: Even before the launch of the Doha Development Round of multilateral negotiations, expanding trade was a priority for LICs seeking to accelerate growth and reduce poverty. Trade has been the primary channel through which LICs have been affected by the global crisis, and it offers the most obvious path to recovery. With this in mind, G-20 members should continue to promote a multilateral trading system more supportive of development, most notably through renewed commitment to complete the Doha Round as quickly as possible, refrain from raising tariff and non-tariff barriers to trade and investment, especially against LICs, and resist pressures to support domestic demand through measures that could distort trade. G-20 members should also help LICs position themselves to take advantage of the eventual recovery in the global economy by fulfilling their Aid for Trade commitments, cooperating with development partners to improve the effectiveness of Aid for Trade programs, and ensuring that LICs have access to timely and affordable trade finance, including through IFC's Global Trade Liquidity Program (GTLP).

SME finance: Recovery in developing countries will depend on whether their domestic business sectors can rebound, grow, and create new jobs. SMEs are the foundation of the private sector in LICs, and will be critical to the eventual resumption of growth in these economies. Renewed efforts are needed to create a sound regulatory and institutional environment and to tackle financing and capacity constraints that constrain SMEs. At end FY09, IFC's committed SME portfolio was $6.1 billion, and IBRD/IDA lending for SME lines of credit totaled $1.65 billion. G-20 members should actively support the WBG in promoting business environment reform and doubling resources mobilized for SMEs by 2013. G-20 members should also provide resources to strengthen the SME sector; encourage agreement on global standards for branchless banking; and develop financing mechanisms to support cross-border investment.

Stolen asset recovery: As discussed, the theft of public assets is a huge and serious problem, especially for LICs. What is needed is a renewed global commitment to combat corruption and improve integrity in financial markets. The G-20 should: support the World Bank and United Nations Office on Drugs and Crime (UNODC) StAR initiative; ratify and fully implement the United Nations Convention against Corruption; commit to actively investigate and prosecute corruption and the laundering of its proceeds, as well as freeze and confiscate these proceeds; pledge to provide the fullest international cooperation on anti-corruption and the return of stolen assets; and call on the Financial Action Task Force (FATF) to more effectively leverage AML/CFT regimes to deal with the issue of politically-exposed persons and the proceeds of corruption.

To confront and move beyond the global recession, LICs will need additional financial resources beyond existing ODA commitments. The analysis provided in this paper points to two challenges that will shape when and how vigorously LICs emerge from the current crisis. First, they need to deal with bottlenecks that have constrained agricultural sector growth, hampered efforts to promote food security, and stranded millions of rural residents in poverty. Second, resources are needed to help LICs protect core spending during the downturn, in order that short-term distress does not turn into permanent regress.

Agriculture and food security: Experiences with multilateral initiatives in agriculture and food such as the Global Food Crisis Response Program (GFRP) show that success requires a multidimensional approach. Elements of food-related social protection, trade infrastructure, and environment and private sector development issues must be integrated.

The pledge of $20 billion for agricultural development at the G-8 Summit in L'Aquila convincingly makes the case for scaling up support to agriculture and provides a strong signal of intent regarding the availability of resources. But this is only the first step, it is important to move forward quickly with implementation. In this context, we urge the G-20 to:

- Endorse the L'Aquila initiative
- Firm up how country commitments will be met, and address concerns over "additionality"
- Support creation of an institutional structure and governance framework satisfactory to stakeholders and based on country ownership, with a focus on results and effectiveness
- Clarify the division of labor among international agencies involved in this area consistent with their institutional mandates

Box 9: LICs Facing Resource Shortfalls

- **Better-performing LICs:** Countries such as Tanzania, Malawi and Ghana were pursuing inclusive growth and poverty reduction policies while maintaining low debt, deficit and current account levels and maintaining adequate reserves. Without additional resources, recent progress will be eroded, including with respect to poverty reduction.
- **Fragile and conflict-affected states:** Countries such as Liberia, Sierra Leone, Haiti, and Afghanistan were engaging in social and economic recovery efforts and beginning to show signs of promise and stability. Additional resources can buttress hard-won stability and prevent a slide back into conflict.
- **Resource-rich LICs:** Countries such as DRC and Nigeria were expecting to generate public revenues from private investment in natural resources and to utilize these revenues to increase public service delivery and infrastructure investments. With the crisis causing the private sector to reassess investment decisions, additional resources are needed to maintain recently established public services and to finance infrastructure needs.

Crisis response: Despite efforts to date, LICs require financing beyond existing ODA commitments to meet the incremental needs arising from the global recession (see Box 9).

The current crisis—and others past and future—highlights the pressing need for a Crisis Response Facility ready to offer quick and effective assistance to LICs following severe shocks. LICs are at increasing risk of being hit hard by crises not of their making, undermining progress on the MDGs – in the last two years alone they have experienced the food, fuel, and financial crises in quick succession. At present there is a gap in the global aid architecture in the provision of timely and flexible support following crises. Failure to fill this gap could jeopardize the progress achieved in many LICs based on recent strong reform efforts, and instead lead to costly reversals.

Creating a crisis response facility can provide an integrated platform to quickly channel additional resources to LICs. Operating under the IDA umbrella, with a focus on crisis mitigation, resources could be allocated using criteria complementary to the standard performance-based allocation rules. Prioritizing among countries could be based on: crisis impact (projected impact on fiscal balances, core spending and/or growth); resource needs (adequacy of alternative sources of financing including from existing IDA allocations); and a supply of projects that can quickly and effectively mitigate the crisis impact).

The global development community should move to establish this Crisis Response Facility as quickly as possible. The World Bank will consult with key stakeholders and develop a proposal and possible financing options which can be discussed with IDA donors and borrower representatives at the IDA15 Mid-Term Review in November 2009, with consideration by IDA's Executive Directors for approval soon thereafter.

Endnotes

[1] Overseas Development Institute (2009), The Global Financial Crisis and Developing Countries
[2] World Bank (2009), Mongolia: Social Impact of Financial Crisis
[3] World Investment Report, United Nations Conference on Trade and Development (UNCTAD),2008.
[4] Massa, I. and Willem, D., "The Global Financial Crisis: Will Successful African Countries be Affected?", Overseas Development Institute, December 8, 2008.
[5] UN World Tourism Organization, *World Tourism Barometer*, Vol. 7 No 2, June 2009.
[6] Microbanking Bulletin 2007, data as of December 2007 based on financial data of 487 MFIs
[7] SMEs worldwide account for 97 percent of businesses and 50 to 60 percent of employment
[8] "How is the Global Crisis affecting Microfinance? A meta-analysis", CGAP. May 2009. Survey of 400 MFI managers.
[9] Chen, S. and Ravallion, M. (2009), "The Impact of the Global Financial Crisis on the World's Poorest", mimeo
[10] World Bank (2009) "Latin America beyond the Crisis: Impacts, Policies, and Opportunities".
[11] Ivaschenk, O. and Danzer, A. (2009) "Simulation of the impact of reduced migrant remittances on poverty in Tajikistan".
[12] "Rapid, qualitative assessments of the impacts of the economic crisis: Overview of findings from eight countries" (Vietnam, Thailand, Cambodia, Lao PDR, Mongolia, Ghana, Romania and Turkey)
[13] According to the ILO, only a handful of LICs have established unemployment insurance schemes. The vast majority have no schemes in place. See also *World Labour Report 2000: Income Security and Social Protection in a Changing World*,
[14] Tentative estimates from Vietnam suggest that about one quarter of those who had left rural areas for work had returned in the first quarter of 2009. The least skilled, least educated, least attached to a social network and older migrants were more inclined to return home.
[15] Jed Friedman and Norbert Schady. 2009. "How Many More Infants are Likely to Die in Africa as a Result of the Global Financial Crisis?" World Bank Policy Research working paper, WPS 5023.
[16] In technical terms, this suggests that the income effect dominates, a pattern which is consistent with evidence from Cote d'Ivoire, Ethiopia, Malawi, Tanzania, and Zimbabwe and (for health), India. In more advanced economies, the aggregate effect of a crisis on education and health outcomes cannot be determined *ex ante*, because of the possible strength of countervailing substitution behavior. See "Lessons from World Bank Research on Financial Crisis", Development Research Group, World Bank, November 2008 and S. Baird, J. Friedman, and N. Schady. "Aggregate Income Shocks and Infant Mortality in the Developing World." Forthcoming.
[17] Cambodian Researchers for Development. (2004). Garment employees in Cambodia: A socio-economic survey. Manila: Asian Development Bank
[18] In an analysis of 52 non-deposit taking microfinance institutions in Sub-Saharan Africa, the Consultative Group for the Poorest found that half of them rely on commercial sources for at least 30 percent of their total lending resources. This suggests significant vulnerability to a drying up of private sector sources of credit.
[19] IMF Staff Position Note, "Fiscal Implications of the Global Economic and Financial Crisis", SPN/09/13, June 9, 2009.
[20] The core spending financing gap is composed of three components–social spending, infrastructure maintenance, and social protection. It assumes countries seek to maintain health and education spending and the operations and maintenance of existing infrastructure at their pre-crisis levels as a share of GDP. It adds the estimated cost of providing a safety net to those who, had the crisis not occurred, were expected to emerge from poverty (measured as income of $1.25 per day). The estimate of social protection spending is based on the historic costs of effective, efficient social safety net programs, such as Mexico's Oportunidades program.
[21] For a review of this literature see Morrison, Raju and Sinha 2007.
[22] Sabarwal, Sinha and Buvinic (forthcoming)
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