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The financial crisis and the poor: a second look

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Summary

It is a widely held belief that the financial crisis will hit the poorest the hardest. However, most economic indicators that are pertinent for developing countries - international trade, foreign direct investment, rand emittances - will remain at levels comparable to the mid or late 2000s. And most importantly, global poverty is expected to continue to shrink in 2009 and 2010.

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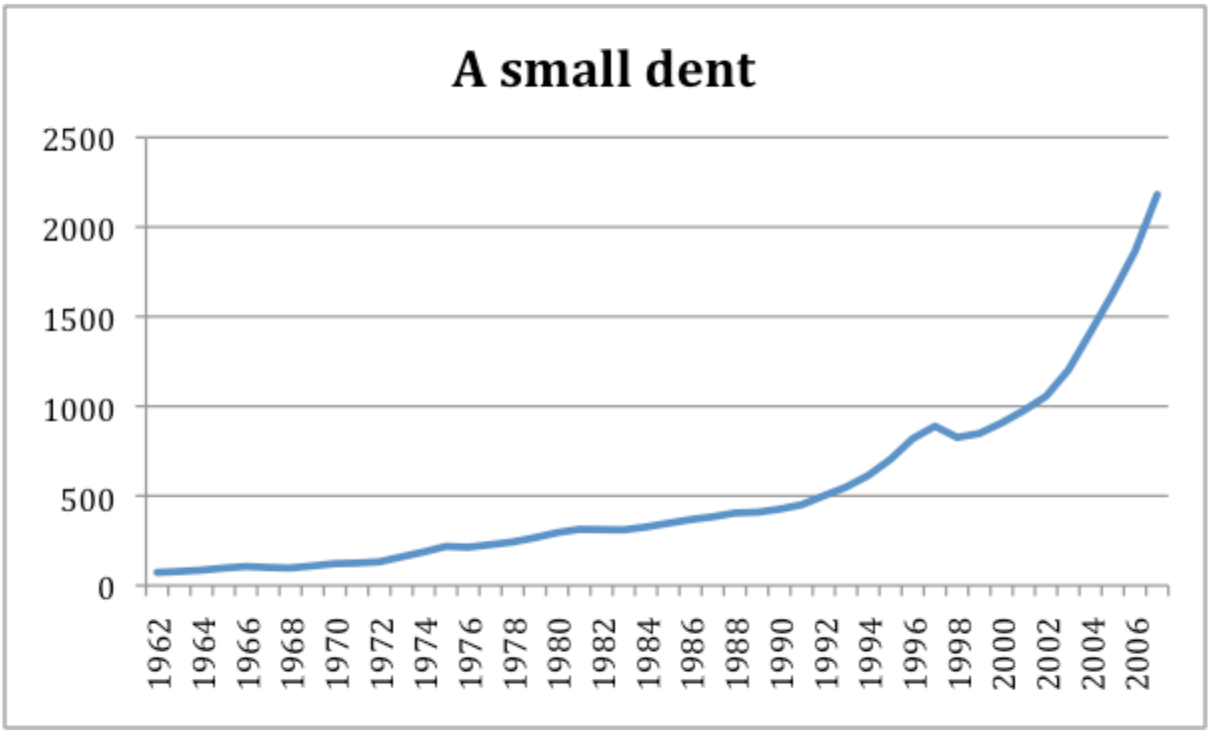
Introduction

"The financial crisis will hit the poorest the hardest". That is a common statement, a widely read newspaper headline and a fact that is taken for granted in the public debate. True, the global economic downturn means that some 100 million people more will live in poverty. And every person living in absolute poverty is a failure. But there is a different story out there. Data on poverty and other measures related the global economy from a developing country perspective actually indicate that the financial crisis seems to be less acute than is often argued.

Previous crises

Let us first take a look at the last time a financial and economic crisis hit the world, and the headlines about the failure of globalization and the international market economy were abundant, namely the one that struck East Asia in the 1990s. True, a lot of people suffered, and lost their jobs and incomes. But a few decades earlier they were much worse off, and they are much better off now. In fact, the crisis was nothing but a small dent in a quickly rising graph-line.

Graph I: Average GNI per capita in East Asia, current US$



Source: World Development Indicators Online

True, the Asian crisis took place more than a decade ago, and it was regional rather than global. But even so, the figures are actually not that alarming.

But how about the current crisis? Should we expect a similar development this time? Let us look at some current data and projections, of international trade, foreign direct investment to developing countries, remittances, and finally poverty in developing countries.

International trade

When it comes to international trade, we have seen a dramatic increase this last decade. In fact, international trade has doubled since the mid-1990s.

Graph II: The trade boom

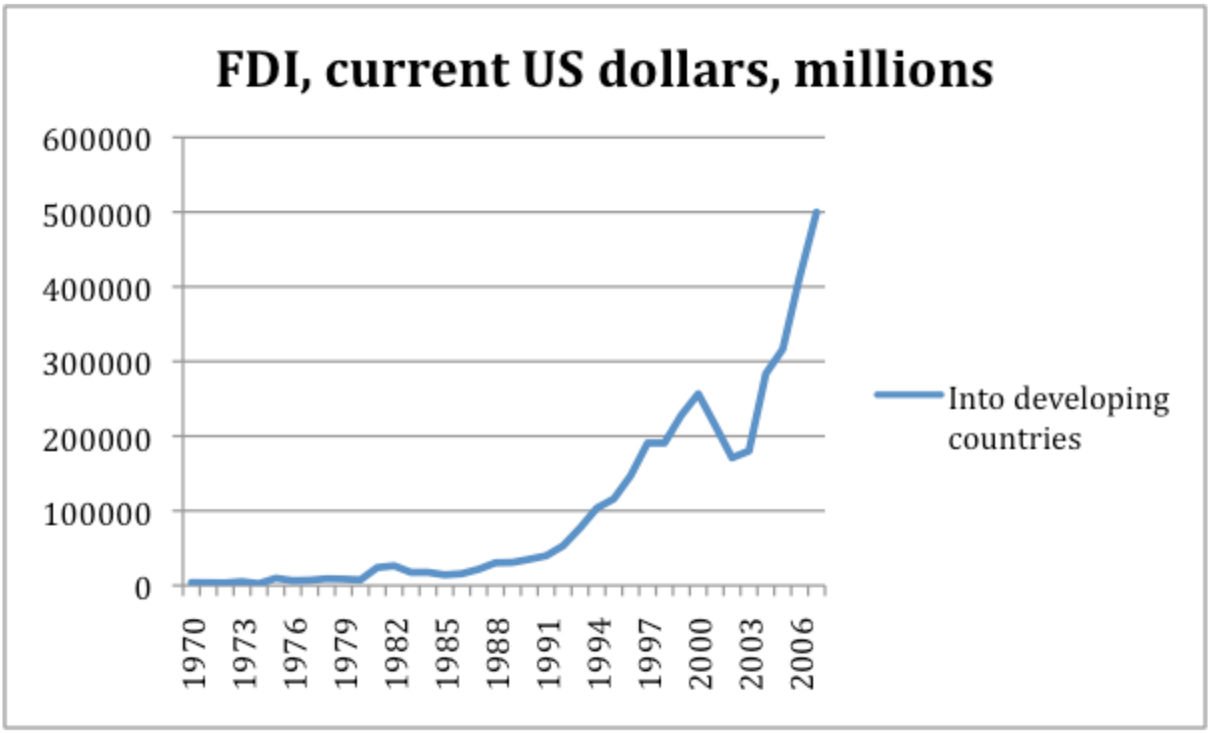
Source: The OECD database Stat Exctracts and WTO forecast (for 2009)

The nine percent cut that is expected by the WTO in 2009 has received a lot of attention. However, this decrease means that international trade will be slightly below the 2006 level, and record high compared to earlier decades.

Foreign direct investment

The flows of foreign direct investment into developing countries have risen sharply these last few decades, and most notably during the 2000s.

Graph III FDI boom in developing countries since 1970



Source: UNCTAD Database FDIStat.

Thus, even if FDI flows to developing countries were to be cut in half (which they are not), the levels would still be significantly higher than in the beginning of this decade. Moreover, according to the World Investment Prospects Survey 2009-2011, published by the United Nations' Conference on Trade and Development (UNCTAD), developed countries are hit harder than developing ones, when it comes to FDI cuts due to the crisis:

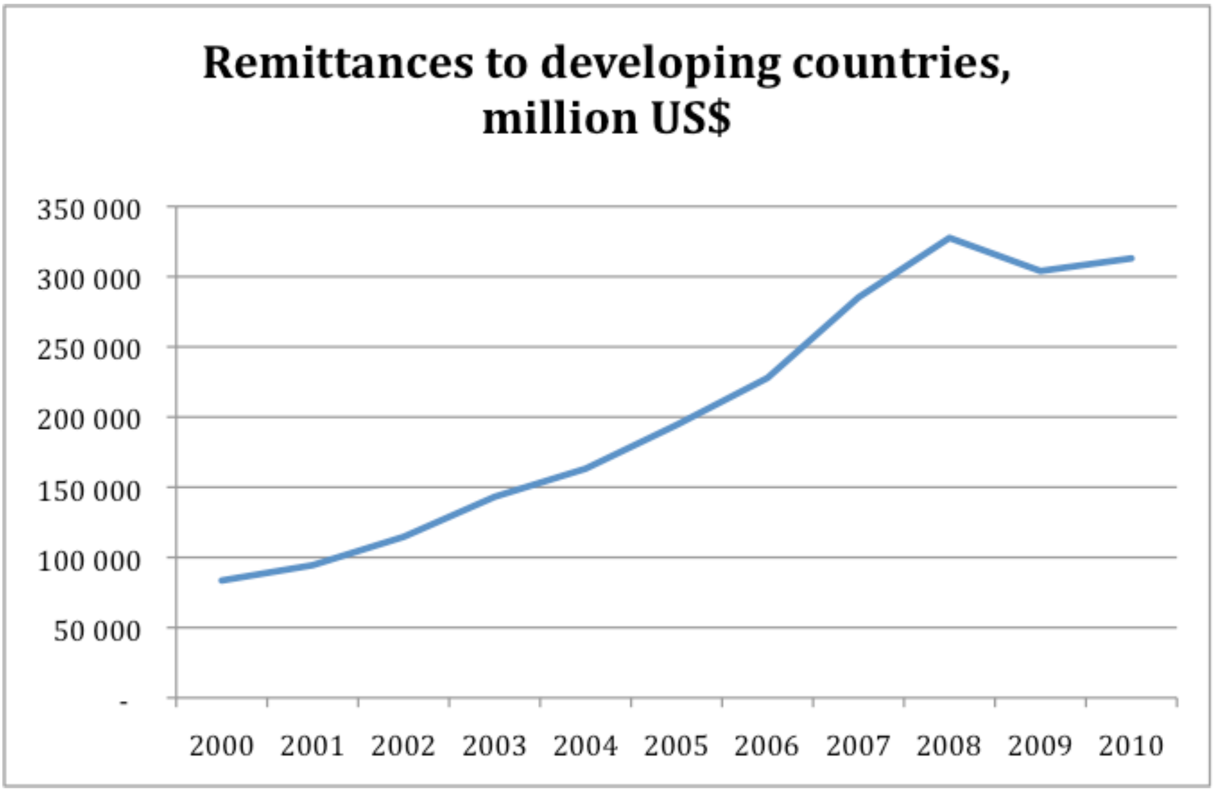
Responses to this year's survey, supported by the most recently available data on FDI flows, suggest that the setback in TNCs' FDI plans is affecting developed countries more than developing countries. In addition, there is a continuing trend towards a rising preference for emerging economies in TNCs' internationalization strategies, and some evidences suggests that the crisis may even have given added impetus to this trend.

In fact, according to the UNTAD survey, the region that is least affected by the downturn in FDI is Sub-Saharan Africa. Furthermore, as many as half of the transnational corporations covered by the UNCTAD survey report that their FDI levels will be higher in 2011 than in 2008.

Remittances

Remittances, i.e. financial transfers from migrant workers in rich countries to their countries of origin, are a vivid illustration of the internationalization of the global economy and of the importance of including the movement of labour in the globalization equation. Remittances have risen enormously the last decade. And they will not decrease by much.

Graph IV: Remittances to remain high



Source: Ratha et al 2009. Estimate for 2008, forecast for 2009 and 2010.

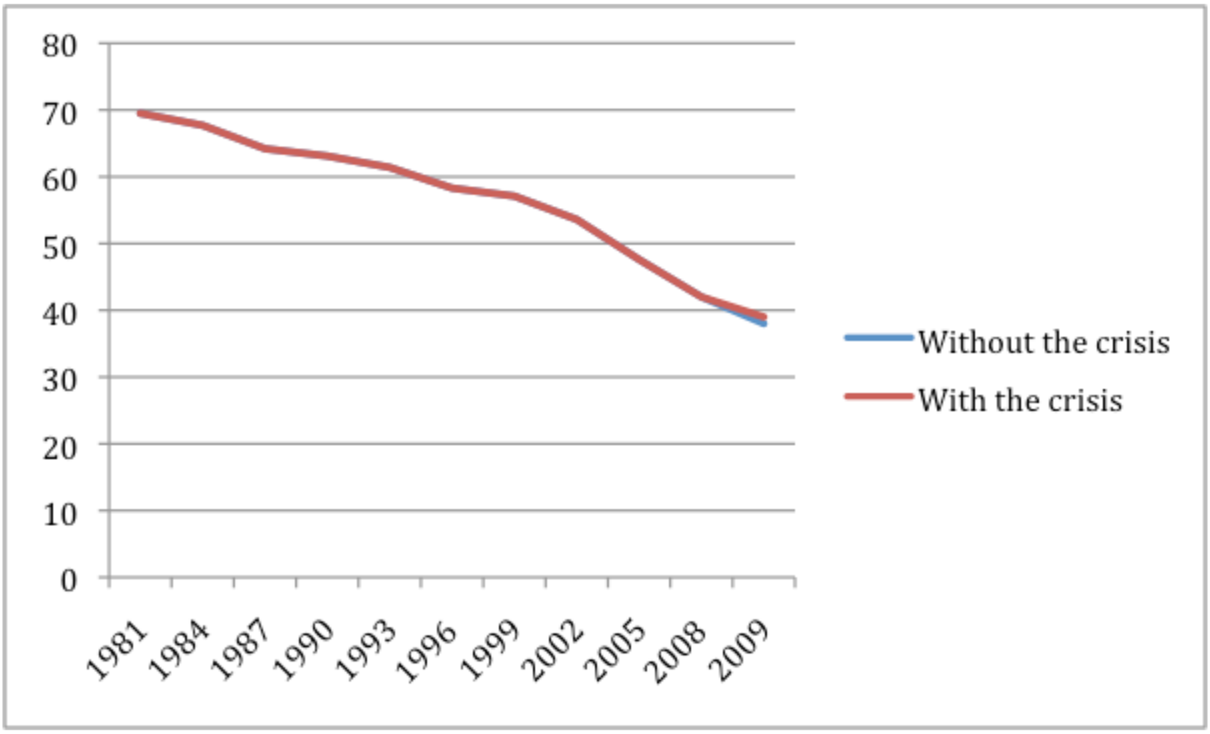
In fact, the current crisis is expected to have only a limited impact on this kind of flow to poor countries. The cut in remittances expected for this year means that 2009 still beats 2007, and next year flows will increase yet again, to the second highest level ever

Poverty

All of the above flows are different expressions of globalization, and from a global poverty perspective they are to be seen as means, rather than ends. The most important end in this context is poverty reduction. And here, largely as a result to the increased flows described above, since 1981 we have seen the sharpest reduction in the history of mankind. In 1981, 69.5 percent of the population in developing countries lived in poverty, at an income level of less than $2 per day, adjusted for differences in price levels. In 2008, this figure had been reduced to 42 percent.

World Bank economists Shaohua Chen and Martin Ravallion expect the effects of the global economic downturn to be a decrease to 39 percent instead of 38 percent. True, this means that one percentage point more of the developing world population will live in poverty, which is one percentage point too many. However, from a perspective covering the last three decades, this lower speed of the poverty cut is very limited. And more importantly, even during the peak of the crisis, the share of the world's population living in poverty is expected to continue to shrink. The fact is that in 2009, global poverty will probably once again be at the lowest level ever.

Graph V: Share of developing world's population living on less than US$ 2 per day, PPP, %



Source: Chen & Ravallion 2008 and Chen & Ravallion 2009.

Conclusion

True, this brief is based on projections and forecasts which are as uncertain as the prospects for recovery. But so are the alarmist headlines, both since they are based on similar (and sometimes the same) publications as this study, and by definition, since 2009 has not yet come to an end, and 2010 has not even begun. More importantly, however, these negative headlines have failed to give the full picture of the effects of the global crisis on the world's poor, and to put the short-term development in a longer-term perspective. Even though we are experiencing the most severe global economic downturn since the Great Depression and even though a similar crisis may be relatively stronger felt by someone who lives with small economic margins, several important indicators of globalization and development indicate that the poor are actually less hurt by the crisis than are people in rich countries. Furthermore, the decreases are so limited that the different flows of resources from rich to poor countries will be at levels seen sometime during this decade. Most importantly, global poverty is expected to continue its historic decrease. Finally, the most important lesson to be drawn from these data is that we must not reject the process which has led to this dramatic poverty cut, at least not without serious reflection.

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