Assessing the Impacts of the Global Financial Crisis and Appropriate Policy Responses in Asia

Synthesis of Outcomes from 3 Case Studies in Bangladesh, Pakistan and the Philippines

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At the onset of the global financial crisis, there was considerable debate as to the eventual repercussions it might have in developing countries, i.e. whether and how it would impact national economies and worsen deprivation among the most vulnerable. Strong voices emerged to suggest that weak integration into the global economy, particularly in the case of Africa, would protect these countries from the worst effects of the crisis.

Yet, as the crisis evolved, falling world export demand, foreign direct investment, remittances and, more recently, aid flows inexorably drew these countries into the global slump. Furthermore, weak fiscal situations and lack of access to a severely constrained global credit market denied these countries the most important tools – stimulus spending – that developed countries used to weather the storm.

In 2009, PEP decided to mobilize several of its (alumnae) members in Asia, Africa and Latin America to monitor, analyze and forecast the impacts of the crisis in terms of socioeconomic well-being in their respective countries. Small teams of researchers were selected in over 20 countries to take part in the initiative, which was granted support from several institutions such as AusAID, CIDA, IDRC, IFPRI and UNICEF. The research initiative was broken down into three components, or groups of studies, each providing a different analytical perspective on the issue, for more comprehensive results.

Anticipating national impacts of the crisis and designing appropriate responses

One of these components mobilized nine (9) of these research teams to develop and apply a combination of macro-micro modeling and simulation techniques, in order to link the effects of the crisis on national economies to multiple aspects of household welfare, while exploring the likely impacts of various possible policy responses (through the simulation of different scenarios) to protect the most vulnerable. These particular studies were conducted in different countries in Asia (Bangladesh, Pakistan, Philippines), Africa (Senegal, South Africa) and Latin America (Bolivia, Colombia, Ecuador, Uruguay).

Overall, it soon became evident that how much individual countries were affected and how the losses were shared within the population depended, and continue to depend, on the specific global links (particularly trade, investment, remittances and aid) of the country and the policies put in place to respond.

Indeed, if the channels of impact seem to be relatively similar in all case studies – essentially through the reduction in world demand and resulting fall of export volumes and prices – national economies are affected to varying degrees. Initial levels of economic performance, fiscal balance and/or integration into the global economy are obviously crucial, not only for the impacts on the country's economic well-being, but also for the government's capacity to implement policies to counter the impacts of the crisis.

Case Studies in Asia

The following pages summarize the main outcomes, in terms of research findings and policy recommendations, ensued from the three case studies in Asia, i.e. in Bangladesh, Pakistan and the Philippines.

Bangladesh

"*Implications of the Global Economic Crisis for the Bangladesh Economy*"

- By Selim Raihan and S.M. Abdullah. Final report.

According to their simulations' results, Raihan and Abdullah have identified exports and remittances (both subject to strong reductions in growth rates) as the main transmission channels through which the global crisis would affect the Bangladesh economy and population's welfare.

The shock that represents the combination of these reductions is expected to aggravate the negative impacts of the global crisis both in the short and long terms in Bangladesh; In all cases, however, the short term negative effects would be larger than those expected in the long term.

- The fall in overall exports would lead, in turn, to a decrease in aggregate consumption and imports, which would seem to affect consumption and, thus, welfare at the household level – with the poorer households affected to a greater extent.
- The impact of the fall in remittance rates on household welfare is obvious, as it affects directly the income, and thus real consumption, of beneficiary households – where those with higher initial endowments (in terms of remittances as share of income) are affected to a greater extent.

Policy implications and recommendations

The simulations have shown that, initially, it is a steeper decline in the growth rates of exports from the specific sectors of woven and knit "ready-made garments" (RMG) that contributed to such low rates of overall growth in total exports from Bangladesh - which, in turn, had such negative impact on the overall economy and welfare in the country. As projections suggest that the decline in these sectors might persist, the researchers recommend the intervention of policies to boost activities and performance in these two export-oriented sectors. The researchers have, in fact, identified a variety of issues – such as weak physical infrastructure and high transaction costs, or lack in skilled labor, in backward linkages and in access to capital – all causing serious constraints and bottlenecks on the supply side, that may be addressed to enhance the competitiveness of these sectors.

On the other hand, as Bangladeshi exports are highly concentrated in – and thus dependent on – these two sectors, the researchers also strongly recommend initiatives to diversify the country's "export basket", in order to reduce such dependency and the economy's vulnerability to external shocks.

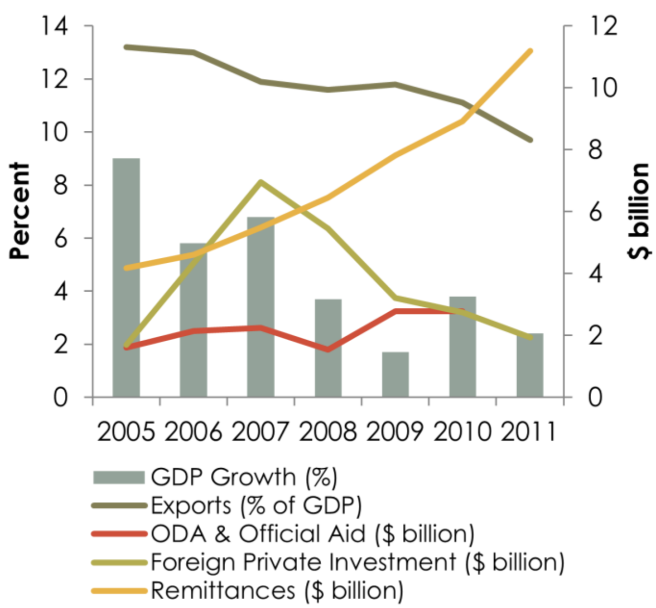
On the subject of remittances, the researchers refer to both the simulations' results and previous studies to confirm the importance, in terms of strong "welfare-enhancing" effects, of remittances in Bangladesh – thus the worrying consequences of the drastic reduction in remittances inflow, as a result of the crisis, on welfare in the country. They even predict a worsening of the situation, i.e. further reduction of remittances' inflow, due an observed trend of (declining) annual migration from Bangladesh.

Their conclusions thus suggest the need for policies to encourage both outward migration and larger inflows/better use of remittance money. Such measures, for example, could help reduce hassles (or remove impediments) to the processes associated with the sending of remittances through formal channels, or provide appropriate guidance and support in channeling remittance money towards productive investments. The researchers also believe that the government should negotiate agreements with international partners (wither bilaterally or multilaterally, at WTO) that would encourage the export of Bangladeshi labor force.

Pakistan

"*Impact of the Global Financial Crisis in a Small Open Economy: the Case of Pakistan*"

- By Vaqar Ahmed, Saira Ahmed and Ahsan Abbas. Final report.



By 2009, the Pakistani economy, which had otherwise remained in the league of countries with leading growth rates since 2000, was struggling to keep this rate from turning negative.

The national economy's downward trend (after 2007) was essentially induced by a steep decline in foreign investments and in exports' growth rates.

Unlike Bangladesh, however, some relief was seen through rising remittances from abroad and pick up in foreign assistance for flood affected areas.

While many have attributed Pakistan's economic problems to the food and fuel price shocks, and energy crisis that preceded the global financial crisis, the PEP researchers' simulations results show how a reduction in foreign savings has adversely impacted overall GDP, poverty and inequality levels. They also find that, between 2007 and 2009, while remittances remained resilient, it was the decline in trade, private and official capital inflow, official development assistance and foreign direct investment that led to the slowdown in economic growth and sharp decline in pro-poor budgetary expenditure.

- In terms of "value added", while both the agriculture and industry sectors experienced downturns, the services sector - in particular domestic services - witnessed an increase. This caused a movement in the labor market (away from agriculture and industry) towards the service sector. On the other hand, as external resource inflow declined and due to pressures on the exchange rate, imports became more expensive.
- The investment and consumption levels decreased across the board which, in addition to a reduction in foreign savings, has caused both poverty and inequality to deteriorate, particularly for the two most populous provinces of Pakistan (Sindh and Punjab). Overall, it is the urban poor who faced the highest decline in consumption.

Policy implications and recommendations

Indeed, volatile global export prices pose a threat to the terms of trade in countries which have a dominate commodities export base, and Pakistan has been slow to diversify its export structure in terms of the commodities it produces and markets abroad. The regional diversification has also been slow as most of the exports are still destined to the US and EU (both hardly hit by the global financial crisis). Therefore, the researchers recommend that the future trade policies of Pakistan should focus on both export sophistication and diversification.

Plus, given that the foreign aid inflows have been on a decline for the past several years, emphasis should now be on improving domestic resource mobilization. This may be supplemented by the rising remittances from abroad, which could be even more profitable if channeled towards investments, instead of meeting short term consumption needs. For this, both the government and banking system must develop a wide range of savings instruments for corporate and household sectors. Incentives such as the Pakistan Remittance Initiative (PRI) should be widened.

Dealing with the crisis was difficult for Pakistan, especially due to pre-existing fiscal constraints. Specific weaknesses in terms of balance of payments weaknesses have forced the country to resort to an IMF stand-by arrangement, which imposed further conditionalities related to budget restrictions. Subsidies on wheat, electricity, fertilizer and oil had to be phased out, which in turn increased the inflationary burden on the consumer.

Finally, while some social safety nets have been implemented both at the federal and provincial levels, access to these programs remains generally difficult for the poorest. There is thus crucial need for better targeting of these social protection programs and pro-poor interventions.

Philippines

"Global Economic Crisis and the Philippine Economy: A Quantitative Assessment"

- By Erwin Corong. Final report.

As was the case for many developing countries, despite relatively limited exposure to US financial assets, the Philippine economy suffered a dramatic slowdown, essentially channelled through international trade (falling world export prices and global demand) which, as the study shows, contributed to deceleration in both economic growth and employment in the country.

In addition to the "crisis scenarios" that he simulated to understand how contracting international trade transmitted the impact of the crisis into the Philippine economy, however, the researcher also went on to explore the effect of the 10 percent increase in social expenditures that was prescribed in the government's stimulus program implemented in early 2009.

The results show that the impact of the global financial crisis was to reduce growth rate in GDP in 2009 by about a quarter compared to what it would have been in the absence of the crisis, while the stimulus package only improved the situation slightly.

- Both sectoral outputs and labor demands were affected to various degrees, depending on each sector's exposure to the international market.
    - As expected, the more outward-oriented manufacturing sector suffers the biggest contraction, with demand falling for both skilled and unskilled labor.
    - However, demand for skilled labor also decreased in the agricultural sector, which is more inward-oriented.
    - With expanded public expenditure from the government's stimulus package, the service sector expanded, leading to an increase in demand for labor and a migration of workers to public service.
- Both inequality and poverty worsened.
    - The poverty gap and severity increased more than the poverty headcount - i.e. an increase in the share of poor and a bigger increase in disparities among the poor.
    - All households experienced a reduction in real income, particularly those in the lower deciles.
    - Poverty increased more in urban areas, where most export-oriented industries are located.

Policy implications and recommendations

In the case of the Philippines, the simulations' results suggest that, while the government's stimulus program helped alleviate the impact of the crisis slightly, it was not enough to completely outweigh the negative effects on welfare arising from the crisis. Because of tight fiscal conditions, the increase in government spending was quite modest and focused on expanding employment in the public services sector, financing of small infrastructure projects located within communities, as well as social protection measures.

The study concludes that the Philippine government now faces the challenge of designing post-crisis policies that could further stimulate the recovering economy, as well as targeting the most vulnerable individuals/households. Against this backdrop, the Philippine government needs to become more proactive in finding ways to mitigate the potentially harmful effects arising from future economic and financial crises on vulnerable household groups, particularly the poor.

Among the researcher's recommended responses in terms of policy measures to be implemented by the Philippine government to address the aforementioned issues are:

1) to improve the existing social protection program by addressing many of its bottlenecks - such as inadequate benefits, low coverage, and poor targeting - as well as expanding the delivery of social protection;
2) to spend more in improving the economy's physical infrastructure to create job opportunities, improve productivity and complement its social protection measures;
3) to help promote intra-regional trade with other Asian economies, thus moderating its export dependence to Western economies like the United States and Europe.

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