



# **Impact of the Financial Crisis on LDCs**

by

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# Introduction

- Initial impact less pronounced, as LDCs are not deeply integrated into global financial markets.
- Impact of crisis on LDCs is multifaceted and affects countries in different ways.
- LDCs have been more affected during the later phase of crisis, through a:
  - Sharp reduction in world trade and rapid decline in commodity prices.
  - Reduction of FDI flows.
  - Slowdown of worker remittances flows.
  - Potential decline of ODA.
- Global crisis is likely to have important implications for growth and poverty in LDCs.



# Impact of the Financial Crisis on LDCs

## 1. TRADE

- Impact of trade shocks on LDCs is sharper and quicker than before.
- How LDCs are affected by the collapse of world trade depend on the nature of their trade specialization.
- Commodity price boom period is associated with faster growth in LDCs, but food and fuel price hikes are moderating the impact on rising standards of living and reducing poverty.
- Global recession has led to drastic fall in export volumes and prices.

## Impact of the Financial Crisis on LDCs (cont.)

### 2. INVESTMENT

- The direct fallout of crisis on LDCs has been relatively limited in LDCs.
- However, they have found it difficult to mobilize funding in global financial markets.
- Premiums on trade credits have substantially increased.
- Global crisis likely to undermine FDI flows to LDCs, as MNCs lack access to funds.
- Decline of FDI inflows in the form of cross border mergers and acquisitions.
- However, FDI in greenfield investment in mineral and oil exporting countries may continue.



## **Impact of the Financial Crisis on LDCs (cont.)**

### **3. OFFICIAL DEVELOPMENT ASSISTANCE**

- LDCs face a large resource gap.
- ODA flows play an important role in financing development in LDCs.
- LDCs rely heavily on ODA for financing a large part of their budget.
- During the crisis, as budgets of many donor governments have come under extreme pressure, it is likely that ODA flows may be curtailed (30% reduction projected, IMF 2009).
- This could endanger LDCs' development prospects.

# **Impact of the Financial Crisis on LDCs (cont.)**

## **4. REMITTANCES**

- Remittances have become an important source of development finance for LDCs.
- Remittances mainly come from other developing countries in the vicinity, hence the collapse in the commodity boom is likely to have a dramatic effect on remittance flows (around 5%, according to the WB, 2009).
- Adverse effects for poor households, where worker remittances often form a large part of their income.
- Collapse of remittances together with a slump in the domestic economy, resulting from negative trade and investment shocks, intensifies poverty and reduces the use of migration as a source of insurance to shocks.



## **Implications for Growth and Poverty**

- The ongoing global financial crisis is having a significant impact on growth and poverty.
- The impact of the global economic crisis for growth and poverty varies across LDCs.
- Income growth in LDCs will likely stagnate as a result of the rapidly deteriorating external conditions.
- LDCs have their policy space limited due to generalized poverty.
- Low domestic resources available for finance (DRAF) rates in LDCs are due to extreme low productivity levels and lack of productive capacities.



## **Implications for Growth and Poverty (cont.)**

- The crisis intensifies poverty in LDCs through a number of channels, direct and indirect.
- Directly, through its impact on economic growth, employment, wages and distributional changes.
- Indirectly, through its effect on government revenues, which may lead to a cut in government expenditure on social services.
- The crisis can lead to an increase in interest rates in LDCs, with negative effects on investment and employment, further hitting the poor.
- Decline in remittances and ODA could further exacerbate poverty.
- Conservative IMF estimates project that by 2010, as a result of the crisis, there will be 9.5 million of new poor in Africa and Asia.

# Policy Responses

## (i) National Level

### □ Fiscal Policies

- Governments should use counter-cyclical policies, whenever possible.
- Increment of investment in infrastructure, agricultural extension and in creation of jobs with low import content.
- Planned investment for future years.
- Protection of budgetary allocations to education, health and social welfare.

# Policy Responses (cont.)

## (i) National Level

### □ Monetary Policies

- Monetary policy should accommodate fiscal policy in stimulating aggregate demand.
- Stimulation of private investment.
- Provision of subsidized credit for investment in specific sectors.
- Macroeconomic frameworks for poverty reduction should allow for access to sizable contingency funds to cope with negative shocks.

### □ Close monitoring of the domestic banking sector.

## **Policy Responses (cont.)**

### **(ii) Regional Level**

- Regional Development Banks are required to help LDCs to cope with the decline in government revenues.
- Recapitalization of the multilateral development agencies is necessary to deal with the scale of the current crisis.
- Transfers should be made with an unjustified conditionality and with respect to countries' ownership of their policies and initiatives.
- Greater coordination, transparency, flexibility and democratic governance from all involved organizations is needed so that efforts become more fair and effective.

## **Policy Responses (cont.)**

### **(ii) Global Level**

#### **❑ Official Development Aid**

- Honor commitments to increase aid to LDCs.
- Improve the delivery of aid.

#### **❑ Additional resources are required**

- Welcome global plan and reform adopted by the G20 at its recent London Summit.
- Provide US\$ 1.1 trillion dollar programme of support.
- US\$ 50 billion for LIC, NOT adequate.
- Increase resources available to the IMF.

## **Policy Responses (cont.)**

### **(ii) Global Level**

- ❑ **Multilateral Development Finance Institution (IMF) providing additional funds to DVCs**
  - Overhauling IMF's lending and conditionalities framework.
  - Flexible credit line and high access precautionary arrangement.
  - However, these facilities are unlikely to benefit LDCs given the strict eligibility criteria.
  
- ❑ **No protectionism**
  - Recommit to free trade.
  - Conclusion of the Doha Round of trade negotiations.
  - Duty and quota free market access to LDCs.



**Thank you**



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LDCs

