The Global Economic and Financial Crisis: Regional Impacts, Responses and Solutions

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A Crisis Across the Regions

The five Regional Commissions come together at a time in which the world's economies face some of the most difficult challenges presented in the past century: from climate change effects to extreme food/fuel price volatility to the worst global recession since the Great Depression. The effects these are having on developing countries' efforts to meet the Millennium Development Goals are worrisome.

This report focuses on the economic crisis. What started as a financial crisis in the United States has quickly unfolded into an economic crisis that now threatens to roll back the development gains of the last decade and may precipitate a human tragedy in many parts of the developing world. The issues are global: this affects every developing country from every region requiring that each country devise a strategy for addressing the challenges. At the same time, intergovernmental cooperation, both globally and regionally will be central towards ensuring that the solutions are equitable and efficient.

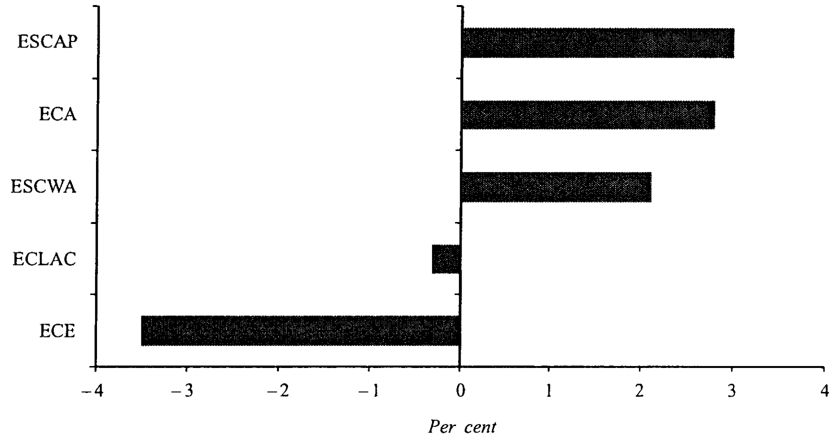
The analysis presented in this report provides a regional perspective on how this crisis is impacting the member states of the five Regional Commissions of the United Nations, and examines the type and adequacy of responses at the national and regional levels. It suggests ways in which the Regional Commissions can use their collective strengths to prevent the economic crisis from becoming a human crisis.

Each region, not to mention each country, has its own unique set of challenges, but the report finds many commonalities and, based on these, it identifies further opportunities for policy coordination and cooperation at the regional and inter-regional levels. The report concludes that the regional dimension provides an important and effective framework – not just for mitigating the impact of the current crisis but also for reducing the chances of similar crises in the future.

All regions have suffered declines in growth

According to World Bank estimates, the global economy is expected to contract by 1.7 per cent in 2009, the first decline on record in world output (World Bank, 2009). The crisis will plague economies all over the world – but the impact will differ in scale and severity from one country and region to another (Figure 1). The epicentre is the ECE region where economic growth in its ad-

Figure 1 – Real GDP growth by region, 2009



Source: Based on data from Regional Commissions.

vanced economies turned negative between late 2007 and 2008. Annual real growth in the region as a whole is forecast to fall from +1.5 to −3.5 per cent between 2008 and 2009. The emerging European economies in particular have been hit hard – suffering from a sudden halt in capital inflows while lacking the policy space to implement expansionary monetary and fiscal policies.

In the ESCWA region, between 2008 and 2009, GDP growth is expected to fall from 6.1 to 2.1 per cent. The Gulf Cooperation Council countries, which are now suffering from large declines in oil prices and depressed real estate markets, will see growth fall from 5.8 to 1.1 per cent. The economies in the ECLAC region are also experiencing falls in commodity prices, which for some countries make up a large part of GDP, as well as from declining flows of remittances. This will depress economic growth across Latin America and the Caribbean where, after six consecutive years of steady expansion, ECLAC estimates GDP is expected to contract to −0.3 per cent. In the ECA region, preliminary evidence also indicates slower growth. Despite earlier predictions that African economies, with relatively low levels of integration with the global economy, would, to a certain extent, be insulated from the brunt of the crisis, growth forecasts for 2009 are being reduced by between 2 and 4 percentage points. In the ESCAP region the developing economies initially showed resilience since, following the Asian financial crisis in 1997, they had implemented wide-ranging financial and regulatory reforms. Now, however, they are feeling the effects through declining trade, on which the region is heavily dependent. As a result, compared with 5.8 per cent growth in 2008, the ESCAP region is expected to grow in 2009 by only 3 per cent. This is nevertheless faster than in many other parts of the world so, given that the region's developing economies account for 16% of World GDP, Asia and the Pacific is likely to be the locus of global growth in 2009.

Despite banking sector rescue plans, risks remain

When the United States property bubble burst, dramatic increases in mortgage defaults brought insurmountable consequences for the world's banking sector and financial markets. Many banks were over-exposed to bad loans or the complex financial assets derived from them. As a result, market participants became risk adverse and when questions arose about the solvency of major financial institutions; this triggered a severe credit crunch which ultimately affected the real economy.

The IMF estimates that toxic assets held by banks and financial institutions, most of which are in the developed ECE economies, could reach $4 trillion (IMF, 2009a). Since their exposure is on such scale as to threaten systemic failures in banking systems, governments have been assembling rescue plans – unloading the toxic assets from bank balance sheets as well as recapitalizing the banks so they can resume normal lending operations. This may be essential but it is also risky, for if the plans to 'fix' the banks fail, and require large additional sums, this will continue to absorb funds that are urgently needed for stimulating the real economy and addressing the world's other pressing problems.

A further source of vulnerability in many places, including the emerging European economies, is that foreign capital is drying up. This is not yet a severe issue for the major economies in ESCWA and ESCAP regions, which have relatively low levels of non-performing loans – currently under the 8 per cent threshold. But if the credit crunch gets worse many other enterprises and banks will come under stress. In the ECA region many of the banks are foreign owned, exposing them to a risk that their owners may choose to offer less support to operations in Africa or sell their assets with serious consequences for Africa's financial sector.

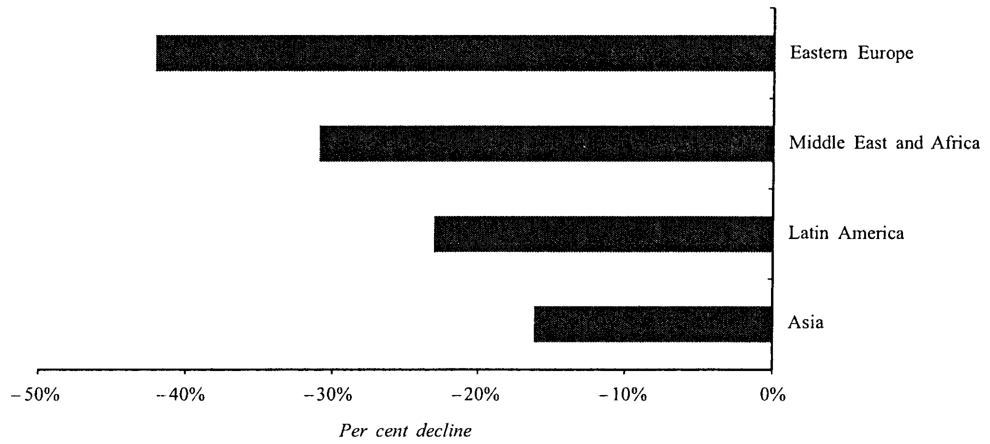
Falling equity prices

All regions first felt the impact of the economic crisis through rapidly declining equity markets – in some cases coupled with massive outward capital flows and an associated depreciation in exchange rates. The ECE region, especially the emerging markets in Eastern Europe, has substantial exposure to foreign capital, and since September 2008 markets have declined by over 40 per cent, while stock markets in the ESCWA region witnessed a sharp decline of nearly 50 per cent in 2008, pushing them to their lowest level since December 2004. Most African countries, on the other hand, with less-developed financial markets and limited links with the global financial markets, have been insulated to some extent from the global financial crisis. Nevertheless, countries like Egypt and Nigeria, with more developed financial markets, have taken a hit: between March 2008 and March 2009, their stock market indices declined by around 67 per cent. Some countries in the ESCAP region have also recorded sharp declines since the crisis, though the losses in Asia and the Pacific have generally been lower than elsewhere (Figure 2).

Capital flows have been drying up

The global economy has seen a reduction in all categories of capital flows including overseas development assistance (ODA),

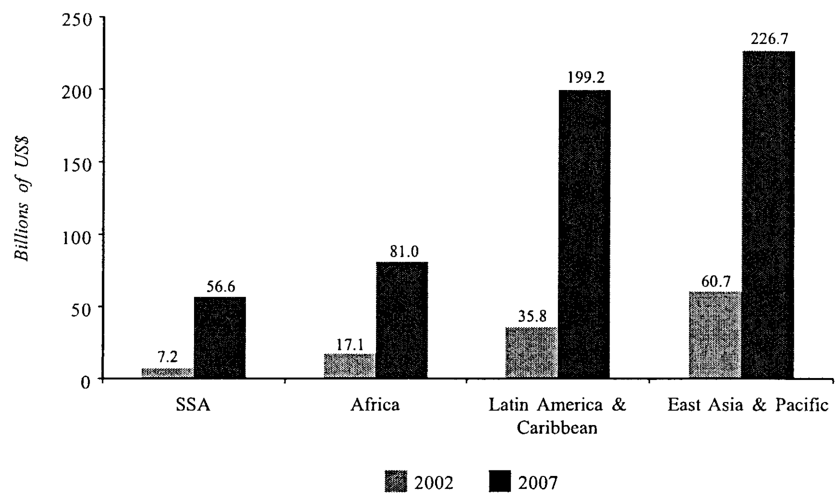
Figure 2 – Regional emerging markets equity indices, 19 September 2008-16 April 2009



Source: ESCAP calculations based on data from MSCI Barra.

foreign direct investment (FDI) and remittances. This has affected developing countries in all five regions, though to varying extents. Over the past decade, all five regions have seen dramatic increases in capital flows (Figure 3). These are now under threat. Countries in the ECLAC region and the CIS, for example, have already seen a drop in FDI. Here one of the triggers has been a fall in commodity prices since most of the region's FDI comprises investment in natural resources. The ESCAP region has also been affected: after rising dramatically during the past decade, FDI inflows have started to decline. The ESCWA region is expected to have witnessed a decrease of

Figure 3 – Net private capital flows to developing country regions, 2002 and 2007



Source: Economic Commission for Africa.

21 per cent in FDI in 2008, largely due to a sharp setback in the last quarter.

Many developing countries also depend heavily on remittances to combat poverty and meet basic needs, such as food, housing, health and education. As migrant workers lose their jobs, remittances are expected to fall. Indeed there are already reports of an increase in the return of unemployed migrants in Asia as well as the ESCWA region. This will affect some of the poorer countries in the ESCAP region as well as countries in the ECLAC, ECA and ESCWA regions.

ODA commitments are increasingly shaky. Pressures are mounting in major donor countries to recapitalize financial institutions, support other ailing industries and revive domestic demand – leaving less available for ODA. Among the recipients likely to suffer most from falling ODA are the least developed countries, of which many are in the ECA region and vulnerable populations in conflict-affected member states throughout the world.

Sharp falls in commodity prices

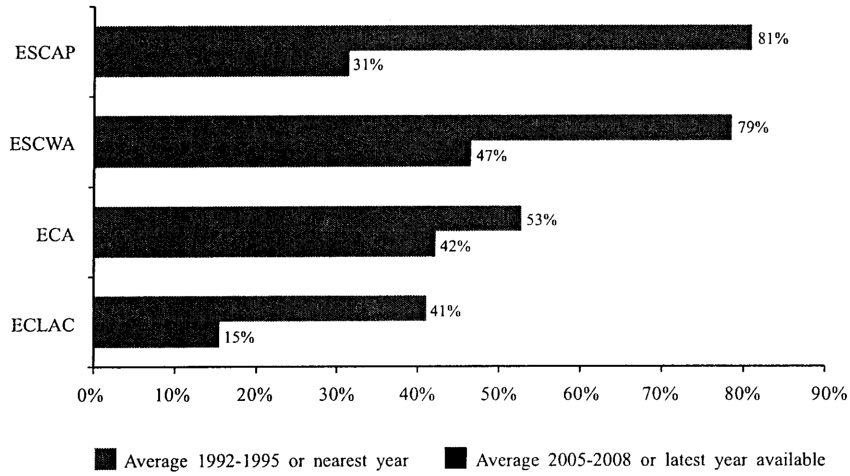
Following the slump in global demand, the commodity price boom has turned to bust. Since their peak in mid-2008, oil prices, for example, have fallen by more than 70 per cent, energy prices by 60 per cent, and food and metals by nearly 36 per cent. This is hurting many developing countries in Africa and Latin America and the transition economies of the CIS that are heavily dependent on primary exports. OPEC members have now cut production, but oil prices are expected to remain below $60 per barrel for 2009 with serious consequences for oil exporters, not just in the ESCWA region but also in North and Central Asia (IMF, 2009b).

On the other hand, many non-oil producing countries and regions will benefit from the relatively low prices of oil and other commodities, and a consequent easing of inflationary pressures. The volatility of oil prices in 2007 and 2008 has made it difficult for countries to make the necessary plans for meeting basic energy and subsistence needs.

Contracting global trade

Falling global demand and the drying up of trade finance have dramatically reduced trade. The World Trade Organization projects that in 2009 the volume of world merchandise trade could plunge by 9 per cent (WTO, 2009). The ESCAP region will, given its high trade-orientation, be hit particularly hard – especially in some of the export-oriented South-East Asian economies where, during 2008, exports switched from double-digit growth to double-digit decline. These countries are particularly exposed because they have focused on meeting consumer demand in developed countries. And while in recent years they have also increased exports to developing Asian markets, this is unlikely to serve as much of a cushion because a lot of this intra-regional trade, especially with China, consists of manufactured parts and components which are assembled in China but destined for developed country markets. Many African countries also depend on a few key exports, such as textiles and cut flowers, and have seen their trade income fall. The export declines have also been large even in the advanced economies of the ECE whose exports are extremely diversified in manufacturing, while the ESCWA region will be deeply affected by contractions in oil exports to developed countries.

Figure 4 – Total trade as a percentage of GDP (constant 2000 prices)



Source: IMF statistical databases, http://www.imfstatistics.org/imf/, as of 5 May 2009.

Rising protectionism

There are rising concerns that governments in recession-hit countries will give in to protectionist pressures. The pending conclusion of the Doha round of WTO negotiations has left trade more vulnerable to government impulses for protectionist and other trade-distorting measures. Many countries are, to a certain degree, already introducing either covert or explicit forms of protectionism through their fiscal stimulus packages. Since September 2008, countries across the world have implemented 47 trade-related measures and have proposed an additional 33 (Newfarmer, 2009). In the ECLAC region there were five cases of increases in tariffs or import restrictions. Such restrictions have also been seen in the ESCAP region, where, for example, China and India have imposed more stringent import measures while Indonesia requires special licenses for imports of some products. The sectors typically affected are textiles, footwear, toys, electronics, food and beverages. Protectionism while palatable for dealing with immediate pressures, only exacerbates the downturn and makes it more difficult to achieve strong growth during the subsequent recovery. This makes it all the more important to conclude the Doha round in a manner that institutionalizes the trade and development linkages through a rules-based system of multilateral trade.

Rising unemployment, increasing poverty

Sharp declines in aggregate demand across all five regions are taking their toll on industrial production and leading to rising unemployment. Factory closures and layoffs will hurt the working poor, especially women and youth, as the manufacturing industry employs large numbers of unskilled workers. This will place an enormous economic burden on many developing economies. In the ESCAP region, the 1997 crisis showed that when people are hit by sudden shocks, those most at risk are the poor, the youngest and oldest people, and socially excluded groups. In the labour force, the main casualties are those with flexible employment- low skilled, temporary, casual workers. Women often constitute the majority of these workers. The damage also lasts much longer than the crisis itself. After the 1997 Asian financial crisis, for example, economic growth resumed relatively quickly, but some countries took up to 10 years to recover the ground they had lost in the struggle against poverty (ILO, 2008a). In 2008, the employment impact was felt most in the export manufacturing sector, including garments, electronics and automobiles, but the crisis is also expected to hit construction, tourism, finance, services and real estate. The least developed countries have less exposure to the financial crisis, since their financial sectors are less integrated into the global markets, but the poor in these countries will nevertheless be affected through lost exports and remittances and reduced donor assistance.

The ILO is predicting that 50 million people will likely lose their jobs during the current crisis as world unemployment increases from 180 million in 2007 to 230 million. Over the next year, 23 million workers in Asia and the Pacific could lose their jobs. In the ECLAC region unemployment in 2008 was 7.5 per cent but in 2009 it is expected to rise to between 8.5 and 9.0 per cent. In the ECE region, by 2010, unemployment rates in the United States, Europe, Turkey and the CIS are likely to reach double digits. In sub-Saharan Africa, ILO estimates that in 2009 as many as 3 million workers could lose their jobs. In Western Asia, it is anticipated that 10 percent of unskilled workers will return home from the Gulf Cooperation Council (GCC) countries, thus worsening unemployment in their home countries in other parts of Western Asia and beyond. According to the latest ILO estimates, the Middle East and North Africa had the highest unemployment rates – at 10.3 and 9.4 per cent respectively – in 2008.

The crisis is disproportionately affecting the groups that did not benefit much from the earlier expansion of the global economy. In most regions the economic crisis will push a large number of workers into vulnerable employment in the informal sector – which already absorbs a high proportion of workers. Youth, women and migrant workers – groups which already face labour market discrimination – would feel the effects most intensely.

Unemployment can threaten many hard-won social achievements, particularly in education. During times of economic crisis, the poorest families may pull their children from school and require them to work to supplement the family income resulting in losses in human capital that undermine prospects for future economic and social development. The majority of people who become unemployed do not get unemployment benefits. About 80 per cent of the world population is not covered by social protection. Supporting households helps sustain domestic demand and thus acts countercylically to promote macroeconomic stability, if such systems are in place before the crisis hits. It is clear that effective systems of social protection to make societies more resilient will need to be given higher priority and be implemented with more urgency than in the past.

To meet the employment challenge, the United Nations supports a "Global Jobs Pact" to generate decent work as a mainstay of any global stimulus (United Nations, 2009a, ILO, 2009a). Such an approach takes account of the interlinkages between the financial, trade, economic, employment and social roots of the global crisis and the required policy responses.

Expansionary monetary and banking policies

Around the world, most countries have responded to the economic crisis by cutting interest rates and injecting more liquidity into financial systems. In the ECLAC region, for example, several central banks, in addition to cutting key interest rates, have lowered reserve requirements. Also in some cases in the ESCAP and ESCWA region guarantees for bank deposits have been provided. Similarly, in the ECA and ESCAP regions, governments have established loan guarantees for domestic firms in order to facilitate lending and improve the flow of credit. But not all countries have the flexibility to implement such policies. In the ESCAP region, some countries have already implemented historically low interest rates. However, for many emerging markets there are concerns that further cuts in interest rates could destabilize their currencies by triggering capital outflows; for example, this would be a risk for Egypt and Lebanon and for many of the emerging European economies.

Moreover, if the downturn deepens and inflation is replaced by deflation, conventional monetary easing will lose its effectiveness. For this reason, the advanced economies in the ECE region that already have near-zero interest rates, such as the United States, the United Kingdom and Switzerland, have found it necessary to increase their money supplies through quantitative easing. In the ESCAP region, developing countries experiencing deflationary pressures may have to consider similar measures if the macroeconomic environment deteriorates further. Expansionary monetary policies do, however, create the risk that excess liquidity, if left unchecked, may find its way into speculative markets, triggering, once again, volatility in commodity prices and, in the aftermath of the crisis, inflationary pressures.

Combating recession with fiscal stimulus

In light of the relative ineffectiveness of monetary policy caused by already low interest rates and dysfunctional financial markets, much of the attention has focused on fiscal policy. Many governments have concluded that the best way to combat recession is to introduce fiscal stimulus packages that can boost domestic demand and help counteract losses in confidence. To date, the major industrialized countries, and some developing countries, have devised fiscal stimulus plans totalling about $2.6 trillion, or 4 per cent of world gross product (WGP), to be spent between 2009 and 2011 (UN-DESA, 2009). In some countries this will lead to massive budget deficits, but even so it may still fall short of what is needed. The United Nations estimates that the world needs a stimulus of around 3 per cent of WGP per annum (IMF, 2009c). Also, to maximize the multiplier effects globally, there is an urgent need for policy coordination.

Most agree that the stimulus packages should be front-loaded and commensurate with the size of the crisis, but debate continues over their contents – on whether governments should devote their resources to investment in infrastructure, or to direct transfers or on tax cuts. The packages also have to be tailored to national priorities and circumstances. Some countries, for example, are in a better position to embark on extensive stimulus packages while others are impeded by large existing fiscal deficits. In the ESCAP region, strong macroeconomic fundamentals and high savings rates have enabled some countries to introduce large fiscal stimulus packages. China for example has announced a package amounting to $586 billion, the second largest in the world (US being the largest) amounting to around 13 per cent of GDP. Overall, fiscal stimulus packages have been focused on macroeconomic stabilization and infrastructure spending, with relatively less attention having been given, particularly at the beginning, to the social consequences, and the disproportionate burden of the crisis on the poor and women. Putting in place social protection systems is a centrepiece of the policy responses required. Not only does it create more inclusive and harmonious societies, it also mitigates the depth of the economic crisis. By increasing income security, the spending power of middle and lower income people is freed up, thus increasing domestic demand and macroeconomic stability.

An uncertain economic outlook

In the second quarter of 2009, the economic situation appears to have plateaued and some countries are showing tentative signs of recovery. However, there is also the risk that the global economy could take another plunge. The uncertainty has been exacerbated by the outbreak of influenza A, and the ongoing uncertainties on how virulent it will turn out to be. It could impose enormous economic costs – as have already been witnessed in Mexico.

Regional responses for early recovery

Most responses to the economic crisis will take place at the national level, while others ideally should be globally coordinated. But many can best be undertaken at the regional level. Even in a globalized world, the strongest links – whether for trade, finance, remittances or migration – are typically with neighbours. Countries in the same region or subregion are also more likely to share common problems and have a clear self-interest in arriving at mutual solutions. Equally important is that policy-making at the regional level promotes consensus that can serve as building blocks for multilateral policy coordination.

In all of this they can take advantage of the expertise and activities of a large number of regional institutions, with Regional Commissions presenting an institutional blend of multilateral and regional approaches that is unique.

Regional financial cooperation

Regional financial institutions have been active in providing support. Many have been extending their credit lines and lending facilities to help member states overcome short-term difficulties, and in certain cases have been providing access to long-term finance. Additionally, regional and subregional organizations have been playing an important role in cross-border anti-crisis measures. In the ESCAP region, for example, one of the major regional groups has created a multilateral foreign exchange pool: in May 2009 the ASEAN+3 Finance Ministers reached an agreement which paves the way for converting an existing bilateral fund of $80 billion to a multilateral pool of $120 billion (ASEAN, 2009).

Efforts at regional coordination

Across all five regions, governments have been coordinating their responses to the crisis through policy dialogues. For example, following their meeting in Tunis in November 2008, the African Ministers of Finance and Planning and Governors of Central Banks agreed on measures to be taken at the national, regional and international levels to mitigate the effect of the crisis on African countries. Similarly, in Kuwait, in January 2009, the First Arab Economic Summit called for a coordinated policy response among the Central Banks in the region and endorsed several major infrastructure projects to strengthen regional cooperation among Arab states and mitigate the impact of the crisis. The EU leaders have been in close consultations throughout the crisis in attempts to coordinate their countries' fiscal and regulatory responses, while in the first Latin American and Caribbean Summit for Integration and Development, held in Brazil in December 2008, countries agreed to discuss creating a regional and subregional financial architecture for further integration of financial markets in the regional and sub regional sphere, to develop or strengthen regional mechanisms for balance-of-payments stabilization, promote further cooperation between national and regional development banks, and consider the installation of a mechanism for trade payments in local currencies. In the ESCAP region, at the 65th Session of the Commission, held from 23 to 29 April 2009, governments adopted resolution E/ESCAP/65/L.7 (ESCAP, 2008). While expressing concern about the financial crisis which had become a global economic crisis that could complicate efforts to achieve energy and food security in the region, the Commission urged implementation of regional cooperation initiatives. To this end it requested the Executive Secretary to continue to assist countries through indepth analysis, policy dialogue and advocacy and increased capacity-building activities (ESCAP, 2009).

The way forward: the role of regional policy-making

As the Secretary-General of the United Nations said to the leaders of the G20, "a genuine solution of the crisis requires a new international financial and economic architecture that reflects the changing realities in the world and gives greater voice to emerging and developing economies" (United Nations, 2009b).

Developing countries are contributing ever larger shares of economic output in the globalized economy – and are thus deeply affected by decisions taken in developed countries. They must therefore have a greater voice in the global debate, through participation in the bodies charged with economic recovery and regulatory reform.

For this purpose, they could use existing regional platforms, more effectively. The secretariats of the Regional Commissions can support governments and their partners to consider policy options, sharpen their common positions and put in place the building blocks for essential multilateral reforms. They should be able to use these platforms to argue for the most positive long-term solutions – including policies on trade, finance, and overseas development assistance. For finance, the area where policy coordination is still at a nascent stage compared to other areas such trade, this would mean measures to reform the international system to make it more inclusive with developing countries assuming a more influential voice on the reforms needed to avoid the depth of boom-bust cycles and encourage the stable flow of capital to developing countries. For trade, for example, this would mean an expedited conclusion of the Doha Round that would discourage protectionist measures and promote international trade for development. For overseas development assistance, this would mean encouraging developed countries to follow through on their declaration at the G20 Summit in London in April 2009, which reaffirmed all existing commitments to provide more aid and debt relief to the poorest countries and promised $300 billion in support.

Developing countries will also play a central part in the United Nations global vulnerability monitoring and alert mechanism. This country-driven mechanism will be light in structure and build on existing alert and monitoring capacities and mechanisms across the United Nations system in an inclusive manner. In this regard, the Regional Commissions can support developing countries through their existing well recognized analytical and statistical capabilities. Their distinctive region-specific analysis could make an important contribution in filling the large information gap that exists between when a crisis hits vulnerable populations and when information reaches policy-makers through official statistical channels (United Nations, 2009c). The rapidity and depth of the current crisis underlines the importance of real-time and compelling analysis. Looking forward, what will be needed is faster and improved preemptive analysis and advocacy.

Regional Commissions can also provide an important platform for deeper regional economic and financial cooperation. In this crisis, the current international architecture has demonstrably failed to respond with sufficient speed or force to the distinctive problems faced by developing countries. Instead regions can work together to marshal their own resources and "insulate themselves from regulatory and macroeconomic failures in systemically significant countries" (United Nations, 2009d). If countries coordinate their policies at the regional level they will gain greater credibility, helping to shore up confidence while enhancing regional and global multiplier effects. This should not, however be regarded as an alternative to full participation in global economic relations but rather as a complement to it, by filling in the gaps in the global system.

Future intraregional financial and economic cooperation can include, for example, pooling funds to respond to balance-of-payments and liquidity crises, cooperating more closely on monetary issues such as exchange rates, integrating equity and debt markets, coordinating financial regulation and supervision, and promoting intraregional trade, such as by providing trade credit. This enhanced cooperation will also mean complementing international financial institutions by upgrading the existing regional financial architecture.

Of particular importance in the current crisis is the coordination of fiscal policies because they provide an excellent opportunity for promoting the idea that economic recovery should be based on a more inclusive and sustainable development paradigm. The Regional Commissions could provide the institutional infrastructure for an intergovernmental fiscal policy regional coordinating mechanism.

A global crisis demands a global response. But action will be much more effective if it is built on strong regional foundations, as groups of developing countries with similar problems share their experiences and coordinate their activities. Rather than competing with each other they can take complementary and mutually reinforcing actions that re-ignite national economies and enable people all over the world to live free from want, from fear, and from discrimination.

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