Chapter I

The global economic crisis: causes and transmission

Impact, response and recovery

The recent financial and economic crisis—the worst since the Great Depression of the 1930s—originated in the United States and quickly spread through multiple channels to other industrialized countries, low- and middle-income countries, as well as economies in transition. The result has been the still-unfolding global financial, economic and social crises now often referred to as the “Great Recession”.

The global economy contracted by 2 per cent in 2009 in sharp contrast to the several preceding years of high growth in excess of 3 per cent annually (United Nations, 2010c; 2011). While many rich countries experienced economic contraction, the rate of economic growth in developing countries slowed significantly to 2.4 per cent for 2009. In 2009, 52 countries experienced declines in per capita income. In the same year, output in economies in transition as a group contracted sharply by 6.7 per cent as Russian output declined by almost 8 per cent. Also in 2009, economies in Latin America and the Caribbean contracted by 2 per cent, as Mexican output fell by 6.5 per cent. Western Asia was the other developing part of the world experiencing negative growth (United Nations, 2011).

Global trade volumes fell from the end of 2008 through the first half of 2009 as a result of declining imports by developed countries, especially in the United States which accounted for 15 per cent of the global total (United Nations, 2009a; 2010b). At the height of the crisis, between July 2008 and April 2009, the value of imports of the European Union, Japan and the United States plummeted by almost 40 per cent and triggered a worldwide collapse in international trade.7 Despite the gradual recovery of the past two years, the value of imports of the three largest developed economies was still about 25 per cent below pre-crisis peaks by August 2010. Global trade is expected to grow by about 6.5 per cent in 2011 and 2012, significantly less than the 10.5 per cent rebound in 2010 (United Nations, 2011).

7 The volume of imports of the three major developed economies fell by about 18 per cent during that period, a situation which was compounded by a decline of about 24 per cent in import prices.
The extent as well as manner in which a country is integrated into the global economy has determined the severity of the crisis in different countries. The effects of the crisis spread to developing countries, primarily through declines in trade and commodity prices and reduced access to credit, as lower demand in developed countries hurt the export sectors and slowed growth in developing countries. The plight of many developing countries heavily dependent on the export of primary commodities was especially worsened by falling commodity prices. At the same time, international bank loans and foreign direct investment (FDI) declined. While some of these flows have since recovered, the cost of finance is still high and access to bank loans remains especially tight with stringent implementation of the regulations introduced by the Basel Committee on Banking Supervision. The effects of the crisis also spread through secondary transmission channels, such as lowered remittance flows to some countries and reduced earnings from tourism, of particular importance for many small island States.

Sub-Saharan Africa has not been immune to the effects of the crisis despite its marginal role in the global economy. That region has experienced significant slowing of economic growth and poverty reduction but the impacts were less severe there than elsewhere. Although parts of the Asian region have led the recovery, the crisis has reduced the region’s remittance inflows and export earnings. Some countries in Latin America with strong ties to crisis-affected Spain and the United States have suffered quite badly, although overall the region has proven quite resilient (United Nations, 2010b; World Bank, 2010a). Central Asian countries were also relatively less affected, except for Kazakhstan which had fuelled its rapid growth with heavy private sector external borrowings from foreign capital markets. The crisis spread through the operations of the banking subsidiaries in Kazakhstan to other countries in that subregion. The other channel of contagion was the drop in remittances of migrant workers, mostly from Tajikistan and Kyrgyzstan, working in Kazakhstan and the Russian Federation. The worst affected area was Eastern Europe, which suffered heavily because of its exposure to toxic assets in the United States. Almost all countries in that part of Europe experienced declines in real gross domestic product (GDP) in 2009. The most severely affected countries were Estonia, Latvia and Lithuania, where real GDP fell by 15 to 18 per cent in 2009 and did not recover in 2010. The unemployment rate in Latvia rose to 22.5 per cent in 2009 and to 15 per cent in the other two Baltic countries. In 2010, the unemployment rates were 20 per cent in Latvia, 19 per cent in Estonia and 17.3 per cent in Lithuania (Eurostat, 2011).

**International response averts deeper recession**

The leaders of major economies came forward and took unprecedented coordinated actions, adopting stimulus packages and furnishing resources to boost the lending capacity of the IMF and multilateral development banks. These actions succeeded in averting a deeper recession. The global recovery has proven
The Global Social Crisis

to be stronger than had been initially forecast, though it is still uneven and the potential for volatility remains high. The policy response has weakened since 2010, and many Governments, particularly those in developed countries, have shifted to fiscal austerity. Partly as a result of these policy shifts, global economic growth started to decelerate in mid-2010. Government policies are expected to be much less expansionary in the near term, especially as widening fiscal deficits and rising public debt have undermined support for further fiscal stimulus measures. Therefore, slower growth is expected to continue into 2011 and 2012.

Recovery: tepid, uneven and uncertain

The global economy grew by about 3.6 per cent in 2010. Asia has led the recovery among developing regions, while Europe and the Commonwealth of Independent States are still lagging behind. The United Nations estimates that the global economy will grow by 3.1 per cent in 2011 and 3.5 per cent in 2012. The recovery may, however, suffer setbacks and slow to below an annual rate of 2 per cent, while some developed economies may slip back into recession should several downside risks materialize (United Nations, 2011).

Many fundamental causes of the crisis have not been addressed, such as insufficient financial sector regulation, unrealistically high executive compensation (salaries and bonuses), stagnating real wages and consequently rising inequality and debt-financed consumption. Some countries have continued, or even intensified, expansionary monetary policies (low interest rates and “quantitative easing”) to support economic activities while fiscal stimulus measures are being phased out and to help financial sectors return to normalcy. However, these actions have created new risks such as greater exchange-rate volatility among major currencies and a surge of volatile capital flows to emerging economies. These developments have already become a source of economic tension and weakened the commitment to coordinate policies at the international level to deal with the global imbalances and other structural problems. This could harm recovery in the near term and make it difficult to respond to more challenging emerging issues.

Background

In the years preceding the crisis, most economies experienced high rates of growth, low inflation and monetary stability. Many countries, particularly in Africa, grew at historically high rates not seen for decades, largely as a result of the boom in commodity prices. Developing countries became increasingly integrated into the global economy as liberalization, deregulation, trade and financial globalization spread, with the encouragement of the international financial institutions.

This relatively long period of economic growth with low inflation gave rise to a number of dangerous illusions. First was the notion of a “great moderation” in
developed countries, meaning that the monetary authorities had achieved growth with low inflation by taming the business cycle with inflation-targeting policies. This bred a sense of collective complacency about the future and heightened optimism about the efficiency of financial markets and the creativity of recent financial innovations.  

Table I.1

Growth of global output, 2006-2012

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global output (^c)</td>
<td>4.0</td>
<td>3.9</td>
<td>1.6</td>
<td>-2.0</td>
<td>3.6</td>
<td>3.1</td>
<td>3.5</td>
</tr>
<tr>
<td>of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Developed economies</td>
<td>2.8</td>
<td>2.5</td>
<td>0.1</td>
<td>-3.5</td>
<td>2.3</td>
<td>1.9</td>
<td>2.3</td>
</tr>
<tr>
<td>Euro area</td>
<td>3.0</td>
<td>2.8</td>
<td>0.5</td>
<td>-4.1</td>
<td>1.6</td>
<td>1.3</td>
<td>1.7</td>
</tr>
<tr>
<td>Japan</td>
<td>2.0</td>
<td>2.4</td>
<td>-1.2</td>
<td>-5.2</td>
<td>2.7</td>
<td>1.1</td>
<td>1.4</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>2.8</td>
<td>2.7</td>
<td>-0.1</td>
<td>-4.9</td>
<td>1.8</td>
<td>2.1</td>
<td>2.6</td>
</tr>
<tr>
<td>United States</td>
<td>2.7</td>
<td>1.9</td>
<td>0.0</td>
<td>-2.6</td>
<td>2.6</td>
<td>2.2</td>
<td>2.8</td>
</tr>
<tr>
<td>Economies in transition</td>
<td>8.3</td>
<td>8.6</td>
<td>5.2</td>
<td>-6.7</td>
<td>3.8</td>
<td>4.0</td>
<td>4.2</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>8.2</td>
<td>8.5</td>
<td>5.2</td>
<td>-7.9</td>
<td>3.9</td>
<td>3.7</td>
<td>3.9</td>
</tr>
<tr>
<td>Developing economies</td>
<td>7.3</td>
<td>7.6</td>
<td>5.4</td>
<td>2.4</td>
<td>7.1</td>
<td>6.0</td>
<td>6.1</td>
</tr>
<tr>
<td>Africa</td>
<td>5.9</td>
<td>6.1</td>
<td>5.0</td>
<td>2.3</td>
<td>4.7</td>
<td>5.0</td>
<td>5.1</td>
</tr>
<tr>
<td>Nigeria</td>
<td>6.2</td>
<td>7.0</td>
<td>6.0</td>
<td>7.0</td>
<td>7.1</td>
<td>6.5</td>
<td>5.8</td>
</tr>
<tr>
<td>South Africa</td>
<td>5.6</td>
<td>5.5</td>
<td>3.7</td>
<td>-1.8</td>
<td>2.6</td>
<td>3.2</td>
<td>3.2</td>
</tr>
<tr>
<td>East and South Asia</td>
<td>8.6</td>
<td>9.3</td>
<td>6.2</td>
<td>5.1</td>
<td>8.4</td>
<td>7.1</td>
<td>7.3</td>
</tr>
<tr>
<td>China</td>
<td>11.6</td>
<td>13.0</td>
<td>9.6</td>
<td>9.1</td>
<td>10.1</td>
<td>8.9</td>
<td>9.0</td>
</tr>
<tr>
<td>India</td>
<td>9.6</td>
<td>9.4</td>
<td>7.5</td>
<td>6.7</td>
<td>8.4</td>
<td>8.2</td>
<td>8.4</td>
</tr>
<tr>
<td>West Asia</td>
<td>6.1</td>
<td>5.1</td>
<td>4.4</td>
<td>-1.0</td>
<td>5.5</td>
<td>4.7</td>
<td>4.4</td>
</tr>
<tr>
<td>Israel</td>
<td>5.7</td>
<td>5.4</td>
<td>4.2</td>
<td>0.8</td>
<td>4.0</td>
<td>3.5</td>
<td>3.0</td>
</tr>
<tr>
<td>Turkey</td>
<td>6.9</td>
<td>4.7</td>
<td>0.7</td>
<td>-4.7</td>
<td>7.4</td>
<td>4.6</td>
<td>5.0</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>5.6</td>
<td>5.6</td>
<td>4.0</td>
<td>-2.1</td>
<td>5.6</td>
<td>4.1</td>
<td>4.3</td>
</tr>
<tr>
<td>Brazil</td>
<td>4.0</td>
<td>6.1</td>
<td>5.1</td>
<td>-0.2</td>
<td>7.6</td>
<td>4.5</td>
<td>5.2</td>
</tr>
<tr>
<td>Mexico</td>
<td>4.9</td>
<td>3.3</td>
<td>1.5</td>
<td>-6.5</td>
<td>5.0</td>
<td>3.4</td>
<td>3.5</td>
</tr>
<tr>
<td>of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Least developed countries</td>
<td>7.6</td>
<td>8.1</td>
<td>6.7</td>
<td>4.0</td>
<td>5.2</td>
<td>5.5</td>
<td>5.7</td>
</tr>
</tbody>
</table>


a Partly estimated.
b Forecasts, based in part on Project LINK and baseline projections of the United Nations World Economic Forecasting Model.
c Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2005 prices and exchange rates.

developed countries, meaning that the monetary authorities had achieved growth with low inflation by taming the business cycle with inflation-targeting policies. This bred a sense of collective complacency about the future and heightened optimism about the efficiency of financial markets and the creativity of recent financial innovations.

---

8 For details of this complacency see box 1 in the overview quoting the Independent Evaluation Office of the International Monetary Fund (2011) p. v.
The second pernicious notion was the so-called decoupling of developed and developing economies. As economies have become more intertwined through trade and finance, the proponents of this belief argued that globalization or international economic integration and decoupling can coexist. This is possible because the opening up of economies not only boosts the trade of poor countries, but also spurs rapid productivity growth, which helps to raise their domestic incomes and spending. Thus, developing countries can continue to grow even with a slowdown in developed economies. The so-called decoupling argument ignored the fact that much of the pre-crisis growth in developing countries, especially those in Africa, was due to booming commodity exports, with hardly any productivity growth or rapid structural change. The idea seduced policymakers in developing countries into believing that there was no need for industrial, investment or technology policies to diversify their economies or to dynamically induce productivity growth. Their collective complacency favoured liberalization of trade and finance, privatization and deregulation.

There was also the presumption that growth is good for the poor. This allowed policymakers to ignore rising inequality, both within and between countries, which many observers believed was due to globalization and deregulation. The collective complacency about inequality and globalization can be gleaned from a remark by the then President of the United States, William Clinton, at the 2000 World Economic Forum at Davos: “We have to reaffirm unambiguously that open markets are the best engine we know of to lift living standards and build shared prosperity”.

The epicentre of the financial collapse was the United States, the world’s largest economy. Despite relatively higher economic growth rates before the crisis, the wages and purchasing power of most Americans were stagnating. The benefits of the country’s growth largely accrued to the wealthiest Americans, as wealth and income inequality worsened. The globalization of labour markets—including through outsourcing jobs from developed countries to lower-wage economies, the weakening of unions and collective bargaining power, increasing returns to capital relative to labour and a falling minimum wage—in effect contributed to wage stagnation in real terms.

Despite static wages for more than two decades among middle-class Americans and growing inequality, consumer spending remained at levels which kept the United States economy growing. This was possibly due to the country’s low-interest monetary policy which kept credit relatively cheap. The easy access to credit increasingly fuelled consumption, and household debt increased from 48 per cent of GDP in the early 1980s to nearly 100 per cent just before the crisis.

---

9 For details of this hypothesis see Dollar and Kraay (2001).
11 Since the minimum wage has not kept pace with inflation, its real value has fallen.
Rising income inequality in the United States and elsewhere also contributed to the financial crisis. In the United States, in the mid-1970s, the richest 1 per cent of the population captured about 8 per cent of national income; by the 2000s, this group received double that proportion, or 16 per cent. The income share of the bottom 90 per cent of the population declined from 65.4 per cent in 1980 to 51.8 per cent in 2008 (Johnston, 2010). Such high income concentration in the hands of so few had not existed since 1929, just before the start of the Great Depression. This massive wealth accumulation sought profitable investment opportunities and increased the pressure on the financial sector to make increasingly risky investments in more unregulated environments. Insufficient regulation, despite the emergence of many new financial instruments, enabled financial institutions to become overleveraged as overconfident investors moved into riskier assets, presuming the continuation of high economic growth rates (Milanovic, 2009; Rajan, 2010).

**United States crisis becomes global**

Recent globalization has been characterized by widespread trade and capital account liberalization, either voluntarily or as a condition for receiving loans or aid. The dominant view, at least prior to the current crisis, had been that freer markets would enhance economic efficiency. That view held that trade liberalization and economic openness should enable countries to maximize resource use and comparative advantage, attract FDI and increase capital formation. The benefits of the ensuing growth would then trickle down to the majority of the population. This approach, however, did not achieve the promised results in many countries, and in fact worsened the effects of the crisis (van der Hoeven, 2010).

The global crisis was, in part, precipitated by the lack of international regulatory coordination. Globalization of financial markets has meant that much credit and capital are no longer under the jurisdiction of national regulatory bodies. Existing national regulation also proved insufficient to protect investors from excessive risk. Governments’ failure to more effectively regulate banks and other financial institutions allowed those institutions to take advantage of loopholes in their search for greater profits, ultimately causing them to become overleveraged (United Nations, 2010b).

Globalization in the years prior to the crisis accelerated the broad economic integration that facilitated the spread throughout the world of the repercussions of unsustainable overleveraging in the United States. The crisis spread through financial market interlinkages across Europe and quickly extended to the real economy as needed loans and investment finance became increasingly unavailable. While the impact of the crisis on economic growth and employment has been most severe in

---

12 For details refer to Torres (2010) and van der Hoeven (2010).
The Global Social Crisis

Box I.1

The Community Reinvestment Act and the United States subprime crisis

The 1977 Community Reinvestment Act was intended to stop discriminatory lending practices—known as redlining—against individuals in low-income and ethnic minority neighbourhoods by requiring lending institutions to apply the same conditions to all borrowers. Some critics attribute the rise in subprime loans and the subprime mortgage crisis to implementation of that Act. They argue that it required banks to lower their credit standards and offer higher-risk mortgage products in order to make loans to lower-income applicants.

Subprime loans are high-risk loans intended for people who do not qualify for other loans owing to their low income or poor or limited credit histories. Such loans typically have higher interest rates than do prime loans along with more or higher fees and penalties. The subprime market experienced many abusive lending practices, including the steering of borrowers who would be eligible for prime loans towards taking subprime loans and pushing loans with low “teaser” rates that would rise sharply over time.

Only 9 per cent of subprime loans made to low-income borrowers or to those in low-income neighbourhoods were compliant with the Act’s regulations (Park, 2008). This argument against financial inclusion overlooks several important facts. Subprime loans generated higher revenue for mortgage companies, so the incentive structure encouraged lenders to push these loans towards potential borrowers. However, 60 to 70 per cent of so-called subprime loans went to borrowers at middle- or higher-income levels and with good credit who should have been eligible for prime loans (Aalbers, 2009). Additionally, the Act could not exercise regulatory control over non-bank lenders. Independent mortgage companies had been the source of the majority of subprime loans in the United States.

Easy access to home loans contributed to a “housing bubble” in the United States, and this situation was at the heart of the crisis. With home ownership long part of the “American Dream”, the idea that all Americans, including those with low incomes and poor credit histories, should be able to own their own homes became increasingly prevalent. Inadequate financial regulation and lax monetary policy encouraged lending to applicants not qualified to obtain such loans.

Low interest rates, lack of information, poor judgment and predatory lending practices – encouraged by commission-based mortgage sales – led many home buyers to take risky mortgages. The regularity with which home values increased yearly led to overly optimistic assumptions, as home owners borrowed and spent against inflated home values. By 2006, 48 per cent of all mortgages were subprime (Verick and Islam, 2010). In the same year, interest rates began to rise and borrowers with adjustable-rate mortgages or low introductory “teaser” rates were soon faced with the stark reality that they could no longer afford their monthly payments; the delinquency rate on home mortgages subsequently rose.

As house prices fell, owners found that they owed more than their homes were worth, further fuelling the delinquency rate. Of all subprime loans issued in 2006, at least 40 per cent were delinquent by the end of 2008 (United Nations, 2009a). As lenders spread the risk around, exposure broadened more than ever.¹

¹ “Mortgages were sold on by the originators to third-parties, which were then repackaged as mortgage-backed securities (MBS) and sold to investors. This enabled lenders to take the loans off their books. In particular, special investment vehicles (SIVs) were pressed into service and kept off the balance sheet, which allowed financial institutions to increase leverage and returns on their investments. Thus, mortgages that were in the past the domain of the traditional banking system could now be traded in open markets both within the US and outside its borders, beyond the scope of regulatory measures (because they were conducted as an over-the-counter transaction thus avoiding the regulations pertaining to the stock market)” (Verick and Islam, 2010).
some high-income countries, there have also been negative impacts on developing countries. Declining global trade and commodity prices hurt export sectors, as the credit squeeze spread to developing countries and transition economies.

**Trade**

Triggered by a collapse of import demand in major developed countries and much less trade finance, trade flows fell between 30 and 50 per cent in most economies in late 2008 and early 2009, with East Asian economies experiencing the sharpest decline. The financial crisis also abruptly reversed the upward trend of oil and non-oil primary commodity prices experienced since 2002. Oil prices plummeted by as much as 70 per cent from their peak levels in 2008 before rebounding. In the same period, metal prices declined even more sharply to about a third of their peak levels. Prices of agricultural products, including basic food grains, also declined significantly (United Nations, 2010b).

As a result, many developing countries suffered strong swings in their terms of trade. In particular, net exporters of oil and minerals felt very strong adverse export price shocks on top of declines in global demand due to the recession. Although net importers of food and energy saw their import bills fall during the crisis, the related terms of trade gain was more than offset by the steep drop in demand for their exports at the nadir of the recession (United Nations, 2010b).

As noted in the United Nations *World Economic Situation and Prospects 2010*, trade protectionism increased as the crisis evolved. A good number of developed and developing countries raised tariffs and introduced new non-tariff measures. The fiscal stimulus packages and bail-out measures also contain protectionist elements, such as direct subsidies and support for domestic industries, or restrictions on the use of these resources to buy foreign products. Some countries also reintroduced previously eliminated export subsidies for some agricultural products.\(^{13}\)

Yet, world trade continued to recover in 2010 mainly due to strong import demand from the emerging economies, and grew by about 10.5 per cent. However, there is considerable doubt whether emerging economies can continue to act as the engines of world trade growth particularly as the dynamics of the initial phase of the recovery seem to be fading and as growth in developed countries remains sluggish. According to the United Nations World Economic Situation and Prospects 2011 world trade is expected to moderate to about 6.5 per cent in both 2011 and 2012.

---

\(^{13}\) For details see Gamberoni and Newfarmer (2009).
Tourism

The effects of the economic crisis have also spread from high- to middle- and low-income countries through declines in international tourism. According to the United Nations World Tourism Organization (UNWTO), tourism registered a strong growth in developing countries, especially in least developed countries (LDCs) since 2001 until the crisis hit. For example, international tourist arrivals grew by 42.5 per cent in LDCs and 30.8 per cent in developing countries as a whole during 2001-2005. Commensurate with this, international tourism receipts grew by over 50 per cent in LDCs and over 33 per cent in developing countries during the same period. Tourism is highly reactive to and dependent on economic conditions in tourist-sending countries, so it is not surprising that international tourism receipts dropped by $89 billion, from $939 billion in 2008 to $850 billion in 2009. All regions suffered lower receipts, with an average decline of 5.7 per cent globally compared with 2008 (World Tourism Organization, 2010a). The biggest losers were the Americas, down 9.6 per cent, and Europe, down 6.6 per cent. Asia and the Pacific saw uneven trends, with South and South-East Asia declining by 3.5 and 7.2 per cent, respectively, and Oceania and North-East Asia increasing by 5.2 and 0.7 per cent, respectively (World Tourism Organization, 2010b).

A slow recovery in global tourism started in the fourth quarter of 2009 and gained speed through 2010, driven by the emerging economies. International tourist arrivals increased by 6.7 per cent in 2010 compared with 2009, with the Middle East and Asian regions leading increases by 14 and 13 per cent, respectively, followed by the Americas at 8 per cent and Africa at 6 per cent. Europe trailed behind with 3 per cent growth (World Tourism Organization, 2011). International tourist arrivals are expected to grow by about 4 per cent in 2011 (World Tourism Organization, 2010a).

International finance

Net private capital inflows to emerging economies declined precipitously in late 2008 and early 2009. After peaking at about $1.2 trillion in 2007, inflows halved in 2008 and plunged further to an estimated $350 billion in 2009. The sharpest drop was in international bank lending to emerging economies, with a total net inflow of $400 billion in 2007, which became a net outflow of more than $80 billion in 2009. The economies in transition, especially the Russian Federation, Ukraine and a few other countries in Central and Eastern Europe, experienced the most dramatic reversal in access to bank lending. Non-bank lending flows also declined significantly during the crisis. Large outflows of net portfolio equity were registered in the second half of 2008. These flows have recovered markedly since

---

14 This section draws on United Nations (2010b).
The Global Social Crisis

While returns of FDI tend to be less volatile than other components of private capital flows, these declined by more than 30 per cent in 2009. External financing costs for emerging market economies surged in late 2008. As a result, private sector access to credit in emerging markets was curtailed, with this trend continuing well into 2009. Outflows of capital from emerging economies, particularly to other developing countries, which had gathered some momentum prior to the global financial crisis, also moderated during the period 2008-2009.

The declines in private capital flows were partially offset by increased official inflows, particularly from the IMF and other multilateral financial institutions, as their financial resources were boosted significantly at the G20 London summit and they started to disburse more lending. Emerging Europe received the lion’s share of these net official flows. Bilateral official, non-concessional flows also increased as central banks arranged foreign-exchange swaps to deal with reduced international liquidity. However, net official flows to developing countries remained negative in 2009 and 2010, continuing the trend of the past decade. The return of net official flows (including ODA) from poor to rich countries was about $120 billion per year between 2006 and 2008 (United Nations, 2010b). There are also concerns about the conditionalities of the IMF’s new crisis lending, which will be discussed further in chapter VI.  

Box I.2

Greek tourism sector adversely affected by crisis

Tourism comprises almost a fifth of Greek national income. In 2009, the country’s fiscal deficit was approximately 13.6 per cent of gross domestic product (GDP), with a total public debt of 115 per cent of GDP (United Nations, 2010d). The country’s debt rating plummeted as it lost investor confidence, putting Greece on the verge of defaulting on its loan obligations. A default was forestalled with assistance from the International Monetary Fund and the European Union. However, by mid-2011 it became apparent that further assistance would be necessary to prevent a default.

In December 2009, the Government began to implement a series of austerity measures, slashing public spending, raising taxes and raising the retirement age. The public has reacted strongly, with massive—and, at times, violent—protests beginning in February 2010. Major labour strikes further disrupted economic activity, especially in the country’s crucial tourism sector (BBC, 2010). In the first half of 2011 protests against further budget cuts and tax increases escalated in Athens.

After two years of sharp decline, there is cautious optimism that Greek tourism revenues could increase by up to 10 percent in 2011 (Melander, 2011). Tourism in Greece, Spain and Portugal has risen in the first half of 2011 as tourists who might have opted for destinations such as Egypt and Tunisia are opting for alternative travel locations (Bawden, 2011).
The Global Social Crisis

Development aid

Development aid can be an important source of support for economic and social development and accounts for as much as 20 per cent of government spending in some developing countries. At the 2002 Monterrey International Conference on Financing for Development, developed countries once again made commitments to providing 0.7 per cent of their gross national income (GNI) as development aid.

According to the United Nations MDG Gap Taskforce Report 2010, aid from members of the Development Assistance Committee (DAC) reached almost $120 billion in 2009, increasing by less than 1 per cent, in real terms. However, the share of ODA in donor GNI was mere 0.31 per cent, well below the target of 0.7 per cent, which has been reached and exceeded by only five donor countries.

Aid budgets rose in Belgium, Finland, France, Norway, the Republic of Korea, Switzerland and the United Kingdom of Great Britain and Northern Ireland, but fell in some countries, particularly those experiencing debt crises. Greece, Ireland, Portugal and Spain all reduced their aid budgets in 2009, along with Austria, Canada, Germany, Japan and the Netherlands (Organization for Economic Cooperation and Development, 2010).

However, based on earlier government aid cuts during previous economic crises, such as in Finland and Sweden in 2001, the World Bank has predicted that development aid may fall by nearly one quarter (World Bank, 2010b). Moreover, even if donors maintain the ratios of their aid to national income, the amount of aid will decline if national income falls. The aid budget has come under pressure as many donor governments turned to fiscal austerity measures. According to the United Nations World Economic Situation and Prospects 2011, the fragile recovery in developed countries and the possible threat of a double-dip recession create considerable uncertainty about the future volume of ODA flows, while aid delivery is falling short of commitments by the donor community.

Remittances

Remittances have become a growing source of income in many developing countries, reaching a high of $336 billion in 2008. In past crises, remittances were counter-cyclical, going up when times were hard in receiving countries, thus furnishing an important buffer against economic shocks. Overall, remittances declined by 6.1 per cent, from $336 billion in 2008 to $315 billion in 2009 (World Bank, 2010). However, in the current crisis, remittances have proven more resilient than private capital flows and are expected to rise again in 2010 and 2011 (Ratha, Mohapatra and Silwal, 2010).

The impact of the crisis on remittances varies by region. Remittance flows to Latin America were down by 12 per cent in 2009. In Eastern Europe and Central Asia, many countries that rely heavily on remittances saw these flows fall by an
The Global Social Crisis

estimated 21 per cent. Remittances, equivalent to over 50 per cent of national income in Tajikistan and about 20 per cent in Armenia, have declined by 30 per cent in both countries. North Africa has also been severely affected owing to high unemployment in oil-rich countries. In sub-Saharan Africa, the impact has been smaller, and in some countries, remittances went up. In South and East Asia, remittances have continued to grow, although more slowly than in recent years (Ratha, Mohapatra and Silwal, 2010).

Concluding remarks: bleak prospects for social development

Despite signs of early recovery, the fallout of the Great Recession of 2008-2009 in terms of increased poverty, hunger and unemployment has been significant and will continue to adversely impact on social development. While it is still too soon to quantify with much accuracy the full impact of the crisis on many social outcomes, the current predicament has almost certainly contributed to rising unemployment in developed countries and increasingly vulnerable employment in developing countries. Unemployment is not expected to return to lower pre-crisis levels for many years. As more Governments in developed countries are embarking on fiscal tightening, the prospects for a quick recovery of employment look even gloomier.

Yet, unemployment figures do not tell the whole story: the number of discouraged workers—those who have given up looking for a job and hence are no longer included in unemployment figures—has risen further. The longer-term employment consequences of the current crisis are already becoming visible, as the share of structural or long-term unemployment has increased significantly in most developed countries since 2007. Problems consequent to long-term unemployment will linger, particularly in wealthy countries, and vulnerable employment is likely to persist in developing countries. In many countries, job-rich economic growth remains elusive.

Malnutrition, already on the rise prior to the crisis, remains a grave threat to human well-being. The economic crisis reinforced the effects of the food and fuel price hikes in 2007 and 2008. Although the target under Goal 1 of halving global poverty rates by 2015 (from 1990 levels) is apparently on track to be achieved for the world as a whole,15 the joint International Monetary Fund–World Bank Global Monitoring Report 2010 estimated that by 2010 an additional 64 million people fell into extreme poverty as a result of the economic crisis alone.

The crisis has also significantly increased the challenge of achieving the Millennium Development Goal targets for universal primary education, child and maternal mortality, and environmental and sanitary conditions. The

---

economic slowdown has reduced the funds available to support social spending in developing countries due to falling revenues and smaller tax bases. Even before the crisis, the requirements for stepping up economic growth and social spending posed significant macroeconomic challenges. These have become all the more pressing, especially where the setbacks caused by the crisis have been the greatest.

The growing pressure for fiscal consolidation has also put social spending at risk in developed countries. To make matters worse, food prices are rising again and have recently passed the previous peak. Extreme weather conditions, likely linked to climate change, threaten food security as never before. The effects of diverting food products to the production of biofuels and as feed for animals and much greater commodity price speculation and volatility with financial asset diversification and lax monetary policies have pushed up food and energy prices again, undermining efforts to reduce poverty and hunger.

Stimulus measures implemented by many Governments have been essential to initiating the global recovery. While a deeper and prolonged global recession was averted, the recovery remains fragile and uneven. The main underlying roots of the crisis have not been addressed, threatening the sustainability of the recovery.

There are still significant uncertainties and risks. Continued high unemployment, financial fragility, exchange-rate instability as well as heightened perceptions of sovereign debt distress and inadequate policy responses could further undermine business and consumer confidence in developed countries. The much hoped for rise in business confidence with the phasing out of the stimulus packages has not materialized in a robust way as overall demand remains depressed. In countries imposing austerity measures, budget cuts are leading to the loss of public sector jobs, a situation which leads in turn to a decline in the ability of people to access publicly provided social services. Thus, with premature withdrawal of various stimulus packages and the imposition of fiscal austerity, the prospect of a double-dip recession cannot be discounted. Recent trends in some European countries underscore this risk.