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The global financial crisis: Poverty and social protection

Evidence from 10 country case studies

Key points

- The financial crisis will exacerbate poverty and inequality and undermine progress towards the MDGs – the nature of this impact will vary between and within countries
- Social protection responses to the crisis in developing countries have been marginal in scale
- Developing countries need to address the immediate needs of the poor, as well as investing in growth and stabilisation packages

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While the repercussions of the financial crisis on poverty in the developing world are severe and likely to worsen, the response to date by governments and donors has been marginal. The World Bank estimates that the 'triple F' crisis: financial collapse, combined with the food and fuel price crises, will increase the number of poor by between 53 and 64 million people in 2009, based on estimates of those on less than $2 a day and $1.25 respectively (Chen and Ravallion, 2009). The UK Department for International Development, meanwhile, estimates that an additional 90 million people will be living on less than $1.25 a day by the end of 2010.

What we are seeing, however, is a minimal social protection response to the crisis. Even the roll out of existing social protection commitments is being threatened by the reduction in public resources.

The combined effects of worsening poverty as a result of the financial crisis, and a weak social protection response set the scene, not only for severe and growing poverty and inequality in the medium and long term, but also for stifled growth when the upturn comes – undermining progress towards the Millennium Development Goals.

Working with national researchers, ODI has conducted an assessment of the impact of the financial crisis in 10 countries – Bangladesh, Benin, Bolivia, Cambodia, Ghana, Kenya Nigeria, Indonesia, Uganda and Zambia. An ODI Working Paper discusses the macro-economic, poverty and social protection impacts (te Velde et al, 2009). This paper highlights social protection, underscoring its importance to stop people falling into poverty; stop the poor and vulnerable falling deeper into poverty; and promote the livelihoods of poor people so they can catch the upturn when it comes. It examines social protection policy responses to date.

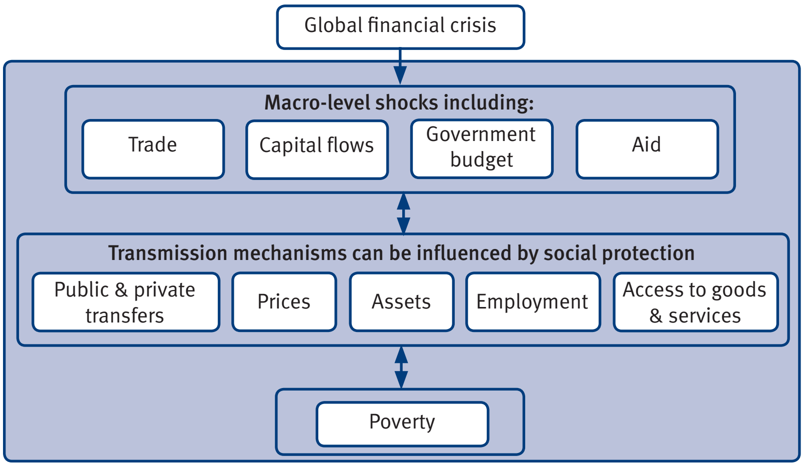
The garment industry in Cambodia has seen job losses as a result of the global financial crisis.

The poverty impact of the crisis

While the overall poverty impact of the triple F crisis has been estimated, the specifics of that impact become less clear when one begins to drill down. Timely, relevant and disaggregated data is hard to find. The impact has not yet been fully felt. Nor can poverty implications be attributed to the global financial crisis alone. Poverty, in the broadest sense, is transferred through five key transmission channels that link macro-level shocks to poor people (see also Lustig and Walton, 2009): employment; prices; public and private transfers; assets; and access to goods and services (Figure 1). How shocks are transmitted through these channels determines who is affected, how deeply, and for how long.

Employment. Loss of jobs has been a feature across the 10 countries. In Zambia, for example, the mining sector lost 27% of its jobs in 2008. By mid-2008, Cambodia's construction sector had lost around 5% of its jobs, leading to some de-urbanisation as affected workers return to rural areas. The garment industry has

Figure 1: Impact of global financial crisis on poverty



been hard hit, with around 4% of workers (51,000) laid off (many of them women) between September 2008 and March 2009. There is bound to be fallout for the wider economy. In Zambia, for example, each job in the formal sector is reported to support another 20 jobs in services and the wider informal economy (Green, 2009). The potential implications for poverty are staggering.

Loss of income in a poor household is a serious shock. Obviously, it increases poverty in that household. It also makes it more likely that the wider community will become poor. It undermines a household's ability to buy basic supplies, and can lead to ways of coping that will derail family well-being in the longer term, such as pulling children out of school or cutting back on food. These strategies undermine the younger generation's chances of moving out of poverty or contributing to economic growth. It may push vulnerable households into a vicious cycle of chronic inter-generational poverty.

The ability of a household to cope is linked to assets, which may be social, physical, natural or financial. Following the food and fuel price crises, poor people may be exceptionally vulnerable to the additional shock of the global financial crisis. Evidence from Zambia's copper belt, for example, suggests an increase in commercial sex work as households struggle to cope.

Not only are people losing their jobs, employment conditions are also worsening. In Cambodia's garment industry, workers are being forced to work fewer hours. On the other hand, some people are being asked to work more hours, with less remuneration (i.e. Cambodia's tourism sector). A female head of household who has to increase her working hours will have less time to spend running her household, feeding her children, and caring for the sick. She will also have less time to rest, undermining her own health and wellbeing.

The immediate poverty impacts of this crisis are likely to be concentrated in regions supplying the export sectors. In Indonesia, for example, the plantations supplying international markets are concentrated in five provinces, each of which depends on revenue from a small range of crops, or even just one. Zambia's export sector, for example, is almost entirely dependent on the copper belt in the north, which is, therefore, more likely to feel the pressure. In 2008, copper represented approximately 70% of total exports from Zambia.

Prices. Poor people will also be affected by changes in prices as a result of the financial crisis. Changes in both consumption and production prices affect net consumers and net producers in different ways.

Lower global market demand for commodities is pushing prices down, reducing the profits of firms and the incomes of producers. In Cambodia for example, reduced demand for cassava has resulted in a steep drop in profits. Some farmers are reacting by letting their once valued crop rot in the fields. Others, who took loans to grow cassava or expand production, are seeing those loans turn into debts that they are now struggling to repay.

A drop in prices is good for net consumers. However, the fall in world food prices has not yet reached poor consumers (Blas, 2009). Evidence from Bangladesh shows that, since November 2008, food-price inflation has been higher than aggregate inflation, particularly in rural areas. Poor people spend a large proportion of their household budgets on food, so food price inflation hits them particularly hard.

In countries that distinguish between aggregate and food-price inflation, the latter tends to be higher. Persistently high inflation, in particular on food prices, will challenge food security and reduce the resources poor consumers can spend on non-food items, such as education and investment.

Private and public transfers. The World Bank (2006) estimates that remittances to Kenya reduce the number of people living in absolute poverty by 8.5%. Yet Kenya has seen a fall in international remittances of over 10%; declining from $316.6 million in the second half of 2007, to $281.7 million in the second half of 2008. Between January 2008 and 2009 Money-Gram (a bank that transfers remittances) in Ghana reported a fall in remittances of 10-13%. Based on a study in Uganda, as much as one quarter of remittance income is spent on school fees. So a drop in revenue from remittances may induce families to remove children from school, damaging their future ability to seize economic opportunities.

Reduced public revenue and an expanding debt (resulting from currency depreciation) are increasing the pressure on government budgets. How governments reprioritise public spending (both including and beyond social protection spending) across regions, vulnerable groups and over time will shape the short and long run impacts of the financial crisis on growth and poverty.

Assets and goods and services. The provision of goods and services by governments, NGOs and the private sector may be waning as a result of falling revenue. In Uganda, for example, NGO revenues are reported to have fallen by over 5% in the space of a year with the decline more pronounced since October 2008. Reductions in both service provision and uptake are likely to deepen as the impact of the crisis works its way through the economy.

The social protection response

Social protection plays an integral role in mitigating against the impact of poverty in an economic crisis and is, therefore, an important counter cyclical social policy. However, the social protection response to the global financial crisis has been minimal, and increases in coverage have been marginal.

Countries have adopted a range of different responses to the poverty impacts of the crisis, with some struggling to meet pre-existing social protection commitments (Kenya and Uganda). Others try to extend the coverage (Ghana), even at the cost of a widening fiscal deficit (Cambodia). Still others have put social protection aside, and now focus on addressing macroeconomic stabilisation (Indonesia) or promote fiscal stimulus packages while controlling a widening deficit by reducing social sector expenditure (Nigeria).

What determines the response? Resources to address the poverty impacts of the financial crisis are limited. Actual and anticipated falls in public revenues are constraining the social protection budget, and existing funds have already been subjected to additional demands to cope with the fuel and food crises. Developing country governments face tough decisions on what to prioritise in terms of public expenditure as deficits rise, including the provision of social protection. Developing country responses, therefore, depend not only on their budgets, but also on the relative priority they give to social protection, and whether they can access alternative sources of income to address the fiscal deficit (e.g. official development assistance).

Social protection provision. Social protection coverage is low in all 10 countries. The distribution of programmes is inequitable and they help only a small percentage of the poor, offering disproportionate support to those in formal employment, particularly government employees. There is little evidence of any major increases in coverage in response to the crisis, with only Bangladesh and Cambodia reporting significant expansion during 2008 and 2009. In the case of Bangladesh, however, much of this expansion was planned before the onset of the financial crisis (rather than in response to it). Some countries, such as Indonesia, are prioritising spending to stimulate the economy, rather than social protection, with social protection investment still based on plans drawn up in 2006.

While the financial crisis has not yet resulted in major policy reform or the large scale expansion of social protection in most countries, a number of pre-existing programmes have been extended, and new programmes introduced, albeit on a modest scale, and largely in response to the food and fuel price crises. The major interventions to date are food subsidies and rationing (Bangladesh and Indonesia), food distributions for vulnerable groups, including school feeding programmes (Bangladesh, Cambodia, Ghana, Indonesia, Kenya and Nigeria), in-kind transfers offering fertilizer to promote agricultural production (Kenya), cash transfers (Ghana), education scholarships and subsidies (Cambodia and Ghana) and public works programmes (Bangladesh, Cambodia, and Indonesia).

Across the 10 countries, social protection provision is piecemeal and fragmented. Some countries are struggling to protect funding for existing commitments, while others are trying to extend coverage. Cambodia has initiated new programmes and Ghana is trying to expand its existing programmes with support from the World Bank. However, these may be unsustainable, institutionally and financially. Kenya is developing national programmes, but there is little prospect of these being realised on a significant scale in the short term, given the reduction in available funding.

This weak social protection response is, in part, because large scale impoverishment arising from the crisis is not yet visible. Without data on the scale and depth of the problem, policy-makers may be reluctant to allocate additional resources to poverty alleviation and food security, particularly when it is not clear who is affected or where.

Resource availability. The financial effects of the crisis were not recognised fully in most 2008-2009 budgets, which underestimated the likely impact on government revenue. The budgets of the 10 countries were based on more optimistic growth scenarios than those currently forecast by the International Monetary Fund (IMF), leading most budgets to indicate only modest reductions in the real value of social protection allocations. The medium-term effects on social protection allocations are more likely to be significant, and the extension of social protection to those affected by the crisis is likely to be compromised by lack of resources. Even the extension of existing programmes, planned prior to the financial crisis, will be limited by falling revenues and concerns regarding the control of budget deficits.

The role of donors. Evidence suggests that most donors have held firm on their funding allocations and commitments for social protection. Several countries will face a growing dependence on donor funding in the wake of the crisis if they are to meet their commitments to health and education, and continue rolling out social protection. Timely emergency funding by the World Bank and Asian Development Bank has supported one-off responses in countries such as Ghana and Cambodia. But large scale, long-term funding from donors is needed if social protection is to reach those impoverished by the crisis, particularly given governments' reluctance to take on medium- or long-term financial liabilities in the context of a volatile economic climate.

Given the paradox of greater need for social protection at a time of dwindling resources, there is a need for more efficiency in social protection spending and the rationalisation of resource allocation, which is fragmented at present in terms of programming and objectives in each of the case study countries.

Policy priorities. The extent to which expenditure on social protection, and social sector generally, is protected is informed by both political priorities and perceived need. In Kenya for example, the needs of Internally Displaced People following the civil unrest in 2008 and the national food shortage mean that 15% of the total government budget is allocated to food security. Where components of social sector expenditure are funded from conditional Highly Indebted Poor Country (HIPC) debt relief funds, these allocations are ring-fenced and enjoy some protection even when other areas of social sector expenditure are cut (as with Universal Primary Education in Nigeria and Uganda). In Zambia, ring-fencing has been less positive, with spending on pensions for government employees – accounting for 75% of government social protection expenditure – being protected, while provision for others has decreased.

Elsewhere, stimulus packages and growth-oriented initiatives are being prioritised over the provision of direct social protection for the poor. Governments are trying to respond to the needs of the poor indirectly through the anticipated employment effects of increased infrastructure investment (Indonesia) and labour market initiatives to stimulate formal and informal sector employment.

Conclusions

The impact of the global financial crisis on poverty is likely to be mediated and felt in different ways across different countries, sectors, social groups, locations, time and according to the level of integration into the global economy. The immediate impacts appear to be transmitted most strongly through employment, private transfers and prices and these impacts are likely to worsen over the medium term without direct measures to dampen them. The second and third wave effects are yet to be fully experienced in many developing countries.

Social protection responses to the crisis have, in general, taken the form of marginal increases to already limited programmes and countries are struggling to maintain existing commitments. The roll out of new initiatives developed before the crisis is threatened by the fiscal contraction caused by the crisis. There is little evidence of interventions to address its poverty consequences on any significant scale.

Social protection is essential to stop more people falling into poverty, to stop those who are already poor falling further into destitution, and to support inclusive growth when the upturn comes, with all groups able to contribute to and benefit from growth.

Recommendations for national governments:

- monitor the poverty impact of the crisis: identify who is affected and where, and what other groups will be affected in the medium and long term;
- rationalise and target social protection interventions and expenditure spending to address priority needs;
- ensure that responses mitigate against the immediate poverty impacts of the financial crisis as well as promoting macro-economic stability and growth in the medium term.

Recommendations for donors:

- support the development and implementation of nationally owned social protection strategies providing high levels of coverage among the poorest, rather than continuing to promote multiple small-scale or pilot initiatives with patchy and inequitable coverage;
- commit to medium- to long-term social protection funding at national level (five to 10 years), to facilitate developing country government planning in response to the crisis;
- safeguard existing ODA allocations for the health, education and social protection sectors.

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