

# ***Fiscal Policy in Developing Countries: Implications from the Current Crisis***

---

**Otaviano Canuto**  
**Vice President and Head of Network**  
**Poverty Reduction and Economic Management**  
**The World Bank**

**65<sup>th</sup> Annual Congress of the  
International Institute of Public Finance (IIPF)**

**Cape Town, South Africa  
13-16 August 2009**



# A Two-fold Message

1. Aggressive counter-cyclical fiscal policies are among the factors differentiating the current global economic crisis from the Great Depression

2. Setting aggressive fiscal policies as a cornerstone of crisis response is an idea that may not travel well to many developing countries

# Part I

## Why the current global economic crisis differs from the Great Depression

- Larger weight of developing countries
- Larger share of services in global activity
- Changes in the structure of world trade
- Different policy responses: monetary, financial sector, and fiscal policies

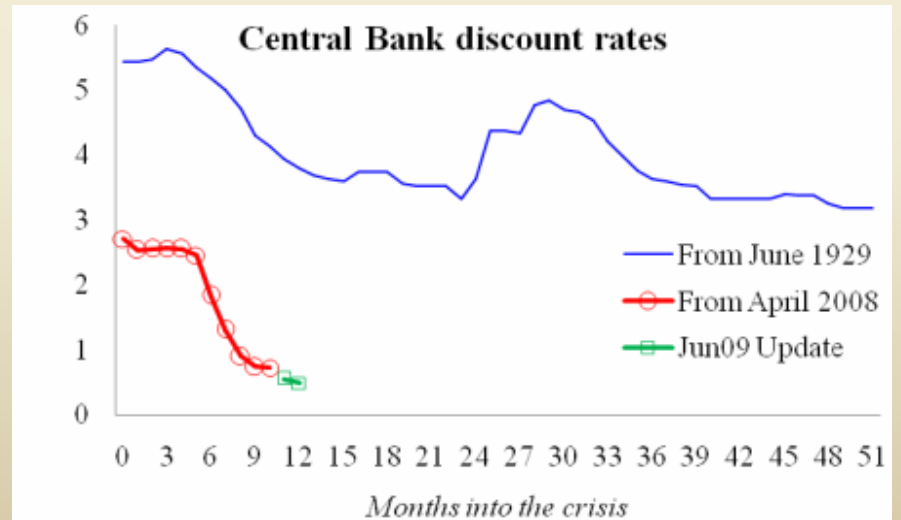
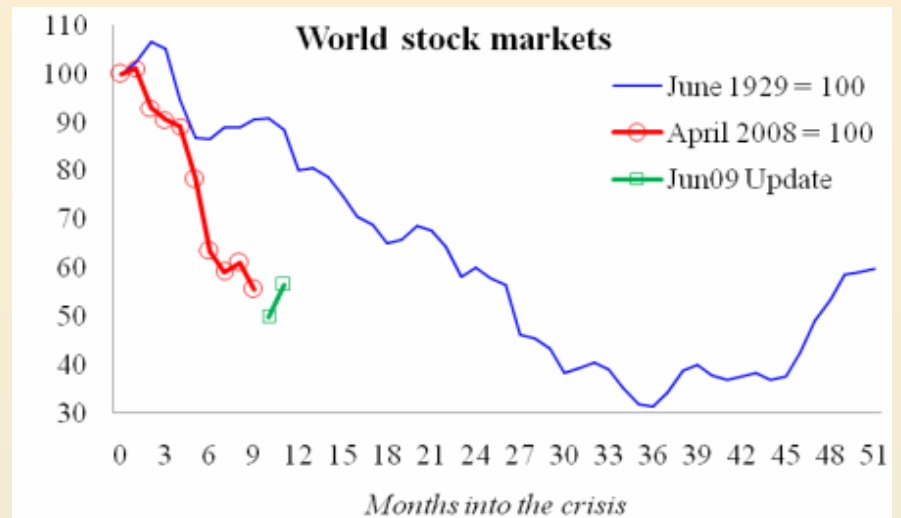
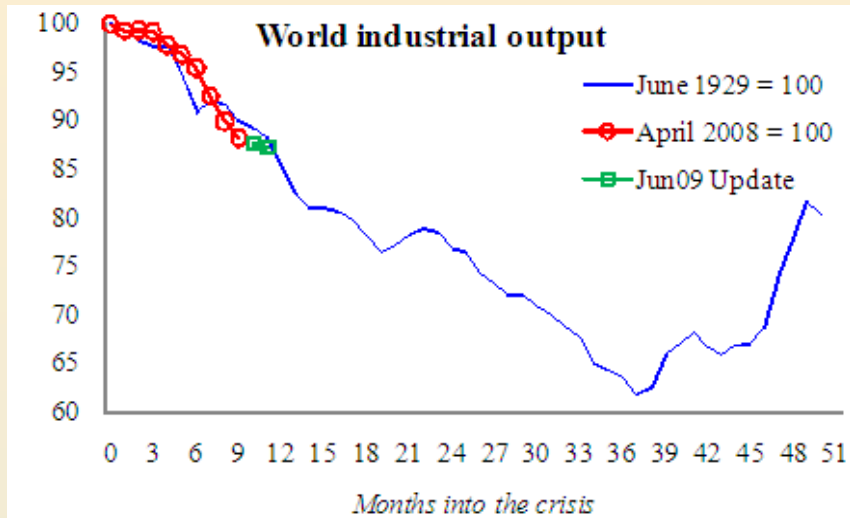
## Stylized scenarios for the recovery

# Part II

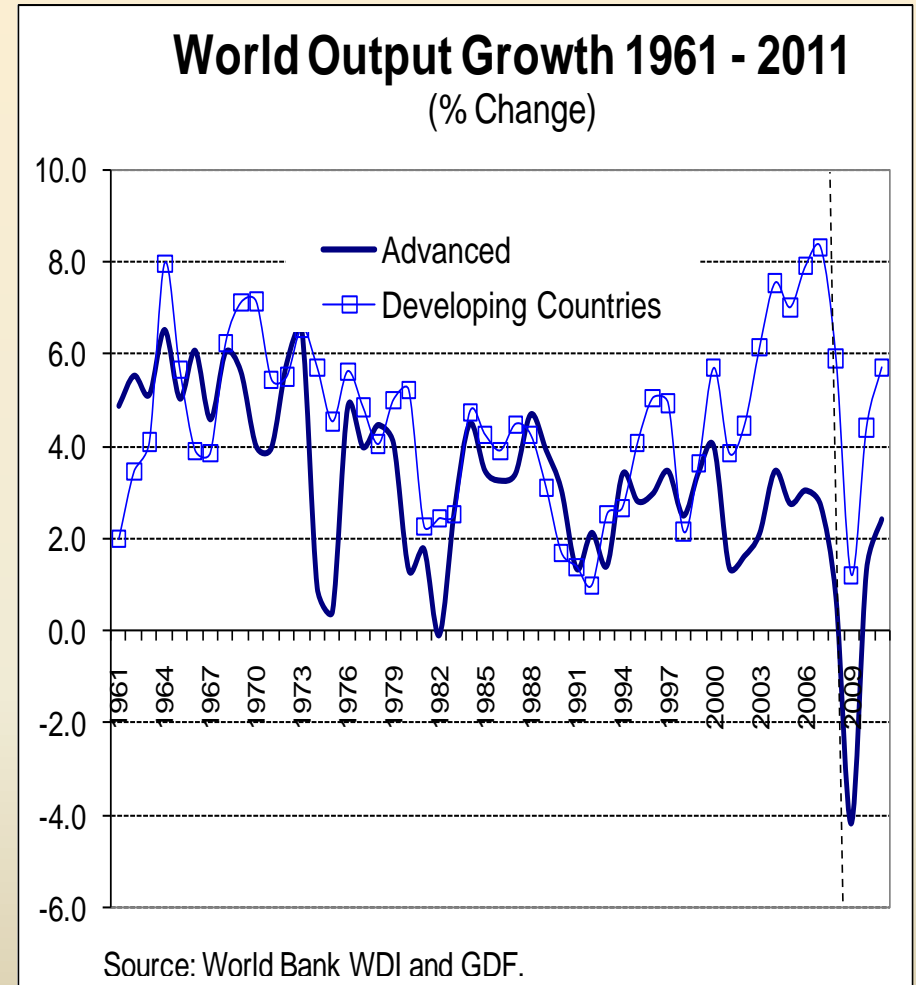
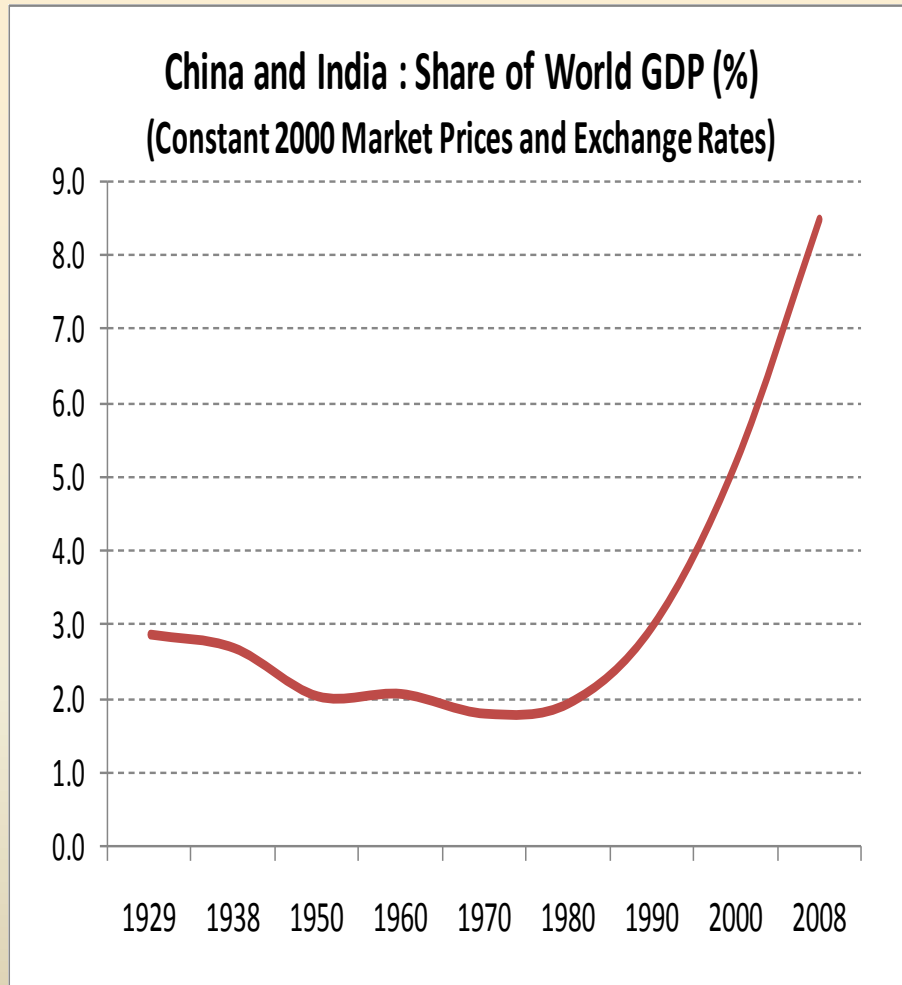
## Fiscal policies in developing countries

- Channels of transmission of the crisis on developing countries
- Fiscal policy responses to the crisis: constraints and options

# A Tale of Two Depressions

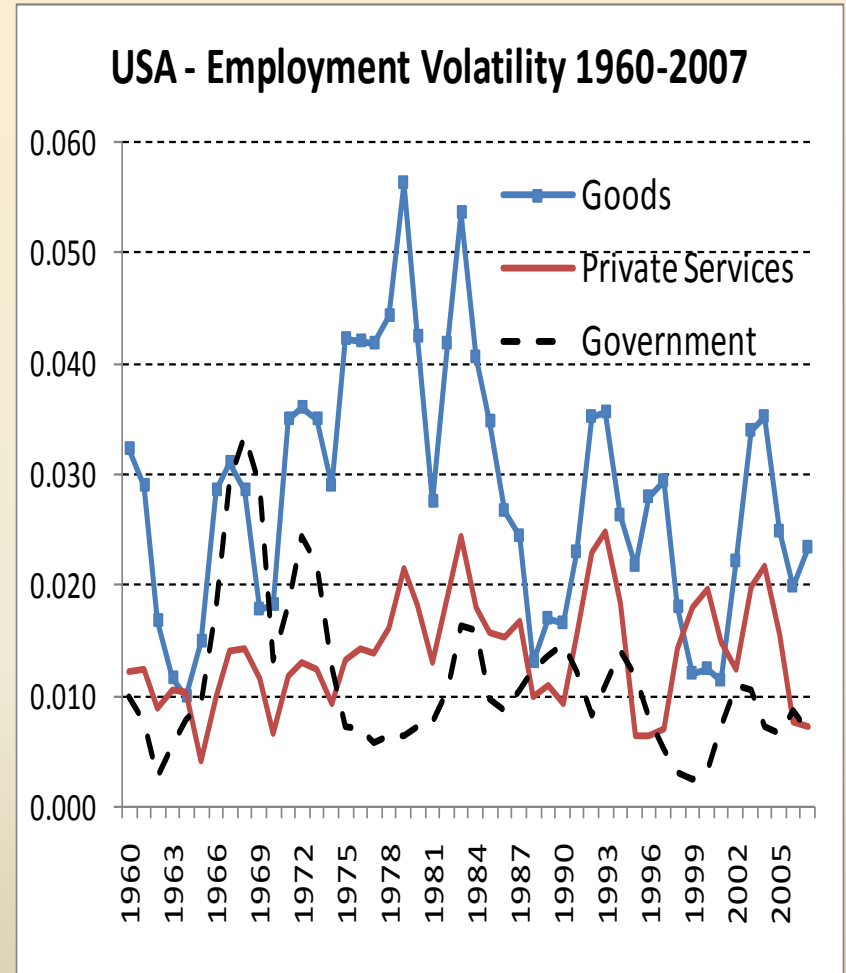
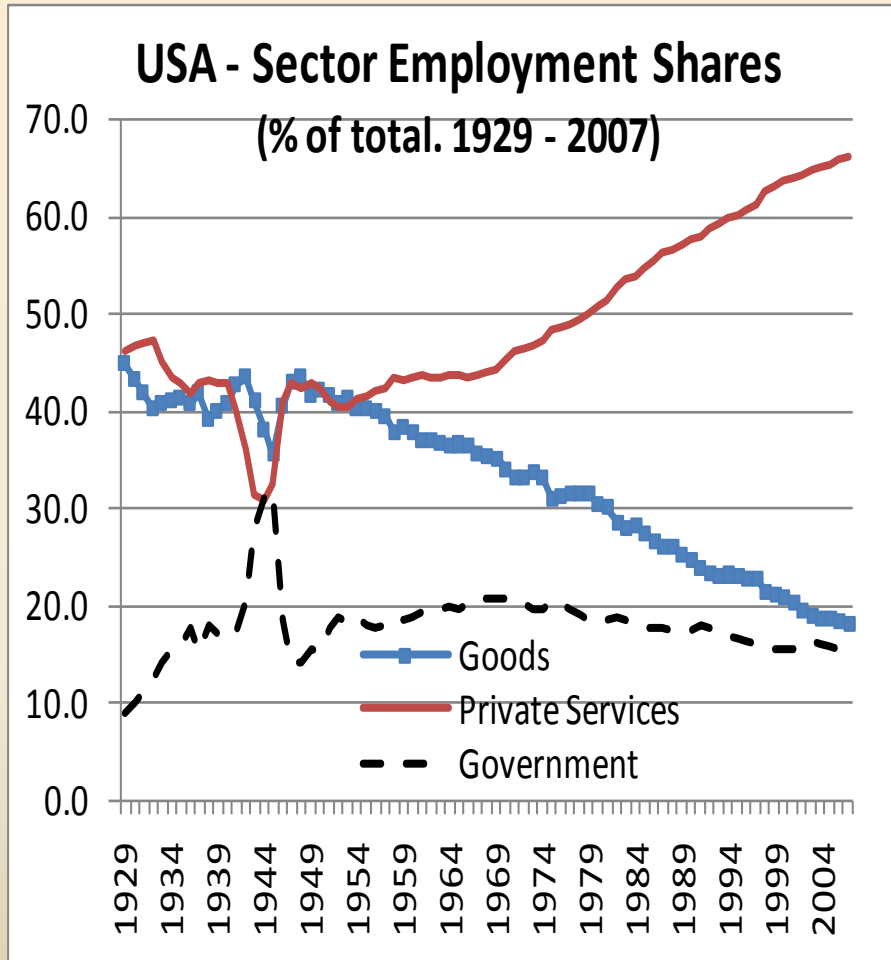


# Larger weight of developing countries



Source: World Bank (PREM and DEC), "Comparing the Great Depression with the Current Global Financial Crisis and 'most likely' recovery scenarios for 2009-2010", August 2009

# Larger share of services in global activity

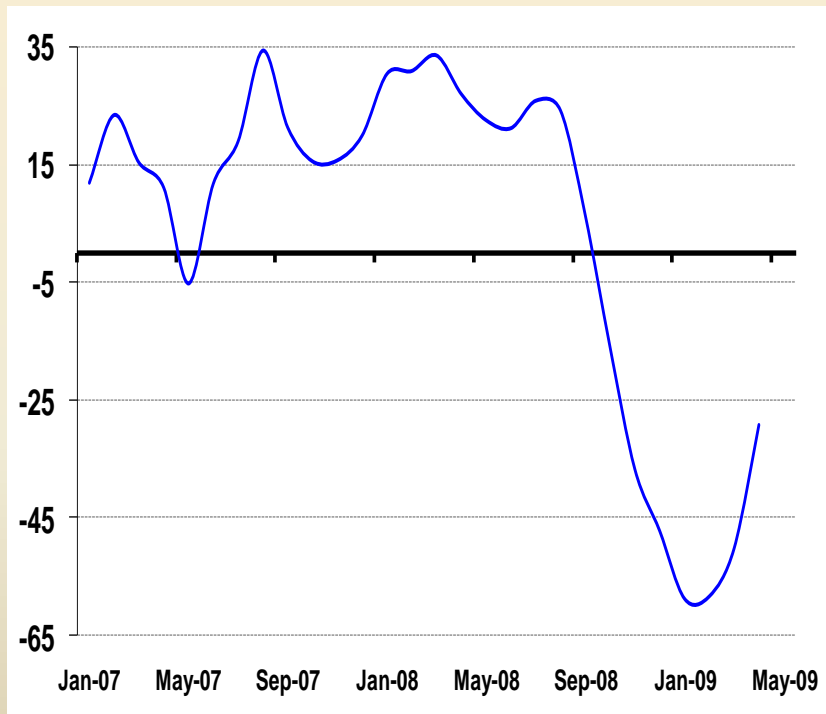


Source: World Bank (PREM and DEC), "Comparing the Great Depression with the Current Global Financial Crisis and 'most likely' recovery scenarios for 2009-2010", August 2009

# Changes in the structure of trade

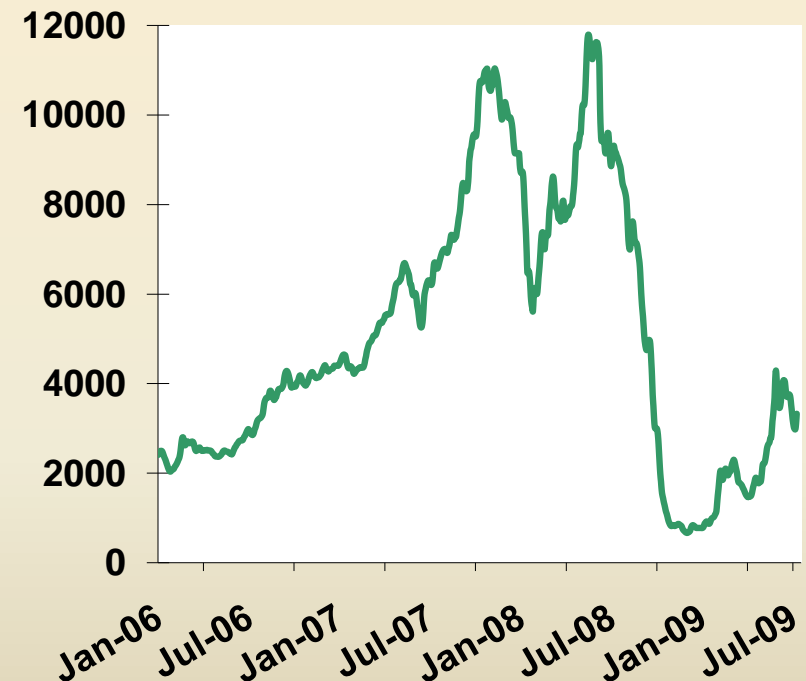
## World export growth appears to be bottoming

exports, ch % seasonally adjusted annual rates (saar)



Source: World Bank data

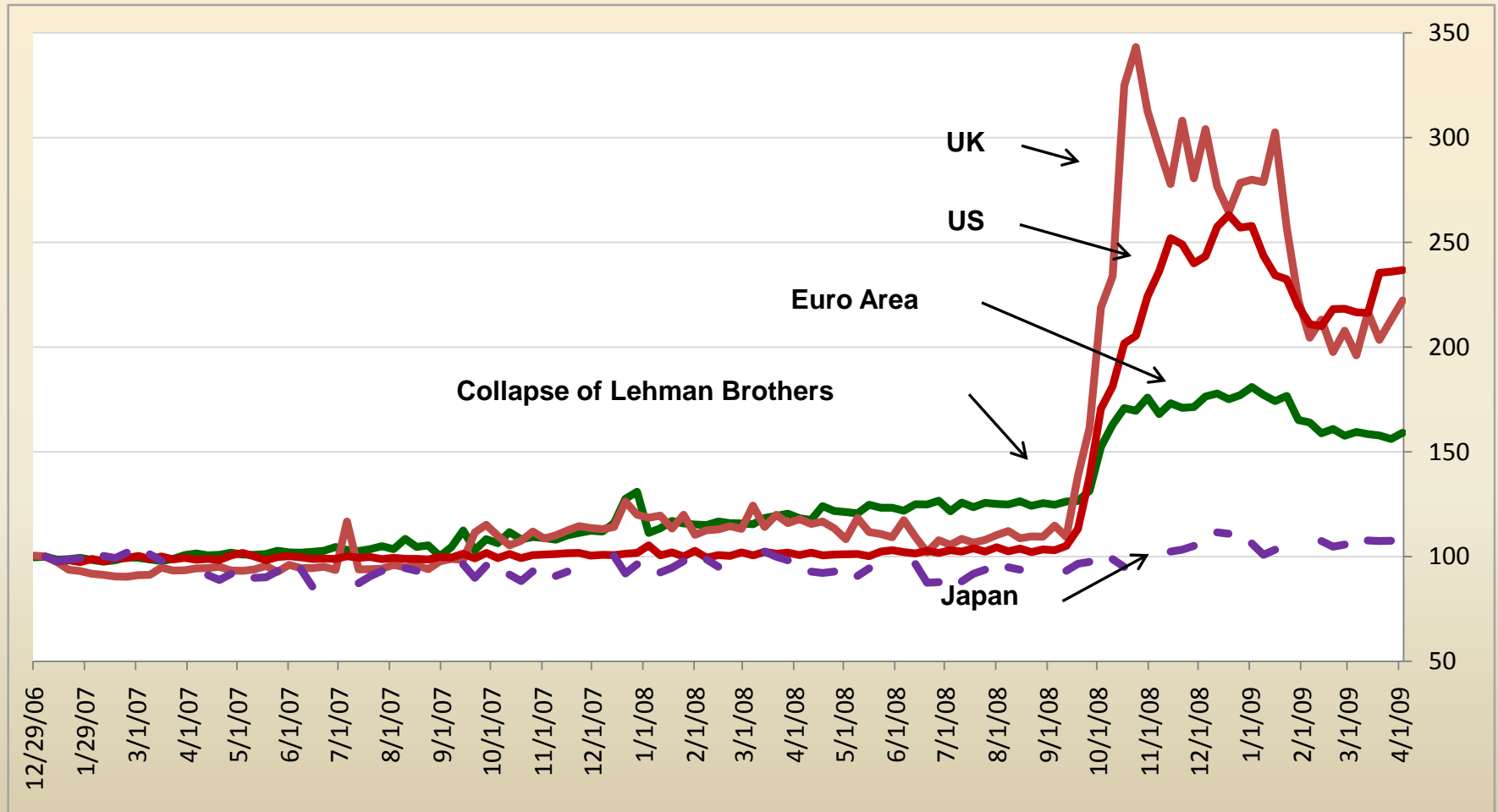
## Bulk freight rates starting to recover from extreme lows



Source: Datastream and DECPG  
Commodities Group

# Policy Responses (1): Central Banks' Total Assets

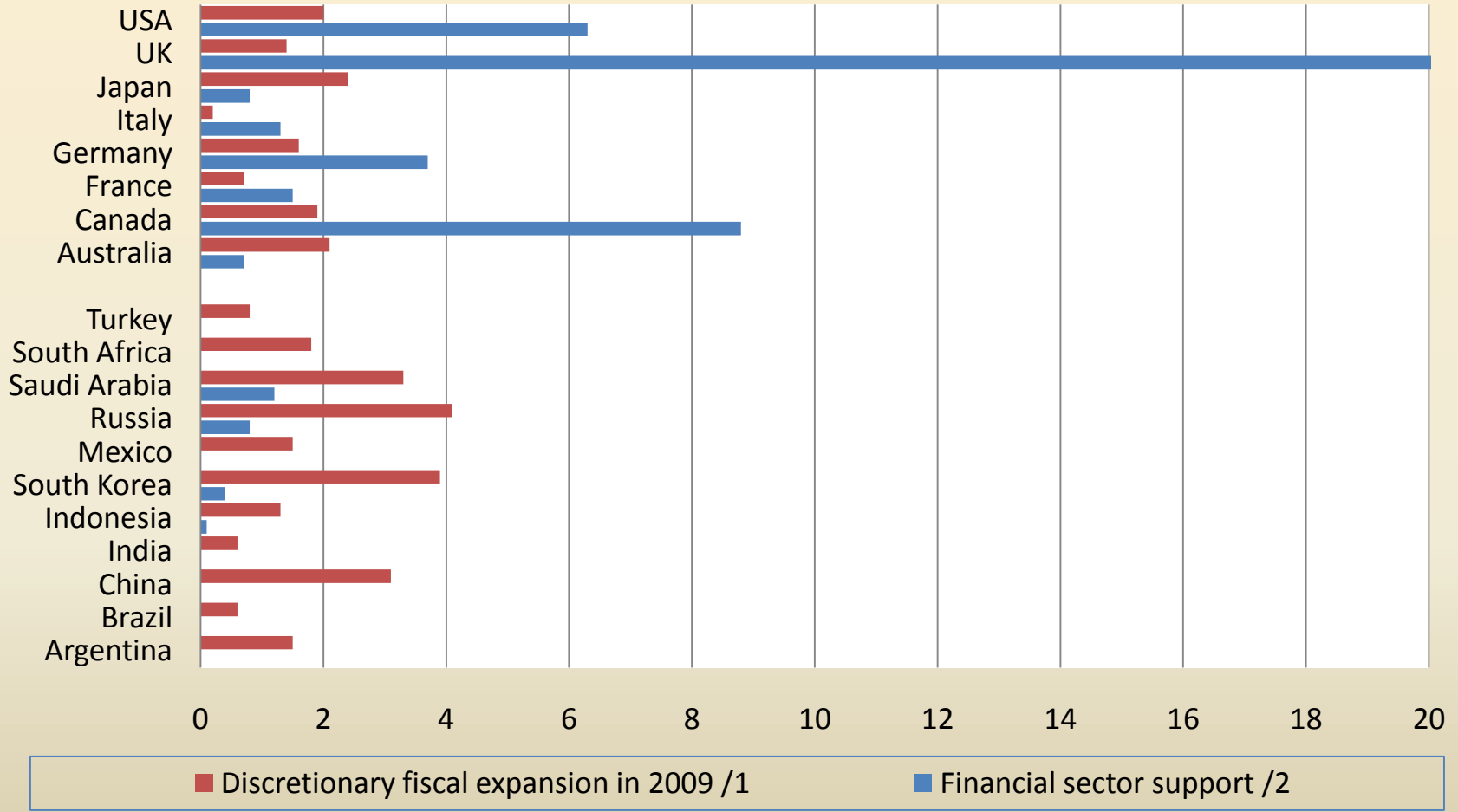
(Index, 12/29/06 = 100)



Source: IMF – World Economic Outlook, 2009



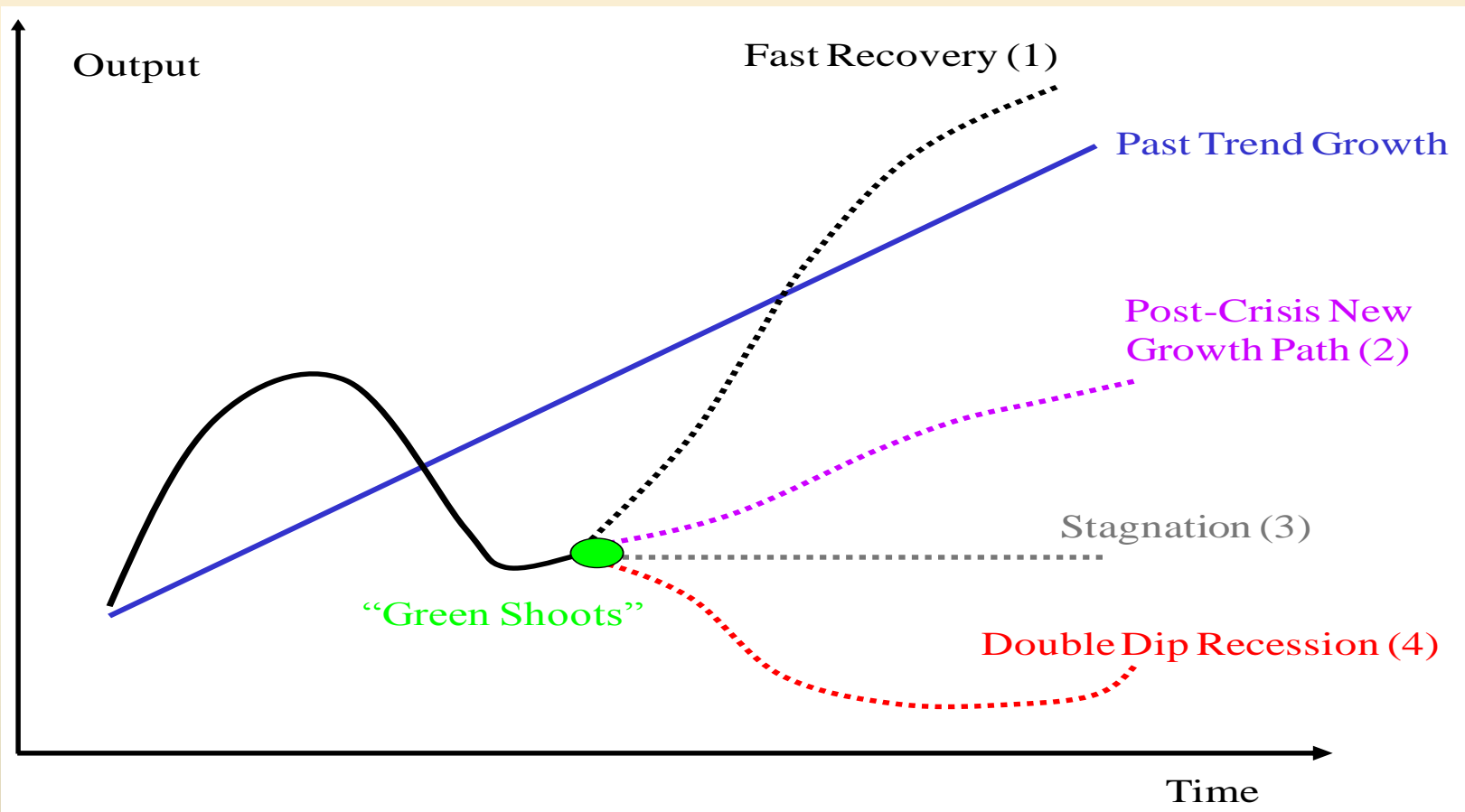
# Policy Responses (2): Fiscal Stimulus and Financial Sector Support



1/ In percent of 2009 GDP. Excludes below-the-line operations that involve acquisition of assets.

2/ As of Apr. 15, 2009, in percent of 2008 GDP. Consists of capital injection, purchase of assets and lending by Treasury, and central bank support provided with Treasury backing.

# Stylized scenarios for the recovery



Source: World Bank (PREM and DEC), "Comparing the Great Depression with the Current Global Financial Crisis and 'most likely' recovery scenarios for 2009-2010", August 2009

# Part I

Why the current global economic crisis differs from the Great Depression

- Larger weight of developing countries
- Larger share of services in global activity
- Changes in the structure of world trade
- Different policy responses: monetary, financial sector, and fiscal policies

Stylized scenarios for the recovery

## Part II

**Fiscal policies in developing countries**

- **Channels of transmission of the crisis on developing countries**
- **Fiscal policy responses to the crisis: constraints and options**

# Channels of Transmission of the Crisis on Developing Countries

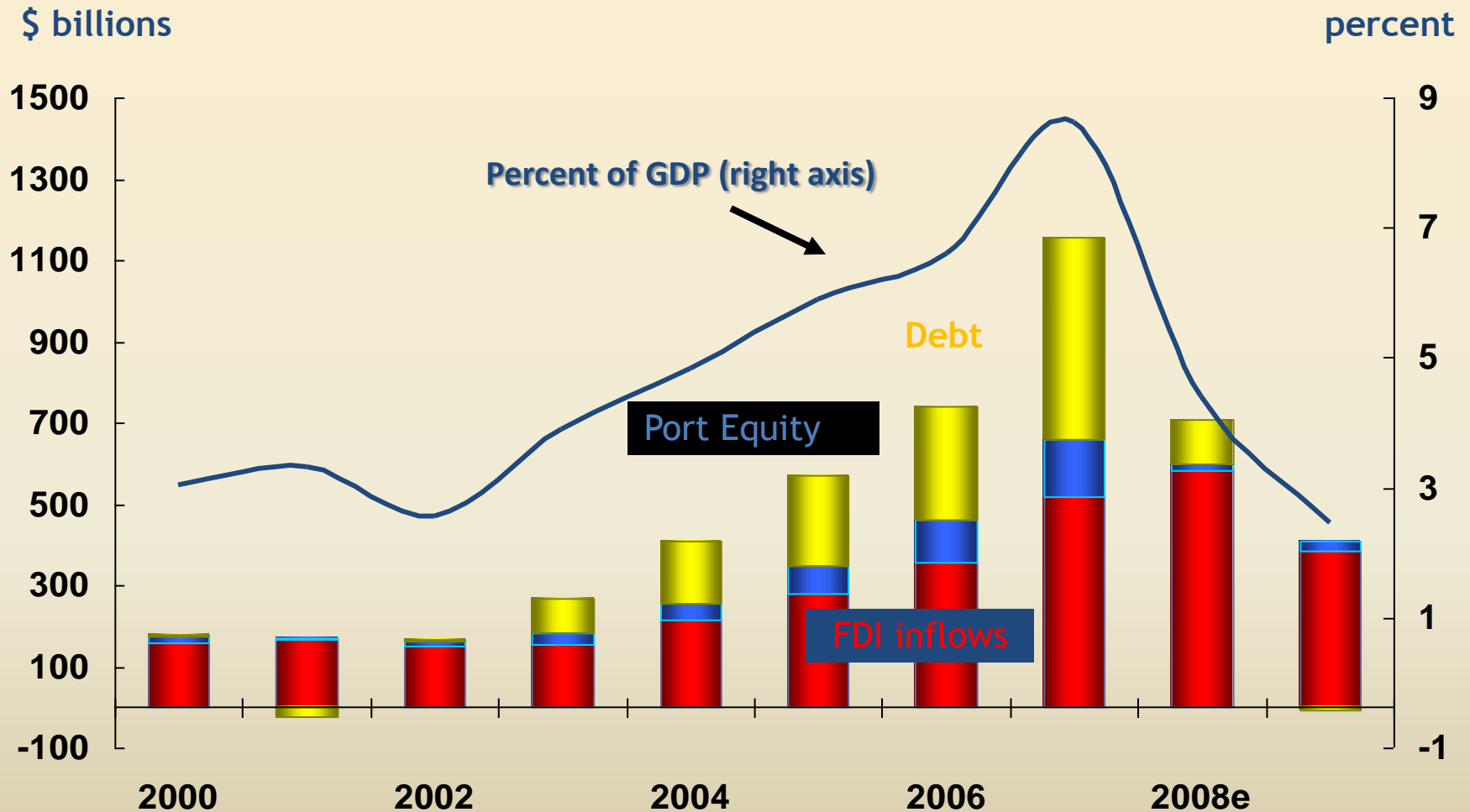
- Lower and more selective private capital flows
- Declining migrant remittances
- Squeezing aid flows
- Lower and more volatile commodity prices
- Smaller world trade volumes

# First-half volumes halved from a year earlier

Gross capital flows to emerging markets								
\$ billion	2007	2008		2009				
	Total	H1	H2	Total	H1	Apr	May	Jun
Total	652	258	132	389	106	14	24	21
Bonds	146	53	12	65	36	6	8	3
Banks	312	151	106	257	37	2	9	6
Equity	194	54	14	68	33	5	7	12
Lat. America	156	61	29	90	34	2	5	7
Bonds	45	17	3	20	15	2	1	2
E. Europe	247	99	57	157	22	4	7	5
Bonds	64	27	8	35	13	3	5	1
Asia	188	69	29	98	42	7	10	9
Bonds	23	7	0	7	6	1	1	0
Others	61	28	17	44	7	0	3	1

Source: DECPG Finance Team

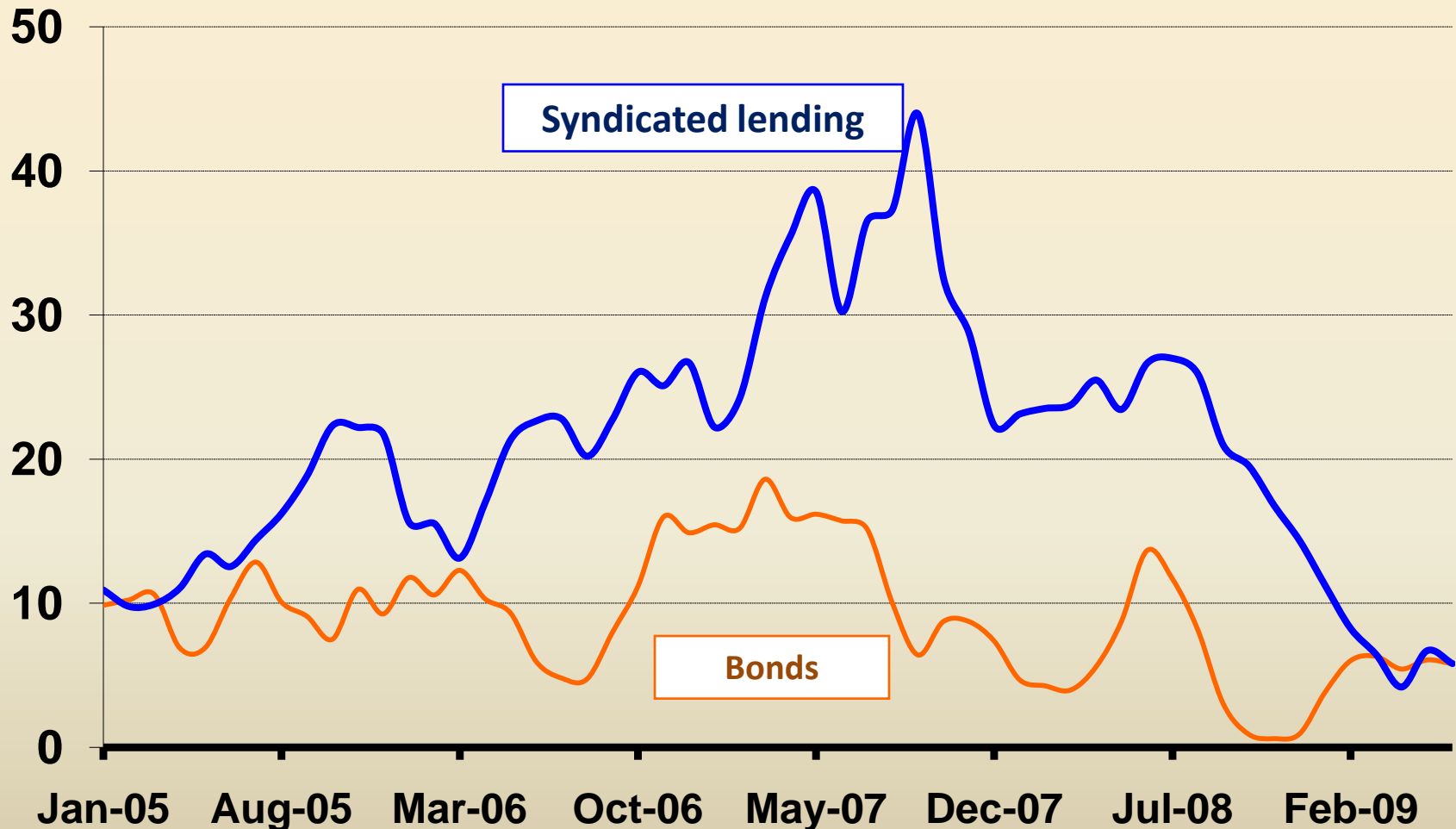
# Changing composition of private capital flows to developing countries



Source: DECPG/GDF 2009

# Cross border bank flows remain well below the levels seen in previous years

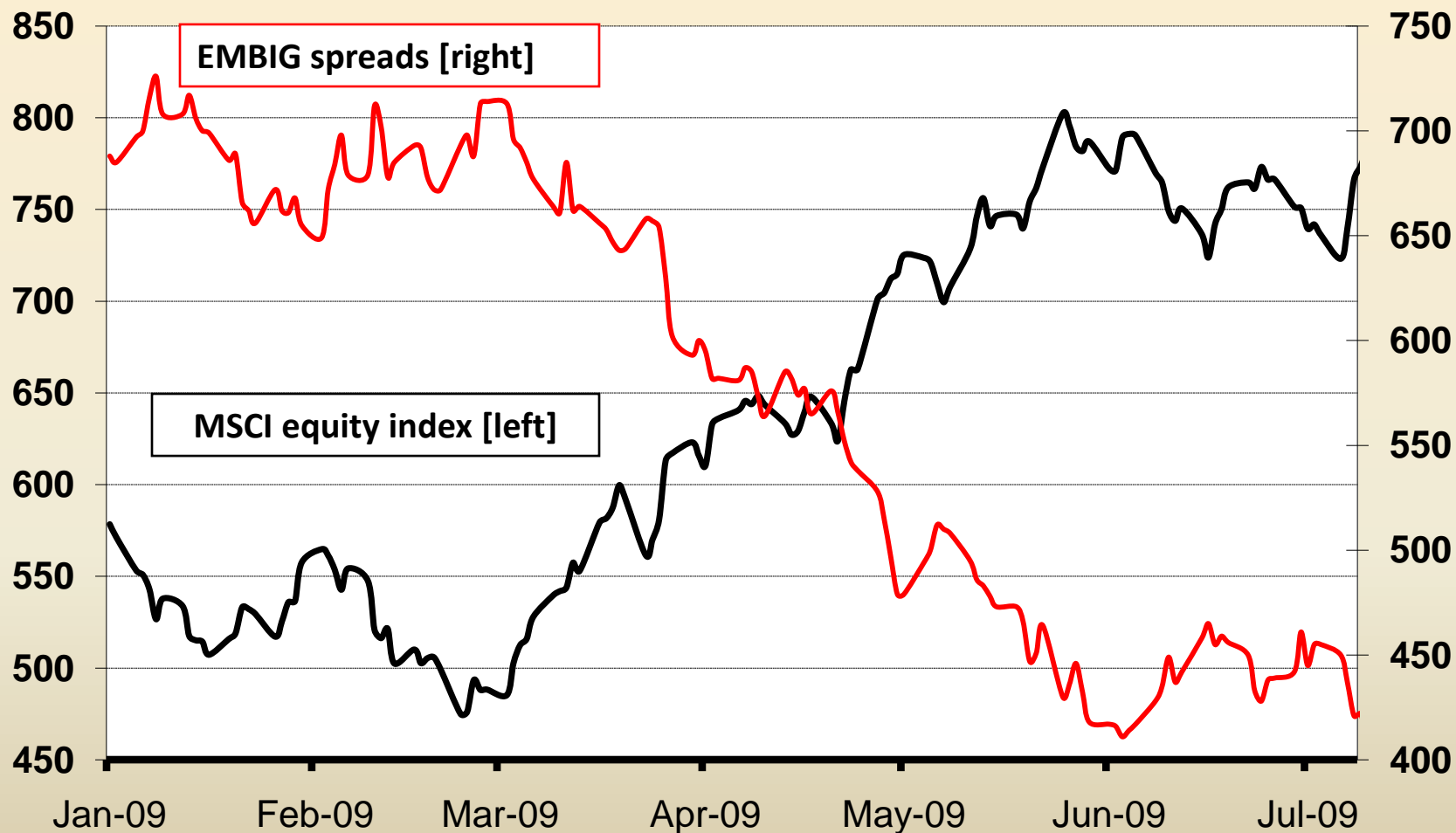
(billions USD, 3-month moving average)



Source: Loanware and Bondware

# EM assets rebound from recent corrections

MSCI equity index, USD [left]; EM bonds spreads, bps [right]

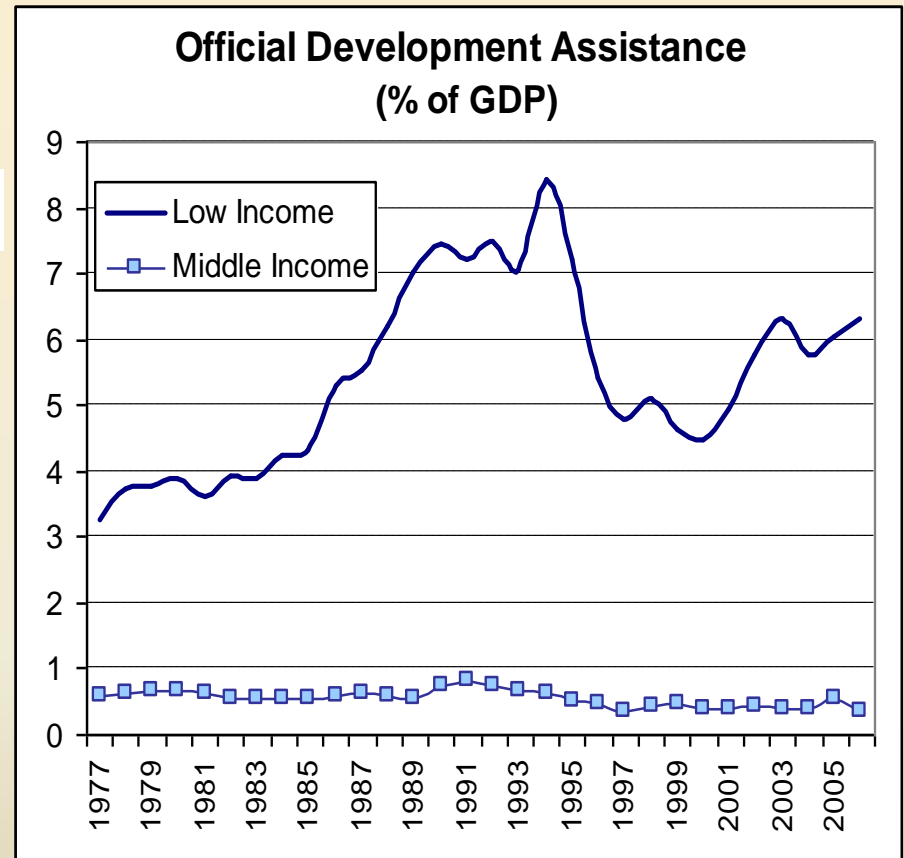
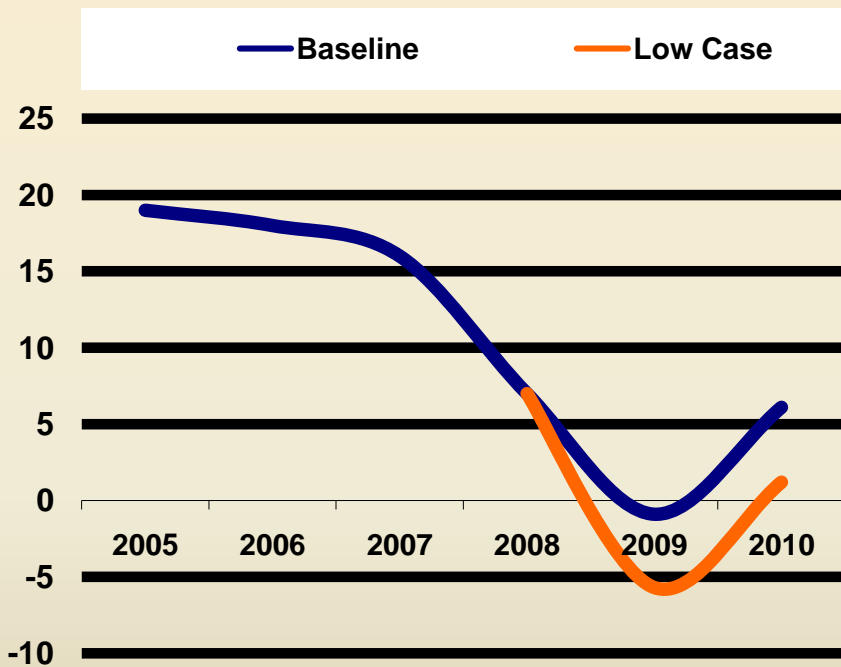


Source: Morgan-Stanley and JPMorgan-Chase.



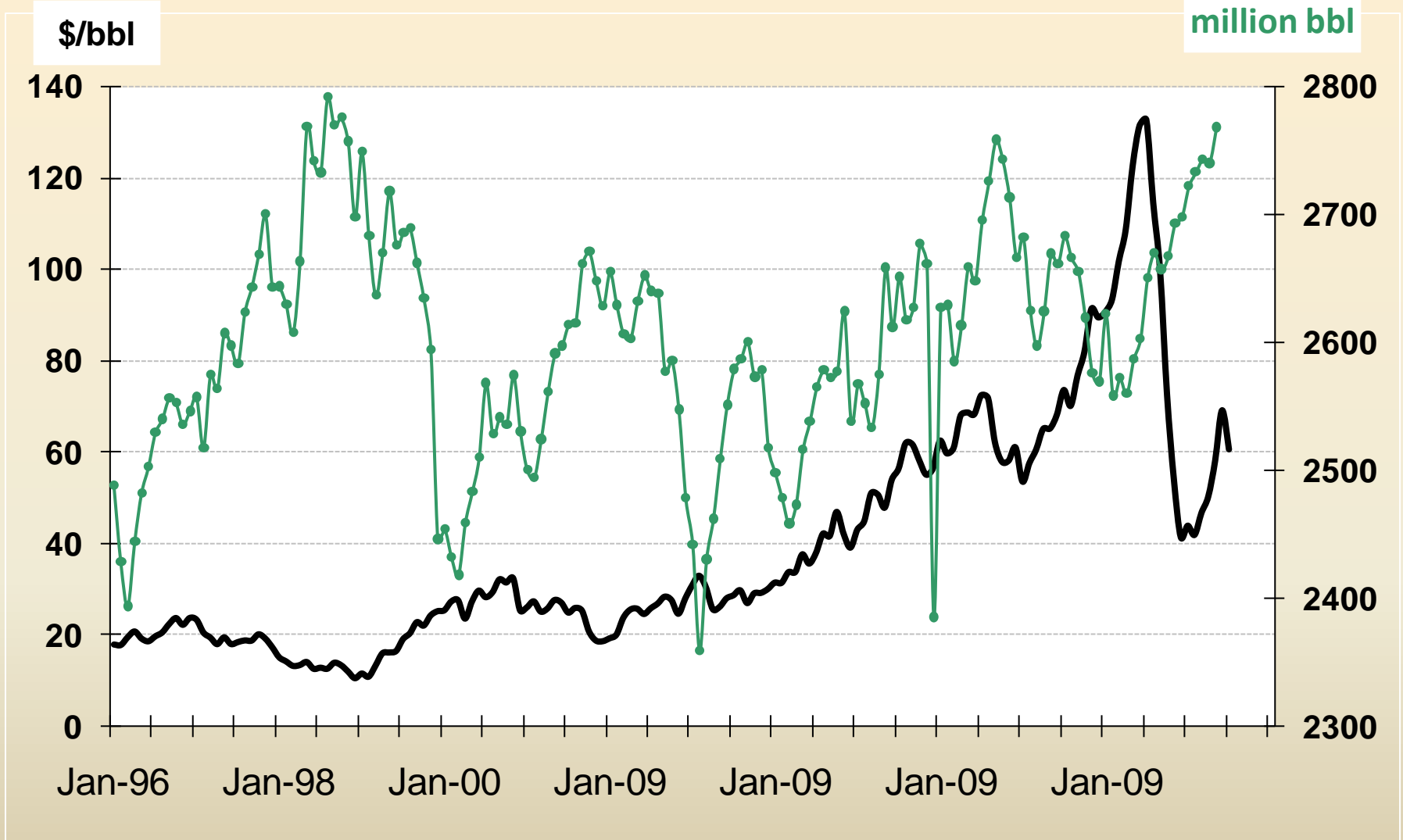
# Potential declines in remittances & ODA

Remittance Flows to Developing Countries  
(USD, % Change)



Source: World Bank data and staff estimates

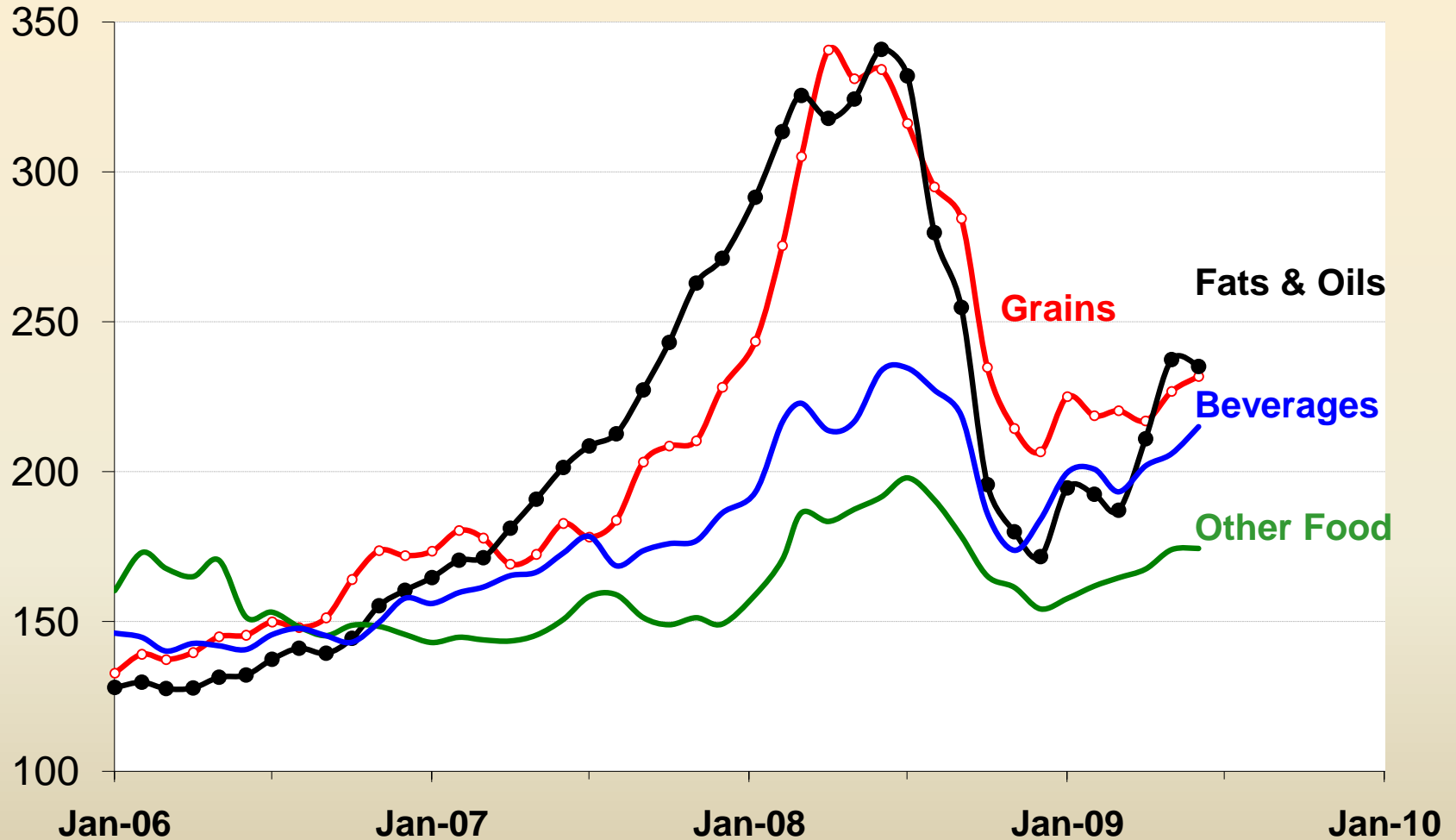
# Oil prices and OECD oil stocks



Source: IEA and DECPG Commodities Group.

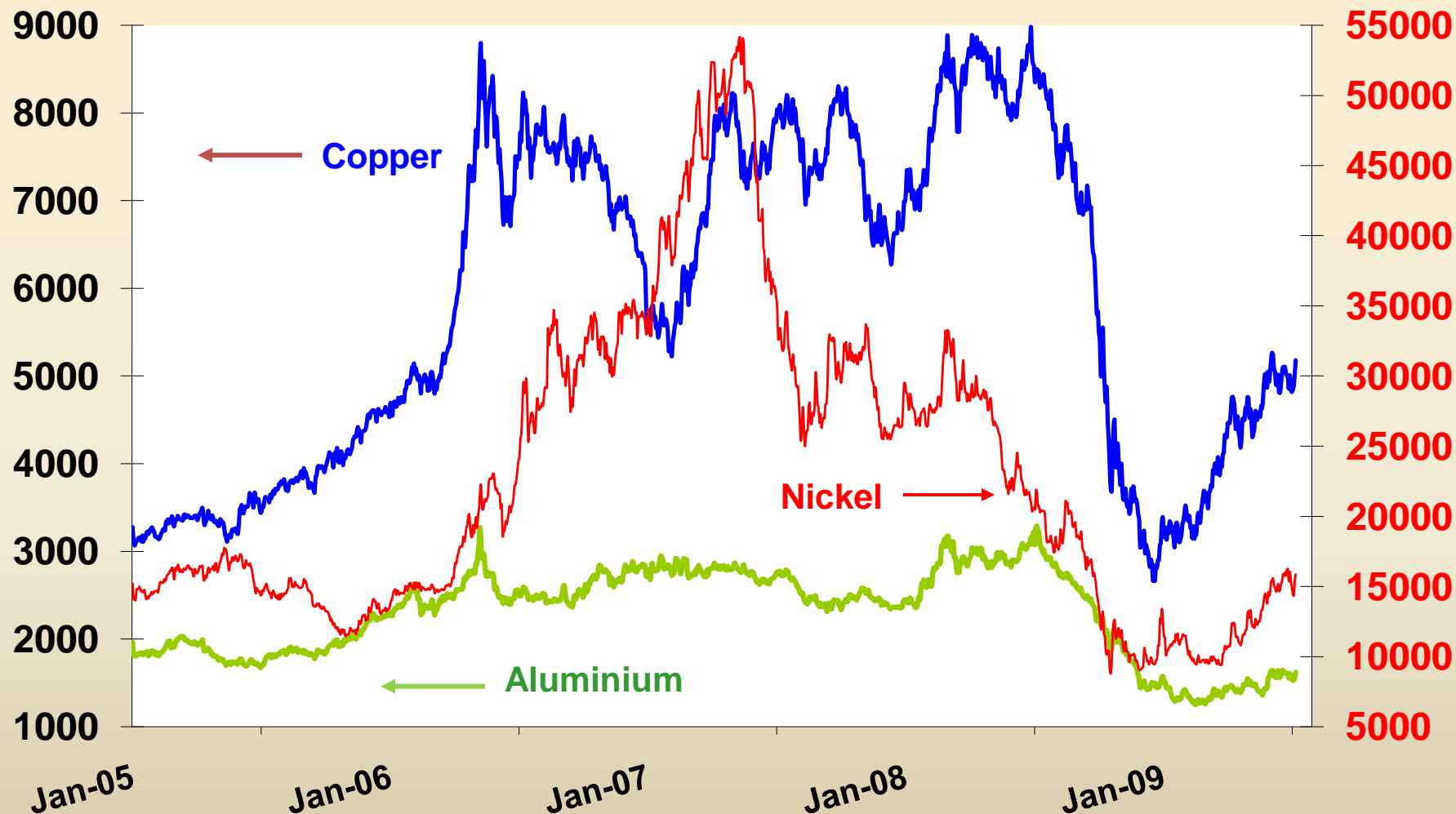
# Food prices edged higher in June

(2000=100)



Source: DECPG Commodities Group

# Metals prices ease following large gains in first-half 2009



Source: LME and DECPG Commodities Group

# **Fiscal policy responses to the crisis in Developing Countries: constraints and options**

## **1. Macroeconomic Constraints**

- Fiscal sustainability
- External constraints
- Domestic financing options
- World Bank Fiscal Survey results

## **2. Institutional Constraints**

## **3. Protection of “Core Spending”**

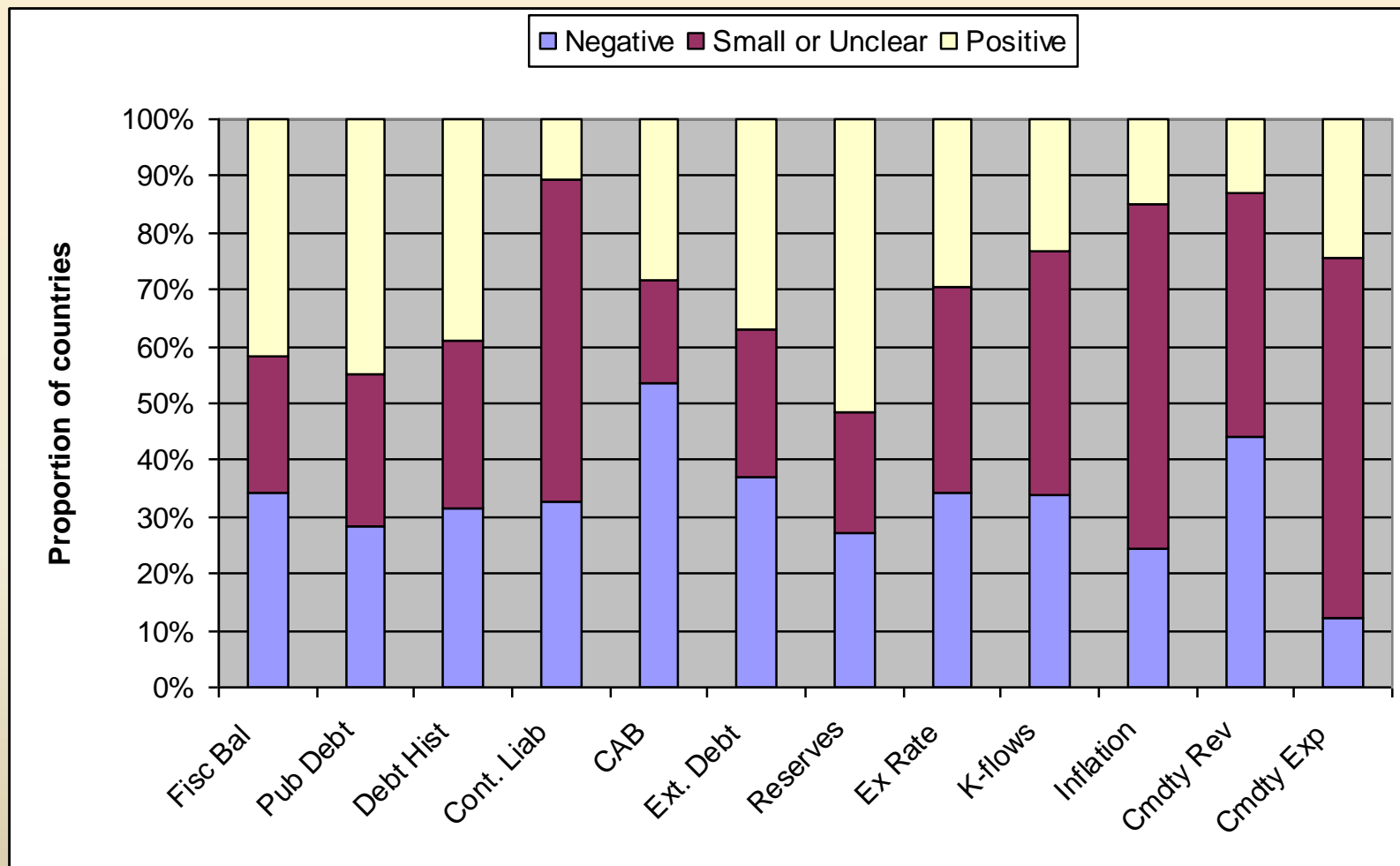
# G20 Government Debt: medium term prospects

- Significant expansion of public debt in G20 economies may shrink the space available for riskier sovereign debt

## Public Debt/GDP Ratios

	2007	2009	2014
Advanced G20	77.6	97.7	114.1
Emerging G20	37.8	38.7	35.0
USA	63.1	87.0	106.7
Japan	187.7	217.2	234.2
UK	44.1	62.7	87.8
Korea	33.0	40.0	51.8
Brazil	67.7	65.4	54.1
China	20.2	19.8	17.9
India	80.4	86.8	76.8

# How different factors impact a country's scope for fiscal stimulus



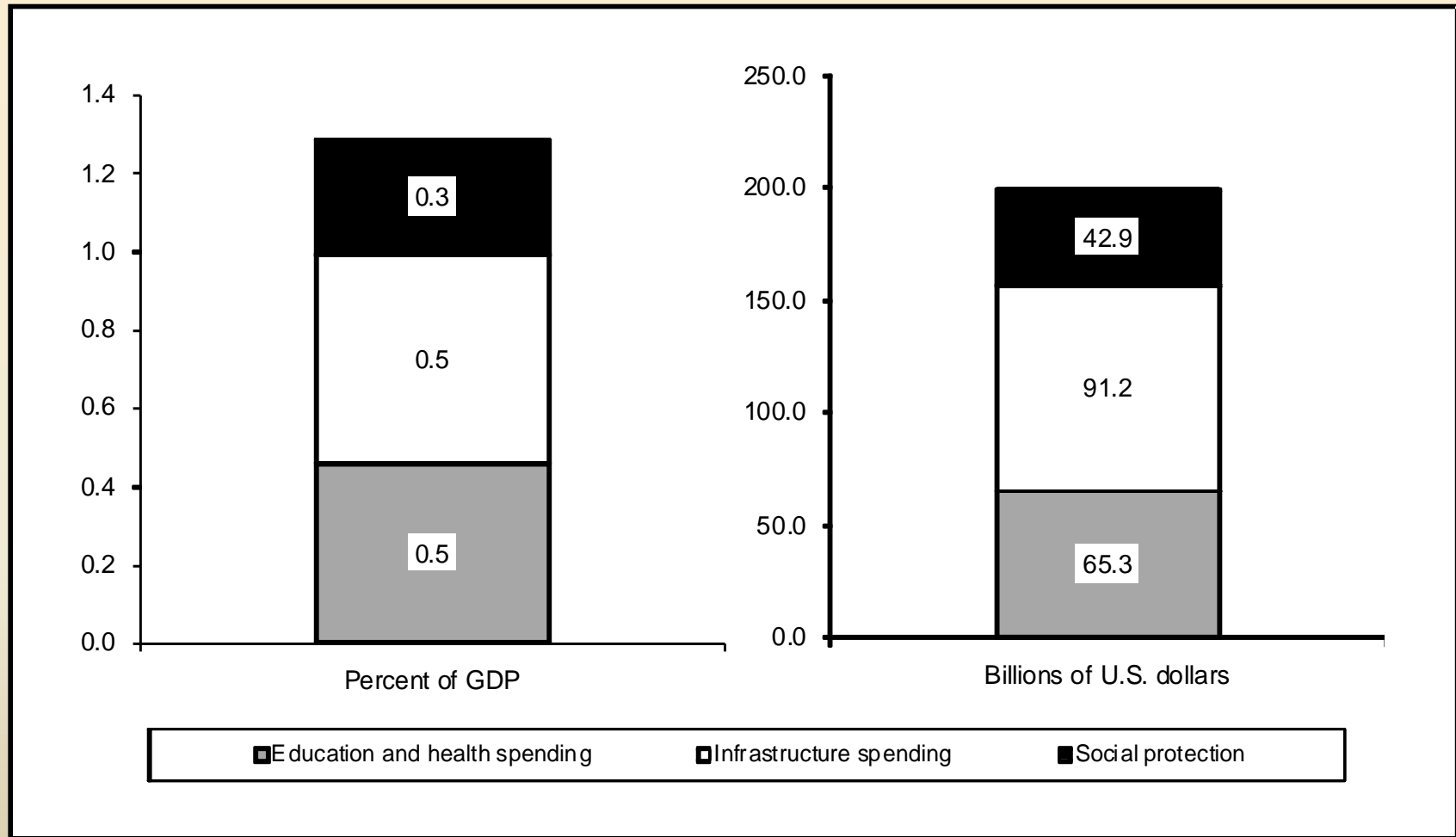
Source: World Bank, "Developing countries and the financial crisis: vulnerabilities and fiscal policy options", February 2009.

# Quality of counter-cyclical fiscal policy matters

- Timeliness
- Delays in implementation
- Reversibility (ring-fenced from entrenched interest groups)
- Implications at the sub-national level
- Growth-enhancing measures
- Administrative capacity to provide short-run assistance to vulnerable groups
- Bail outs
- “Bang from the buck” (especially in cases of “low fiscal space”)



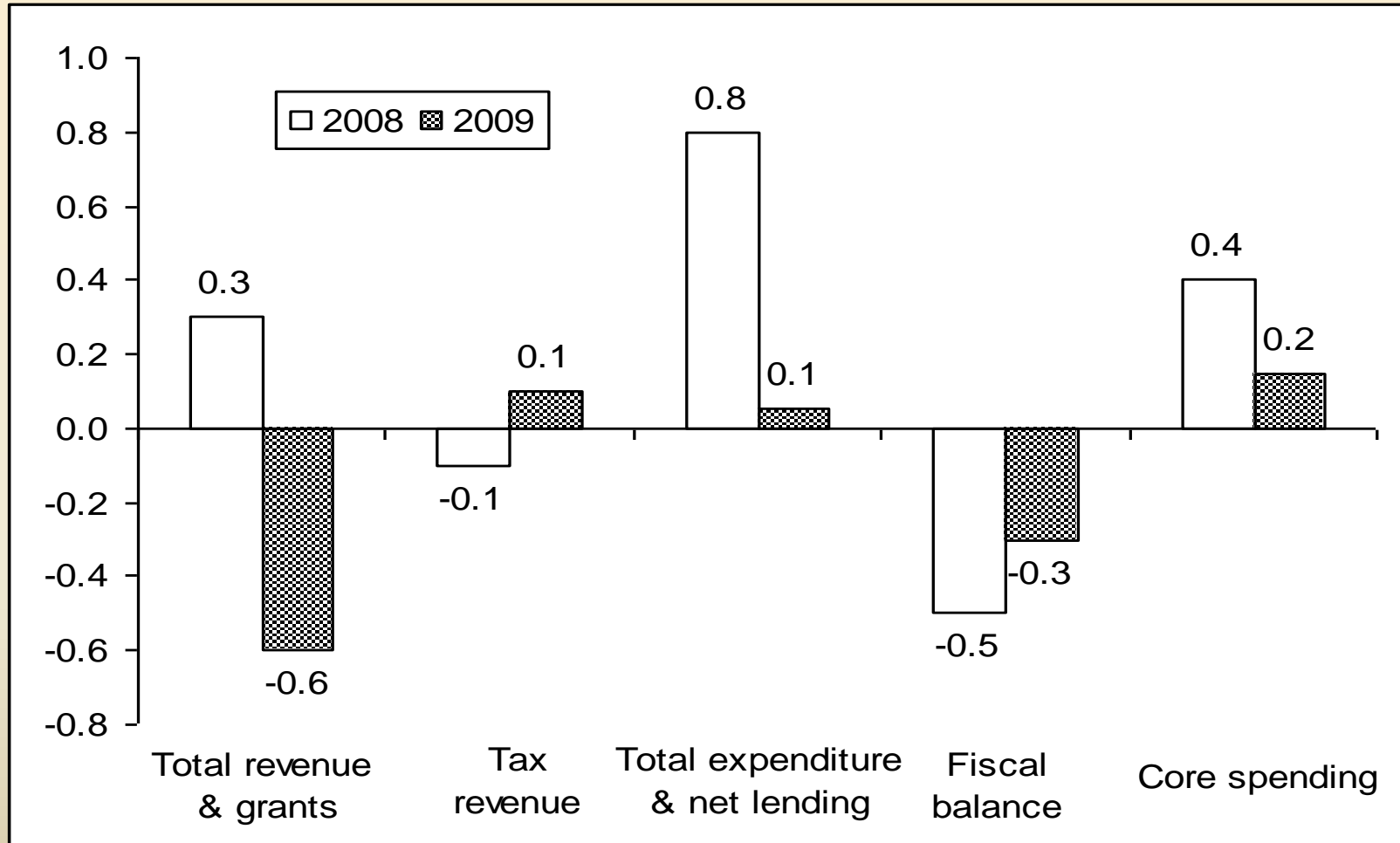
# Additional fiscal spending for protecting core priorities in developing countries, 2009



Source: PREM, World Bank, "Protecting core public spending during the global economic crisis", 2009

# Fiscal Trends in Developing Countries, 2008–09

(Median change on the previous year, in % of GDP)



Source: PREM, World Bank, "Protecting core public spending during the global economic crisis", 2009

# The World Bank Group response

- ✓ Increase in IBRD lending (mix of Development Policy Loans (budget financing/fast disbursing: financial sector restructuring; contingent source of liquidity...) and Investment Loans (preserving infrastructure spending; support for clean technology; social safety nets...)) + fast-tracking IDA funds + Vulnerability Financing Facility + INFRA (support for infrastructure) + guarantees via MIGA + new IFC facilities (support for trade; recapitalization of banks; refinancing of microcredit institutions).

## World Bank Group Commitments

*Fiscal years 2009 and 2008 (in U.S. billions)*

---

<b>World Bank Group</b>	<b>FY09*</b>	<b>FY08</b>
• IBRD	<b>32.9</b>	<b>13.5</b>
• IDA	<b>14.0</b>	<b>11.2</b>
• IFC	<b>10.5+</b>	<b>11.4+</b>
• MIGA	<b>1.4</b>	<b>2.1</b>

---

<b>TOTAL</b>	<b>58.8</b>	<b>38.2</b>
--------------	-------------	-------------

\*Unaudited numbers as of July 1.

+Own account only. Excludes \$4.5 billion in FY09 and \$4.8 billion in FY08 mobilized through syndications and structured finance.

# ***Fiscal Policy in Developing Countries: Implications from the Current Crisis***

---

**Otaviano Canuto**  
**Vice President and Head of Network**  
**Poverty Reduction and Economic Management**  
**The World Bank**

**65<sup>th</sup> Annual Congress of the  
International Institute of Public Finance (IIPF)**

**Cape Town, South Africa  
13-16 August 2009**

