The Great Recession had strong though quite diverse effects on the developing and transition economies. One channel of transmission was through falling remittances, which impacted several, mostly small countries heavily dependent on remittances of migrants to the US, Western Europe and Russia; in contrast, remittances from the Gulf countries to South Asia and the Middle East did not experience a similar downward trend. The financial shock was severe, mainly for middle-income “emerging” economies, but it was short, thanks to the largest Keynesian policies ever adopted in history, including those put in place by several major developing countries, and to the massive bailouts of financial institutions in industrial countries. The trade shock was also severe, longer lasting (its effects are still visible today) and affected all countries. In the developing world, high and mid-tech manufacturing exporters were hardest hit by the collapse of export volumes. In turn, energy and metal exporters were initially more affected by the collapse of commodity prices than agricultural producers. Dependence of many low-income countries on agricultural exports thus turned out to be a relative blessing under the circumstances. In a longer term perspective, however, real agricultural prices came back to levels below those of the 1970s, in sharp contrast to relatively high real oil and metal prices.

Countries and regions hardest hit in terms of GDP contraction are clustered in two groups. The first is made up of those countries with weak external balance sheets (large external debts relative to foreign exchange reserves) and/or traditional domestic financial vulnerabilities (a previous boom of foreign private sector borrowing followed by a credit squeeze and, even worse, the devastating effects of currency mismatches in domestic portfolios). This is the situation faced by many transition economies of Central and

Eastern Europe as well as several that are now members of the European Union (with Poland as a major exception). The second group comprises manufacturing exporters heavily dependent on US and European markets. The high-income and highly open East Asian economies of South Korea, Taiwan, Hong Kong, Singapore, along with Mexico and Turkey are the main cases in point. China’s exports were also strongly affected but this country came out from the slowdown generated by the Great Recession very soon, thanks to the most expansionary fiscal and credit package in the world. Indeed, in a significant way, aside from the massive Keynesian policies and bailouts, the other major difference between the Great Recession and the Great Depression of the 1930s was that this time the world had, in China, a substantial economy with strong trade linkages and without a financial sector in crisis and, therefore, with the policy space and willingness to pursue aggressive Keynesian policies.

Aside from China, many other developing countries adopted variable mixes of expansionary fiscal, monetary and credit policies. Most East and South Asian countries (with the major exception of Pakistan), together with Brazil stand out in this regard; and in South Asia, this was true of fiscal policies despite their initial weak fiscal stances. But there are similar cases of expansionary policies, including in Sub-Saharan Africa. The existence of state financial institutions (as in Brazil, China and India) turned out to be a blessing for supporting expansionary policies, whereas the credit squeeze in countries with heavy dependence of banks on external funds defeated otherwise very expansionary macroeconomic policies (with Chile and several Gulf countries being major examples of this pattern). There were few domestic financial crises, thanks, basically, to stronger regulation in place, as a response to the developing countries’ own past crises.

Overall, China and South Asia (notably India but also the largest least developed country, Bangladesh) had the best performance, and North and Sub-Saharan Africa a fair one (though on average per capita income fell in Sub-Saharan Africa). The performance of South Asia and much of Sub-Saharan Africa, the two regions with the highest incidence of extreme poverty, implied that the effects of the Great Recession on world poverty have been relatively muted so far. Whilst the deviation from the success achieved during the 2003-2007 boom in advancing towards the Millennium Development Goals
has thus far been not fatal, there are serious concerns about the continuing impact on world poverty of a slow and prolonged world recovery. Most other economies in East Asia, as well as Brazil, experienced a strong recovery after the initial recession. Overall, however, Latin America did not do well despite stronger external, financial and fiscal stances than in the past. This is particularly true of Mexico, which along with Turkey was amongst the economies that experienced strong contractions. The worst hit by the Great Recession were the transition economies, particularly the CIS countries but also some that are now EU members.

Multilateral response was strong (and certainly stronger than during past crises), as reflected in the largest emission of Special Drawing Rights (SRDs) in history, major innovations in IMF programs, some improvement in its conditionality, and rapid increase in lending by the Multilateral Development Banks. However, that response exhibited two major weaknesses. First, it was much weaker than the shock warranted, given the strong contraction in private financial flows, and came with a lag. In the case of the World Bank, large expansions in commitments were not matched by an equally dynamic pace of disbursements, so that its contribution to the recovery was marginal at best. Second, it was biased towards middle-income countries. This was reflected both in the responses from the IMF and the Multilateral Development Banks, as well as in reduction of Official Development Assistance.

Going forward, there are major uncertainties that surround the world economy and associated global policy issues. Those that have received greatest attention relate to the need to avert early withdrawal of stimulus in the industrial countries, and to face the implications of rising public sector debts, which have short-term effects on financial markets and medium- and longer-term implications on the policy space that these countries have to continue using fiscal expansion. We will leave these issues aside, as well as the important long-term questions pertaining to the relationship between future world economic growth and climate change. We will concentrate, rather, on five issues that we see as particularly important in terms of global economic policy and the developing world.
The first relates to the large asymmetries between the expected growth of industrial and developing countries. The world had never experienced before a situation in which, given the weakness of industrial countries, major developing countries are, in a sense, the only available engines of world economic growth. Continuing expansion of these countries is therefore crucial for the world, but so is the capacity of these economies to transmit their growth dynamics to the rest of the world. The most important is, of course, China, which has a much larger share of global trade than other large developing countries. In the case of China, the capacity to induce growth in the rest of the world inevitably implies turning its large trade surplus into a balance or even a trade deficit. This problem is absent in other large developing countries, like Brazil and India, which have the tendency to run current account deficits anyway.

In the case of China, the transition from export-led to domestic-led growth raises a myriad of questions, including the capacity to shift domestic demand dynamics from investment to consumption and, therefore, the reversal of the dramatic reduction of consumption and wage shares, as well as the significant overcapacity generated by the highest investment rate ever recorded in history (Akyüz, 2010; Yu, 2010). Also, given that large parts of its trade linkages are associated with the demand for inputs for its export sector, the shift from export-led to domestic demand-led growth may actually reduce Chinese import demand (Akyüz, 2010).

Under any scenario, it is essential that the world does not throw the baby out with the bathwater, to use a typical American saying. In particular, although some real appreciation of the renminbi should be part of this process, a strong and disorderly appreciation may have the effect of seriously affecting Chinese economic growth. This is a likely interpretation of how Japanese growth came to a halt and its costly financial crisis was incubated. In any case, it the one that Chinese authorities seem to have in mind to avoid repeating the story. The only desirable scenario is, therefore, a Chinese economy that transmits its stimulus to the rest of the world through rising imports generated more by the income (rapid economic growth) than the substitution (real exchange rate appreciation) effects. Opening space for Chinese investment abroad should also be an essential part of this strategy.
A second and interrelated issue is the implication of current trends on global imbalances. One of the major paradoxes of the Great Recession is that building stronger external balance sheets in the developing world through self-insurance contributed first to building up global imbalances during the boom years, that dampened global demand, which then came to depend heavily on the US as “the consumer of last resort”; but second, the resulting strong external balance sheets also contributed to the resilience of many developing economies during the Great Recession, which has was a major factor behind the recent recovery. Going forward, the worst global scenario is thus one in which all or most countries, including now industrial nations, aim at improving their current accounts, as current IMF projections indicate, since this is nothing but a scenario of weak global demand and even a new recession. A desirable global scenario is thus one in which most developing countries (and not only China) run current account deficits. However, this requires major reforms in the global financial system to reduce the vulnerabilities that this pattern generated in the past and that were reflected in major financial crises in the developing world. Recent IMF reforms are just a small step in that direction, and must be followed by many additional reforms. It is essential, in particular, to create a sovereign debt resolution mechanism and active financing during crises, through a mix of counter-cyclical issuance of SDRs and emergency financing without onerous conditions (Stiglitz et al., 2009).

Furthermore, generating these current account deficits the way they are now being pushed by financial markets, through massive capital flows towards emerging markets, runs the risk of generating future busts, following well-known patterns. So, a more orderly way of inducing such current account deficits without risking the disruption in world economic growth should be on the cards. In our view, this inevitably require a serious discussion of capital account regulations in the world, an issue that has been raised by several analysts (see, for example, Subramanian, 2009 and Ocampo, 2010), but is surprisingly missing from current discussions of global financial reform.

A third set of questions relates to the weakest link in the current recovery: international trade. There are two scenarios here: a continuation of the rapid recovery of trade that started in mid-2009 and that will generate a return to the situation that prevailed
in recent decades, of a world trade that is more dynamic than world GDP; or, alternatively, a situation in which this will not happen, and we are going to see a world in which trade is not particularly dynamic, and not necessarily because protectionism is back on the agenda. We are inclined to think that the second outcome is quite likely and, furthermore, that even a successful Doha trade round (a very unlikely scenario) would not make much of a difference for the outcome. If this is so, the best world scenario is, curiously, the return of *inward*-looking strategies, not necessarily protectionist but with a focus on the dynamism of domestic markets. After all, the Keynesian policies that have been the essential ingredient of the current recovery are nothing else than inward-looking policies.

What this implies is that the desirable situation is more like that of the late nineteenth and early twentieth century according to some economic historians (notably Bairoch, 1993), in which economic growth of different nations (in, for that matter, generally protectionist world) was the engine of world trade, and not the opposite. In recent decades, the “trade as an engine of growth” view has, curiously though in different ways, been both the orthodox dogma (preached amongst others by the International Financial Institutions) and the heterodox practice (in several East Asian countries).

A transition towards more inward-looking strategies has, of course, a major implication: it biases growth towards countries with large domestic markets, and therefore against small economies. One major implication is that regional economic integration processes may have to play a more important role in the future, as sort of “expanded domestic markets”, particularly in those regions where such processes are weakest: Sub-Saharan Africa and South Asia. This is an equally challenging issue for Latin America and Western Asia. A related implication is that developing countries should not forego such opportunities that exist for benefiting from trade –indeed by becoming scarcer, such opportunities will be, in a sense, all the more valuable.

This leads to a fourth set of issues that relate to how growth is going to be distributed *among* developing countries. In a sense, if we project current trends, East Asia and India (not South Asia as whole) are likely to be part of the dynamic poles of the new
world economy. But this may leave many developing countries behind, particularly those with weak links with these dynamic poles, or competitors with them in global markets, or with patterns of growth that are only partly desirable (e.g., booming Chinese and commodity-led growth in Sub-Saharan Africa). The bias in recent international cooperation towards middle-income countries is also part of the problem. So, a major issue going forwards is to guarantee that we are not in the face of another major divergence in development, now not between industrial and developing countries, but among developing countries. Indeed, this has already been one part of the patterns of global development in recent decades, which Ocampo and Parra (2007) have characterized as a “dual divergence”. This implies, in particular, serious thinking about the specific mechanism through which the most dynamic poles of the developing world are going to disseminate their growth to the developing world at large.

What all this implies, finally, is that the world we are looking forward at is going to be, in economic terms, much more dependent on the developing world than any we have observed in history. Never before has the call of the 2002 Monterrey Consensus (United Nations, 2002) to increase the participation of developing countries in global economic decision making been more important. Managing this world requires, therefore, major reform of global economic governance away from the industrial countries-centered institutions designed after the Second World War. The G-20 has been a step forwards in this regard, but its representation is inadequate (in particular, medium and small-sized countries are entirely unrepresented, and there are major problems of representation of Sub-Saharan Africa, among others), it is still dominated in its specific dynamics by industrial countries and, particularly, lacks the legitimacy of a body that is elected as part of a process of global consensus-building. So, in this area, as in the specific mechanisms to manage such a world economy, there is a long road ahead.

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