Crisis in a Global Economy. Re-planning the Journey
Pontifical Academy of Social Sciences, Acta 16, 2011
www.pass.va/content/dam/scienzesociali/pdf/acta16/acta16-derbezbautista.pdf

WHERE DO WE STAND? THE IMPACT OF THE CRISIS ON PERSONS AND INSTITUTIONS

LUIS ERNESTO DERBEZ BAUTISTA

Let me start by congratulating Professors Betancur and Zulu on their very impressive papers. Both describe in excellent manner the effects of the 2009 global financial crisis over developing nations. In particular I would like to congratulate them for their review on how poor nations addressed the cut in financial flows to their economies, as well as on the specific details on how the people of the countries reacted to their income losses as the crisis took hold of their economies.

Professor Zulu puts his emphasis on the major consequences brought about by the crisis over developing nations in Africa. In a vivid narration, his evaluation shows how the political interface between fragile democracies (like many are in developing countries) and negative economic impacts can destabilize many nations. In particular, it is sad to learn how the global crisis seems to be unraveling South Africa's Black Economic Empowerment Program (BEE); a program designed to mainstreaming low income population into the market economy of that nation after the end of *apartheid*.

Professor Betancur emphasizes the derailing of the Millennium Goals. He makes it clear that as a result of the global financial crisis, 2010 may be the first year of this decade in which the poverty reduction objectives established by the United Nations may not be reached in many developing countries. More importantly, though, his paper explains why we need to define new regulatory frameworks for financial markets if we wish to avoid a repetition of the crisis. And while making his point, he shows that to obtain the full benefits of a market oriented economy, governments need to minimize the negative aspects of the 'normal human behavior' in those markets.[1]

[1] The definition in inverted commas is mine and should not be attributed to Mr. Betancur.

I fully enjoyed Professor Zulu's discussion on the five elements which will affect growth and development in Africa for many years to come. He carefully evaluates the impact that the 2009 crisis will have over: (i) exports of raw materials from mining and agriculture; (ii) exporting human resources which results in remittances from the host to the guest countries; (iii) capital inflows through foreign investment and bank loans; (iv) earnings from tourism; and (v) foreign official aid.

The severe loss of income reported by the studies quoted in his paper makes it evident that it will take a long time to reverse the loss of income suffered by most of the population working in Africa's agriculture and manufacturing industries linked to external trade. Although he does not explicitly make the point, his analysis leads one to conclude that developed nations will have to define programs to compensate African nations for the negative impact brought about by the irresponsible way in which they behaved in international financial markets.

If there is to be a just compensation for the suffering imposed on developing nations by the 'irrational behavior' of developed nations, strong increases in official financial aid, trade preferences and programs supporting the entrepreneurs of African nations must be the response of developed nations for at least the coming decade. Indeed, as the global economy recovers, Professor Zulu's paper shows that it is incumbent upon developed nations to fortify the recovery in developing nations by providing at the very least official financial aid in an amount equivalent to the costs extracted to these nations by the global crisis of 2009.

Professor Betancur's paper makes it clear that implementation of this solution is highly improbable. Despite the unfairness of the current economic situation, and the moral obligation of developed nations to reverse the damage caused to developing nations, his evaluation of the 'Greek effect' shows why the solution currently applied by European nations to deal with the problems faced by Greece, will become a major impediment for such foreign policy to be applied by developed countries. If the response to Greece's crisis is an example of the generosity of developed nations, one has to be too optimistic not to forecast a very depressing future for the world as a whole, and for developing nations in particular.

The 'Greek solution' may become the benchmark against which foreign aid policies will be measured by developed nations; not a good omen for the cause of justice and fair income distribution in the coming years. As Greece demonstrates, most developed nations have grown impervious to other countries suffering; a trend which if continued will go against the recommendations made by His Holiness and many other world leaders concerned about fairness and justice in today's world.

And yet, the costs paid by developing nations are already gigantic. As mentioned by Prof. Zulu in his paper during 2009:

> the impact of job losses in the formal economy is the increase in vulnerable employees (unpaid family workers and own account workers as a share of total employment). The ILO Observatory noted that in Africa the ratio of vulnerable employees had increased by 5 percentage points between 2007 and 2009 pushing the figure up to 81.8 percent. In absolute numbers this represents 28 million persons or an additional 36 million persons earning less than US$1.25 per day. This translates into 67.2 percent classified as the extreme working poor. This has a severe impact on growth, poverty and job creation.[2]

One can only guess the suffering that fiscal adjustment policies demanded today from Greece could have if applied in developing nations. That is why it is imperative to send a strong message to all nations and multilateral institutions against such requirements to provide developing nations with trade preferences or financial aid in the coming years. *Caritas in Veritate seems like a far away possibility at the moment*.

Yet there is a glimmer of hope if, as Professor Zulu writes, 'Africa may not be typical of the developing world with which it shares vital socio-economic features'. A recent report[3] of the UN's Economic Commission for Latin America (ECLA) shows that, although the economic crisis put an end to six years of growth in that region, the lessons of the past were put to good use during the global crisis. Lack of inflation, sound financial systems and fiscal leeway built up by past experience cushioned the negative effects of the crisis in many of the countries of the region. Instead of tightening spending, privatizing socials services and deregulating the labor market, the region kept up social spending, expanded investment in social services infrastructure. If the Latin American countries had responded to this crisis with the type of fiscal adjustments shown in Prof. Zulu's description of Africa, the social impact would have been much harsher than the effects seen today. *There is a lesson to be learnt in this for other developing nations*.

Nevertheless, as Professors Betancur and Zulu make clear, the poverty issues brought about by the crisis need to be dealt with social policies

[2] Prof. Zulu's paper, p. 4.

[3] ECLAC, *Social Panorama of Latin America*, Santiago, Chile, 2009.

which will ameliorate the current situation faced by many of the poorest families in developing nations. Heavy negative impacts on education and social care programs need to be redressed, if we wish to provide a better future to the people of developing countries in the coming years since, as Professor Zulu mentions in his paper, 'some respondents sacrificed items such as leisure and clothing in favor of basics such as children's education, food and shelter'.[4]

To get a stronger view of what developing nations are facing today, let me provide these facts extracted from the latest World Bank Global Development Report.[5] According to this report, by the end of 2009, 89 more million more people were living in extreme poverty on less than $1.25 a day, and the global recession had put at risk $11.6 billion of core spending in areas such as education, health, infrastructure and social protection in the most vulnerable of the developing countries. Moreover after three months of global recovery, an estimated 43 low-income developing countries were still suffering the consequences of the global recession, highlighting the need to increase support to the poorest countries dealing with economic volatility and crisis. The question then becomes, how can we ensure that developing nations provide quality education and social care to their citizens? If the answer to this question is incorrect, the long term effects of the 2009 crisis will be felt for many years to come in those countries.

In their papers, Professors Betancur and Zulu seem partial to government-led and morally-led responses. In my opinion neither of these are the optimal solutions for the problems faced by developing nations today. If we want to ensure that these nations integrate successfully into the global economy in the remainder of this century, we may need to recommend an incentive system for those nations which produces the adequate combination of government intervention, market operation and national entrepreneurs which will provide the required innovation-based growth that will lead to fair income distribution in those nations.

In particular, the incentive system we should propose must respond to the three generally accepted normative principles in the literature of social protection: (i) greater equality in access to services among people of differing resource levels who need care; (ii) universal and needs-based services and benefits; and (iii) intergenerational solidarity. All these principles must

[4] Prof. Zulu's paper, p. 8.
[5] World Bank, *Global Development Report*, Washington, D.C., USA, 2009.

be enshrined in the countries' respective education and social protection systems, according to their measurement of risk profiles, the place attributed to family and policy and the type of welfare regime instituted.

Such a framework can only emerge from a discussion which differentiates between the short term responses applied in 2009 by many developing nations, and those required for their long term successful integration into the global economy. Thus, whereas as mentioned in both papers the actions taken by many developing nations to reduce job losses in the economy, to scale up welfare programs and to accelerate access to social basic services may look as the right actions for the emergency of 2009, if maintained they will stifle the entrepreneurial class in a way that will make it impossible for those nations to successfully confront the globalization process of the 21st century. A government which believes that its role is to provide goods and services for its population, control markets and create monopolistic industries to provide employment, and generate a closed environment for social and educational delivery, will be a government which will condemn its population to a long term path of impoverishment, to a non-democratic system and to emigrate to obtain jobs in other countries.

Thus, although I agree with most of the papers general content, conclusions and recommendations, after reading the papers I became concerned that many of the current wisdom emerging in developing nations about the role that entrepreneurs, markets and governments should play may be going in the wrong direction.

For example, Professor Zulu does not explore in depth the possible consequences of a disappearing entrepreneurial class in South Africa after the crisis; *a point that in my opinion deserves further exploration in discussions between Academicians.*

A successful integration into the global economy demands entrepreneurs

As developing nations continue their global integration, they will need local entrepreneurs to lead their way into such integration. Too much government intervention would stifle the advent of such a group of people.

Despite his provocative thoughts about the effects of the financial crisis in market behavior and regulations required, Professor Betancur does not address the need to keep markets as the major institution for allocating goods and resources in developing nations. *Despite the well documented failure of international financial markets, there is no better instrument to assign resources in most economies today.* Markets need regulation; there is no doubt about it. The recent developments demonstrated that there is no such thing as a truly competitive market when the government renounces to its regulatory role. Such a provision of a competition policy must be one of the key elements of future government empowerment in developing nations.

But more than anything else, markets need competition

Contrary to what today is taking place in many of these countries, the need for competition should not translate as a government-led economic recovery program with public enterprises and excessive spending as the policy prescription to reach economic growth and income distribution. Such is the danger faced today by developing nations: a return to old practices where the role of the government is interpreted as provider of jobs, participant in the allocation of resources in the economy and defender of monopolistic behavior under the disguise of fair income distribution and protection of the country's sovereignty. Regulation does not mean control. Control does not mean fair income distribution.

Government policies are not neutral in the redistribution of wealth and the protection of special interest groups in society

Although the response to the 2009 emergency might have been correct, most of the economic policies applied by governments in developing nations are clearly unsustainable in fiscal terms in the long run. Continuation of these policies would only lead to inflation, fiscal and balance of payments disequilibrium, and loss of economic competitiveness for domestic enterprises. It is thus imperative to change the role of the State towards one where it will act as regulator of markets rather than as savior of the people.

Moreover, few of the poorest countries will have the fiscal space to respond to the economic dislocation caused by the crisis without significant additional financial assistance. It is estimated that IDA countries will require an additional $35 billion to $50 billion in funding just to maintain current levels of programming, let alone come up with the additional funding required to meet the needs of those additional individuals thrown into poverty. That is why within the complex layout of responses applied during the global crisis, those provided by the State (through policies that touched on the economy and social redistribution policies) could have long term negative impacts on the solutions worked out within families, those sourced from the market and those crafted through community action in developing nations.

Finally, political stability cannot be the direct outcome of the capacity of the State to dispense public goods and services in the economy

Great uncertainty continues to surround future prospects in many developing nations. Even the weak recovery outlined by many international agencies for 2010 is not certain in many of those nations. If the private sector does not become the building block for a strong middle class, it is entirely possible – especially as the impact of fiscal disequilibrium and inflation takes its toll – that those countries will relapse unto undemocratic systems where dictators present themselves as saviors of the people to undo the political progress achieved up to this point in many of those countries.

That would be the saddest consequence of the global crisis; one that most of us did not predict at the start of the new millennium.