Economic Trouble in the South

The global economic crisis is finally hitting major developing countries, many of which face lower growth, current account deficits, falling currencies and a reversal of capital flows.

By Martin Khor

The global economic crisis is now hitting many developing countries, in some ways worse than during the Great Recession of 2008-9.

The economic growth rates of big countries like China, India, Brazil and Argentina have gone down.

In recent months, the currencies of India, Brazil and South Africa also declined. In itself this may not be bad as some of the currencies had been over-valued and a depreciation is good for trade competitiveness.

However, this is also a sign of a slowdown in foreign inflow of funds. And those countries having a deficit in their current account of the balance of payments need inflows to cover it.

They face a bad combination of high current account deficit, reversal of capital flows, declining currency and the prospect of higher interest rates.

Suddenly the Western media story is no longer about the great rise of the South and the BRICS. The hype has turned almost full circle to the decline of the emerging economies.

Just as the original headlines of rise were exaggerated, so too is the anticipated collapse exaggerated.

Nevertheless, the world economic crisis has finally come to ground in the developing world.

A recent paper by the South Centre by its chief economist Yilmaz Akyuz argues that the present “recovery” phase in the developed countries is actually more problematic for developing countries than when the former fell into recession in 2008-9.

This is because the US, Europe and China countered that recession through expanded government spending, and this gave a boost to exports and growth in developing countries.

But there has since been a reversal of policies as Western governments turned to austerity and budget cuts.

Instead, they have relied excessively on easy-money policy. The US in particular injected massive liquidity into its financial markets, with interest rates close to zero.
The increased liquidity instead of benefiting the real economy went mainly as loans to investors which placed the funds in stock markets and developing countries, in their search for yield.

Akyuz’s paper highlights the negative spill-overs of these policies to developing countries.

First, the austerity policies meant a slowing down of exports of developing countries to advanced economies, and commodity prices have started to decline.

Second, due to the anticipation that the quantitative easing in the US will taper off, the flow of funds to emerging economies has slowed or reversed.

Third, the good effects of the developing countries’ own earlier countercyclical policies are fading and the space for more expansionary policies is limited.

Economic growth has thus fallen. In 2012, Asia growth was around five percentage points below the rate achieved before the onset of the crisis; in Latin America it was reduced to almost half.

According to the paper, there is a lack of demand in the world economy, and the major reason is low and declining share of wages in national income in all major advanced economies.

A more equitable allocation of wealth is needed to allow rapid economic expansion based on income-supported, as opposed to debt-driven, household spending. But this is not happening.

In the US, the ultra-easy monetary policy instead of achieving sustainable growth could degenerate into new credit and asset bubbles and yet another boom-bust cycle that is more damaging to the world than the present crisis.

If, on the other hand, the US does not allow the new bubbles to develop, the outcome could be sluggish growth, sharply increased interest rates and a stronger dollar, a combination that often breeds problems for developing countries, says Akyuz.

Meanwhile, the Eurozone appears to be mired in economic weakness for an indefinite period. It cannot generate growth for the rest of the world.

And China, facing an export slowdown and the need to shift to domestic consumption-led growth, will likely have a lower growth path in the medium term.

All these imply that there will be economic difficulties for the South. Developing countries are likely to encounter a much less favourable global economic environment in the coming years than they did before the onset of the Great Recession.

“Developing countries need to improve their own growth fundamentals, rebalance domestic and external sources of growth and reduce dependence on foreign markets and capital,” concludes Akyuz.
Note: The research paper, “Waving or Drowning: Developing Countries After the Financial Crisis” can be accessed in the South Centre website (http://www.southcentre.int).