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OVERALL CONSEQUENCES OF GLOBAL CRISIS

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Abstract: - The world economy started slowing down since the third quarter of 2008 leading to economic crises worldwide. GDP declined from an average growth of 3 per cent during 2003-2007 to 1.5 per cent during 2008-2012. The decline of world GDP growth was the sharpest at 42 per cent during the third quarter of 2008 to the second quarter of 2009. Not only capital inflows to developing and emerging market economies declined during this period, there has been significant shrinking of markets for developing country exports. This paper determines overall consequences and its policy implications of Global Crisis. Time period is 2003-2012, from these 2003-2007 is the pre crisis and 2008-2012 is the post crisis period.
JEL CLASSIFICATIONS-, F1, F6

Keywords: - Global Crisis, Pre Crisis, GDP, Post Crisis

PART 1

Introduction

The world economy started slowing down since the third quarter of 2008 leading to economic crises worldwide. GDP declined from an average growth of 3 per cent during 2003-2007 to 1.5 per cent during 2008-2012. The decline of world GDP growth was the sharpest at 42 per cent during the third quarter of 2008 to the second quarter of 2009. Not only capital inflows to developing and emerging market economies declined during this period, there has been significant shrinking of markets for developing country exports. World trade declined rapidly beginning in the third quarter of 2008 through the second quarter of 2009. World trade declined in real terms by 12.2 per cent during 2008-2010, with a larger decline of 30 per cent in world trade between the third quarter of 2008 and the last quarter of 2009 (UNCTAD, 2009). This recent global economic slowdown originated in the financial sector of the United States, where the housing market sold sub-prime mortgages to large number of consumers with inadequate income. The financial crisis very rapidly spreaded to real sector in the US economy. The economic crises spreaded to Europe and then to rest of the world. There was a short-lived recovery in 2010, but the global economy slipped into deep recession in the latter half of 2011.

During the crises since 2008, there is a change in trade pattern as well. While it is important to understand that there might have been loss of trading partners, trade intensity with respect to traditional trading partner fell substantially as well. Further, trade in new products might have been adversely affected during crises, trade in traditional products, even though survived, could have declined. The adverse impact of crises could have been larger in Emerging Market Economies (EMEs), who have transformed through rapid increase in trade and capital flows during globalization. This dissertation investigates into the extent to which the recent global economic crises have impacted on trade in emerging market economies. The issues relating to global economic crises and its impact on emerging market economies trade can be arrived at from a review of the existing literature.

1.2 Review of Literature

The literature on global economic crisis and its impact on trade is large and also growing. Even though Rakshit (2002) argues that the impact of decelerating exports on GDP growth was large during the East Asian crises, Duttagupta and Spillimbergo (2004) show that export volumes from East Asian countries responded with a notable lag to large exchange rate depreciations following the 1997 East Asian crisis. Two main explanations have been proposed on this observed lag: that contraction in domestic credit affected supply of exports and that "competitive depreciation" by other countries neutralized the effects on demand for exports. The main results are that demand for East Asian exports is very sensitive to prices – both their own and competitors' – and to world import demand. Export supply prices are very sensitive to depreciation and domestic input prices. These results indicate that competitive depreciation played a key role in exacerbating the real effects of the crisis by working through a trade channel and that these effects occur relatively quickly between 4 months and 16 months.

Most studies show a large decline in trade across countries, especially emerging market and developing economies. Shelbourne (2010) shows that the global financial crisis of 2007-2010 impacted trade both globally and more severely for the European emerging market economies, as compared to other regions of the world. It is found that exports for over one half of these European economies declined by more than 50 per cent between the third quarter of 2008 and the first quarter of 2009. The terms of trade also deteriorated significantly. Meyn and Kennan (2009) show the impact on LDC exports was extensive though varying across sectors. Demand for exports contracted during ther period. In addition to declining prices and lower demand for some goods, the global financial crisis has also affected developing countries by aggravating the price volatility for some commodities, increasing revenue uncertainty for commodity-dependent countries. On the other hand, Liu (2011 shows that "overshooting effect" on exports during crises cannot be explained by demand or volatility in exchange rates. Because of the adjustment in inventory and overcorrection in demand forecast by every entity of the supply chain when facing an economic crisis, exporting countries, which were at the upstream end of the supply chain, faced a much greater demand oscillation than the demand at the retailer end. A longer supply chain implies larger demand variability and bigger export fluctuations when economic crisis occurs.

Rakshit (2010) explains decline in trade in emerging market economies during crises in terms of demand and income elasticity of demand and disinvestment in inventories, he also provides with a supply side view of trade contraction during crises by relating it to credit constraints. The study argues that with EME exporters and importers experiencing credit stringency during crises, volume of trade fell and this had considerable contractionary consequences. The credit-constrained fall in exports led to a decline in domestic production and demand. However, such disruptions in EME trade forming part of the global value chain tended to have a disproportionately large impact on total trade relatively to the cutback in credit or fall in world income. Thus, demand-side explanations to contraction in trade during crises do not deny the role of credit constraints faced by exporters. In addition to declining demand for trade in emerging market economies during crises, evidence from IMF Trade Finance Survey 2008-09 shows that cost of trade finance increased leading to lower availability of trade finance during crisis (Dorsey 2009).

Milan (2010) finds that world trade declined dramatically in 2009, which was on account of a fall in the intensive margin rather than extensive margin. Further, the fall in demand for tradable goods, in particular durables and intermediate goods, is the most important explanation for the decline in the intensive margin. In addition, trade finance and involvement in global value chains do explain downturn in trade to some extent. Nicita and Klok (2006) show that the magnitude of economic crisis had severe implications on bilateral trade flows with the economic crisis likely to affect the global economy and global trade by producing delays in the international product cycle. The recent decline in international trade, as argued in the paper, is on account of traditional and larger exporters lesser likelihood of new entrants surviving the crises. The study shows that, within each HS six-digit product, small trade flows are less likely to survive the crises, while traditional and larger trade flows having a higher probability of survival. Berman, Sousa, Martin and Mayer (2012) show that the effect of crises in destination countries is magnified at both the intensive (export volumes and values) and the extensive margin (exit probability) of firms levels.

Bricongne, Fontagn, Gaulier-Taglioni and Vicard (2011) show that global trade contracted during the recent global crisis, which is largely on account of unprecedented demand shock and product characteristics. While all firms have been affected by the crisis, the effect on large firms has been mainly at the intensive margin and has resulted in a smaller portfolio of products being offered to export destinations. Bergeijk (2015) explains trade collapse during the 1930s and 2000s in terms of demand shock, manufacturing share in imports and the political system, with demand shock being the most significant factor explaining trade downturn globally. It is also evident that heterogeneity is important for understanding the drivers of global trade collapse.

On the whole, based on some recent literature on global economic crises and trade, it is evident trade, growth and intensities, declined during crises. However, it remains inconclusive whether such declines occur at the intensive or/and the extensive margins. Moreover, some these exisiting studies only provide conjectures on the margins of trade. Further, the studies do not provide any explanation on observed trade patterns in terms bilateral intensities except for an explanation in terms of demand shock. This study attempts to fill in these gaps and add to the existing literature.

1.3 Objectives of the Study

The aim of this study is to find whether the recent economic crisis has adversely affected trade in emerging market economies. In specific, the study investigates into whether economic slowdown consequent upon recent global economic crises has impacted trade performance of these economies at the intensive and extensive margins. Further, it is important to gauge the factors that explain bilateral trade intensities during crises.

1.4 The Methods and the Data

In this paper, we want to analyse overall causes, consequences of Global Economic Crisis. Databases of aggregate country groups are considered.

IMF World Economic Outlook database is used to calculate growth of global GDP and exports as well as for the emerging market economies. Further, for data on savings and investment rates, employment growth rates, and current account as percentage of GDP for emerging market, the World Economic Outlook database is used.

1.5 Chapterisation Scheme

Other chapters of this paper are as follows. Apart from this overview chapter dealing with the review of the existing literature, objective and a description of the methodology and data used in the study, there are four other chapters. Part 2 provides a snapshot view of the Global Economic Crisis along with certain stylized facts on performance, in particular trade performance of emerging market economies during crises. Chapter 3 analyses Conclusion, Policy Implications and limitations of this study.

PART 2

RECENT GLOBAL ECONOMIC CRISES: EXTENT AND CONSEQUENCES

2.1 Introduction

The world economy experienced its most severe financial shock in 2008-09 since the Great Depression of the 1929, which is followed by a deep economic downturn. Earlier instances of economic crises originating in the East Asian countries led to substantial decline in GDP worldwide (Rakshit, 2002; Dutta and Spilimbergo, 2000). The recent global economic crisis is commonly believed to have begun in July 2007 with the credit crunch arising from a loss of confidence by US investors in the value of sub-prime mortgages. By September 2008, the crisis had worsened as stock markets around the globe crashed. Global Economic Crisis, which started in the US, and then spreaded to Europe, led to decline in economic activity worldwide since 2008. The manifestation of economic crises was in terms of deterioration in GDP and empoloyment growth, saving- investment rates and current account balance across countries. From the review of literature in Chapter 1, it is evident that Global Crises have had impact on trade. Concomitant with the recession since 2008 was the Great Trade Collapse. The decline in world trade is evident in its depth and spread. This chapter delineates the extent of the recent Global Economic Crises and their impact on trade.

The chapter is divided as follows. Section 2.2 describes the depth of the recent crises in terms of GDP and employment growth, savings-investment rates and current account balances.

Section 2.3 analyses the consequences of global crises primarily in terms of trade growth and changes in its pattern. The last section summarises the major findings of this chapter.

2.2 Global Economic Crises Since 2008: An exposition

The depth of the economic crises since 2008 can be understood by observing the trends in activity levels globally as well as in major groups of developed and developing countries. In order to understand the depth of the crises, it is imperative to compare the post crises activity levels with that of the pre-crises period. Growth rates of GDP presented in Table 2.1 show that there is a large decline in GDP growth rates during post

Table 1.1: GDP Growth in Pre- and Post Crises Period (average growth in per cent)

Country Groups	Pre-Crises Period (2003-07)	Post Crises Period (2008-12)
World	10.81	5.22
Advanced economies	8.48	2.21
Emerging market and developing economies	12.81	-0.22
Commonwealth of Independent States	18.67	11.68
Emerging and developing Asia	29.92	11.29
Emerging and developing Europe	18.16	15.86
ASEAN-5	20.47	3.20
Latin America and the Caribbean	15.35	12.54
Middle East, North Africa, Afghanistan, and Pakistan	15.10	9.16
Sub-Saharan Africa	20.56	10.33

Source: IMF World Economic Outlook Database

crisis period for all country groups as compared to that during 2003-2007. GDP growth rate more than halved from 10.81 per cent during 2003-07 to 5.22 per cent during 2008-2012. The fall in the corresponding growth of advanced countries was even sharper from 8.48 per cent during pre-crises to 2.21 per cent during the latter period. In terms of GDP growth, the global recession has had the worst impact on emerging market and developing countries, the rate of GDP growth turned negative during 2008-2012. While the downturn is evident across all emerging markets and other economies, it is deeper for emerging and developing Asia and ASEAN-5. The labour market contracts and unemployment rises along with downturn in GDP. The recent global economic downturn is also reflected in terms of lower of employment growth. The IMF World Economic Outlook estimates an increase in global unemployment by 8.4 million in 2008 (7.4 per cent) and further job losses of about 50 million in 2009. The report also predicts a shift from higher to lower productivity jobs for nearly 233 million more working poor during 2007 to 2009.

An immediate impact of the financial crisis and decline in GDP growth is observed in terms of savings and investment rates. It is noted from Table 1.2 that savings-GDP ratio of advanced countries declined by 2 percentage points from 21.49 per cent to 19.78 per cent between 2003-2007 and 2008-2012. The investment rate in advanced economies also declined by 2 percentage points in the latter period, which in a way accelerated the deepening of economic crises. With respect to savings, as observed by Reinfort and Rogoff (2011), Zdzeinicka (2012), previous financial crises have typically reduced the saving-to-GDP ratio by about 2 percentage points over a two-year horizon, which tapers off in the medium term. As regards investment rates, previous studies (Furceri and Mourougane, 2012; IMF World Economic Outlokk 2009) show that financial crises have typically reduced this ratio by about 1 percentage point in the short term (one year after the occurrence of the crisis), with a peak effect of 3 to 3½ percentage points three years after the crisis. The estimated effect matches the 2½ percentage point decline in the investment-to-GDP ratio between 2008 and 2013 remarkably well. The pattern in advanced countries is in sharp contrast to an increase in savings and investment rates for some emerging and developing countries. However, the savings rate lowered during post-crisis period (2008-2012) for all emerging and developing Europe, Commonwealth of Independent States, Sub-Saharan Africa, Latin America and Caribbean countries.

Table 1.2: Savings-and Investment Rates in Pre and Post Crises Period (in per cent)

Country Groups	Pre-Crises Period (2003-07)	Post Crisis Period (2008-12)
Advanced Countries	21.49 (22.37)	19.78 (20.35)
Emerging market and developing economies	30.67 (27.12)	32.77 (30.78)
Commonwealth of Independent States	29.62 (22.78)	26.66 (23.02)
Emerging and developing Asia	40.46 (36.24)	44.05 (41.28)
Emerging and developing Europe	16.44 (22.00)	16.15 (21.56)
ASEAN-5	25.31 (25.12)	27.69 (28.33)
Latin America and the Caribbean	21.02 (20.20)	19.88 (21.15)
Middle East, North Africa, Afghanistan, and Pakistan	37.03 (24.48)	37.90 (27.45)

Source: IMF World Economic Outlook Database

Note: Figures in the parentheses indicate investment rates in pre- and post-crises periods.

During crisis (2008-2012), current account as a per cent of GDP worsened for most country groups from that in pre-crises period (see Table 2.3). The current account position remained negative, though improved, for the advanced countries during the post- crises period. For Emerging Market Economies, the current account is found to be deteriorated in sharp contrast to that of advanced countries. However the current account position remained positive for developing and emerging economies, which might be largely on account of a large positive current account balance of China and in some ASEAN countries. This is particularly evident when the post-crises figures are observed for emerging and developing Asia. For all other groups of countries, even though current account deficit persisted during 2008-2012.

Table 1.3: Current Account Balance (as a per cent of GDP) across Country Groups

Country Group	2003-2007	2008-2012
Advanced Countries	-0.89	-0.34
Emerging market and developing economies	3.36	1.84
Commonwealth of Independent States	6.85	3.57
Emerging and developing Asia	4.22	2.72
Emerging and developing Europe	-5.86	-5.45
ASEAN-5	3.84	2.71
Latin America and the Caribbean	0.82	-1.24
Sub-Saharan Africa	1.57	-1.33

Source: IMF World Economic Outlook Database

On the whole, a sharp downturn is observed in activity level across advanced as well as emerging market and developing economies. This has particularly happened during 2008-2009, and again after 2011, as is evident in the literature. GDP growth declined with a worse off situation in emerging market and developing countries. Even though the current account balance remained positive in emerging market and developing countries, this is largely on account of China and some ASEAN countires. The worsening of current account position in most countries can be on account of worsening export performance during crises.

2.3 Impact of Global Crisis on Exports

From the snapshot view of crises in Section 2.3 and the evidence in the existing lieterature, it can be conjectured that international trade and capital flows were adversely affected particularly in emerging market and developing economies. In this section, we turn to a descriptive analysis of the extent of adverse effects on exports of goods and services in particular in emerging market and developing countries. Table 2.4 presents average growth rate of exports of goods and services during pre- and post crises periods.

It is evident from Table 1.4 that growth rate of export of goods and services declined, in some cases more than halved, across emerging market and developing country groups. It declined from 23.65 per cent to 10.97 per cent between 2003-2007 and the post crises period in all emerging market and developing countries put together. The fall was more severe in emerging and developing Europe along with that in Middle East and North Africa, especially Sub Saharan Africa.

Table 1.4: Average Growth of Exports of Goods and Services in Developing Countries (growth rate in per cent)

Country Group	Pre-Crises Period (2003-2007)	Post Crisis Period (2008-2012)
Emerging market and developing economies	23.65	10.97
Commonwealth of Independent States	26.94	12.89
Emerging and developing Asia	24.33	12.05
Emerging and developing Europe	23.82	6.77
Latin America and the Caribbean	16.84	8.82
Middle East, North Africa, Afghanistan and Pakistan	17.1	12.27
Middle East and North Africa	26.97	11.69
Sub-Saharan Africa	25.10	10.23

Source: IMF World Economic Outlook Database

In particular, as UNCTAD (2009) estimates, world merchandise trade fell between 6 and 8 per cent in 2009. Exports from developing countries and countries with economies in transition could potentially decline in 2009 in the range of 7 to 9 per cent in volume. Developed countries' exports are projected to decline by up to 8 per cent this year. The trade contraction in value would be much greater. The situation for LDCs also looks grim, in terms of an overall projected decline of exports this year (in 2009) of between 9 and 16 per cent. Landlocked developing countries experience a larger export fall. The decline in export growth is expected for some large emerging market economies. For instance, as UNCTAD 2009 predicts, exports from Brazil could fall by more than 4 per cent in 2009. Exports from China and India could drop by 13.5–16 per cent and 8–10 per cent respectively. South Africa could face an approximately 5.5–7 per cent decline in exports. Such large and extensive decline in export growth can largely be on account of contraction of world demand along with emerging market and developing economies losing international competitiveness in a large range of products. These countries could have adversely affected with adverse movements in international terms of trade.

2.4 Summary of Findings

On the whole, with economic crises since 2008 and deepening of recession, GDP growth declined world wide, with larger fall in emerging market and developing countries. The current position worsened across emerging market and developing economies, except China and some ASEAN countries. Further evidence points to declining growth of exports of goods and services, merchandise exports in particular. This evidence leads to a further probe of what accounts for such declining export growth during crises.

PART-3

CONCLUSION AND POLICY IMPLICATION OF GLOBAL CRISIS

Economic crisis may be producing delays in the international product cycle, with traditional and larger exporters holding ground in a relatively better way than new entrants. In particular, we find some indication that the volume of the trade flow relates to the magnitude of the effect of the crisis. That is, larger trade flows appear to be proportionally less affected. Further research on this topic would be necessary, but if this is confirmed, the reduction in international demand would be most damagingfor smaller and low-income countries with a limited market share in international trade.While the financial crisis will have significant implications for the design and operation of the international financial system, its implications for the world trading system are likely to be relatively minor. Although the crisis resulted in some increased trade barriers, for the most part they were relatively insignificant and temporary. The disciplines of the WTO proved to be quite effective in containing protectionist tendencies. Most policy experts therefore do not feel that the experiences during the crisis require any significant reforms of the WTO. Thus unlike the world financial system and the main international organization (IMF) that oversees it, the world trading system and the WTO are unlikely to be significantly altered based upon the financial crisis. Even the current Doha negotiations are unlikely to be significantly altered from their pre-crisis course. Given the regulatory failures of the advanced economies' financial systems, one might have expected the desirability of developing countries liberalizing their financial sectors to foreign investment under the General Agreement on Trade in Services to have been reduced, but that does not appear to have happened.

At the national level, although the crisis affected many countries through their trade accounts, there has been no real discussion about limiting the size of the traded sector. The major implication that has been drawn has been simply to reinforce what was believed before the crisis regarding the importance of diversification. And given that in countries where there is significant concentration, it is natural resource commodity concentration; for practical purposes this means the emphasis needs to be on increasing the size of manufacturing sectors. The reason for this advice is twofold. Given that some sectors were much more impacted than others, it makes sense to be diversified as a way of limiting large swings in particularly impacted sectors. Secondly, the commodity sectors experienced larger declines than for manufactured goods during the crisis so having a greater share of manufacturing would be a way to minimize export volatility.

The crisis may have implications for the level of development assistance including that for developing trade capacity, or more specifically the "Aid for Trade" initiative. The fiscal positions of the advanced economies which provide most of the aid have deteriorated due to the crisis. As a result, significant cut-backs are being implemented in government budgets, and foreign assistance is unlikely to be spared. In fact a recent Harris poll taken in the donor economies found that when given a choice, a majority of the public favored cutting aid to developing countries, and this was most often their first choice of what to cut (figure 25).24 However, the UK government has so far ring-fenced foreign assistance from the deep budget cuts recently proposed by the newly elected conservative government but that is likely to be an exception. The OECD DAC donors have failed to meet their commitments made in 2005 at the Gleneagles G8 meeting and at the UN Millennium +5 Summit. Historical evidence shows that financial crises often lead to a decline in foreign assistance.25 Over the 2001-2007 period, the transition economies received over $1.9 billion for Aid for

Trade projects, which included improving the transport infrastructure and border crossing procedures, and assistance in complying with technical barriers to trade and sanitary and phytosanitary measures.

A further development that has come out of the global financial crisis that may have some long-run implications for the world trading system is that the G-20 effectively replaced the G-8 as the main global economic policy making group. To some degree this did represent a significant move towards making the governance of the global economy more democratic and thus representative of the interests of developing countries. Given an expectation that increased representation will be reflected in the decisions made by the group, this development could be viewed as an important step towards making the international economic order more development friendly. However, it is not clear at this point how this more general change in representation might impact specific economic policies.

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