Helping countries emerge from the economic crisis

Even though world leaders are talking up signs of economic "green shoots", it's still too early to tell whether the global economic crisis is near a bottom or even whether the economic decline is slowing, says Shigeo Katsu, Vice President for Europe and Central Asia at the World Bank.

As unemployment mounts amid the economic turmoil, Katsu warns that a "human crisis" could ensue, particularly for poorer developing countries which do not share the same economic cushion as developed countries.

So while thousands of American families face the threat of losing their homes due to housing foreclosures, between 55 million and almost 100 million people in developing countries "find themselves pushed into extreme poverty" just this year alone.

"We think we're probably going to face a situation where maybe more than a billion people will find themselves going to bed hungry. Those are real human crises," says Katsu in an INSEAD Knowledge interview with Soumitra

Dutta, INSEAD Dean of External Relations, at the inaugural Knowledge Economy Forum (hosted by the World Bank and held recently at INSEAD's Europe campus in Fontainebleau).

And because of the global economic crisis, the targets of the United Nations Millennium Development Goals would be "much more difficult now to reach", adds Katsu. These targets include halving poverty, sending all children to school by 2015, improving childcare and maternal health, providing people with access to safe drinking water, and combating contagious diseases such as HIV and malaria.

Katsu, who helps oversee developmental aid to countries in Europe and Central Asia, says most of the developing countries in these regions have also been hard hit by the global economic turmoil.

These countries, which managed to transition from centrally-planned economies to free market economies in just 20 years, "grew very fast" following the fall of the Berlin Wall in 1989, thanks to integration with the global marketplace and financial integration with European markets. But it also made them extremely vulnerable to external shocks because of their high dependence on the international financial markets and "relatively modest" level of domestic savings.

"In order to fuel this fast growth and the quest for higher consumption levels, this was intermediated in most cases through the banking system.

"And yet it was the same banking system that completely seized up. So yes, our countries were the ones among the emerging markets that were hit hardest and fastest," notes Katsu, referring to countries in Central Eastern Europe, the Baltic region, Southeast Europe and in the Commonwealth Independent States (CIS).

He also points out that economic growth in the last quarter of 2008 in these countries "just simply fell off a cliff", while industrial production was down by 15 to 30 per cent.

"We are facing pretty dismal economic statistics but (we are) also starting to see all these effects in terms of unemployment and other numbers starting to shoot up, so our countries are certainly under stress."

When asked if there is an irony in preaching the benefits of globalisation to developing countries, given that the current global economic turmoil was caused in part by global financial integration, Katsu says that isolationist policies in today's globalised world would not be helpful, "I think the wrong message and the wrong lesson to take away (from the crisis) would be to turn your back on globalisation."

"I think that the welfare of your population actually depends on continued integration. But you've got to integrate smart and you've got to create the institutional infrastructure to do so. That means better, more solid market-oriented institutions with proper regulatory framework oversight and so on."

Indeed, a key lesson of the current global crisis is that major financial and regulatory institutions have been shown to be "not very robust". As such there needs to be greater focus on the development of institutions and not just on changing the financial markets, argues Katsu.

But, with institutions in even developed countries in the West deeply flawed, how should the developing countries build their institutional infrastructure?To this question, Katsu points out that some of the fundamentals of what constitutes good economic and financial management are timeless, and that learning can, and should, occur at all levels. Besides learning from the West, developing countries should learn from everywhere, given there's also innovation in emerging markets, says Katsu.

Furthermore, innovation will play a "bigger and even more important" role in helping economies emerge from the current global economic crisis, Katsu says. So countries should take advantage of the current economic doldrums to use innovation to "retool" for the post-crisis recovery period.

"Innovation is part and parcel of this exercise because … the global marketplace will continue, countries will have to continue to compete and whoever comes out of this crisis as solid as possible – and in particular, with good entrepreneurship, good innovation and systems – will have a leg-up (with regard) to the competition."

On its part, the World Bank is taking a multi-pronged approach to help countries in need emerge from the current crisis, says Katsu. These measures include a pledge to increase its loans to emerging economies to US$100 billion over the next three years, accelerate its financial support to the poorest countries, and to work with the International Finance Corporation

(IFC), which is part of the World Bank Group, to provide funding for infrastructure projects, social protection and agricultural research.

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