

17 July, 2009

## Implications of the global economic crisis for Sida's allocations of development cooperation

Sida is requested by the Government to assess the composition and direction of its development cooperation programmes within current cooperation strategies, and propose revisions in view of the ongoing economic/financial crisis.<sup>1</sup>

This is an initial reporting in response to this request. The final report, including suggestions for possible revisions of country strategies, is to be submitted by September 21 2009.

### 0. Summary

The current crisis hurt Sweden's partner countries, because of direct exposure to financial turmoil and/or because of their weak institutional capacity and poverty.

Revisions in Sida development programmes are motivated by reductions in appropriations due to the fall in GNI, and a concern that resources should be focussed on the most relevant interventions for mitigating the effects of the current crisis.

Sida's principles guiding reductions and reallocations of appropriations include safe-guarding development interventions in order to preserve predictability and long-term objectives, while considering marginal revisions for potentially high-yielding mitigating interventions.

The resulting strategy is, primarily, to safe-guard bilateral programmes within categories I-III, with a special emphasis on category II and on Africa. While there may be space for re-allocations in global programmes in 2009, global programmes and research are particularly targeted for reductions in 2010.

A preliminary assessment of individual country programmes shows that most of them are in line with development needs in response to the crisis, including social protection and productivity interventions.

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<sup>1</sup> Government Decision UF2009/38074/USTYR, June 4 2009

In some cases (Kenya, Uganda, Georgia), social sector support may be front-loaded in 2009. Front-loading is also proposed for Cambodia (for local investments) and Guatemala (micro-credit programmes).

Budget support may be suggested to be further explored for Bolivia, Cambodia, and Liberia.

Revision of the current country strategy is necessary in order to increase social protection interventions in Mozambique. Other potential country strategy revisions, as well as implications for global, research, civil society and regional programmes will be further explored and presented in the final report in September.

### **1. The economic crisis and developing countries**

The magnitude of the current financial and economic crisis as well as its duration is continually debated and revised. IMF's most recent economic outlook (July 2009) claims a somewhat more speedy recovery compared to figures presented in April. Still, the general picture is that of a contraction of global output (by 1.4 percent) in 2009, while growth will recover moderately (by 2.5 percent) in 2010, compared to the global growth rate of some 5 percent in 2007.<sup>2</sup>

The emerging and developing economies fare relatively well in this global outlook, as output will continue to grow even in 2009. The positive growth is largely explained by the continued expansion of the Chinese and Indian economies, whereas the sphere of Eastern Europe (Russia), and Central Asia, as well as Latin America by and large will have negative growth in 2009. Meanwhile, Africa's modest positive growth in 2009 translates into a negative per capita growth.

But also within each region there is substantial variation between countries. Direct effects depend on the degree to which countries are integrated in the global economy: the more integrated, the more directly hurt. In particular, countries dependent on oil, minerals and other primary commodities for their export earnings, are under pressure. Commodity importing countries may, on the other hand, benefit from the crisis to some degree, as dropping commodity prices help to off-set inflation pressures and current-account deficits caused by previously rising food and fuel prices.<sup>3</sup>

Thus, the poorest countries, less globally integrated as they are, may not be so directly hurt by the crisis, at least not in the short run. However, the crisis comes on top of other vulnerabilities. Weak fiscal positions and weak institutional capacity increase the sensitivity to even modest balance of

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<sup>2</sup> IMF: World Economic Outlook UPDATE, July 8, 2009

<sup>3</sup> See *Global Development Finance: Charting a Global Recovery*, World Bank, 2009

payments problems and fiscal shocks. One estimate suggests that an additional 53 million people will fall into a poverty of less than USD 2 per day, and that the current crisis could lead to some 700 000 further infant deaths in Sub-Saharan Africa.<sup>4</sup>

The crisis provokes difficult trade-offs for public spending, as short-term requirements for social protection, and possibly counter-cyclical interventions (such as public road works) may come at the expense of longer-term infrastructural investments, longer term educational developments etc, setting back long term growth prospects.

For the poorest in these poor countries, the crisis may indeed mean transition from a state of poverty to destitute. Job losses, shrinking remittances and/or price falls of e.g. agricultural products may necessitate selling out basic endowments, such as land or cattle, and pulling children out of school. A lesson from previous crises is the need to maintain basic health facilities, keep children in school and focus on, for example, infant nutrition.

At the same time, the dominance of subsistence farming among the poorest in many of the countries, as well as the positive effects of falling prices, cushions segments of the population from direct crisis effects, at least to some degree. The crisis does not strike uniformly.

## **2. Effects of the crisis in partner countries**

Which of Sweden's partner countries are most hurt by the crisis? The question is not easily determined, as it partly depends on what type of vulnerability to assess, ranging from the country's exposure to international financial turmoil to its magnitude of poverty, while many of the most affected countries also have seen big rescue packages supported by IFIs.

In addition, few global cross-country vulnerability assessments exist so far, making any comparison between countries difficult.<sup>5</sup> Nevertheless, Sida has attempted to compare existing vulnerability indices to arrive at a preliminary list of partner countries most exposed to the crisis.<sup>6</sup> Focus is on partner countries within categories I-III, which arguably should be the target for any substantial re-orientation of cooperation programmes in view of the crisis. In comparison to the countries listed by the World Bank,

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<sup>4</sup> Issues Note, DCD/DAC 9 April 2009

<sup>5</sup> Attempts made include EC, preliminary data (ACP countries only to date), DG DEV 2009; IMF "The Implications of the Global Financial Crisis for LICs" (March 09); WB Brief "The Global Economic Crisis: Assessing the Vulnerability with a Poverty Lens" (Jan 2009 data)

<sup>6</sup> Memo, *Implications of the Economic Crisis for Sida Partner Countries and Aid Allocations*, Sida, May 2009.

which are referred to in the assignment for this report, an additional five countries score as highly vulnerable in the Sida assessment.<sup>7</sup>

Note, however, that these are only preliminary attempts to assess vulnerability. They must be accompanied by a more qualitative analysis of individual country experiences, in light of existing country programmes and other development partners' activities, in order to determine the relevance of strategy revisions and focussed crisis mitigating interventions.

According to Sida's assessment, African partner countries dominate among the most vulnerable countries. For instance more than 70 percent of the African partner countries are considered vulnerable. This is consistent with the general picture. Many African countries enter the crisis with large current account deficits and weak fiscal positions, which means less resilience in responding to the crisis. In addition, even modest crisis-transmissions may have large impacts on poverty. Social unrest may also follow as competition for scarce resources increase, while fading political support due to political turbulence, partly provoked by the crisis, may threaten reform measures.

Among partner countries in Asia, Bangladesh and Cambodia are highly exposed to the crisis, but the effects on the Cambodian economy appears more severe, with expected negative growth for 2009. Countries such as Vietnam, Lao and India are also deemed highly vulnerable, but Swedish cooperation with these countries is either phasing out, or is relatively small and their country programmes are therefore not subject to potential reorientation. Afghanistan remains highly exposed according to the World Bank assessment, but this is largely due to the difficulties facing country development per se, and not so much caused by the economic crisis.

Latin America faces a sharp drop in demand as the US is a major trading partner and as FDI plummets from rather high levels. Overall, the region is affected considerably and growth is forecasted to contract. Guatemala is hurt through its large dependence on declining US demand and contracting remittances. Social spending in health and education is directly jeopardised, but Guatemala, not assessed by the IMF, does not appear in Sida's highest scoring group. Honduras, however, does, since it is assessed vulnerable by the IMF. Bolivia, on the other hand, scores low in

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<sup>7</sup> These categories I-III countries on the World Bank list are Afghanistan, Bangladesh, Burkina Faso, Cambodia, DRC, Ethiopia, Mali, Mozambique, Rwanda, Sierra Leone, Sudan, Tanzania and Zambia. In addition, Sweden's partner countries within categories IV-VI on the World Bank list are India, Indonesia, Vietnam, Botswana, Namibia, and South Africa (category V), Honduras, Lao, Kyrgyz Republic, Tajikistan and Sri Lanka (category VI), and Belarus. Meanwhile, Sida assesses that also Albania, Moldova, Turkey, Burundi and Liberia are highly vulnerable, based on an average of World Bank, IMF and EC-indices, among countries within categories I-III. Note again however that these assessments are problematic. For example, a few of the World Bank high exposure countries do not score as high in Sida's assessment (Afghanistan, Mali), but to some degree this has to do with data omissions.

the World Bank and in the IMF indices, but more recent studies indicate that with increasing unemployment due to exports decline, closing of mines and small industries, and shrinking remittances, the country may be more vulnerable than initially anticipated.<sup>8</sup> All in all, this illustrates the problem of too much reliance on simple vulnerability indices.

As for countries in Europe and Central Asia, a significant number of partner countries are also severely affected, although data is weaker with fewer countries assessed than in other regions. The largely impressive growth experience of the region has depended on large inflows of commercial loans and foreign direct investments, which are now cut back resulting in a regional economic contraction of some two percent.<sup>9</sup> Among Sweden's partner countries, the World Bank assigns particularly high exposure to the crisis to Tajikistan, but since its focus is on highly exposed countries with high degrees of poverty, fewer countries in this region are targeted. Sida also includes Albania, Kyrgyz Republic, Moldova and Turkey among the most vulnerable, when taking also (scarce) IMF and EC indices into account.

Middle-East and North Africa growth forecasts are down considerably as a consequence of the low oil prices. Growth projections, however, remain positive, but there is country variation. In particular, in OPT the crisis comes as an extra burden in an extreme situation as remittances shrink. In Iraq, plummeting oil revenues may threaten fragile state building endeavours.

### **3. Implications for Swedish development cooperation**

The situation is severe in Sweden's partner countries, while a considerable cut-down of development cooperation volumes due to reductions in the Swedish GNI for 2010 is expected.

#### **3.1 Guiding principles**

Sida has elaborated principles to guide the necessary reprogramming induced by the cut in Swedish ODA 2010, taking into account the implications of the economic crisis.

These principles partly stems from a number of observations confining Swedish development cooperation to directly contribute to crisis combat. Firstly, the relevant response to the crisis is primarily the monetary and fiscal policies undertaken by the partner countries, and the major stabilization funding now being put forward by IMF and others. The role of Sida is not to stabilise but possibly to help mitigate in the current crisis.

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<sup>8</sup> The global financial crisis and developing countries. Synthesis of the findings of 10 country case studies. ODI, Working Paper 306, June 2009.

<sup>9</sup> The World Bank, EBRD and EIB have produced a joint initiative to support banking and finance in Eastern Europe in a two year programme amounting to some 25 billion EURO.

Secondly, the turn-around of the crisis will be driven by the advanced economies. Aid, hence, cannot create development, but it can contribute to adequate institutional development in partner countries, in order for them to take advantage of positive global developments and mitigate effects on vulnerable groups.

Thirdly, we lack important knowledge about the impact and duration of the crisis across countries, as well as of other (bilateral) development partners' measures and strategies in view of the crisis, which makes relevant responses difficult to identify. Fourthly, new initiatives must be assessed against existing support as there are no additional funds. Finally, new initiatives may create uncertainty and transaction costs, and may also risk to bail out poor economic governance.

With these caveats in mind, Sida has established the following guiding principles:

- Do no harm – be predictable and long-term. There are considerable risks involved in reacting too strongly and perhaps too late to the economic crisis on the basis of imperfect knowledge. Standing by commitments and focusing on development issues rather than crisis management reduce uncertainties for vulnerable partner countries and other actors, avoid adding to transactions costs and protect the investment in development under way.
- Prioritise country programmes in order to preserve predictability and avoid creating uncertainties for partner countries. Within this priority, prioritise categories I-III and in particular the vulnerable countries.
- Scale up support with more direct mitigating effects and scale down support with less direct mitigation effects. With predictability and long-term commitment as the overarching principle, there is need for flexibility, to mitigate the effect of the crisis on the poor. Guiding such flexibility includes assessing :
  - social protection needs and measures
  - the support of livelihoods and economic opportunities
  - Infrastructure, including opportunities as regards investments related to climate change and environment
  - priorities *within* programmes (example: school feeding programmes may replace curriculum development due to the acute situation).
- Safeguard programme development cooperation and budget support as it has been programmed in partner budgets (bearing in mind that partner Governments might already have diverted state budgets towards the social sectors as a crisis response mechanism and away from productive and job creating sectors like infrastructure).

- Given the need for predictability, it is important to stick to principles of international development cooperation co-ordination and division of labour. In the current situation, it is of greater importance than ever to co-ordinate effectively. Failure to do so may result in unwanted symmetric action across and transaction costs for partner countries.
- Respond already in 2009 by additional measures to provide fiscal space for vulnerable countries and respond to pressing sector needs. First option would be emergency budget support as this instrument would respond to the partner government need of flexibility to act on upcoming priorities. Consider also top-ups/frontloading of ongoing programs – in particular in social sectors, infrastructure and to sustain livelihoods through safety nets and public works. Other aspects that should be considered are phase-out plans of sectors which perhaps should be delayed.
- Utilise the new guarantee instrument fully where possible to protect crucial investments with financing problems.

### 3.2 General implications for Sida

Based on the above, in combination with variables such as the government's priorities and absorption capacity in partner countries, Sida has considered reallocations in 2009 and revised planning figures for 2010. The overarching principle has been to safe-guard bilateral relations as far as possible, in addition to the vote for humanitarian assistance.

The necessary reductions in 2010 are suggested to be targeted towards the global and research votes in particular. Within the regional votes, continued priority has been given to Africa but also reform cooperation in Europe. Regional cooperation is taking the brunt of the reductions within the regional votes.

For 2009 there may be space for additional funding of global initiatives in order to meet crisis management needs, and Sida will examine such possibilities further.<sup>10</sup> Similar regional initiatives in 2009 may also be assessed, although it appears more likely that any additional regional funding in 2009 will serve to front-load committed support in order to balance cuts in 2010.

Moving on to country categories, the indicative planning figures for 2010 translates into a continued priority for category II countries (post-conflict) which will receive a slight increase over 2009, despite reduced allocations. Overall, these country programmes are directed towards relevant areas

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<sup>10</sup> Examples of such initiatives include "FIRST governance council for special funding arrangement for crisis preparedness activities" and "IMF Trust fund on debt sustainability and public debt/asset management".

targeting vulnerability in particular. Category I countries will also be shielded against reductions in line with the reasoning above. This priority means inter alia that social sectors and programme support will be safeguarded. Category III will be protected to some extent but will not be unaffected as categories I and II receives overall higher priority. As for the other categories they will be affected more than proportionally by the reduced allocations apart from category IV where funds have been set aside to accommodate a possible turn-around in Zimbabwe.

#### **4. Country responses**

In anticipation of the current government assignment, to which this report is a partial response, Sida, in late May 2009, requested country teams for categories I-III to provide views on relevant responses to the economic crisis, taking into account reduced appropriations. The country teams were instructed to review the cooperation programmes and suggest adaptations in response to partner needs while taking into account other development partners' actions.

The overall conclusion from the submissions by country teams is that country programmes by and large remain relevant and adequate in relation to the economic crisis and the longer term development objectives for Swedish development cooperation. The forecasted reduction in Swedish ODA 2010 severely limits the ability of country teams to prioritise new interventions, as they would be at the expense of ongoing programmes which remain relevant and effective. Hence, efforts could be wasted and results would be jeopardised. Country teams also clearly signal the need to maintain predictability in an increasingly uncertain environment for our partners.

Nevertheless, where deemed feasible and called for, a number of concrete measures have been suggested to respond to the economic crisis and handle the foreseen reduction in allocations 2010 through frontloading and other measures. Country teams are requested to further develop plans and look for opportunities as part of the 2<sup>nd</sup> management review in September.

##### **4.1 General pattern**

For category I countries, the responses confirm the relevance of shielding bilateral programmes from substantial reductions in 2010 in order to keep up with the priority on Africa, maintain predictability and protect programme support. Country teams have also been given the opportunity to respond by frontloading particularly relevant programmes in 2009. Most country programmes are assessed to be relevant and cooperation strategies well aligned to the situation although individual adjustments such as the ones highlighted below are suggested by the country teams to

address the crisis.

The country programmes in category II countries are already targeted towards the most vulnerable groups and strategically directed to prevent conflict and handle internal crisis situations, in most cases over-shadowing the impact of the economic crisis. Moreover, in many cases allocations to these countries are being expanded in line with the emphasis put on this category in Swedish development cooperation. Consequently, the responses are foremost one of safeguarding the category while pressing ahead with the implementation of the newly decided cooperation strategies such as the one for DRC.

The country programmes in Category III are focussed on reform activities and capacity development in line with the objective of EU accession. In concrete terms they contain substantial elements geared towards increased prospects for growth and poverty reduction through inter alia adaptation and reformation of the agricultural sector to meet EU-standards. These reform activities remain even more relevant in the current context and need continued prioritisation. Therefore, only marginal adaptations are suggested in a few cases. The country strategies and programmes remain relevant, addressing key constraints for development.

#### 4.2 Implications for individual countries

In addition to the general direction indicated above, Sida intends to make adjustments to the following country programme to ensure the relevance of the cooperation, mitigate the impact on the poor and strengthen prospects for development. The programmes in countries not mentioned below remain valid and no specific alterations are foreseen at this moment.

##### 4.2.1 Africa

The country programme in **Kenya** is proposed to be frontloaded in 2009. Vulnerability in urban areas is a concern not least in the aftermath of the political crisis and violence. A new programme will be started to address this with a first planned disbursement of 10 MSEK in 2009. The frontloading of up to an additional 30 MSEK also gives room for temporary measures in 2009, including increased funding to the labour intensive roads programme, increased support to child protection via UNICEF, and in complement to the agricultural programme (NALEP), a short-term intervention via a WB programme for enhanced productivity that include safety net measures.

As **Liberia** is in-between a HIPC decision and completion point, external loan financing is not an option and hence the budget must balance. Sida will thus in line with the cooperation strategy propose a limited general budget support 2010 to increase fiscal space for priority programmes. The

country programme is new and highly relevant. A quick build up of it is deemed to be an adequate response and priority will be given to productive sectors.

In **Mali**, the country programme remains relevant with emphasis on social sectors, including a specific child protection programme focussing on rights, and natural resources. As a response, a new contribution to social protection is suggested 2010. Further measures will be considered in the new cooperation strategy to be developed 2010.

As for **Mozambique**, social protection will be targeted via the One UN programme. There is a funding gap for the programme and Sida is in a position to allocate 30-40 MSEK within the existing frames in 2009. An alteration in the current cooperation strategy may be required to allow for this measure which is regarded as highly desirable given the impact on poor and risk of social unrest in urban areas.

In **Rwanda**, the new cooperation strategy 2009-2013 (180 MSEK per annum) proposal to be decided upon by the government, apart from putting emphasis on peace, human rights and democracy, explicitly targets rural livelihoods, employment creation and social protection along with other measures to improve growth prospects through land reform and sustainable use of natural resources.

Slow implementation and weak management by the WB of the Multi-Donor Trust Funds (MDTF) for Northern and Southern **Sudan** means that the planned contributions through these mechanisms in 2009 are not needed. Sida will thus seek to reallocate these resources within the remits of the cooperation strategy which remains relevant. A first priority is to respond to the acute fiscal crisis in Southern Sudan (with a budget deficit 40 percent as oil revenues dropped) which carries with it risks of social unrest and conflict. As a first measure, the counter finance requirement of the MDTF on the Government of South Sudan (GoSS) will be waived by the donor-group to allow for fiscal measures through other channels by the GoSS (78 MUSD). Secondly, Sida will seek to direct the annual contribution of 65 MSEK to inter alia the Sudan Recovery Fund handled by UN and The Basic Services Fund initiated by DFID. As regards the 35 MSEK originally planned for the MDTF for Northern Sudan, work is ongoing to find ways of directing these funds to the most war torn and marginalised areas in the North.

The water and sanitation programme in **Uganda** is proposed to be frontloaded as a response to the crisis and in light of reduced allocations for Uganda 2010. Consequently, subject to consultations with the government, the country programme will increase by around 30 MSEK compared to the original planning figure in 2009.

The country programme in **Zambia** remains valid and should be safeguarded as far as possible. Apart from the general budget support and sector programmes in health and energy, the new agricultural support programme will directly target food security and productivity – eventually reaching 100 000 small-scale farmers. A new rights-based programme also starts mid-2009 to support community based analysis of the effects of the crisis in different locations and amongst different livelihoods groups to improve responses by policy makers.

#### 4.2.2 Asia

In **Cambodia**, the country programme as a whole will be safeguarded as far as possible. A proposal for a limited budget support for poverty reduction may be submitted for consideration by the government 2010. Within the existing programme support to decentralisation will be increased to 75 MSEK (50 MSEK) as from 2009, as a measure to mitigate the effect of the crisis. The increase will mainly be directed to investments at local level.

#### 4.2.3 Central America

The government of **Bolivia** is expected to seek budget support for 2010, partly to finance its announced crisis mitigation package, including a programme to eradicate extreme poverty to address delays in reforms in key social sectors. There is room for such support in Swedish development cooperation strategy 2009-2013, and Sweden and some other development partners are envisaged to pursue a dialogue in 2009 with the Bolivian government and initiate preliminary analysis of such option.

In **Guatemala**, the allocation to the country programme will be increased by 20 MSEK in 2009 to allow for a scaling-up of support to micro-credit institutions which are becoming affected by increased financing costs and squeezed private sector financing. Meanwhile, the need to increase social sector interventions, where Sida contributes to the health sector, is hampered by low execution capacity in the relevant ministries, motivating postponement of any scaling-up of such support in 2010.

#### 4.2.4 Europe and Central Asia

The new cooperation strategy for 2010-2013 under elaboration for **Georgia** will bring on board further considerations as regards the economic crisis. However, Sida envisages within the current programme to scale-up support to improve living conditions for the internally displaced persons as a response to the crisis. In the agricultural sector an extension will be considered of the successful cattle winter feeding component which directly improves incomes of poor farmers.

**Moldova** is in a very serious economic situation exacerbated by political turmoil. The political situation needs to stabilise for Moldova to respond to the crisis. Substantial emergency support is envisaged from the IFIs subject to austerity measures, although it will not cover the funding gap. EC and some bilateral development partners are preparing for budget support. Given increased unemployment the on-going programme to vocational training, currently being phased-out in accordance with the cooperation strategy, may be extended as a concrete action to mitigate the impact of the economic crisis. However, such a redirection requires an alteration of the cooperation strategy.

## 5. Concluding remarks

This report is a first attempt to respond to the government's assignment as of June 4 on possible revisions of Swedish development cooperation in view of the ongoing economic/financial crisis. A couple of remarks on the assignment from the government conclude this preliminary report.

Sida has been requested to particularly review implications for the countries that are directly affected by the crisis, singling out ten countries in accordance with World Bank assessments. It has been argued in this report that such specific targeting is difficult to pursue, in light of the many dimensions of vulnerability.

The government also requests an analysis of opportunities to reallocate resources to social sectors. In the preliminary indications for revisions of existing country programmes identified for some countries, most of the proposals for additional funding and/or front-loading of the programme for 2009 indeed concern social sector support of one kind or another (also in the cases where increased budget support is to be considered).

In addition, Sida should also consider allocations to interventions of particular importance for increased productivity and growth, and here there are fewer obvious examples. It may be argued that such interventions are more difficult to identify, since a large number (if not all) types of interventions should have a (long-term) growth effect. However, there are potentially immediate and relevant trade-offs between individual interventions, which indeed have different implications for productivity and growth. Sida will explore this issue further in the final report.

Moreover, Sida will examine implications for appropriations to global, research and civil society programmes, as well as for regional programmes. Finally, Sida will further address how any reprogramming adheres to the government's thematic priorities, Sweden's comparative advantages, other development partners' actions, and the priorities of partner countries, and will also examine further implications for current country strategies in the final report, due September 21.