THE IMPACT OF THE GLOBAL FINANCIAL AND ECONOMIC CRISIS ON THE DEVELOPMENT PROSPECTS OF THE LANDLOCKED DEVELOPING COUNTRIES

Report Prepared by John Serieux

UN-OHRLLS consultant

Contents

1. INTRODUCTION 4
2. THE CONTEXT FOR LANDLOCKED ECONOMIES 5
   2.1 The Implications of Being Landlocked 5
   2.2 Crisis Transmission to Developing Countries 6
   2.3 Important Vulnerabilities of Developing and Landlocked Economies 9
   2.4 A Closer Look at Landlocked Economies and their Vulnerabilities 11
   2.5 Regional Effects 13
3 MITIGATION AND THE PROTECTION OF DEVELOPMENT OBJECTIVES 15
   3.5 Global Institutions 16
   3.6 The Regional Development Banks 19
   3.7 The Domestic Challenge: Responding to External Shocks 21
4. COUNTRY AND REGIONAL CASE STUDIES 23
   4.1. Country Case Study: Malawi 23
   4.2. Regional Case Study: Central Asia 24
5. CONCLUSION 27
References 29
Appendix A: 31
Appendix B 38

Note
The views expressed in this report are those of the author and do not necessarily reflect the views of the United Nations. The designations employed and the presentation of the material in this report do not imply the expression of any option whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area, or of its authorities, or concerning the delimitation of its frontiers or boundaries.

2. THE CONTEXT FOR LANDLOCKED ECONOMIES

2.1 The Implications of Being Landlocked

The landlocked countries are marked by specific vulnerabilities that are a direct consequence of being landlocked. These can be divided into two types of vulnerabilities, both of which can have significant economic, as well as non-economic, implications (Faye *et al*, 2004).

(a) The Transportation Challenge

The fact that goods (and even some services) entering and exiting the landlocked economy must pass through a transit country brings with it several inherent disadvantages:

- The land passage through another country adds, inevitably, to the cost of transport and the administrative burden of transit across more than one border also adds to transport costs in terms of both time and treasure;
- The physical, legal and administrative implications of transmitting goods through another country often have implications for the reliability of transport;
- The landlocked country must live with the quality of the transit country's infrastructure; thus, to some degree, transport quality is an externally-imposed constraint;
- The landlocked country is not only subject to the effects of natural and manmade factors within its borders; it must also contend with the effect of such factors on transit countries, since this also has an effect on the cost and speed, or even availability, of transportation routes (Faye et al, 2004)[1].

(b) The externalities related to being landlocked

For landlocked countries, the lack of ocean access means having land borders on all sides and, almost by definition, a larger number of bordering countries than non-landlocked countries. The landlocked country is, therefore, faced with both the positive and negative externalities derived from proximity to a wider range of countries (MacKellar *et al*, 2000).

Landlocked economies can take advantage of this multitude of proximities to develop stronger economic links to neighbouring countries. To some degree these links can mitigate some of the inherent disadvantages involved with trade with non-neighbouring countries and provide some insurance against transmitted economic effects from a single neighbour. However, this approach also means that the fortunes of such an integrated economy become much more strongly tied to the fortunes of the regional economies to which it has linked itself. Thus, the degree to which this network of links is an advantage or disadvantage for the landlocked economy will ultimately depend on the strength and diversity of the regional economy to which it is linked.

When landlocked economies are also developing economies, not only do these vulnerabilities have immediate implications for growth and development outcomes, but they may interact with and magnify some of the attributes of underdevelopment itself.

Given the disadvantages faced by landlocked economies, one would expect these countries to have lower incomes and trade levels compared to their non-landlocked neighbours. Indeed, as Figure 1 shows, when landlocked developing countries are compared with a sample of their (non-landlocked) neighbours of comparative size and levels of development, they do have lower per capita incomes (measured in purchasing power parity terms).[2] Surprisingly, though, they have sometimes had higher trade-to-GDP

[1] The transportation challenges faced by Zambia, Zim

to experience a sharp decline relative to the previous year (IMF, 2009a). The reason for this lag in developing country performance has to do with the dual nature of the crisis and differences in the means of transmission of the effects of these crises onto

and other primary commodity prices, remittances from migrants in primary commodity-exporting countries (such as the oil-producing countries of the Middle East) may decline even more than remittances coming from advanced economies. This effect will likely be exacerbated by exchange rate depreciations in the source economies that reduce the domestic currency value of these flows in the destination economies. If conditions in destination countries deteriorate considerably, there is the real possibility that migrants may be forced to return home – creating an additional burden on recipient countries.

2.3 Important Vulnerabilities of Developing and Landlocked Economies

The modes of transmission elucidated above imply that certain types of developing economies will be more vulnerable than others. Generally, attributes that imply a high concentration in terms of economic interaction with advanced economies (or other vulnerable economies), dependence on external capital flows, specialization in primary commodity export production and a weak balance of payments position will increase the likelihood that the downturn in advanced economies will be transmitted to that developing country, and may even exaggerate the effect. More specifically, the attributes that increase the likelihood that transmitted economic effects will be large and strongly negative are:

-

- **Countries with weak reserve coverage**

Contractions in the flows of both goods and finance will likely mean that countries will face shortfalls in foreign exchange earnings. Countries that have high reserve coverage can expect to weather the storm, unless it is prolonged, but countries with weak reserve coverage may soon face balance of payments crises. The policies that may be compelled by these circumstances may simply add to domestic demand contractions (at least in the short run) unless a substantial amount of external assistance is forthcoming.

- **Countries carrying high external debt burdens**

Much like weak reserve coverage, countries facing high external [illegible]

remittances shocks and medium vulnerability to trad

within the region, but the countries of Europe and Central Asia have the highest proportion of citizens abroad. South and South East Asia demonstrate the weakest exchange of migrants, while South America and South and East Africa fall somewhere in between. It would be a fair presumption that the exchange of migrants also means an ongoing exchange of remittances (though the correspondence may not be one-to-one). The degree to which this proves a strength or weakness will depend on the strength and diversity of regional economies, particularly the large regional economy.

For landlocked economies, trade integration is much less advanced than labour movements (Table A1). Only about one-half of landlocked developing countries (sixteen) count neighbours as one of their primary trading partners and only a small minority (Lao PDR, Moldova, Paraguay, Turkmenistan and Zimbabwe) count neighbouring countries as their top two trading partners. The degree to which this proves advantageous for these countries depends, of course, on the region and, again, on the strength of the dominant regional economies which are, typically (though not always), the dominant trading partners when countries have a high level of participation in intraregional trade.

Table A7 offers some data that speak to some of the

greater proportion of their total merchandise exports, and they are significantly more dependent on development assistance from advanced economies and remittances from migrants abroad. Those vulnerabilities increase both the likelihood that these countries will be negatively affected by the global financial and economic crises and the potential magnitude of transmitted effects on their economies. What is more, close economic ties with the major regional economies will sometimes serve to mitigate or exacerbate these effects depending on the vulnerabilities of those regional economies and the strength of linkages to these economies.

To reiterate, these countries face potential negative external shocks that may take the form of: reduced access to external credit generally, and most acutely in the area of trade financing; a fall in trade volumes; a fall in primary commodity prices; reduced flows of investment finance; increased variability and potential reduction of aid flows; and a sharp drop in remittance flows. Most of these countries are far from having the foreign reserve cushion that might provide them with the ability to "ride the storm," by simply running down reserves (to make up for the shortfalls in foreign exchange earning and to increase domestic demand). In the majority of cases, external (financial and demand) shocks will have to be dealt with through more active and complex policy interventions and resort to external financing.

Because these potential negative external shocks emanate from global crises, uncoordinated efforts to

- **The Global Equity Fund** – An International Finance Corporation (IFC) facility meant to utilize a total of $1 billion over three years to recapitalize systematically important banks in emerging market economies.
-

。

and quality of their responses. The ADB has proposed a substantial deployment of resources and detailed a broad range of actions. The IDB, by contrast, has taken a more ad hoc approach. While it has announced resource deployments, there is little detail on proposed actions. . The AfDB has detailed a plan of action that is more explicit than the IDB proposals, but less comprehensive than the program put forward by the ADB.

A caveat is necessary here. While the participation of these institutions in mitigating and addressing the effects of the crises is both necessary and welcome, there is no indication that their intervention can go very far in correcting some of the imbalances noted in the World Bank and IMF proposals. Funding for IDA-eligible countries still seems either limited o

manifestation of the crises and the pre-existing economic and institutional context) as well as the availability of external resources.

In a summary of studies of Latin American countries facing sudden contractions in external funding, Cavallo and Izquierdo (2009) conclude that the evidence indicates that countries that were able to engage in expansionary fiscal and monetary policies were best able to reduce the extent and time-span of the net output effect, while countries that engaged in tight fiscal and monetary policies had exaggerated effects. However, they caution that the evidence is silent on whether expansionary policies in the face of weak domestic conditions (structural deficits, thin foreign reserve coverage and highly inflationary conditions) would have been equally successful. It remains distinctly possible that expansionary policies, under these conditions, would likely have made matters worse. This is, more or less, the position taken by the IMF

4. COUNTRY AND REGIONAL CASE STUDIES

4.1. Country Case Study: Malawi

After experiencing a decline in growth from 12 percent in 2007 to 6.3 percent in 2008, the Central Asian region (including both landlocked and non-landlocked economies) is expected to reach a nadir of 0.9 percent growth in 2009 and recover to a modest growth rate of 5.0 percent in 2010 (IMF, 2009g). Since landlocked countries form a majority of the region's countries, the evolution of growth in the landlocked economies of the region (as a group) is expected to followto

The G20 has taken up the challenge of addressing th

References

African Development Bank (2009). *The African Development Bank Group Response to the Economic Impact of the Financial Crisis,* Tunis-Belvedère: The African Development Bank Group (March 2009).

Asian Development Bank (2009a). *The Global Economic Crisis: Challenges for Developing Asia and ADB's*

Inter-American Development Bank (2008a). *IDB and Other Multilaterals Launch Liquidity Facilities for Latin America and the Caribbean*. News Release, October 13, Retrieved on May 6, 2009 from http://www.iadb.org/news/detail.cfm?language=EN&id=4806

Inter-American Development Bank (2008b). *IDB Fund Provides Emergency Liquidity Facility for Microfinance Institutions.*

Table A3: Capital Flows to Landlocked Economies (Average 2003-2007)

Country	Net FDI Flows (% of GDP)	Country	Aid (% of GDP)	Country	Remittances (% of GDP)
Azerbaijan	16.13	Burundi	47.92	Moldova	28.46
Chad	13.64	Afghanistan	36.10	Lesotho	26.26
Lesotho	8.056	Rwanda	23.88	Tajikistan	21.66
Moldova	7.49	Malawi	20.72	Nepal	13.73

Table A4: Reserves in Months of Imports

Country	Reserve Coverage (2008)
Zimbabwe	0.2
Tajikistan	1.3
Malawi	1.3
Niger	2.3
Ethiopia	2.6
Zambia	3.2
Lao PDR	3.7
Swaziland	3.8
Central African Republic	
Burundi	3.9

Table A5: The Debt Burdens of Landlocked Economies

Country	Total External Debt in 2007 (% of Exports)	Country	Total Debt Services as % of Exports (Average 2006-2007)
Central African Republic	382.85	Kazakhstan	44.09
Nepal	270.48	Burundi	39.59
Lao PDR	217.20	Central African Republic	34.83
Kazakhstan	185.46	Moldova	19.28
Armenia	163.51	Macedonia, FYR	17.15
Tajikistan	160.10	Lao PDR	15.66
Moldova	159.59		

Appendix B

Table B1: List of Country Groups with Regional Distribution

Landlocked Developing Countries	Comparative Group of Countries	Large Neighboring Countries
Region: West Africa		
Burkina Faso	Benin	Nigeria
Chad	Cote d'Ivorie	
Mali	Ghana	
Niger	Mauritania	
	Senegal	
	Togo	