DOLLAR & SENSE: THE BROOKINGS TRADE PODCAST

THE UKRAINE WAR'S IMPACT ON DEVELOPING COUNTRIES

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DOLLAR: I'm David Dollar, host of the Brookings trade podcast Dollar and Sense. Today, my guest is Indermit Gill, the World Bank's vice president for equitable growth, finance, and institutions and a nonresident senior fellow in the Global Development group at Brookings. Indermit has a recent blog post on the Brookings website on the impact of the Ukraine war on developing countries, and that's going to be our topic. So thank you for joining the show, Indermit.

GILL: It's a pleasure, David. It's a pleasure to be with you.

DOLLAR: So let's start with the situation before the Ukraine war hit. Have most developing countries recovered from the COVID pandemic, the economic downturn that went with that? Were there preexisting vulnerabilities as this year started?

GILL: So, yes, there were preexisting vulnerabilities, David, and big time. Essentially, we put out a report in January called the Global Economic Prospects Report, and we were saying that most developing countries were in a tight spot and the world was at the risk of a hard landing. The thing to keep in mind is that we were we were used to seeing things looking better in advanced economies. But a large number of poor countries had not recovered nearly as much as others. And we didn't expect per capita incomes in these countries to go back to pre-pandemic levels until two years later.

Now the thing that has happened is that we were expecting in January that growth in developing economies was about six percent in 2021, it was going to go down to about five percent in 2022, and four percent in 2023. But it was going down already, and this was before the war. So expect with the war and the doubling of oil prices since September of last year, expect to shave off about one percentage point of growth in 2022 and 2023. We are now talking about very, very low rates of growth.

The thing also was it wasn't just growth. We found from our numbers that inflation was already at a decade high. Right. Forty percent of developing countries' central banks had started to tighten monetary policy and raise interest rates in response. And you know that inflation in the U.S. was also becoming a problem, and there was an expectation that the U.S. Fed would start to raise interest rates. We were really concerned about this because total debt was at a 50-year high in these countries. There was a very good report by Homi Kharas and his coauthors at Brookings Global, found that the total debt service obligations over the next three or four years was going to be about one point six trillion dollars for these developing economies.

These were about 120 countries, David, and for these for about 50 countries, things didn't look that bad. But for the other 70 countries that have more than half a trillion dollars of debt service that is due over the next three years, 40 of them were already in debt distress or high risk of it. Right. And so, yes, the existing vulnerabilities were already bad. And yes, the war has made them worse.

DOLLAR: So that's a very clear picture of developing countries not having fully recovered from the pandemic and from the downturn. And then the Ukraine war comes on top of that. So of course, that's going to create a variety of difficulties and we can talk about different aspects of that. The most visible one you see on the front page of newspapers concerns the price of energy and the price of food. And of course, in the developing world, you have a great diversity of countries. Some countries export quite a bit of oil, for example, so they actually get a positive windfall. But lots of developing countries import energy and food. So can you give us a sense of how those price increases are affecting developing countries?

GILL: Well, you're absolutely right that higher food and energy and minerals prices, this will be the most immediate source of pain for developing countries, but this it'll hurt poorer countries more than others. Right. And this is for two reasons, David The first is that Ukraine and Russia are a big part of these global grain, oils, fuel, and fertilizer markets. And I'm not just talking about oil like crude oil, I'm also talking about cooking fuels. I'm speaking about both cooking fuels as well as cooking oil. Right? So I guess if you think about these commodities, David, they are perhaps the most essential commodities. These are things that people can't do without. So I would say that oil is the most important fuel and wheat is the most important food. So this war will affect the world.

So I can give you a few numbers. So, for example, I know that we always talk about Russia when we talk about commodities, but Ukraine is pretty big too, right? So it's the number one exporter of sunflower seeds, and it has more than a third of the global market. It's the fourth largest exporter of wheat with a 10 percent share, and it's the fifth largest exporter of corn with a seven percent share. So that's Ukraine.

Then Russia—Russia is a commodities giant. And it's the biggest exporter of wheat. It accounts for a quarter of the market for natural gas, nearly 20 percent of the market for coal. Fourteen percent of the market for platinum. And more than 10 percent of the market for crude oil.

So basically, you're going to get a huge shock. Now the problem is that because food and fuel tend to be larger shares of the budgets of poorer people, and more poor people live in poorer countries, this is going to affect poorer countries more than rich countries. So the share of food and consumption in the average poor country, David, is more than 40 percent. In rich economies, it's half that. So that's why we are worried about poor countries. That's why we are especially worried about the poor in poor countries.

DOLLAR: So we've seen examples of this in the past when there have been spikes in energy prices, actually there have been quite a few cases, but probably the food is more worrisome. And we've seen some past shortages of certain food crops increase in price. One of the risks is that international trade in these products starts shutting down. Some countries ban exports or try to control exports for fear of not having enough food, and that can really gum up the works for the whole international food trade system. So do we see examples of this happening yet? Are we worried about this?

GILL: This is a big worry for us, David, and we track this very, very closely. Even before the war started by the third or fourth week of February, there were 40 new policy actions since the start of the year that were affecting food trade. And 30 of them actually had restricted exports or imports of food. So this was already happening even before the war started. So, for example, on February 15, Russia stuck on new order on the exports of wheat and other cereals to countries outside the Eurasian Economic Union, and that was already beginning to have an effect on inflation and so on. But it's not just Russia by the way. So in January, for example, Indonesia put in something that they called a domestic market obligation to sell 20 percent of exports of palm oil at home below a set price. Our experience is that such actions actually don't help with inflation and food prices at home, and they do harm abroad. So I call them "beggar they world" policies, David.

DOLLAR: So that's surely the international trade side. Obviously, there are a lot of different commodities. The rise of protectionism for particular food products we may later see it for energy. That's worrying because we have a real shortage and then those distortions just make the distribution more inefficient, basically. Another way that this whole crisis could potentially affect developing countries is financial contagion. You know, Russia has a fairly significant amount of outstanding foreign currency bonds that have either been issued by the Russian government—so sovereign debt—or I think more commonly, they're big state-owned enterprises, which are particularly in the oil sector, have issued euro and dollar denominated bonds. And it seems now that they're having trouble making payments. And the West has put pretty severe sanctions on Russia.

So it's all logical that those Russian entities will not be able to service the debt. But still it becomes a default, it takes a little time for these things to play out, but there's a high risk of default in international markets.

So in the past, we've sometimes seen cases where default in one country leads to capital fleeing all developing countries even though, as you and I know, a lot of developing countries have pretty good macroeconomic management, and you already mentioned some statistics on debt issues. So we are we worried about financial contagion? Do we see evidence of this yet, of capital leaving even the well-managed developing countries?

GILL: So not too much, David. But this is a concern. I guess the first thing to sort of say is that just like Russia is a big part of world food and fuel markets, it's not a big part of world debt and equity markets, right? So you wouldn't see that immediate effect that you would see from the commodity side. You won't see that. Now, there is an exception, and the exception are countries in Central Asia that do have Russian banks and so on, and they do have direct exposures to Russian banks and they'll be affected by the sanctions and so on. But outside of that, you won't get this immediate effect.

Now that said, there are two channels through which these things start a start to create problems. The first one is too much inflation and the second one is too little information. In terms of the too much inflation, essentially what we are worried about, of course, is that while countries were expecting interest rates in the West to rise, this could mean that some countries would actually do this faster than expected and so on. And that has the usual effect, as you know. And that can easily lead to investors confusing countries that have liquidity problems and those that have solvency problems. And that's the definition of contagion in a sense, right? But that's one problem.

And I think that we are on guard for that and we are trying to get countries to prepare and so on. And we've been sort of sending them briefs about where we think the vulnerabilities lie and that kind of thing, and we can do all that we can. Of course, we can always do more on that.

But the thing that we worry about, of course, David, also is the lack of information about some of these connections and so on. That's the thing that could really surprise us all, right. So, those are the things that we know about, those are things that we worry about.

DOLLAR: Yeah, it seems to me this two track recovery in the world economy really creates some serious risks. The U.S. is growing pretty well, and it's projected to continue to grow pretty well in the next couple of years. So that statement from the Fed, the most recent March Fed meeting, was pretty clear. They expect robust growth in the U.S., low unemployment, and they have a pretty ambitious plan for raising interest rates. And actually, there are outside economists criticizing them that their plans are not tough enough in a sense, because, you know, our inflation reached up to seven point nine percent annual inflation in February. That's, that's a number really worth worrying about.

We have to worry about countries like the U.S. quite legitimately tightening monetary policy, raising interest rates. But obviously, the dollar plays a key role in world finance. And that could create problems for developing countries that are, as we've discussed, lagging behind in terms of recovery and facing potential contagion risk. So it does seem like a particularly dangerous year.

GILL: It is, David. I think that at least in this matter, I think you're right about that, but I also think that the Fed did something very good, which is that they actually announced the next series of increases. So that you try to minimize the amount of surprise in this. I think that's like 50 percent of the problem when countries surprise others with big increases. And so I would actually get very, very high marks to the Fed for this one.

DOLLAR: So we've talked about trade and capital. It seems to me the other obvious topic I'd like to take up with you is is the human being side of this. You know, we see obviously a tremendous number of refugees coming out of Ukraine. So it's a tragic humanitarian situation. It has economic implication. Is it mostly an intra-European affair? Refugees leaving Ukraine and going to other European countries? Is this going to affect some developing countries? And and I guess I would also link, somewhat different but still related human issue, is the remittances—a lot of developing countries rely on remittances. Are some of those going to be upset by this Ukraine war?

GILL: So about the movement of people, I think that you've actually mentioned two of them, David. The first one is refugees, and you're right that the refugees will be going mostly towards the West. Now there is this other issue about refugees, though. We've learned from past experience that when you give a lot of attention to refugees, you take away attention from your own poor people. So one of the things that we are advising countries that are hosting refugees is to not forget about their domestic or people at the same time, because that can create a lot of resentment and so on. But you are absolutely right about that. That's going to be a big part of it.

But that's not going to be the only part of it, as you just intimated, because one of the things that people don't know about Russia is that it's the second largest recipient of migrants who come to work and so on. So I've seen numbers that say that you'll get a loss of jobs in Russia because of the sanctions of about half a million. That means that you have a lot of migrants, especially from Tajikistan, Uzbekistan, Kyrgyzstan, and others who come to work in Russia and they send back remittances. So for example, in Tajikistan, I think remittances account for like 30 percent of GDP or something like that. So they're going to get a big effect.

And the third part, David, is the movement of people, but in a different one, which is tourists. So you actually found the Russian tourists were really big in developing Asia—Turkey, India, and so on. And that's going to dry up, too. And that's a concern as well as many of the countries.

DOLLAR: Let's talk a little bit about what kind of policy response we can see from developing countries, what is in their interest to do. You're sitting there at the World Bank, which is best known for financing development, and we can we could talk a little bit about that before we're done. But my own personal experience is that the policy advice, the analysis, advocacy from the World Bank is actually more valuable than the money. I remember writing in an early report I did that good policy is more important than finance, and I ran into a little problem is that flew through the bureaucracy and it ended up sentence being "good policy is as important as finance." Anyway, what would constitute good policy in this situation? What can developing countries do to help themselves?

GILL: Well, the usual things, David. Essentially, because these countries have not had big buffers going into this crisis, they're going to have to change policies as compared to two years ago when they went into the COVID crisis. So you won't have these big fiscal buffers and so on. So the usual thing then is, of course, you try to sort of make sure that you spend more wisely. You can't spend more so you have to spend more wisely.

The second thing, David, actually, many of these countries are going in with strengthened social safety nets, both because of the pandemic and because of the financial crisis and so on, that we've actually been strengthening the social safety net, not just social insurance, but also social assistance programs. So these social assistance programs were often used for things like chronic poverty, but you can repurpose them very quickly and we have been doing that and so on. And so, especially because you want to protect people against against these big increases in food and fuel prices and so on, you can repurpose those. We are and we are actually trying to provide not just advice, but also money. Though I agree with you that I think that the advice part of it is always far more bigger scale in terms of impact as compared as compared to the money.

They should of course be making sure that their monetary policies don't actually get them in trouble very quickly. As we talked about earlier, that you want to make sure that investors know that these countries, they may have liquidity problems, but they are solvent. So one of the things that we told our debt managers in these countries also is to talk to the markets frequently, and not to hide debts, because one of the things that we also find is that when these debts, they ultimately do get exposed and they usually bring even solvent countries down. So, those are the kind of things that we are doing. And of course, we are actually providing emergency financing to countries both like Ukraine, but also countries that are going to be affected by these higher food prices and so on.

DOLLAR: I was just going to follow up and say what you were saying about social protection, that's encouraging. I mean, can countries realistically limit the increase in poverty that you would expect to come from this kind of global shock?

GILL: You know, we are still tallying our numbers, David. But I think that based on COVID responses, initially we expected poverty to go up by about 100 million over these, I think. And then I think both because of the social safety nets and because of some of the other measures that countries took, I think that if we actually tallied those numbers now or tallied the numbers before the war, before these increases in prices, and so on, it was probably less right. And in part, it was because of exactly these things. I mean, taking social assistance programs and repurposing them, expanding social protection and so on.

Of course, the one thing that we worry about, David, even those ones, is that we worry about the growth effects of those policies. So for example, in the case of India, I remember there were some numbers that indicated that labor force participation of women really went down a lot. And it hasn't been coming up. So you have to worry about those things, too. And that's where the point that you made about policy advice is very important because you want to make sure that you actually use these programs well.

You know, the other thing, David, is that there's always this tendency that when you a shock in world markets that reduces the supply of food and food grains, you start to think about, oh, well, you know, we should become self-sufficient in foods and food grains. And we find that that will only take you a very small part of the way, you would still have to depend on trade and so on.

But you also know that it makes sense to expect that, you know, sometimes you get disruptions in trade and you get disruptions in the flows of these goods, even when they aren't export bans and things like that. We always ask countries to sort of plan, so one of the things that these countries can do that when commodity prices fall, when they become more abundant and so on, to build buffers. Right. So some countries like Egypt have actually done that. You know. And they will be protected from at least for a few months, you know, and sometimes that's all it takes. So just like we've been telling countries to build fiscal buffers in good times, we are also telling them to build food buffers in good times.

DOLLAR: Indermit, let's end on a positive note about what World Bank and other development agencies, bilateral donors, international community can do to help developing countries get through this crisis. You've touched on it a little bit, but let's pull it together.

GILL: I guess the question is, what should the world do now, right, in terms of big things? There are two types of things, David: first do no harm and then do some good. I think first and foremost, I think it's just logical that we have to find ways to get Russia and Ukraine to make peace. So I'm glad that Turkey is trying to do this and I think others who joined the peacemakers or at least stop banging the war drums.

The second thing I think is keep trade channels as unobstructed as they were before the food grain prices and oil went up. And this is especially the case for food grains and cooking fuels, but it's also the case for oil and gas and coal and things like that. We know that these export restrictions don't help. They invariably boomerang.

I think the third one, we talked about this already, is that don't surprise with sudden monetary moves. I think what the Fed did yesterday was exactly the right way to do things. I think it's very good practice and I hope other central banks do pretty much the same things.

The fourth is to help poor countries in debt distress by expediting their restructuring. So an example is Zambia, David, which has been trying to negotiate a debt restructuring for nearly a year and a half, since November 2020. Sixty percent of its people, 70 percent of their revenues would go to servicing debt if it resumed payments on schedule. Seventy percent. So it needs help and it needs it now. And there are many countries that are that are in similar trouble. And I think that just as we sort of talk about debt restructuring for Ukraine and so on, we should be thinking about all of these other countries that really do need debt relief.

And then fifth and last, I think we have to get real about economic growth in developing countries. We have to stop trying to strong arm them into doing things that might jeopardize growth, especially in these volatile times. We shouldn't be trying to strongarm them into cutting energy powered by fossil fuels, for example. You know, they already know that they have to do this. But if you kill economic growth, David, I think you'd put a sudden stop both to poverty reduction and to climate action. So 20 years back, two guys wrote this really great paper called "Growth Is Good for the Poor." I think now they should get back together and write a paper called "Growth Is Good for the Planet."

DOLLAR: Thank you very much, Indermit, thank you for referring to my paper with Art Cray, but mostly thank you for your really good analysis. So I'm David Dollar. You've been listening to Dollar and Sense podcast and I've been talking to my old friend Indermit Gill from the World Bank, painting a very realistic picture of some of the difficult challenges developing countries faced even before the Ukraine war and then accelerated by the Ukraine war. But some good practical ideas about what countries can do to help themselves and how the World Bank and others can help them. So thank you very much for joining the show, Indermit.

GILL: Thank you, David. It was a pleasure. Thank you very much.

DOLLAR: Thank you all for listening. We release new episodes of Dollar and Sense every other week. So if you haven't already, follow us wherever you get your podcasts and stay tuned. It's made possible by support from producer Fred Dews, audio engineer Colin Cruickshank and other Brookings colleagues. If you have questions about the show or episode suggestions, you can email us at podcasts@Brookings.edu.

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Until next time, I'm David Dollar and this has been Dollar and Sense.