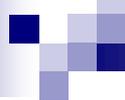


Impact of Financial Crises on Poverty: an empirical approach

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Introduction

- Main idea behind the paper
- What the paper does and what it does not
 - It is a cross-country study of the impact of financial (banking, currency and sovereign debt) crises on poverty;
 - It does not analyse the causes of financial distress.

Overview of the existing literature

■ Cross-country studies

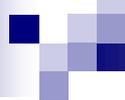
- Baldacci et al. (2002); Honohan (banking crisis and inequality)

■ Individual country studies

- Latin American crises (Lustig (2000), Lustig (2002), World Bank (2000), World Bank (2003))
- Asian crises (Indonesia (Suryahadi and Sumarto (2003)) , Malaysia (Zin(2002)), Thailand (Natenuj(2002))
- Russian crisis (Ravallion and Lokshin (2000), Skoufias (2006), Lokshin and Yemtsov (2005), Gerry and Li (2007))

Main channels of influence – short run

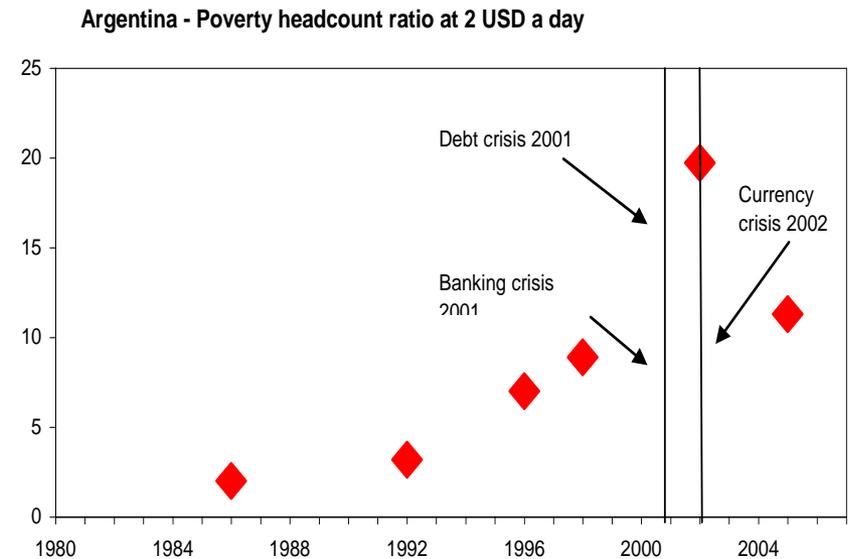
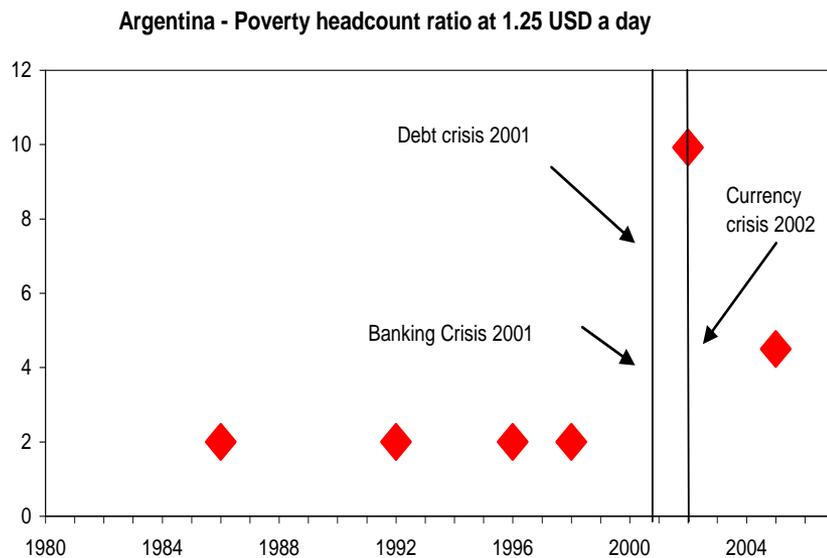
- Slump in economic activity;
- Relative price changes;
- Decrease in earnings and labour market implications;
- Fiscal retrenchment – decrease of funds earmarked for health, education, social safety spending;
- Financial channel.



Main channels of influence – medium and long run

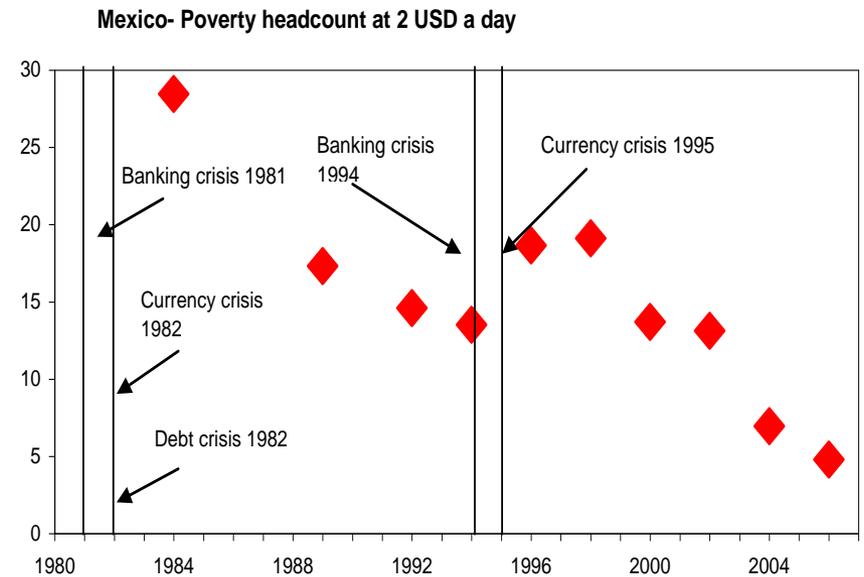
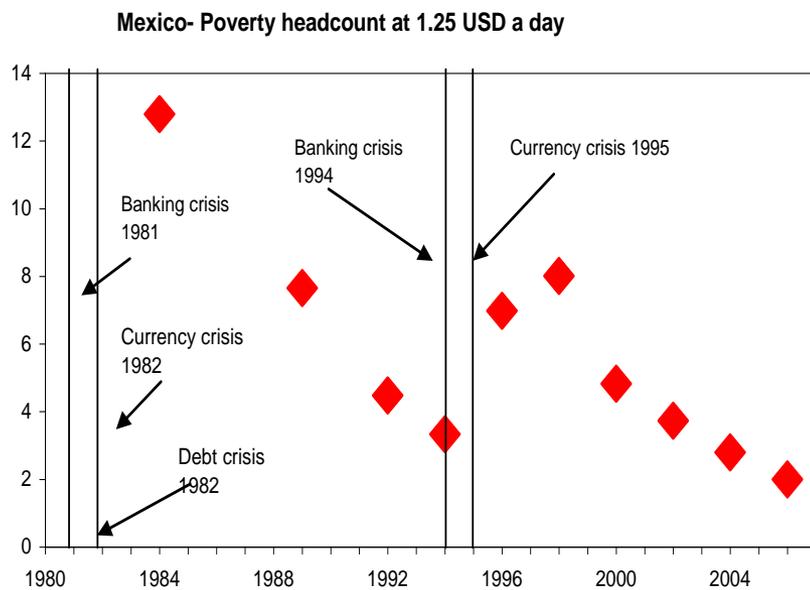
- Financial crises could not only exacerbate the current poverty levels, but they could also hinder future prospects for emerging out of poverty;
- Lustig and the examples of the Mexican financial crisis.

Basic empirical evidence



Source: World Development Indicators (WDI) and Laeven and Valencia (2008).

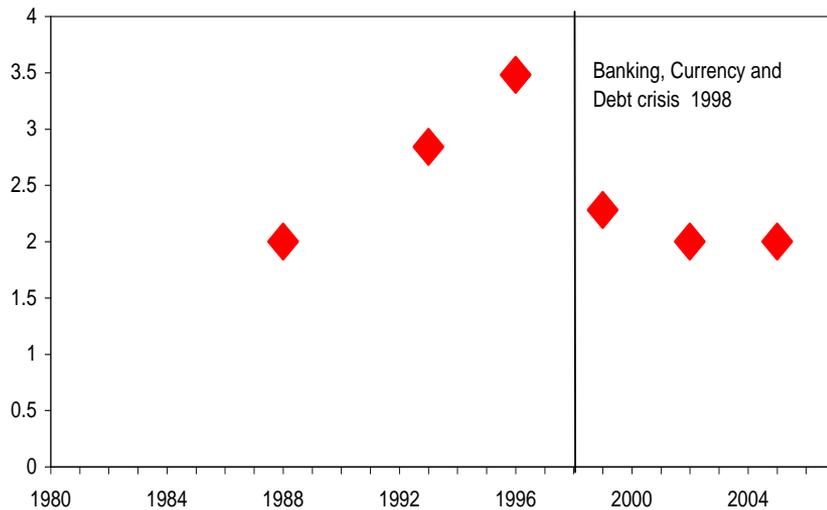
Basic empirical evidence (2)



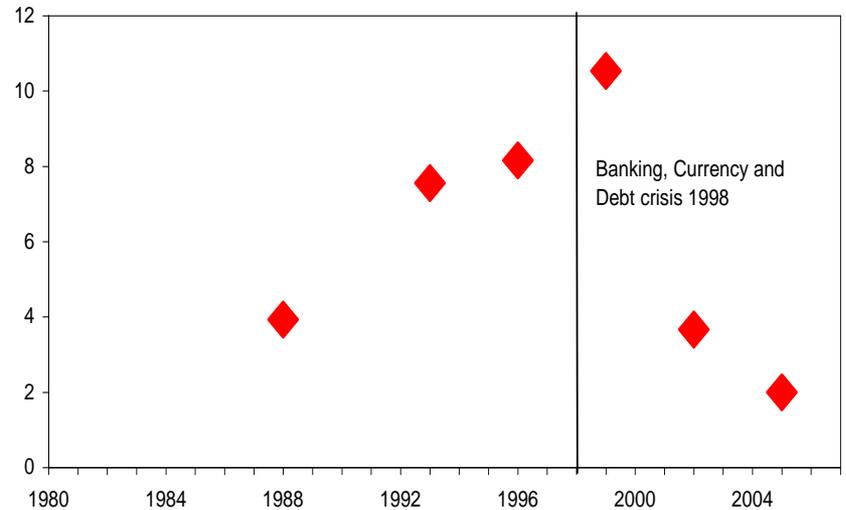
Source: World Development Indicators (WDI) and Laeven and Valencia (2008).

Basic empirical evidence (3)

Russia- Poverty headcount at 1.25 a day



Russia- Poverty headcount at 2 USD a day



Source: World Development Indicators (WDI) and Laeven and Valencia (2008).

Model, data and estimation method

- Model

Poverty measure $_{i,t} = \alpha + \beta \text{Crisis variable }_{i,t} + \gamma \text{Crisis variable }_{i,t-1} + \delta \text{Crisis variable }_{i,t-2} + \zeta X_{i,t} + \text{error term}$

- Data

- Data on poverty (poverty headcount ratio, poverty gap - WDI);
- Data on currency, banking and sovereign debt crises – Laeven and Valencia (2008);
- Control variables (World Development Indicators).

- Estimation Method

- Fixed effects with robust standard errors

Descriptive statistics

- Number of crises
 - 96 banking crises
 - 147 currency crises
 - 52 sovereign debt crises
 - 13 twin (banking and currency) crises
 - 10 twin (banking and debt) crises
 - 15 twin (currency and debt) crises
 - 7 triple (banking, currency and debt) crises

Summary of Observations

<i>Variable</i>	<i>Number of Observations</i>	<i>Mean</i>	<i>Standard Deviation</i>	<i>Minimum</i>	<i>Maximum</i>
Poverty headcount ratio at 1.25 USD a day	477	21.1758	23.5739	2.0000	92.5500
Poverty gap at 1.25 USD a day	479	8.1947	11.3260	0.5000	63.3400
Poverty headcount ratio at 2 USD a day	479	34.7132	29.9811	2.0000	98.4400
Poverty gap at 2 USD a day	477	15.5736	17.0198	0.5000	75.6300
Log of GDP per capita PPP	464	8.1837	0.9330	5.7771	10.0222
Openness	460	73.9253	39.4148	13.0536	254.6059
Polity2	460	3.3435	6.1915	-9.0000	10.0000
Constraints on the executive	460	3.1652	12.2438	-88.0000	7.0000
Inflation	436	63.1853	413.2367	-4.4756	7481.6780
Government expenditure	454	14.0443	5.0960	2.2096	31.8194



Results - interpretation

- Currency crises – strong and robust impact on the poverty headcount ratio and poverty gap;
- Banking crises – associated with higher depth of poverty but they do not seem to matter for the incidence of poverty;
- Banking crises, to the extent that they are significant at all, tend to be ephemeral in nature;
- Sovereign debt crises – insignificant;
- Results robust to the inclusion of standard control variables (level of development, trade openness, institutional development, inflation and government spending).

Robustness checks

- New dummy variables created to capture the occurrence of double and triple crises
 - Results for double crises positive and significant, while triple crises insignificant
- Difference-in-difference estimation
 - Currency crises coefficient positive and highly significant
 - Banking crises coefficient significant only vis-à-vis poverty gap
 - Debt crises coefficient insignificant
- Poolability of series – exercise conducted on sub-samples based on geography (AFR, ECA, EAP, LAC, MENA and SAR) as well as income (low, lower middle and upper middle income countries).
- Magnitude of crises
 - New index constructed to capture the impact of currency, banking and debt crises
 - Results broadly confirmed. Some scant evidence that debt crises are associated with higher poverty rates.

Further steps

- Complement the findings with individual case studies in order to understand the impact of the crises on micro level;
- Test the model using alternative datasets on poverty and financial crises;
- In a dataset with more data on poverty experiment with an autoregressive term (in order to capture persistence of poverty);
- The implications of the current crisis (for example, there has been an increase in subsistence poverty in Russia by 7 million people. Also, a recent World Bank publication mentioned that the recent financial crisis will throw about 35 million people in ECA region back to poverty).