

The financial crisis impact on human development



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The current global financial crisis has shown the high level of economic integration across the nations all over the world and the costs of living in such a globalized world. In the present context, the human well-being in both rich and poor countries has been affected and the human development could suffer a downturn. This essay features the close relation between the financial crisis, the international aid and the human development, explaining the crisis effects in people's lives, focusing essentially on the developing countries. It aims to understand critically the way in which international crisis can negatively influence the human development and the connection between crisis and development practice – aid for development, depending on the aid flows from donor countries. Concerning the developing countries, in particular, surely the most vulnerables to external shocks, aid may be most clearly justified in today's international crisis environment. In contrast, what could happen is that aid should fall in coming years because all donor countries are being hit hard by the current global recession. So, the developing countries will face a great challenge to their own development processes and the well-being of their population in the years to come. This challenge probably won't be well addressed without the international cooperation – international aid and the country's right measures and policies. Our analysis will be concerned with relating the financial crisis and the quality of life in hard times, emphasizing the developing countries situation.

Financial crisis, economic recession and aid for development

The 2008 global financial crisis, which began in the developed countries, can affect negatively the Official Development Assistance (ODA), expecting that aid could fall by a significant amount in the coming years. It is so different from the past crisis because of its impact in the ODA flows. Let's take into account one of the recent past crisis: the East Asian financial crisis of 1997-98. Like most of the recent past crisis (for example, the Mexico 1994-95 crisis), it affected mainly the developing world, in that case the East Asian region. So, the developed countries provided loans and grants to the crisis-afflicted countries. In a different way, the current global recession began in the wealthy

countries and affected enormously their banking and financial sectors. The outcomes of a 2009 research, from Human Development and Public Services Team, appointed that aid flows from crisis-affected countries fall by an average of 20 to 25 percent. Even worse, this trend will continue 10 years after the banking crisis hits¹.

The world economy is suffering its severest downturn since the Great Depression of the 1930s. It was beginning as a subprime market crisis, in USA, which initially affected the banking sector of USA and United Kingdom. Perhaps the biggest particularity of this crisis was its origin in the first world economy, spreading among the rich countries (donor community). As one can imagine, its direct impact on aid for development is particularly high. That is to say, aid has been suffering a substantial reduction because, unlike most recent past crisis, the global recession affected the donor country economies: incomes fall, the banking sector is hardly affected and the fiscal cost of this crisis is very high. In time of global economy slowdown, there is obvious that developing countries suffer more than the developed ones. Poor countries, mainly Least Developed Countries, cannot address their own economic and social problems and alone overcome this crisis. International cooperation, more than ever, is needed. For we underscore the Millennium Development Goals (MDG) Gap Task Force Report 2009 consideration: “Strengthening global partnerships by delivering on all commitments in the areas of aid, trade, debt relief and access to affordable medicines and new technologies is critical in order to prevent the economic crisis from turning into a development crisis”². Both to fulfill and to protect hard-won progress towards the MDG, the donor community must commit with their promises from Monterrey (2002), providing 0.7% of the gross national income (GNI) to ODA, to Gleneagles, by increasing the ODA to higher levels, especially those for Africa³.

¹ Hai-Anh Dang, *et al*, “International Aid and Financial Crisis in Donor Countries”, Human Development and Public Services Team, Policy Research Working Paper 5162, December 2009.

² United Nations, *MDG GAP Task Force Report 2009: Strengthening the Global Partnership for Development in a Time of Crisis*, United Nations Publications, p. vii.

³ *Idem*, pp. 3-4.

According to the MDG Gap Task force Report 2009, from the United Nations, ODA increased since the adoption of the United Nations Millennium Declaration, with a setback in 2007 and its highest level in real terms in 2008⁴. Since then, ODA decreased because of the current international crisis. International responses, such as the decision taken by the Group of Twenty to make massive additional amounts of international liquidity available to countries in crisis, play a vital role in tackling the crisis. Adopting strong and concerted measures to reform international financial system seem to be critical to achieve the stability of the world economy and prevent future shocks. However, much more is needed; more action is necessary to avoid a development crisis in the developing countries. Future flows of ODA to poor countries are at risk, just when they are important to counter the effects of the global slowdown.

The global recession pressures donor countries to cut their aid budgets. Thus, that may limit the resources to developing countries, which in turn will face further difficulties in dealing with the crisis and providing for the needs of their people. The eight MDGs, which stay at the center of global development agenda, are made up by some targets – supposed to be the first step in constructing a better world and advancing the development process. But the economic crisis threatens the efforts to achieve the MDG in the developing world. 2009 MDG report stated slowing pace of progress towards the MDG, notably the eradication of extreme poverty⁵. There had been grate and continuous reduction of people living in extreme poverty (less than 1.25 dollar *per* day) between 1990 and 2007, in terms of percentage. However, for 2009, the same report predicted more 55 to 90 million people leaving in extreme poverty than estimated before the crisis.

The way forward looks troubling, for the crisis future repercussions aren't expected at all. Nevertheless, it seems very hard to achieve fully the MDG in the countdown to 2015; the crisis is making things much more complicated. Time is running short. In a broad sense, “the crisis attacked two critical drivers of progress toward the MDGs: faster growth and better service delivery. The impact was undoubtedly negative because of the severity of the recession and the tendency for indicators of human development to

⁴ *Idem*, p. 4.

⁵ Instituto de Estudos para o Desenvolvimento, *Relatório sobre os Objectivos de Desenvolvimento do Milénio 2009*, Nações Unidas, pp. 2-7.

decline much more in bad times than they improve in good times”⁶. Lower rates of Foreign Direct Investment and less amounts of aid for development can impinge several reductions in financial resources available to development countries. We must consider the high cost of the financial crisis. The economic and social impact of the downturn can potentially deteriorate the living conditions in the developing world: we will certainly see significant harm, health, nutrition, and poverty indicators, especially in low-income countries. Hence, aid budgets cuts from donor countries have major influence in the development process; its impacts go well beyond the economic functioning and performance in poor countries. It’s important that we assess the question in terms of people lives it affects. To be most precise, the progress made in each targets of the MDGs, for example, how many people will remain in extreme poverty, how many will remain hungry and how many more infants will die.

The developing countries are unprepared to cope with the global crisis. “The challenge facing developing countries is how, with fewer resources, to pursue policies that can protect or expand critical expenditures, including on social safety nets, human development and critical infrastructure”⁷. International coordinated actions must be carried on to prevent the economic and financial crisis to reverse the hard-won gains in development over the last two decades. No single country could solve all the problems related to the global slowdown, for some reasons reiterated above. Moreover, we can point out the high fiscal costs of crisis and the debt hangover in the post-crisis periods. Within the present crisis context, the world is facing, at the same time, many problems – environmental problems, poverty, hungry and high food prices – what suggest that is relevant the searching of a “new deal”⁸ to bring about a global sustainable development. All these challenges are global concerns. The international community must work together to find out common answers.

⁶ World Bank and International Monetary Fund, *Global Monitoring Report 2010: the MDGs after the Crisis*, Washington DC, World Bank, p. 2.

⁷ World Bank, *Swimming Against the Tide: how developing countries are coping with the global crisis*, United Kingdom, 2009, p. 1.

⁸ Instituto de Estudos para o Desenvolvimento, *World Economic and Social Survey 2009: Promover o Desenvolvimento para Salvar o Planeta* (versão portuguesa), United Nations publications, pp. 21-25.

A recent research by a team of Overseas Development Institute confirmed that the developing countries were hardly affected by the crisis and its worse effects were yet to come⁹. It also showed that the global recession had negative impacts in the transmission mechanisms (trade, private capital flows, remittances, aid), and the effects varied by country. The entire economy was affected and the economic growth in developing countries has been losing pace, because of the global economic contraction.

ODA flows and human development

The global economic and financial crisis has severe impacts on human development. The decline of the global industrial production and the global GDP, along with the world trade largest decline, has dire consequences to the world economic activities. Then, all the world development dynamic will suffer the sound effects of the crisis. As the global contraction has affected both advanced countries as developing ones, has we have already attested in this paper, the task to find resources to boost the development process around the world is a big challenge.

The decline of the ODA flows, as a result of the world recession, doesn't help to advance the development process. It will occur strictly the opposite: the reverse of the past gains. Recent findings from a World Bank research team, using a model to simulate the impacts of the crisis in developing countries, predicted "some increases in the level and depth of poverty as a result of the crisis in all three countries [Philippines, Bangladesh and Mexico], with the extent of the increase largely depending on the size of the macroeconomic impact in the country"¹⁰.

Many factors affect the level of poverty in the developing countries, but ODA flows play an important role, especially in the poorest countries – with little resources to provide the basic services to their people. In this case, human development depends on the ODA flows, for the development process will not advance without foreign

⁹ Dirk Willem te Velde, *et al*, *The global financial crisis and developing countries*, Overseas Development Institute, Working Paper 316, Março 2010, pp. 2-10.

¹⁰ Bilal habib, *et al*, *The Impact of the Financial Crisis on Poverty and Income Distribution: insights from simulations in selected countries*, Washington D.C., World Bank, 2010, p. 1.

assistance. For example, the High Indebted Poor Countries cannot move ahead in the development course without debt relief.

The international community, specially the development community, is deeply concerned about the world financial and economic crisis adverse impact on development. This crisis spread throughout the global economy, causing severe social, political and economic impacts. So, donor countries must deal with internal problems caused by the crisis; the resources available to ODA are fewer than before the recession. The Heads of State and Government and High Representatives, met in New York from 24 to 30 June 2009 for the Conference on the World Financial and Economic Crisis and its Impact on Development agreed on some considerations. One of them is that “this crisis is negatively affecting all countries, particularly developing countries, and threatening the livelihoods, well-being and development opportunities of millions of people”¹¹.

The economy and social progress achieved in recent years is now being threatened in developing countries, particularly least developed countries. The Heads of State and Government and High Representatives, met in New York, concluded that their “endeavours must be guided by the need to address the human costs of the crisis: an increase in the already unacceptable number of poor and vulnerable, particularly women and children, who suffer and die of hunger, malnutrition and preventable or curable disease; a rise in unemployment, the reduction in access to education and health services; and current inadequacy of social protection in many countries”¹². These are the human costs of the crisis, which show that the global recession doesn’t cause simply economic damage, but social and human problems. Measuring the crisis effects on human lives is more than evaluate its impact on economic activities; it urges a different analysis: in terms of human needs and human development. As an example, “once children are taken out of school, future human capital is permanently lowered”¹³. Fewer

¹¹ United Nations, *Outcome of the Conference on the World Financial and Economic Crisis and Its Impact on Development* (New York, 24-30 June 2009), 2009, p. 5.

¹² *Idem*, p. 6.

¹³ World Bank and International Monetary Fund, *Global Monitoring Report 2010: the MDGs after the Crisis*, p. 3.

resources available to poor countries means less investment in public services, for example, education and health services.

The financial and economic crisis has affected all countries: However, it is important to take into account the varying impacts and challenges of the crisis on the different categories of developing countries. For countries in special situations, the crisis presents unique challenges to their efforts to achieve their national development goals. In this category we include countries in different circumstances: least developed countries, small islands developing states and landlocked developing countries, African countries and countries emerging from conflict¹⁴. We must also consider the specific development challenges of middle-income countries and low-income countries with vulnerable and poor populations. Due to this wide range of crisis impacts in different countries, the responses must be selected and targeted, just as the countries gathered in New York concluded:

*“Our collective responses to this crisis must be made with sensitivity to the specific needs of these different categories of developing countries, which include trade and market access, access to adequate financing and concessionary financing, capacity-building, strengthened support for sustainable development, financial and technical assistance, debt sustainability, trade facilitation measures, infrastructure development, peace and security, the Millennium Development Goals, and our previous international development commitments”*¹⁵.

The crisis highlighted long-standing systemic fragilities and imbalances and has also led to an intensification of efforts to reform and strengthen the international financial system. It is important to ensure that actions and responses to the crisis are commensurate with its scale, depth and urgency, adequately financed, promptly implemented and appropriately coordinated internationally. Overall, international cooperation is necessary to solve international problems of an economic, social, or cultural character.

¹⁴ United Nations, *Outcome of the Conference on the World Financial and Economic Crisis and Its Impact on Development*, p. 7.

¹⁵ *Idem, ibidem.*

“ODA is the cornerstone of the global partnership for development and is playing a critical role in the progress that is being made towards the achievement of the MDGs. Nevertheless, there continues to be a gap between commitments and delivery of ODA, most notably in relation to the United Nations target but also with respect to other more recent but less ambitious quantitative commitments”¹⁶. The international crisis has severely disrupted economic growth worldwide and is setting back progress towards achievement of the MDGs and the other internationally agreed developments goals. Donor countries reduce the volume of ODA and the multilateral ODA has equally reduced. In this way, the reduction in ODA flows have significant impact in human development, for some reasons: the volume of ODA allocated to basic social services, such as health and education, and to reduce poverty will be much less.

In practice, ODA flows are often allocated to countries whose situations aren't the worst, in expense of others where people live in extreme poverty¹⁷. Let's take into account one simple example. Middle-income countries often receive more aid than the least developed countries, for reasons related to the donor countries interests: political, strategic or economic interests. For example, many donor countries choose a middle-income country than a poorest country to offer its development assistance, because the first offer better conditions of returns than the last-one. Thus, the donor community must pay much more attention to the poor countries – the helpless, which deserve more assistance to provide for the basic needs of their people. At the same time, this crisis opens huge opportunities: to assist the most vulnerable people and to steer the global economy in a direction that is more equitable and sustainable¹⁸.

We have already reiterated the relevance of the ODA flows to the human development. However, many others factors contribute to the development process. The global crisis has not only impacted the ODA flows trends, but the entire global economy. Then, we have to examine the crisis impacts on human development, in order to address the real human situations in the developing countries.

¹⁶ United Nations, *MDG GAP Task Force Report 2009: Strengthening the Global Partnership for Development in a Time of Crisis*, pp. 15-16.

¹⁷ *Idem*, pp. 6-8.

¹⁸ Instituto de Estudos para o Desenvolvimento, *World Economic and Social Survey 2009: Promover o Desenvolvimento para Salvar o Planeta* (versão portuguesa), pp. 3-8.

Crisis impacts in the developing countries

Even though many developing countries were not directly exposed to the financial turmoil, they are being hurt through a variety of channels, including collapsing trade and commodity prices, capital flows reversals, higher costs of borrowing, declining remittance incomes and strains on official development assistance. The economic crisis increases poverty worldwide. “The principal transmission channels will be via employment and wage effects as well as declining remittance flows. While labor markets in the developing world will take a while to experience the full effects on the on-going global contraction, there is already clear evidence of the fall-out”¹⁹. There is a potential for a slowdown in progress towards the MDGs: especially child and maternal mortality but also primary school completion, nutrition, and sanitation – were unlikely to be met.

The level of poverty will deepen, and also the number of people living in extreme poverty. Recent research findings suggests “a strong positive (though not linear) correlation between gross domestic product (GDP) per capita and human development indicators: economic growth helps to generate the resources needed for improved human development, and improved human development enables higher potential growth”²⁰. With the world recession and the global GDP decline, it’s normal that human development indicators experience a setback. Evidence suggests that growth collapses are costly for human development outcomes, as they deteriorate more quickly during growth decelerations than they improve during growth accelerations.

The impacts of economic fluctuations on human development outcomes vary across countries and periods. Improvements in health and education outcomes are common in rich countries, while for poor countries setbacks are the norm. We must know that the impacts of the crisis on human development go well beyond the income. The financial and economic crisis originates income poverty, but also human poverty. And if we understand the crisis effects in this broader way, we will certainly have a different

¹⁹ World Bank, *Swimming Against the Tide: how developing countries are coping with the global crisis*, p. 9.

²⁰ Pedro Conceição, Namsuk Kim and Yanchun Zhang, *Economic Shocks and Human Development: a review of empirical findings*, UNDP/ODS Working Paper, New York, 2009, p. 2.

perspective. Economic crises may have a permanent effect on poverty if the crises deplete the assets and hurt the human capital of affected people, especially the poor. At the same time, economic crises may deteriorate the human conditions, that is, the living conditions of human beings in the developing countries: health, education, nutrition.etc. With scarce resources, developing countries tend to invest more in economic infrastructure than in basic services provision, mainly education and health care. Economic shocks potentially reduce labor demand, which can result both in a drop in real wages and/or loss of employment. Not surprisingly, the well-being of people will be highly affected.

The report on the World Social Situation 2010, from United Nation Economic and Social Affairs, suggests a new way to rethink poverty²¹ – including not just the income poverty, but also human poverty. It proposes a new way to analyze poverty and its consequences: examining its effects in people lives and looking at poverty as a principal cause of hunger and undernourishment. To be more precise, this report considers poverty in a single way. “Extreme poverty does not entail just having unsatisfied material needs or being undernourished. It is often accompanied by a degrading state of powerlessness. Even in democratic and relatively well-governed countries, poor people have to accept daily humiliations without protest. Often, they cannot provide for their children and have a strong sense of shame and failure”²².

In sum, it describes the human face of poverty and takes into account the multidimensional nature of poverty. Human poverty is the right concept to embody this poverty understanding, for human lives are at the center of its definition. As Sen has reiterated in one of his most important works, poverty is a multidimensional phenomenon that extends beyond the economic arena to encompass factors such as the inability to participate in social and political life; is the deprivation of one’s ability to live as a free and dignified human being with the full potential to achieve one’s desired goals in life²³.

²¹ United Nations Economic and Social Affairs, *Report on the world Social Situation 2010: rethinking poverty*, United Nations, New York, pp. 1-5.

²² *Idem*, p. 2.

²³ Amartya Sen, *Development as Freedom*, New York, Knopf, 1999.

If we look at poverty in the way of the concept of human poverty we will be aware of the real and potential crisis adverse impacts in people lives. Poverty does not entail just having unsatisfied material needs or being undernourished. It's very important to address several key dimensions of extreme poverty, including income poverty, hunger, disease, lack of shelter, and exclusion.

When people receive lower level of income, it would lead to undernourishment, and not only. People with lower income can be deprived to satisfy its basic needs and to lead a life that they value. A relative decline of growth can add many people to the rank of poor in developing countries. It could mean many children out of school and probably less funds to sustain the daily life of the family. Many children taken out of school affect the human capital of the future generations, i. e, the human capital could decline, having an influence over the development process of the community and the country as a whole. So, the crisis impacts are extremely difficult to predict at all. However, as we have noting above, the impacts are enormous and it could affect adversely the human well-being and the development process in developing countries.

The global financial and economic crisis and its adverse impacts in human development stress another question with unquestionable relevance: the role of government and market in the development process. The global recession has also the effect of prompting a little more skepticism towards the economic beliefs that have constituted the mainstream view about public economic strategy for the past three decades. As a recent research article stated “the Washington Consensus came to be extended over the 1990s to include a ‘good governance’ agenda for strengthening the capacity of the state to provide certain public goods (though not for strengthening its capacity to act as the coordination point for a national development project)”²⁴.

The Washington Consensus and the neoliberalism have at their core the preposition that government failure is generally worse than market failure, which support the default policy setting of ‘more free market’ in most countries most of the time. What the current financial and economic crisis have shown, since it began in 2008, is the

²⁴ Robert Wade, “After the Crisis: Industrial Policy and the Developmental State in Low-Income Countries”, *Global Policy*, Volume 1, Issue 2, May 2010, p. 157.

opposite: market failure have worse effects in the economy and, furthermore, in people lives.

One of the pernicious effects of the current crisis – poverty – is also a violation of elementary absolute standards of social justice. Social justice requires that everyone should have a minimal standard of living, and that people living in poverty should receive assistance when they lack the means to live lives that affirm their human worth and dignity. The entity which has always assumed itself as an actor to guarantee social justice – the state – must play a relevant role in the present crisis context.

The development concept we have emphasized in this paper (human development) put the people at the center of development, advocating that the ultimate goal of development is both to improve living conditions and to empower people to participate fully in the economic, social and political spheres. So, the role of the state in this crisis must be ensure that people stay at the center of development process and every measures to overcome the present crisis are taken in this basis. The crisis that began in 2008 “is forcing liberal market states like the US and the UK to overcome their long aversion to taking responsibility for structural outcomes and lead the effort to save their plunging economies”²⁵. On the other side, the same crisis should motivate developing countries to adopt measures to protect people jobs and provide for the needs of the poorest people.

Global recession and human development relations

The 2008 financial and economic crisis disrupted and no country measure or international coordinated actions avoided its damage to the world economy. Davies argues that the origin of this crisis is in global imbalances and credit expansion, i. e, lack of global financial regulation and unrestricted credit concession²⁶. Different parts of the financial system failed to identify or respond successfully to the macro trends that led to the crisis. No single country has got success in dealing with this crisis, not only

²⁵ *Idem*, p. 159.

²⁶ Howard Davies, “Global Financial Regulation after the Credit Crisis”, *Global Policy*, Volume 1, Issue 2, May 2010, pp. 185-186.

because of its adverse impacts but also because of its deepest origin in systemic failure of the world financial markets. It is clear that there are fundamental problems in the world of international financial regulation, problems that cannot be resolved by bolting yet another committee or working group on to the existing structures.

As a 2009 United Nations Conference on Trade and Development Report advocates, the solution is more regulation, not less, arguing that systemic failures in global economy only have multilateral remedies²⁷. As the same report put it, “the global financial crisis arose amidst the neglect of international governance – the failure of the international community to give the globalized economy credible global rules”²⁸. Countries and international financial institutions learned some lessons from the global crisis: never to put blind faith in the efficiency of financial markets and strength international cooperation – improve international mechanisms to correct global imbalances and institutionalize an international monetary system.

The vulnerability of the financial system which is in the origin of the crisis is related with the slowdown in the human development progress. That is, economic and financial vulnerabilities stimulate or increase human vulnerabilities, as we have trying to argue throughout this article. To better understanding these ideas, one have to know what we call vulnerabilities in human sense. “The concept of vulnerability captures the likelihood that people will fall into poverty owing to shocks to the economic system or personal mishaps. Vulnerability is thus a reflection of economic insecurity”²⁹. In our perspective, vulnerability reflects also other kinds of insecurity, not only economic insecurity. We can refer, for example, job insecurity, food insecurity, and so on.

The Development Co-operation 2010 report, from the OECD Development Assistance Committee, noted that the global financial and economic crisis has opened a great opportunity to stimulate the development in the developing countries³⁰. In fact, investing in the developing countries, at the present, offers many advantages: it boosts

²⁷ UNCTAD, *The Global Economic Crisis: systemic failures and multilateral remedies*, United Nations, New York, 2009, pp. 1-9.

²⁸ *Idem*, p. 8.

²⁹ United Nations Economic and Social Affairs, *Report on the world Social Situation 2010: rethinking poverty*, p. 9.

³⁰ Eckhard Deutscher, *Development Co-operation report 2010*, OECD, pp.3-7.

the development process in many poor countries; it improves the lives conditions of many dispossessed around the world; and with more assistance to development, well managed, the world could become a more secure place to live in.

Conclusions

Throughout this paper we tried to argue in which way the world financial and economic crisis have impacted the human development processes in the developing countries and how its impacts could affect human lives. We hope we have accomplished our purpose in a modest fashion. Due to difficulties to use real statistics, and because of the information diversity, we limited our analyses to the real and potential impacts of the crisis, not taking in account a particular group of countries. To conclude our analyses, three main considerations must be pointed out.

First, the current global recession has affected both developed countries as developing ones, but its origin was in the developed countries. Unlike the majority of the past crisis, it began in the industrialized countries, concretely the two most important players in the world financial and economic markets: US and UK.

Second, the crisis spread across the world because of the high level of international economic integration, from developed countries to developing countries (and even to the least developed countries). Developing countries felt its effect through aid flows and private flows (Foreign Direct Investment and other flows). There is a clear relation between global crisis, ODA flows and human development: donor countries reduce its aid budget because they were hit hard by the crisis. So, the developing countries, especially the poorest ones, with little resources, face more challenges to satisfy their people basic needs.

Finally, the impacts of the crisis go well beyond the economic dimension; it affects enormously the lives of the people in developing countries. One job lost, one children taken out of school, one family fallen into the extreme poverty, a child undernourished have real impacts in the development process in the long-term. The human development process depends on people ability to lead their own lives and participate actively in the life of their communities and countries.

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