



Understanding Children's Work
An Inter-Agency Research Cooperation Project

Understanding Children's Work Programme Working Paper Series, September 2009

Child labour and the global financial crisis: an issues paper

September 2009

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Working Paper

September 2009

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As part of broader efforts towards durable solutions to child labor, the International Labour Organization (ILO), the United Nations Children's Fund (UNICEF), and the World Bank initiated the interagency Understanding Children's Work (UCW) programme in December 2000. The programme is guided by the Oslo Agenda for Action, which laid out the priorities for the international community in the fight against child labor. Through a variety of data collection, research, and assessment activities, the UCW programme is broadly directed toward improving understanding of child labor, its causes and effects, how it can be measured, and effective policies for addressing it. For further information, see the programme website at www.ucw-project.org.

This paper is part of the research carried out within UCW (Understanding Children's Work), a joint ILO, World Bank and UNICEF programme. The views expressed here are those of the authors' and should not be attributed to the ILO, the World Bank, UNICEF or any of these agencies' member countries.

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ABSTRACT

Recent years have seen a sustained progress in the fight against child labour. The current global economic and financial crisis can potentially reverse the positive trends observed in several countries and further aggravate the problem in regions such as Sub Saharan Africa where the phenomenon of child labour has been particularly resistant to policy and programme measures.

In this working paper we try to identify the main channels through which the global economic and financial crisis is likely to affect child labour and schooling decisions of households. We will briefly discuss what we know and what we would need to know better in order to design adequate mitigation policies. As underlined above, the outcomes will largely depend on policy choices; therefore it is urgent to identify the main knowledge gaps and to establish a solid monitoring system.

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1. INTRODUCTION

1. Recent years have seen a sustained progress in the fight against child labour. The current global economic and financial crisis can potentially reverse the positive trends observed in several countries and further aggravate the problem in regions such as Sub Saharan Africa where the phenomenon of child labour has been particularly resistant to policy and programme measures.

2. The level of global economic integration and the current real and financial crisis are likely to produce a large and possibly lasting worldwide adverse impact. It is uncertain, however, what the size of the impact will be, how long it will last and how it would affect different groups of population. The final outcome of the crisis will in any case be largely determined by the policies adopted. Hence it is essential to identify the possible impact of the crisis in order to design the most appropriate intervention mechanisms and instruments.

3. In this working paper we try to identify the main channels through which the global economic and financial crisis is likely to affect child labour and schooling decisions of households. We will briefly discuss what we know and what we would need to know better in order to design adequate mitigation policies. As underlined above, the outcomes will largely depend on policy choices; therefore it is urgent to identify the main knowledge gaps and to establish a solid monitoring system.

4. There are several channels through which the evolution and dynamic of the current crisis can influence household decisions regarding children's schooling and work. Albeit most of these channels are interrelated, we will discuss them separately in order to simplify the discussion of an already complex matter. Five key areas are being elaborated on in this context: (i) the reduction (or reduced growth) of living standards; (ii) access to credit markets; (iii) migration and remittances flows; (iv) public transfers and international aid flows; and (v) the possibility of an increased informalization of developing economies.

2. REDUCTION IN LIVING STANDARDS

5. Progress in reducing income poverty had put the MDG for poverty reduction within reach at the global level. Nevertheless, developing countries are now being affected by an economic and financial crisis, at a time when many of them are still coping with the impact of the earlier food crisis.

6. Growth prospects for developing countries have been revised downward by a magnitude similar to that for advanced economies. Developing countries are forecasted to see growth fall from 5.8 percent in 2008 to 2.1 in 2009, a drop of 3.7 percentage points (World Bank, 2009a).

The current crisis is projected to result in 46 million more people living in poverty in 2009 (World Bank, 2009b).

7. Evidence from previous economic and financial crises indicates an important link between economic downturns and rising income poverty (Table 1). For instance, in most countries of East Asia poverty rose as a result of the financial crisis of the late 1990s: it reached almost 50 percent of the population in Indonesia and urban poverty doubled in the Republic of Korea. In Russia the incidence of poverty rose from 22 percent to 33 percent between 1996 and 1998. During every crisis in Latin America and the Caribbean the incidence of poverty increased and several years later it remained higher than it had been before the crisis (World Bank, 2001a).

Table 1. Effect of economic crises on incidence of poverty in selected countries

Country	Before crisis	Year of crisis	After crisis
Argentina (hyperinflation and currency)	25.2 (1987)	47.3 (1989)	33.7 (1990)
Argentina (contagion)	16.8 (1993)	24.8 (1995)	26.0 (1997)
Indonesia (contagion and financial)	11.3 (1996)	18.9 (1998)	11.7 (1999)
Mexico (currency and financial)	36.0 (1994)	... (1995)	43.0 (1996)
Russian Federation (financial)	21.9 (1996)	32.7 (1998)	...
Thailand (currency and financial)	11.4 (1996)	12.9 (1998)

Notes: Based on national poverty lines and per capita household income except for Indonesia (per capita expenditure), Mexico (household income), and Russia (household expenditure per equivalent adult). Data for Argentina refer to Greater Buenos Aires. For Indonesia poverty estimates before and during the crisis are based on the full SUSENAS (the national socioeconomic survey) conducted in February 1996 and 1999; estimates after the crisis are based on a smaller sample. Figures are not comparable across countries because poverty lines differ.

Source: World Bank, 2001a

8. The reduction in living standards linked to a decline in economic growth has, abstracting from the changes in structure of the labour market discussed later, two different effects on children's schooling and work status. On the one hand, a decrease in household income might force households to send their children to work and/or take them out of school (income effect). On the other hand, worsening labour market conditions, both in terms of lower real wages (or lower returns to family economic activities) and/or fewer employment opportunities might lead to a decrease in returns to work and might induce households to keep children in school (substitution effect).

9. The question of whether the income or the substitution effect dominates depends essentially on the following factors: i) on the ability of the household to cope with the shock (e.g. households with higher incomes or

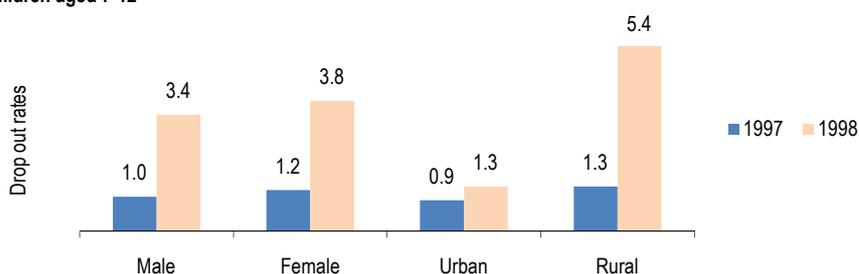
greater access to credit markets might not need to revert to child labour), ii) on the characteristics of production (e.g. in economies with subsistence production or high level of informality it may be easier to employ children), and iii) on the public policies put in place to address the crisis. In what follows, we briefly discuss available evidence on the effects of reduced living standards on children's schooling and involvement in child labour.

2.1 Impact on schooling

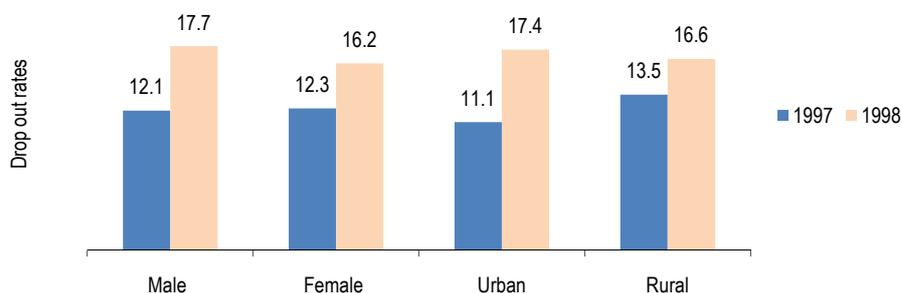
10. Many developing countries have seen dramatic reversals in progress in raising school enrolment during times of economic crisis. In Indonesia, for example, the percentage of children not enrolled in school rose after the 1997 economic and financial crisis. Economic and financial downturns are also found to be associated with a higher proportion of children leaving the schooling system prematurely. Again looking at Indonesia, school drop-outs rose significantly after the 1997 financial shock (Beegle et al., 1999), as shown in Figure 1.

Figure 1. Drop out rates in Indonesia, before and after the 1997 economic crisis

(a) Children aged 7-12



(b) Children aged 13-19



Source: Beegle, Frankenberg and Thomas, 1999

11. Similar effects have been observed during the recession in the early 1980s in Costa Rica (Funkhouser, 1999) and in Mexico (Binder, 1999). Both of these studies show the pervasive effects of macroeconomic

downturns on schooling indicators. In these countries, the negative effect of decreasing income outweighed the positive effect of lower opportunity cost, resulting in worsening secondary school enrollment rates in times of economic downturns.

12. However, evidence from other economic downturns in Latin America (see for example Peru in Schady, 2002 and Mexico in McKenzie, 2003) points to weaker or even marginally positive impact of recession or financial turmoil on education. For instance, during the Central America coffee crisis in 2000-2001, Nicaragua witnessed a progress in primary enrollment rates and a slight decline in child labour. Maluccio (2005) shows that Nicaraguan social safety net programmes played an important role in protecting households' well-being and promoting investment in children's human capital. His findings suggest that households in coffee-growing areas with social safety net programmes in place were better able to protect household expenditures and other outcomes (as indicated by increased enrollment rates, decreased child labour and improved height-for-age) than their counterparts in coffee-growing areas without the programme.

13. The consequences of the crisis are, hence, likely to vary across countries, based on a number of economic and social indicators and different policy responses. It should be also noted that the impact of the crisis on education and child labour seems to be milder in presence of well-functioning social protection schemes.

14. Reduced school enrolment can be the product of non-entrance, delayed school entrance or early school leaving, each with distinct effects on educational attainment. This underscores the fact that attention needs to be given to analyzing and addressing the specific role of economic crisis in preventing and delaying school entry and in children leaving school prematurely.

15. Irregular school attendance can also affect the total time that children spend in school, and hence their educational attainment. However, data on attendance regularity are rarely collected as part of household surveys or government education statistics. The limited evidence from Korea (Moon, Lee et Yoo, 1999) and the Philippines (Knowles, Pernia and Racelis, 1999) indicates that the regularity of school attendance decreases substantially during economic recessions, mainly due to the need for children to help out on the farm to save on labour costs and the need for children to watch over younger siblings while parents work. This implies that the impact of a crisis on human capital accumulation might become more apparent in the medium term since the effect on school performance would take time to manifest itself.

2.2 Impact on children's work

16. There exists an important body of empirical evidence on the effect of economic shocks on children's labour supply in developing countries. This evidence indicates that households in low income countries with little access to credit markets are more likely to reduce children's full time school attendance and send them to work when hit by economic shocks. Households in these instances appear to use child labour as a form of risk coping mechanism, helping to offset sudden losses of income arising from economic shocks.

17. Empirical results from Guatemala, for example, show that households hit by shocks reduce children's full time school attendance, and increase children's work. (Guarcello, Mealli and Rosati, 2009). As shown in Table 2, following a collective shock (earthquakes; floods, fires, etc), children's participation in economic activities increases by 5.5 percentage points. Most of the impact is borne by full time students who start to work without dropping out of school. Individual shocks (loss of employment, bankruptcy, etc.) have a similar overall effect as collective shocks. Child labor participation for households hit by collective shocks is about 5 percentage points higher than average. About two thirds of the children that enter the labor force, however, also continue to attend school. In a similar vein, Guarcello, Kovrova and Rosati (2008), using data from Cambodian villages, find that crop failure increases the probability that a child enters the labour force and drops out from school.

Table 2. Multinomial logit model Marginal effects

	Work only	School only	Work and school	No activities
Collective shock	0.004	-0.020*	0.044**	-0.028**
Individual shock	0.011**	-0.041**	0.039**	-0.009

Notes: **statistically significant at the 1% level. *statistically significant at the 5% level. ‡ statistically significant at the 10% level

The control variables include: the age of the child and its square; a gender dummy; a dummy variable taking value 1 if the child belongs to an indigenous household; the number of the household members; the number of children aged 0-5 in the household and the number of school age children; an interaction term between gender and the presence of young siblings; and a series of dummy variables for the education of the mother and of the father.

Source: Guarcello, Mealli and Rosati, 2009

18. Beegle et al (2003) also show that in Tanzania households respond to transitory income shocks by increasing child labour. For instance, a one standard deviation income shock is associated with a 10 percent increase in the mean hours children spend at work during the reference week. Similar positive effects of aggregate shocks on labour supply of 14-17 year olds are obtained for Argentina during the period of 1998-2002 (Rucci, 2003).¹

¹ In this study, Rucci (2003) uses Brazilian exchange rate fluctuations to instrument household income.

19. Blanco and Valdivia (2006) note that during the economic downturn in Venezuela (2002-2003), the number of children who work increased by almost five percentage points from 2000 to 2003. They show that this increase in the employment rates was driven mainly by the reduction in children in school but not working and by the growth of children combining work and school; overall enrolment rates were unaffected (Table 3).

Table 3. Children aged 10-14 in Venezuela, by activity status and year

	Work only	School only	Work and school	No activities
2000	1.6	91.0	3.2	4.2
2001	1.8	89.8	4.7	3.8
2002	1.8	87.9	6.5	3.8
2003	1.6	87.0	7.5	3.9
2004	1.4	89.0	5.7	3.1

Source: Blanco and Valdivia, 2006

20. Working students who are exhausted by the demands of their work, or whose work schedule leaves them with little time for homework, are less likely to derive educational benefit from their classroom time than their non-working counterparts. Children who perform poorly in the classroom, in turn, are much more likely to leave the school system prematurely (Guarcello, Lyon and Rosati, 2008). This suggests that even in instances such as the one observed in Venezuela, where the initial effect of the economic shock was a rise in working students, there could also be a subsequent impact on drop-outs.

21. Other studies show milder effects of crisis on children's schooling and child labour (Skoufias, 2003). Using large repeated cross-sectional surveys from Brazil over a 20-year period (1977-98), Duryea and Arends-Kuenning (2003) examine the determinants of the decision to work and/or attend school. Controlling for household income and other child and parental characteristics, they find that for 14-16 year old boys in urban Brazil, the reduction in employment opportunities appears to offset the impact of reduction in the household income on children's labour supply. Similarly, in Peru, despite a significant drop in public spending in education, Schady (2002) shows that children were more likely to be enrolled and less likely to be working during the crisis in 1991 than in other years (Table 4).

Table 4. Odd ratios of both attending school and being employed in Peru

Both attending school and being employed	Children aged 6 to 11		Children aged 12 to 17	
	Coefficient	Std. Err	Coefficient	Std. Err
1985/86	4.43**	1.23	3.52**	0.52
1991 (reference category)	---	---	---	---
1992	2.42**	0.72	2.09**	0.32
Pseudo R-squared	0.09		0.07	
N	4 220		4 113	

Notes: **statistically significant at the 1% level. *statistically significant at the 5% level ‡ statistically significant at the 10% level

Standard errors are corrected for heteroskedasticity and clustering. Specification includes strata and gender controls, and a vector of age dummies; variables for the education of both parents (separately), variables for the number of household members under 3, between 3 and 5, between 6 and 8, between 9 and 11, between 12 and 14, and between 15 and 17, as well as a variable for the size of household; the fixed-effects specification.

Source: Schady (2002).

22. In summary, we can expect the economic crisis to be associated with an increase in child labour in low income countries, and especially within the poorer households in these countries. For middle-income countries, there is some evidence that the impact of falling living standards (income effect) might be offset by reduced employment opportunities (substitution effect). Empirical results from cross-country analysis (Flug et al., 1998) and the review of existing evidence by Ferreira and Schady (2008) are highly supportive of these predictions. Available evidence indicates that the impact of the crisis will depend on individual country characteristics and, especially, on policy responses. The case of Nicaragua described above clearly illustrates how households' responses to the crisis will depend on the presence of well-functioning safety nets.

23. Finally, the consequences of the crisis on children's school attendance and employment cannot be considered in isolation from other facets of human capital development, health in particular. Indeed, in their review of studies related to the effects of economic shocks on health, Ferreira and Schady (2008) conclude that economic downturns tend to have negative effects on health and nutrition outcomes of children in poor countries. For instance, Paxson and Schady (2005) find that during the Peruvian 1988-1990 economic crisis there was an increase of 2.5 percentage points in the infant mortality rate, which implies that about 17,000 more children died than would have in the absence of the economic crisis.

3. CREDIT FLOWS

24. Access to credit is an important determinant of households' decisions to send their children to work, as it allows separating decisions concerning

consumption and human capital investment. Moreover, households with easy access to credit are less likely to use children's labour supply as an instrument to cope with negative income shocks.

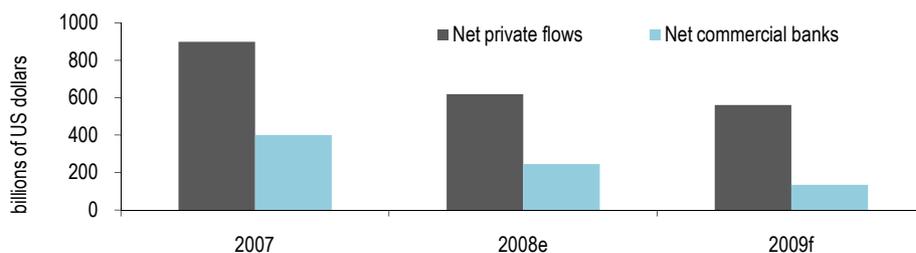
25. Beyond the evidence contained in the seminal paper of Jacoby and Skoufias (1997), some results based on a cross section of countries (Dehejia and Gatti, 2002) indicate that credit market development has an impact on child labour. Using panel data from Tanzania, Beegle et al. (2003) show that the extent to which child labour is used as a response to economic shocks is lower when households have access to credit. Guarcello, Mealli and Rosati (2009) show that in Guatemala that credit rationing is extremely relevant in determining the household's decision to invest in children's human capital and that children from "credit-rationed households" are more likely to be involved in working activities or to be "inactive".

26. Given the critical importance of access to credit in determining child labour, a credit squeeze, especially for poor households, can especially generate a substantial increase in child labour, in the context of a crisis characterized not only by the decline in growth rate but also by substantial reduction in credit flows.

27. To what extent the financial crisis will spill over to credit markets in low and middle income countries? The limited available data indicate that net private capital flows to developing and transition countries will decline from \$898.5 billion in 2007 to \$561.9 billion in 2009. A critical component of this decline is expected to come from shrinking interbank lending due to the broader malaise affecting the banking sectors of many mature market economies (Figure 2).

28. Tighter global liquidity and rising risk aversion will make it much more costly for both the private and public sectors to tap the international financial markets, thus exacerbating the slowdown and also further limiting the fiscal space to undertake countercyclical policies. Among the individual components of net capital flows, net inflows from commercial banks are estimated to show a reduction to \$245 billion in 2008, from a peak of \$401 billion in 2007 (Institute of International Finance, 2008).

Figure 2. Capital flows to developing and transition market economies



Source: Institute of International Finance (2008).

29. How large the impact of reduction in credit availability will be on vulnerable and poor households depends on a series of factors, about which little is known. The credit crunch is going to affect, first of all, the credit availability from the formal institutions (i.e., regulated financial institutions such as banks). The available data show that the access of poor to formal credit markets is relatively low but far from negligible at least in middle income countries (Table 5). It is reasonable to assume that access to formal credit is generally much more limited in low income countries. We can thus expect some impact of reduced availability of formal credit on household members' time allocation decisions.

30. Microfinance institutions (MFIs) are considered as important tools to progressively eliminate child labour in poor households through improving opportunities for income generation and assisting vulnerable households in coping with risk. MFIs use a wide range of lending methodologies to meet the needs of low-income households, who typically have little or no formal income documentation or access to standard loan collateral. Instead of requiring collateral, they reduce risk through group guarantees, appraisal of household cash flows, and small initial loans to test clients (Littlefield and Rosenberg, 2004).

Table 5. Percentage of households with credit from formal and informal institutions

Country	Year	Credit from Formal Institutions			Credit from Informal institutions		
		Poor	Non Poor	Total	Poor	Non Poor	Total
Bolivia	2000	5.3	9.7	7.0	4.5	7.7	5.8
Ecuador	1998	4.9	12.2	9.8	3.5	0.9	1.8
Guatemala	2000	4.2	8.3	6.4	6.9	7.8	7.4
Jamaica	1997	1.0	4.5	3.8	7.9	5.9	6.3
Mexico	2002	5.3	8.2	6.2	17.3	21.9	18.8
Nicaragua	1998	5.0	13.8	10.4	4.3	8.8	7.2
Panama	2003	8.4	20.7	17.5	22.1	19.7	20.3
Paraguay	2001	1.7	3.1	3.4	2.4	1.2	1.5
Peru	2001	1.5	5.1	3.5	8.4	11.9	10.3
Dominican Republic	2001	5.8	13.1	10.9	11.8	11.1	11.3
El Salvador	2002	0.5	1.7	1.3	1.5	1.3	1.3

Source: Tejerina and Westley, 2007

31. MFIs can help households to start or expand an income-generating activity to replace the income formerly earned by children. Besides stimulating additional income, they can also play an important coping role for vulnerable households. Through appropriate risk-managing financial services, such as savings, emergency loans and possibly insurance,

microfinance can help poor families to weather the storms of unpredictable expenses and income droughts without having to resort to child labour (ILO, 2004).

32. As Table 5 shows, poor households depend heavily on informal credit markets and MFIs. To what extent the informal credit markets, or the microfinance institutions, are going to be resilient to the financial crisis? Experience from the performance of banks and microfinance institutions in Bolivia shows that whereas asset quality and financial performance suffered an initial hit around the time of the financial crisis of 2000-2002, microfinance institution borrowers tended to bounce back from the liquidity crisis more quickly than commercial bank borrowers (Fitch Ratings, 2009).

33. However, microfinance might in the future be more affected by economic cycles than it used to be in the past. A recent report by Fitch Ratings (2008) indicates that “as microfinance institutions transform and as their clients become more integrated into the mainstream financial sector, convergence occurs between microfinance and mainstream banking which would reduce their resilience to the broader economy”. The tendency of microfinance institutions to evolve into regulated financial intermediaries that resemble somewhat traditional banks, has in many ways increased their exposure to the cycles of financial markets. Microfinance institutions are now much more exposed to unavailable local credit and to highly volatile interest rates than they were ten years ago when they were financed largely by development institutions (MicroRate, 2009).

34. In particular, microfinance institutions that lend for consumption needs could find themselves heavily exposed to economic downturns. During financial crises and economic downturns, higher inflationary trends might put some pressure on microfinance borrowers' already-tight disposable incomes. This could result in many MFIs experiencing a rise in nonperforming loan levels and declining funding from low-cost savings deposits (CGAP, 2009). Indeed, a recent survey (Duflos and Gaehwiler, 2008) on a limited number of MFIs indicates that high and volatile food prices caused clients to withdraw savings, cut back on nonfood expenses, and in some cases, have difficulty with loan repayments.

35. The difficulty of accessing credit markets and MFIs might generate additional risks for vulnerable households. These conditions might prepare the ground for an increasing use of private money - lenders and usurers.. Poor families may be induced into indebtedness, through accepting relatively small but cumulative loans or wage advances from usurers or employers a time of scarcity (ILO, 2009a). In most cases of debt bondage, for instance, children are not kept separately from their parents. The entire family is bonded and children work for little or no remuneration alongside their parents. In this context, it is clear that guaranteeing and sustaining access of the poor and vulnerable to the informal and microfinance institutions is essential to minimize the impact of crises on human capital investment.

4. MIGRATION AND REMITTANCES

36. There are two main channels through which the effect of the global crisis on migration might have an impact on child labour: the reduction of remittances from international migrants and the return of migrants to their (mostly rural) areas of origins.

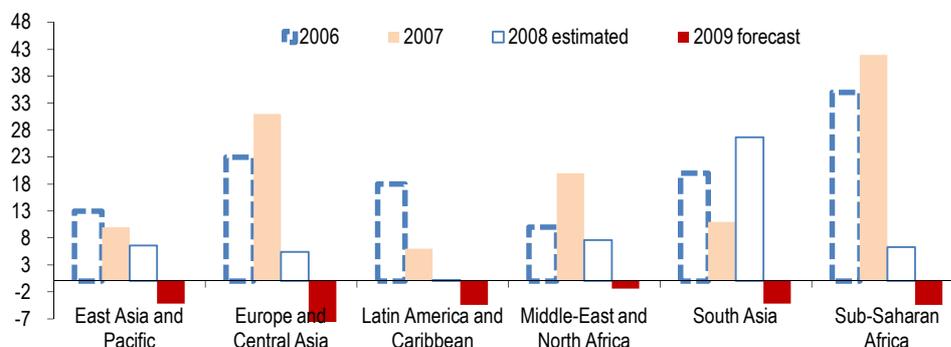
37. Resource constraints and imperfect capital markets play an important role in households' decisions concerning investment in children's human capital. By reducing financial constraints, remittances can promote schooling investment and increase child reservation wages, thereby reducing children's labour force participation. Trans-national social networks provide income diversification strategies and alternative coping mechanisms for consumption smoothing, through remittances, in response to economic shocks.

38. This is confirmed by recent studies showing the role and potential of remittances in influencing human capital accumulation. However, some caution is required when interpreting estimated effects of remittances on school enrollment and child work, in view of their endogenous nature.

39. For example, in El Salvador, children aged less than 14 years from recipient families are more likely to attend school than those from non-recipient households, while remittances also seem to reduce child labour supply (Acosta, 2006). Mansuri (2006) finds strong positive effects of temporary economic migration on investments in children's schooling in Pakistan. This effect is strongest for girls. Similar effects are found for El Salvador in Cox and Ureta (2003) and for Mexico in Hanson and Woodruff (2002).

40. The growth of remittance flows to developing countries started to slow down in response to the global financial crisis in 2008 and is projected to decrease sharply in 2009 (Figure 3). The exact magnitude is hard to predict given the uncertainties about commodity prices, exchange rate and macroeconomic conditions in destination countries. Remittances to Latin America, for example, have already started declining, due to a variety of factors including the economic slowdown in the United States and Spain, which are two major migrant destination countries for the region.

Figure 3. Growth rate of remittances to developing countries (2006-2009)



Source: World Bank, 2008b and World Bank, 2009c.

41. Also migration flows are to be affected by the crisis, with many migrants expected to return to their country and/or area of origin. Such return migration might directly involve children and adolescents, as many migrants, especially internal ones, are likely to move with their families. Migrants returning from abroad or from urban areas to rural areas are more likely to be involved in family based enterprises, especially in agriculture (Fallon and Lucas, 2002), activities where child labour is often more prevalent.

42. The Indonesia Family Life Survey indicates also that some 6 percent of all adults moved from urban to rural areas in just one year from 1997 to 1998; just half of that number moved in the opposite direction. Thus net migration to rural areas in response to the crisis was massive.

43. In Thailand, the crisis is known to have diminished migration to Bangkok by unskilled workers from rural areas, though not by the skilled workers. There are also some indications of substantial reverse migration (Kittiprapas, 2002). During the survey period of January 1997-98, most of the formerly working unemployed migrants were headed to the Northeast (67 percent - of which 48 percent used to live in Bangkok) and the main reason for migration was to return home (70 percent).

44. There are, hence, good reasons to believe that the substantial reduction in remittances as well as the return migration to mostly rural areas of origin may create an increase in children's participation in economic activities. Again, the impact is likely to vary by country and areas and is likely to be heavily influenced by the ability of the governments to support risk management interventions.

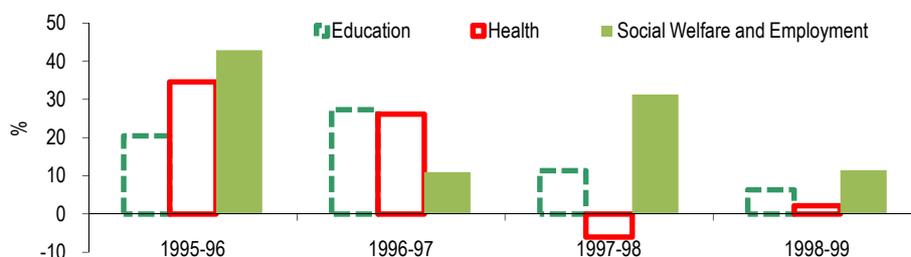
5. CHANGES IN PUBLIC BUDGETS AND INTERNATIONAL AID FLOWS

45. A macro-economic downturn leads to falling tax revenues and usually puts pressure on governments to cut (or reduce the growth of) public spending. During periods of fiscal contraction, social and/or education expenditure typically suffer the most.

46. For example, education budgets were cut in most of the East Asian countries after the 1997 financial crisis. In Thailand, the nominal education budget declined by about 6 percent between 1996/1997 and 1997/1998 (Brooker Group, 1999). The items in the budget that experienced the greatest cuts were expenses and supplies, which declined by 30 percent, and equipment, property and construction, which fell by 46 percent.

47. In a spot survey of 220 schools conducted by the Asian Development Bank, two fifth of schools reported budget cuts averaging 27 percent, while nongovernment budgets fell by 35 percent between 1997 and 1998, as donations from parents, local communities and other sources declined due to the crisis (Knowles, Pernia and Racelis, 1999). In the Philippines, in 1998, allocations for key educational inputs (like textbooks, desks, school buildings and teacher training) were also cut (Figure 4).

Figure 4. Growth rate of national government expenditures in social sectors in the Philippines (1995-99)

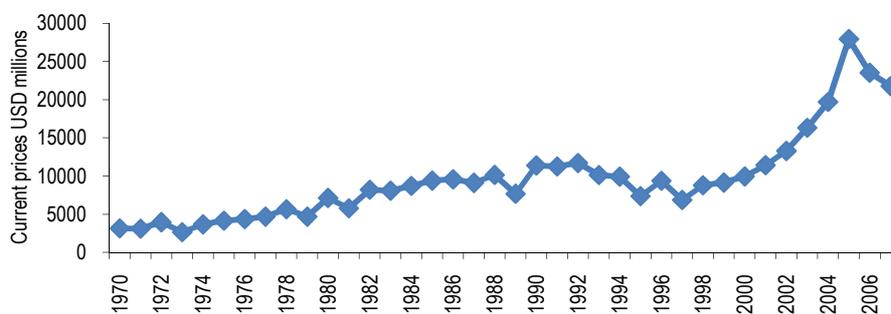


Source: Reyes et al., 1999

48. Developing countries are heavily dependent on aid flows. Sub-Saharan Africa is most at risk since aid averages around 9 percent of GDP, while in South Asia has reduced its dependency on aid flows to only 1 percent. There are wide variations across countries within Africa, with South Africa receiving only a small amount of aid as a share of GDP, whereas Mali (13 percent), Malawi (20 percent), Sierra Leone and Burundi (over 30 percent) are still highly aid dependent (Glennie, 2008). Education as well as social expenditure is substantially supported by international development aid in poor countries. For example, in Nepal, external sources account for about 15 percent of the total public expenditure on education.

49. Donor countries confronting economic recession and rising fiscal strain are expected to face difficulties to maintain their foreign aid commitments. A preliminary analysis of Nordic countries' net Official Development Assistance (ODA) by the Center for Global Development suggests that in times of economic crisis donor countries are likely to reduce aid. The resulting strain put on recipient countries' education and social expenditures may indirectly lead to a decrease in households' incentives to send children to school and an increase in children's labour force participation.

Figure 5. US net Official Development Assistance



Source: Organisation for Economic Cooperation and Development.

6. "INFORMALISATION" OF THE ECONOMY

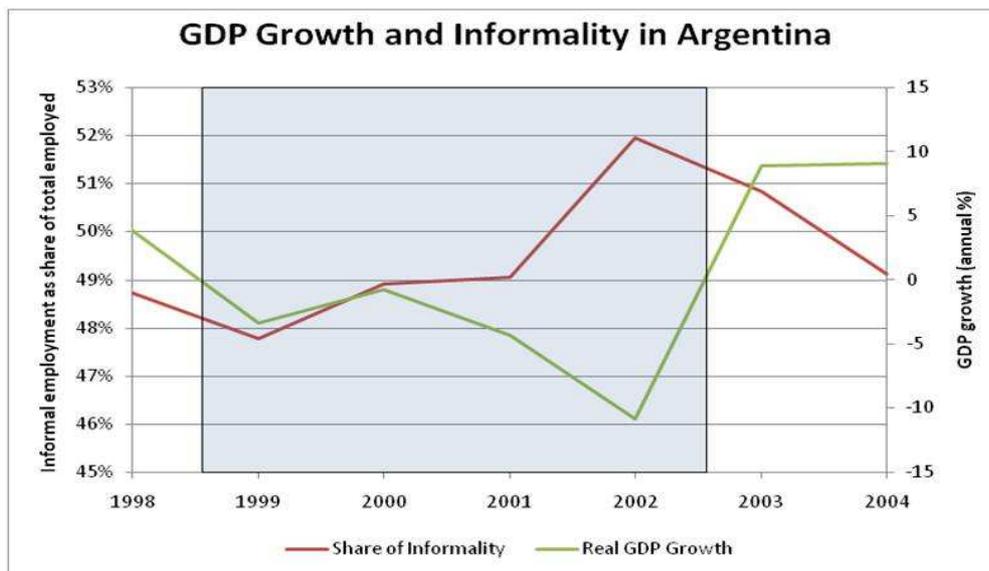
50. The analysis of labour markets in low and some middle-income countries indicates that informal activities are likely to increase as a result of economic turmoil. Informal employment can act as buffer when people are laid off in the formal sector and need to find new job opportunities. Furthermore, an economy entering a phase of recession might experience a shift from the tradable to the non-tradable sector, again implying an expansion of the informal sector (OECD, 2009b).

51. Available evidence supports this predicted shift towards more informal employment. In Argentina, the level of informality tended to increase during economic downturns (Figure 6). Both in Brazil and Mexico, for example, informal sector employment swelled during the recessions of the early 1980s. In Brazil, employment in the informal sector increased by 30 percent between 1981 and 1983 while in Mexico, informal sector employment grew 9.5 percent per year between 1983 and 1988 (World Bank, 1995).

52. Similar observations hold true for many Asian countries during the 1997 economic crisis. The downturn led to a larger informal sector share of

employment in Indonesia and Korea. In Indonesia, the share of informal sector employment increased from 62.8 to 65.4 percent.

Figure 6. GDP growth and informality in Argentina



Source: OECD, 2009b

53. The current crisis is expected to lead to a dramatic increase in the number of people joining the ranks of those in vulnerable employment². In 2009, the proportion of people in vulnerable employment could rise considerably to reach, in the worst-case-scenario, a level of 53 percent of the employed population (ILO, 2009b).

54. As is well documented, child labour is prevalent mainly in the informal sector of economies, where it is easier to find employment. In this sector, the technology level is often such that children can be easily utilized as unskilled labourers. The threat posed by an expansion of the informal sector to children's welfare should therefore not be underestimated. Greater opportunity to find employment in the informal sector in times of economic hardship might push many children out of school and into the labour market.

² Workers in vulnerable employment (that is, unpaid contributing family workers and own-account workers) are most likely to be characterized by low and insecure employment, low earnings and productivity. Vulnerable employment shares are indicative for informal economy employment, particularly for the less developed economies and regions (ILO, 2009b).

7. POLICY IMPLICATIONS

55. Child labour cannot be seen in isolation from the other facets of human capital, namely education and health, to which it is closely linked by a set of common key causes and interconnected by the cross sectorality of relevant policy measures. For this reason the following discussion will focus on policies that have a general bearing on human capital, rather than on child labour only. The crisis also calls for an adjustment of some specific instruments used to address child labour, but such a fine tuning can only be achieved once the overall strategies have been put in place.

56. Policy responses considered in this note are articulated around three main pillars:

- Protect and increase public investment for the fight against child labour, and for education and health.
- Establish and strengthen well-targeted safety nets and social protection systems
- Improve poor households' access to credit

57. It is important to underline that most policies addressing child labour and its worst forms are cross-sectoral in nature. The particular conditions and characteristics of child labour (and its worst forms) and the relative resilience of the economy to shocks will determine the optimal policy mix within a country context.

7.1 Public investment in human capital development (education, health and the fight against child labour)

58. Investment in human capital (education, health and elimination of child labour, particularly in its worst forms) should be placed at the core of the agenda for addressing the economic crisis. In the current economic turmoil, there is a strong need to protect progress made with regard to the elimination of child labour, the achievement of Education for All, and the attainment of MDGs in education and health.

59. The economic crisis also provides an opportunity to reshape poverty-reduction programmes and to develop effective social floors, again through increased investment in education, health and elimination of child labour. The crisis also forces a “new vision” onto policies, strategies and programmes due to the threats of contracting funds. It should perhaps be viewed as an opportunity to solve key problems and make significant improvements in both government and donor programmes and interactions.

60. Sustainable solutions to the economic crisis should include counter-cyclical investments (that is, protect or increase public spending on fight against child labour, education and health), maintaining aid commitments, promote special measures to help the poorest (safety nets), increase efficiency and transparency in the economy.

61. The focus on human capital investments as the key anti cyclical instrument, especially in developing countries, might be coupled with the investment in infrastructures as a traditional anti cyclical instrument. Indeed, past infrastructure investment has been effective in raising employment in the short run, given that infrastructure activity is relatively labour intensive (OECD, 2009a).

62. Labour-intensive public works programmes are considered as an effective strategy to put employment and social concerns at the center of investment policies in response to the current economic crisis. Public works programmes rely on labour-based technology which combines the use of equipment, tools and labour and seeks to optimize the labour-component. If successful, public work programmes can have short term benefits in terms of the wages generated and long term benefits in terms of the skills generated, generation of private investments and a secondary round of (employment) impacts due to the assets created (improved road access, irrigation schemes, water and land conservation, flood protection etc). It will be important to ensure that the promotion of labour-intensive schemes is tightly monitored for the potential use of child labour.

63. There may also be a need for an expanded role of the private sector in improving human capital investments. For instance, a recent World Bank report (Patrinos et al., 2009) points to the increasing importance of well-designed public-private partnerships in improving education service delivery, especially during economic downturns.

64. Effective prevention measures are important to achieve sustainable reductions in children's work and the internationally agreed human development goals (including MDGs and EFA plans). Efforts to stem the flow of school-aged children into work by improving and extending schooling must be maintained, so that families could have the opportunity to invest in their children's education. Public measures aimed at reducing the (direct and indirect) costs of schooling, expanding school access and improving school quality are especially important for sustaining poverty reduction efforts and spurring economic growth.

65. In addition to these prevention measures, direct interventions are needed to ensure the removal, recovery and reintegration of children in hazardous forms of work and other worst forms of child labour. Resources from public budget and donor funds must be maintained to improve labour inspection and reinforce child labour and school attendance monitoring systems at the local level in order to establish an early warning system. A concerted effort is also needed to support recovery and rehabilitation services, including remedial education efforts, which are essential to the successful reintegration of former child labourers and preventing their return to work.

7.2 Social protection

66. The global economic and financial crisis entails real risks for future poverty reduction and exposes poor and vulnerable households to potentially severe welfare losses (UNICEF, 2008 and World Bank, 2009b). Households in many developing countries are in danger of falling (or falling back) into poverty since many safety net programmes are either weak or malfunctioning. Children are likely to be harmed by the increase in poverty, as they might be sent to work and/or taken out of school to help households coping with the reduction in available resources. As explained in earlier sections, the possible expansion of the informal sector and/or return migration also poses a threat of increased child labour. Social protection policies aimed at improving households' capacity to cope with shocks and relaxing the current budget constraint are particularly relevant mitigation instruments in this context (World Bank, 2009d).

67. In countries where social protection systems are already in place, they should be strengthened for protecting poor households that are likely to be hit the hardest by the crisis. It would also be essential for existing social protection programmes that they target those most affected by the economic downturn.

68. However, in many developing countries, public social safety nets tend to be weak, or, as is the case in many low-income countries, almost non-existent. These countries should turn the current economic crisis into an opportunity by dismantling inefficient subsidies in favor of more effective safety net programmes. For instance and as an illustration, the financial crisis of 1994 presented an opportunity for the Government of Mexico to set up an effective safety net for the country's poor, the Progresa/Oportunidades programme. Moreover, economic downturns also provide an important opportunity to set up better information systems for monitoring progress and future preparedness (Ravallion, 2008).

69. The list of social protection instruments available to governments in the event of an economic crisis include, amongst others, cash transfer, public work programs, unemployment assistance, wage and commodity price subsidies, targeted human development or cash transfer programs conditioned on school attendance and/or regular visits to health centers, service fee waivers, food and nutrition programmes, micro-finance and social fund programs.

70. In several countries where safety nets are weak, many of these elements are present through a multiplicity of initiatives that are often inconsistent, insufficiently coordinated and fragmented. It will be necessary to revise these policies and design integrated, incentive-based and sustainable social security programmes.

71. Conditional cash transfer (CCT) schemes are currently being advocated as an important instrument for human capital investment promotion and child labour elimination. CCT programmes aim to alleviate current income

poverty (through cash benefits) as well as reduce the likelihood or extent of future poverty (through behavioral conditions related to the human capital development of children). Though CCT schemes have proved effective in increasing school attendance, further evidence on their impact on child labour needs to be gathered³. For example, empirical analysis from Brazil's Bolsa Escola (Cardosa and Souza, 2003) shows that in some cases CCT programmes have failed to reduce the incidence of child work. While the incentives offered by the programme were sufficiently strong to induce parents to send their children to school, the same incentives were not sufficiently strong to encourage parents to remove their children from work. The main policy challenge in this context appears to strengthen and sharpen the focus of programme incentives.

7.3 Access to credit

72. Access to credit is essential to allow poor household to invest in children's education and to reduce their involvement in work. As discussed in previous sections, credit rationed households tend to show higher levels of child labour. Interventions that favour household's access to credit and financial markets and relax the budget constraints can have an important impact in protecting children living in vulnerable households from child labor and/or early school dropout.

73. Formal financial institutions in many low-income countries, in particular in Sub-Saharan Africa, have not yet faced an important systemic banking crisis because of their limited exposure to complex securitized instruments and their lack of integration with other global financial markets. However, as indicated in a recent IMF study on Sub-Saharan Africa, financial risks could grow as the economic slowdown continues (IMF, 2009). Risks seem greater in those low-income countries where high equity returns had led to borrowing for investment in the stock market (for example, Kenya, Nigeria and Uganda).

74. The current global financial crisis is thus prompting the need for developing countries to establish a framework of regulation, supervision and crisis management and achieve the objective of an efficient banking sector. The necessity of reform of the formal credit system offers a unique opportunity to establish mechanisms that insure that credit reaches down to poor households, allowing them to invest in the human capital of their children. International institutions, for example, could help to guarantee securities that finance loans to poor households for investments in education. Such loans, if coupled with the right incentive system, are able to come with low default rates and therefore would not require high risk premia.

³ For a review of impact evaluations of policies relating to child labor prevention and protection, see Tabatabai, 2007 and Paruzzolo, 2009

75. As mentioned in earlier sections, microfinance institutions have performed an important role in extending access to credit to poor households. Over the past three decades, the microfinance “industry” has witnessed an impressive evolution and performance. MFIs will now have to act within a changing financial landscape, which includes fewer funding offers and fewer structured finance vehicles. The global economic and financial crisis might inhibit the microfinance sector's development. How MFIs are affected will depend on factors such as the structure of an institution's liabilities, its financial state, and the economic health of its clients. Effectively managing and mitigating existing risks (management quality and staffing, governance, technological expertise, and ability to effectively manage growth) while maintaining a commitment to their original mission (financial inclusion for the poor) will be instrumental to expanding the industry, even in the event of a severe economic downturn (Standard and Poor's, 2008).

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