Child labour and the global financial crisis

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University of Galatasaray
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Will the positive trends in child labour be reverted by the current economic and financial crisis?

Through which channels the crisis will affect child labour and schooling decisions of the households?
• There is a large degree of uncertainty with regards to the depth and duration of the crisis. Apparently a partial recovery with increased saving rates is to be expected, as well as high level of unemployment. Public budget will remain under pressure.

• The outcomes of the crisis will largely depend on the policies adopted by the Governments.
Main channels through which the real and financial crisis is likely to affect child labour and schooling decisions of households:

- Reduction (or reduced growth) of living standards
- Access to credit market
- Migration and remittances flows
- Public budget and international aid flows
- Expansion of the informal sector of the economies
Developing countries are anticipated to see growth fall from 5.8 percent in 2008 to 2.1 in 2009, a drop of 3.7 percentage points.

The current crisis is projected to result in 46 million more people living in poverty in 2009.
Evidence from previous crises indicates a link between economic downturns and rising poverty

**Effect of economic crises on incidence of poverty in selected countries**

<table>
<thead>
<tr>
<th>Country</th>
<th>Before crisis</th>
<th>Year of crisis</th>
<th>After crisis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina (hyperinflation and currency)</td>
<td>25.2 (1987)</td>
<td>47.3 (1989)</td>
<td>33.7 (1990)</td>
</tr>
<tr>
<td>Mexico (currency and financial)</td>
<td>36.0 (1994)</td>
<td>...</td>
<td>43.0 (1996)</td>
</tr>
<tr>
<td>Russian Federation (financial)</td>
<td>21.9 (1996)</td>
<td>32.7 (1998)</td>
<td>...</td>
</tr>
<tr>
<td>Thailand (currency and financial)</td>
<td>11.4 (1996)</td>
<td>12.9 (1998)</td>
<td>...</td>
</tr>
</tbody>
</table>

Figures are not comparable across countries because poverty lines differ.

*Source: World Bank, 2001*
Households are forced to send children to work (Income effect)

Decrease in returns to work might induce households to keep children in school (Substitution effect)
The question of whether it is the negative effect of income or the positive substitution effects of wages that dominates depends essentially on the following factors:

- on the ability of the household to cope with the shock
- on the characteristics of production, and
- on the public policies put in place to address the crisis.
Many developing countries have seen reversals in progress in raising school enrolment during times

Ex: Indonesia

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

Source: Beegle, Frankenberg and Thomas, 1999
Similar effects are observed during the recession in the early 1980s in Costa Rica (Funkhouser, 1999) and in Mexico (Binder, 1999).

In these countries, the negative effect of decreasing income outweighed the positive effect of lower opportunity cost, resulting in worsening school enrollment rates.
But..

Well functioning social safety net programme in protecting households’ well-being can mitigate the impact of a crisis.

*Ex:* 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)*
The consequences of the crisis are likely to be differentiated across countries because of different policy responses.

The impact of the crisis on education seems to be milder in presence of well-functioning social protection schemes.
There exists an important body of evidence on the effect of economic shocks on children's labour supply in developing countries.

Households 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 tend to use child labour as a form of risk coping mechanism, helping to offset sudden losses of income arising from economic shocks.

Empirical evidence from Guatemala (Guarcello, Rosati 2003), Cambodia (Guarcello, Rosati 2007), Tanzania (Beegle et al., 2003) and Argentina (Rucci, 2003)
In Venezuela, the percentage of children who work increased by almost five percentage points from 2000 to 2003.

<table>
<thead>
<tr>
<th>Year</th>
<th>Work only</th>
<th>School only</th>
<th>Work and school</th>
<th>No activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>1.6</td>
<td>91.0</td>
<td>3.2</td>
<td>4.2</td>
</tr>
<tr>
<td>2001</td>
<td>1.8</td>
<td>89.8</td>
<td>4.7</td>
<td>3.8</td>
</tr>
<tr>
<td>2002</td>
<td>1.8</td>
<td>87.9</td>
<td>6.5</td>
<td>3.8</td>
</tr>
<tr>
<td>2003</td>
<td>1.6</td>
<td>87.0</td>
<td>7.5</td>
<td>3.9</td>
</tr>
<tr>
<td>2004</td>
<td>1.4</td>
<td>89.0</td>
<td>5.7</td>
<td>3.1</td>
</tr>
</tbody>
</table>

Source: Blanco and Valdivia, 2006
In Guatemala, households hit by shocks reduce children’s full time school attendance, and increase children’s work.

**Multinomial logit model Marginal effects**

<table>
<thead>
<tr>
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<th>Work only</th>
<th>School only</th>
<th>Work and school</th>
<th>No activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Collective shock</td>
<td>0.004</td>
<td>-0.020*</td>
<td>0.044**</td>
<td>-0.028**</td>
</tr>
<tr>
<td>Individual shock</td>
<td>0.011**</td>
<td>-0.041**</td>
<td>0.039**</td>
<td>-0.009</td>
</tr>
</tbody>
</table>

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

Source: Guarcello, Mealli and Rosati, 2009
Economic crisis is likely to be associated with an increase in child labour in low income countries, especially for poorer households in these countries.

For middle-income countries, there is some evidence that the impact of falling living standards might be offset by reduced employment opportunities.

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 for middle income and low income countries.
Available evidence indicates that the impact of the crisis will depend on country characteristics and, especially, on policy responses.

The case of Nicaragua clearly illustrates how households’ responses to the crisis will depend on the presence of well-functioning safety nets.
The consequences of the crisis on children’s school attendance and employment cannot be isolated from other facets of human capital development.

Economic downturns tend to have negative effects on health and nutrition outcomes of children in poor countries (Ferreira and Schady, 2008).

In Peru, during the 1988-1990 economic crisis there was an increase of 2.5 percentage points in the infant mortality rate (Paxson and Schady, 2005).
• Access to credit is an important determinant of households’ decisions to send their children to work.

• Evidence indicates that households with easy access to credit are less likely to use children’s labour supply as an instrument to cope with negative income shocks (Dehejia and Gatti, 2002; Beegle et al, 2003; Guarcello, Mealli and Rosati, 2009).
The limited available data indicate that net private capital flows to developing and transition countries will decline.

**Capital flows to developing and transition market economies**

*Source: Institute of International Finance, 2008*
Poor households depend heavily on informal credit markets and microfinance institutions (MFI).

The issue then becomes to what extent the informal credit markets, or the MFIs, are going to be resilient to the financial crisis.

MFIs evolve into regulated financial intermediaries that look more like traditional banks (Fitch Ratings, 2008).

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).
MIGRATION FLOWS

CRISES

MIGRANTS

REDUCE OF REMITTANCES OF INTERNATIONAL MIGRATION

RETURN TO THEIR (RURAL) AREA OF ORIGIN
By reducing resource constraints, remittances can promote schooling investment and increase child reservation wages, thereby reducing children’s labour force participation (Acosta, 2006; Mansuri; 2006; Cox and Ureta, 2003; Hanson and Woodruff, 2002).

Trans-national social networks provide income diversification strategies and alternative coping mechanisms for consumption smoothing, through remittances, in response to economic shocks.
Remittance flows to the developing world overtook development aid in the mid-1990s and increased by 15 to 20 per cent in the last decade. They decelerated in the second half of 2008 and are expected to drop in 2009.

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

Migration flows are to be affected by the crises, with many migrants expected to return to their country and/or area of origin.

In Indonesia, individuals from the poorest urban households migrated to join households in rural areas where the cost of living was lower (Thomas and Frankenberg, 2005).

In Thailand, the crisis is known to have diminished migration to Bangkok by unskilled workers from rural areas, though not by the skilled workers.

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 utilized.
As the crisis begins to hit, leading to falling tax revenues, there will be a pressure on governments to cut or reduce the growth of their public spending.

During periods of fiscal contraction, social expenditure typically suffers the most.

For example, the nominal education budget declined by about 6 percent between 1996/1997 and 1997/1998 (Brooker Group, 1999).
In the Philippines, in 1998, allocations for key educational inputs were also cut.

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

Source: Reyes et al., 1999
Developing countries are heavily dependent on aid flows. In poor countries, education as well as social expenditure might be substantially supported by international development aid.

For example, in Nepal, external sources account for about 15 percent of the total public expenditure on education.
Donor countries facing slowing economies 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 donor countries facing financial crisis are likely to see their aid decline, recovering only when the economy has also picked up.
Informal employment can act as buffer when people are laid off in the formal sector and need to find new job opportunities.

An economy entering a phase of recession and reduced flows of international trade might experience a shift from the tradable to the non-tradable sectors, again implying an expansion of the informal sector (OECD, 2009).

For example, in Brazil, employment in the informal sector increased by 30 percent during 1981-83 while in Mexico, informal sector employment grew 9.5 percent a year between 1983 and 1988 (World Bank, 1995).
Similar observations hold true for many Asian countries (in Indonesia, the Republic of Korea and Thailand) during the 1997 economic crisis.

In Argentina, the level of informality tends to increase during economic downturns.

Source: OECD, 2009
The greater opportunity to find an employment in this sector in times of economic hardship might push many children out of school into the labour market.

The loss of formal employment of the family members will make households more vulnerable and make them more likely to use child labour to protect the level of family consumption.

The threat posed by an expansion of the informal sector to children’s welfare should not be underestimated.
Policy responses considered are articulated around three main pillars:

- **Protect and increase public investment on fight against child labour, education and health**

- **Establish and strength well-targeted safety nets and social protection system**

- **Improve poor households’ access to credit**

The particular conditions and characteristics of child labour and the resilience of the economy to shocks will determine the optimal policy mix within a country context.
There is a strong need to protect progress made with regards to the elimination of child labour, the achievement of Education for All, and the attainment of MDGs in education and health.

The crisis forces a “new vision” at policies, strategies and programmes due to the threats of contracting funds.

Sustainable solutions to the economic crisis might include counter-cyclical investments, maintaining aid commitments, promote special measures to help the poorest, increase efficiency and transparency in the economy.
A key strategy will be to ensure a healthy balance between investment in infrastructure and human capital-related expenditure.

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.

The current situation also calls for a more important role of well-designed and public private partnerships in improving education service delivery, especially during economic downturns (Patrinos et al., 2009).
Social protection policies aiming at improving households’ capacity to cope with shocks and relaxing the current budget constraint are particularly relevant in the crisis context (World Bank, 2009).

The list of social protection instruments available to governments in the event of an economic crisis include:

- cash transfer programs conditioned on school attendance and/or regular visits to health centers,
- public work programs,
- unemployment assistance,
- wage and commodity price subsidies,
- food and nutrition programs,
- micro-finance and social fund programs.
If countries have already implemented social protection systems, it is important that they:

- adopt appropriate targeting mechanisms,

- provide adequate protection to the poor,

- avoid creating a culture of dependency among beneficiaries, and

- are consistent with economic incentives and overall targets of public finance policy.
Countries (where safety nets are weak) should turn the current economic crisis into an opportunity by dismantling inefficient subsidies in favor of a more effective safety net programmes.

The financial crisis of 1994, for example, presented an opportunity for the Government of Mexico to set up an effective safety net for country’s poor, the Progresa/Opportunitades programme (Ravallion, 2008).
Interventions that favour household’s access to credit and financial markets and relax the budget constraint can have an important impact in protecting children living in vulnerable households from child labor and/or early school dropout.

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.
A thorough understanding of microfinance and its risks needs to be undertaken.

Global economic and financial crisis might inhibit some of 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) and 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; Standard and Poor’s 2007; CGAP and JP Morgan, 2009).
Immediate Knowledge Gaps

- In depth critical review and assessment of knowledge base on the impact on child labour

- Assessment of knowledge base on the impact on access to credit of poor and vulnerable households

- Analysis of the impact of the crisis for a set of countries belonging to different income groups

- Sensitization of stakeholders at global and national level about the impact of the crisis on child labour

- Monitoring system on child labour and school attendance in a few (specially low income) countries