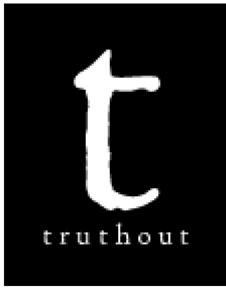

Trickle Down Meltdown

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by: Doug Saunders, The Globe and Mail

A brick works in northeastern Bangladesh is about as far from Wall Street as one can get. Yet the financial crisis is all people here can talk about as jobs disappear, remittances dry up and access to microloans is squeezed.

Sylhet, Bangladesh - In this very poor corner of Bangladesh, where rice farmers get by on household incomes of less than $1 a day, where the most popular mode of transportation is the pedal-rickshaw and where life doesn't seem to have changed for centuries, it's hard to believe that anyone could be affected by the crisis that has humbled Wall Street and Canary Wharf.

But the credit crunch is the main topic of conversation in the rice paddies and village bazaars here.

It is hard to find anyone, from vegetable sellers to floor sweepers, whose life has not been affected by the collapse of institutions in New York and London.

Just listen to Laily Begum, a 50-year-old villager who's just lost the $2-a-day brick-making job she's held for years, forcing her to move into her daughter's one-room family shack, and try to live off the pennies a day earned by her son-in-law's rickshaw-pulling job.

"This is the hardest year I've ever experienced, I've lost my job and my house, and it's all because of the global economy," she says, launching into a surprisingly complex explanation of the series of financial events that led to her job disappearing.

First, the downturn in London hurt Bangladeshi-owned British businesses that had been sending capital to farmer relatives in Sylhet.

Then a plunge in exchange rates and a rise in commodity prices all but killed any demand for bricks or the people who work with them, and a local credit squeeze caused by the crash of interbank lending prevented her from getting a $400 loan to launch a new business.

"Because of what is happening over there in London, a lot of us are having to go back to planting rice and living in small houses," Ms. Begum says.

In some of the world's lowest-income communities, the effects of the downturn appear to have stalled an entrepreneurial boom.

This is the first major financial crisis to have such a direct and immediate impact on the very poor of the world. The forces that brought down Lehman Brothers and humbled the likes of UBS and Royal Bank of Scotland this year, and killed jobs, savings, property value and business prospects in the wealthy West, are having the same effect, sometimes even more dramatically, in the villages and shantytowns of the developing world.

What has made this financial crisis different are the tight bonds that have developed between the world's financial capitals and poor regions such as this. Places like Bangladesh, Nigeria and Guatemala have dense webs of financial ties to the world's money centres that have made them especially vulnerable to the downturn. Those links typically connect the financial centres not just to the capitals of poor countries, but to their more remote and rural regions.

Here in Sylhet, it is easy to trace the chain of connections that leads from the office towers of London's financial district directly to Laily Begum's shack. Her employment was a product of finance-sector wealth being channelled through immigrants to home countries, a worldwide phenomenon. And her access to tiny amounts of credit was a product of the huge success of the microcredit industry - an industry which, we're learning now, is as vulnerable to a collapse in interbank lending as any other loan-making institution.

Decoupling "a Myth"

"It is clear that the idea that developing countries would somehow be 'de-coupled' from the crisis is a myth," said Supachai Panitchpakdi, head of the United Nations Conference on Trade and Development.

He describes a "triple crisis" in which developing-world unemployment is likely to increase next year by 20 million people, after years of employment growth, and rates of extreme poverty are likely to grow after two decades of shrinkage, at the same time as fuel and food prices rise.

Mr. Panitchpakdi's agency is expecting remittances from workers in the West - after growing by 18 per cent in 2006 and 16 per cent in 2007 - will drop by as much as 6 per cent next year to $265-billion (U.S.). These payments, sent by cash or Western Union to villages in Asia, Africa and South America, account for the largest single source of economic growth in many countries, and outstrip foreign-aid spending.

The World Bank projected in November that remittances next year will fall to 1.8 per cent of the developing world's gross domestic product, down from 2.0 per cent in 2007 - the first such fall in more than a decade, and an income decline that could severely hurt economies of poor regions.

In Bangladesh, remittances amounted to $8-billion, or 11 per cent of the country's GDP, last year, but are expected to drop sharply because of their dependence on London's financial sector.

At the same time, exports from the developing world will drop by a projected $95-billion, almost as much as total foreign-aid spending, according to the World Bank.

Especially hard-hit will be the garment and electronics industries that have been central to the emerging-markets boom.

This is compounded by exchange rate changes that have hurt the poor. While those whose families work in the Persian Gulf haven't been hurt (the incomes there are far lower than those in the West), a large number of the world's migrant labourers are employed in Britain, the U.S. and Russia, countries whose currencies have declined dramatically in recent months.

This has hurt the purchasing power of whatever earnings the poor are able to attract from the wealthy world. In Bangladesh, a British pound in late 2007 purchased 150 taka - enough to feed a poor family for a week. Now it purchases only 100 taka.

And direct foreign investment flows to emerging markets are likely to be down 40 per cent this year, according to a projection by the Organization for Economic Co-operation and Development.

Together, these trends are likely to place enormous pressure on countries like Bangladesh.

The country's garment industry, which has grown rapidly during the past decade because Bangladesh has labour costs lower than those in Chinese cities, is being pummelled by these forces.

"We're really suffering from the international market," said Abdur Razzak, manager of Dhaka's Starlight Knitwear, which makes clothes for Kmart and other retailers. "The higher commodity prices and bad exchange rate have raised the cost of living for the poor people who usually move to Dhaka to work here, so we're under great pressure to pay them more. At the same time, demand for our products is slowing. We're really getting squeezed."

Such developing-world downturns have occurred in earlier financial crises. What is unusual this time around is that the victims are not so much the urban elites of the developing world, but the villagers and peasants in some of the poorer regions of those countries.

At root is one of the more interesting and, usually, beneficial effects of globalization. These regions have sent hundreds of thousands of emigrants to work in the Western capitals, in service-industry jobs that have expanded with the financial boom. Many have stayed for generations, their children and grandchildren becoming successful elites in the world's financial capitals. And the money those immigrants and their descendants send back to their families has become the top source of foreign earnings for many countries.

Remittances have been an important form of international development since the 18th century, but they boomed during the 1990s because electronic communication and international banking links made it possible for emigrants in Western capitals to support diverse businesses and building projects in their home countries.

That's the case in Central America and Mexico, which have provided the service workers behind the Wall Street boom; in the countries around the Black Sea, whose workers have staffed Moscow's growth; and in North Africa and South Asia, which have sent hundreds of thousands of people to the Persian Gulf states during the oil boom.

The Sylhet district of northeastern Bangladesh is directly tied to London's financial district. Almost 90 per cent of the 400,000 Bangladeshis in Britain come from this small, entirely rural district, and most live in the neighbourhoods surrounding the London financial district.

Echoes of Subprime Crisis

These ties have created deep webs of employment and financial dependency.

Here in Sylhet, each "Londoni" house - that is, a family receiving a few hundred dollars a month from relatives in London - manages to employ between 20 and 40 people as farm workers, servants, builders, and small-business employees. Tens of thousands of people have migrated from other, even poorer districts to Sylhet to take advantage of this tide of Londoni money.

Alta Bibi, a 75-year-old grandmother and rice farmer whose farm earnings are less than $1,000 a year, is one of the Londoni beneficiaries who has found herself frozen out.

She used remittances from her grandchildren in England as collateral to secure a loan to build the bottom floors of her house.

Now the house sits vacant, open-roofed and half-completed, a victim of the crunch. Her grandsons, squeezed by the huge drop in British consumer spending and the decline in their own house values,

have stopped sending her money, and the microcredit agency has told her they have to withdraw the loan for the house. She, too, is forced to move back into a peasant shack.

Londoni money brought Ms. Begum the brick-maker here. Her skills would have provided intermittent work in her famine-prone northern district of Netrakona. But the London-based money, and the building boom it fuelled, gave her more than 20 years of steady income at twice the rate she'd have earned at home.

She sent more than half of it to family in her home village, seeding more small businesses there.

Such ties have brought about an explosion of property development and small-business growth in formerly destitute regions like Sylhet.

The spread of credit-based small-business financing into the poorest regions of the developing world - often through microfinance loans of a few hundred dollars underwritten by aid agencies and development banks - has turned millions of people living in mud-floor shacks into thriving entrepreneurs. But it's also exposed them for the first time to the vicissitudes of global credit markets.

Those microlenders, who play a central role in peasant communities like this one, are facing the same pressures as lenders everywhere: They're freezing new lending, cutting back their portfolios to eliminate risk, and watching the crisis fill their balance sheets with non-performing credit.

At the local village offices of BRAC, the country's largest microcredit lender, branch manager Pankaj Kumar Roy is telling people that the tiny loans, which were typically used to build a shop, buy a rickshaw or expand a peasant farm into a market-growing operation, simply aren't available any more.

That's because larger banks aren't able to provide reliable interbank financing to microcredit agencies, and because the existing portfolios of tiny loans are becoming plagued with bad debt.

"We are getting a lot of overdue loans," Mr. Roy said from the simple, computer-free offices of BRAC's Biswanath branch, where 3,720 very poor people hold a total of $680,000 in loans.

"In the past six months, we have the equivalent of $10,000 overdue - before, it was only $2,000. And because credit is hard for us to obtain, we've had to cut back the size of our loan portfolio. It's affecting the whole microfinance and development industry - nobody can make new loans. Our loan portfolio is completely frozen."

Microcredit experts say the situation could get even worse, because microlenders have long been in the habit of tolerating short- and medium-term lapses in payments from very poor clients. If the very poor begin enduring long-term unemployment and remittance flows dry up for a long time, the agencies may be forced to admit that large parts of their portfolios are non-performing loans.

It's a striking echo, on a far smaller scale, of the subprime loan crises that have hit financiers in the West.

"The crisis is coming from the U.S., and now it is skirting through the developed world, through the major destination countries, to developing countries," said Dilip Ratha, a senior World Bank economist who specializes in immigrant remittance flows.

"We are in unknown territory now, because both the source countries and the destination countries are not doing very well."

The Chain Reaction

To understand how dirt-poor people end up getting hit by an interbank crisis in the wealthy West, it's worth following the rivulets of money that make their way through Sylhet from London's financial district.

Tariq Mia, a 23-year-old peasant from the northern Jamalpur region of Bangladesh, has been coming to Sylhet to harvest rice twice a year, in August and December, for the past several years. His home village is subject to the Monga, a seasonal starvation caused by poor harvests that kills thousands every year. The Sylhet harvest allows him to take home $40 for each of the two months worked, saving his family from the Monga.

This month, he was told by his gang boss, Cherag Ali, that the work could be jeopardized. The owner of the fields, who lives in a handsome blue house nearby, had lost his source of Londoni money and might have to return to farming himself, or stop paying for seeds and fertilizer.

The owner of the house and the fields is 21-year-old Mominul Islam, who lives in the blue house with his mother and sister. In the 1960s, his grandfather emigrated to London, and opened a restaurant there, Bengal Spice, that's popular with bankers in the City of London financial district. His uncle, Sufe Miah, used the restaurant's proceeds to go into the property-development business in England.

The money flowing from these ventures ended up employing dozens of people in Sylhet. Mr. Islam's uncle built himself a huge house, costing at least $100,000 (it would be worth tens of millions in London), which he used for his weeklong visits three or four times a year. Such lavish and largely empty "Londoni houses" dot the landscape in Sylhet and other developing-world remittance strongholds around the world.

In the boom years, the money from London was allowing Mr. Islam to build a small property and business empire in the village of Biswanath. He owned shops in the bazaar, which he rented to merchants; he was building houses, employing scores of builders; and he had just started his own shoe

shop, with several employees.

Then, suddenly this autumn, everything went wrong.

"The economic situation is very bad for us," Mr. Islam said. "For the past several months my uncle just isn't sending the money. He's stopped sending the money because his property-development business just isn't making any money, it's losing money. So I had to close the shoe store."

He also had to scale back the farm, fire all but two of the servants who take care of the big house, get ready to renegotiate the rent on the shops, and put a halt to all the building projects - the latter because the financing for them had also disappeared with the breakdown in local lending.

He's still able to pay the $180 a month for the two servants who take care of the house - themselves migrants from even poorer regions who send all their money back home - and $60 in utility bills and upkeep costs, and he's been able to keep the farm labourers going, in exchange for half the proceeds from the rice they grow. But he's paying for this using the rent from his shops in the bazaar - an income that could easily be jeopardized if the economy declines any further.

This breakdown in London-financed entrepreneurship and construction has ignited a chain reaction through the Bangladeshi economy.

From Mominul Islam's crumbling Londoni houses, it is possible to trace a direct path to the huge brick-making operation that cost Laily Begum her $2-a-day job this month. In fact, from his blue house on the edge of the rice field, you can see the tall chimneys of the brickworks that now mostly lay idle.

Haji Nurul Hasan is the 75-year-old owner of the Al Fallah Brick Field, and he feels like he's at the receiving end of everything the London and New York financial centres have disgorged this year.

Everything has converged on his company: The disappearance of easy credit, the plunging exchange rates, the sharp decline in property values, the disappearance of remittances from abroad, the increases in the cost of coal and diesel fuel. All have added up to a halt in the Bangladeshi building industry - and in poor districts on three other continents.

"We have no peace here - flood, famine, and now the world economy has struck us, the remittances have dropped away and the property has lost its value, and people can't get loans," he said. "This has affected my business very badly."

In 2007, his workers made four million bricks; the 2008 total will be less than three million, and his orders are drying up fast.

As a result, the number of workers who toil in this dusty, sweat-soaked yard has dwindled from 300

to 200.

One of those hundred lost jobs was Laily Begum's 20-year position pressing clay into brick moulds.

Like so many employees of Lehman Brothers, she has had to sell her house, pack up her belongings, and move in with her family. Unlike most of those bankers, that means living with two other adults and four children in a single room and eating 75 cents worth of rice a day.

It is in that shack, a surprisingly optimistic place under the circumstances, that you'll find the tail end of a long chain that began with subprime loans on the other side of the world.

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