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GLOBAL ECONOMIC MELTDOWN AND SUB- SAHARAN AFRICA: TRANSMISSION CHANNELS, LESSONS AND POLICY OPTIONS

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ABSTRACT

The global events since 2008 seems to suggest that generating the required foreign exchange for sustained growth in sub-Saharan Africa (SSA), which is important for meeting the MDGs, will be a mirage. These events include economic slowdown in major advanced countries, financial crisis in major global financial markets and institutions, and general global credit squeeze. A direct consequence of these events is the drastic fall in international prices of major primary commodities that are fuelling growth in Africa. This implies that many SSA countries might witness drastic swings from fiscal and external current account surpluses to prolong deficits, restricted access to international (trade) credit and massive reduction in foreign direct investment (FDI) inflows among other issues. Consequently, we examine the expected channels through which the global financial and economic crisis can impact on Africa economies, what lessons are (and can be) learnt and considers possible emergency/short-run policy response as well as desirable regulatory proposals and long-term responses which should be designed and implemented to ameliorate the impact of the crises and possibly insulate the sub-continent from future crises. The conclusion is that there is a strong need for a change in development strategies in SSA.

Keywords: Global Financial and Economic Crisis, Transmission Channels, Long-term Policy Options.JEL Classification: F01, F42.

INTRODUCTION

The global financial crisis which started in September 2008 in the advanced capitalist economies, particularly as a result of the financial crisis that hit the mortgage market in the United States of America (USA) has rapidly spread to other parts of the world in at least three dimensions—economic

slowdown (recession), financial crisis, and credit crunch.[1] These dimensions were coming at a time when the whole world admits that Africa, particularly sub Saharan African (SSA) countries, had never had it so good since the late 1970s in terms of export performance and growth. Prior to September 2008, average annual growth rate of per capita real GDP was above 5 percent with some countries like Botswana, Angola, and Sudan achieving annual growth rates above 6 percent. The source of growth has been largely due to impressive export performance and favorable international prices of the major exports from the sub-continent. However, this is largely as a result of huge demand for raw materials by other fast growing countries such as China and India.

Consequently, this impressive growth path has raised expectations about the ability of SSA countries in meeting the Millennium Development Goals (MDGs). It is expected that SSA countries will be able to use international trade to generate the required foreign exchange to finance growth and development and thus achieve the MDGs. Also, with such sustained growth, reliance on foreign aid is expected to decline, as the motive for seeking aid will eventually be eliminated. In sum, there was a high hope that given good governance and sound macroeconomic reform measures, resumption of growth in SSA countries—which seems to be sustained—will lift many SSA countries out of the low-income status by providing the necessary resources for financing development.

However, the financial crisis, which started in September 2008 in the Mortgage Market in the USA, is now dashing all hopes that SSA countries will be able to finance development and meet the MDGs. The global economic slowdown that followed the financial crisis has led to drastic fall in demand for traditional African exports subsequently leading to rapid fall in the international prices of these traditional commodities of export. Effectively, growth seems to have been dampened once again. Consequently, this poses new (but unexpected) growth and development challenges. First is the drastic fall in international prices of major primary commodities that are fuelling growth in Africa. This implies that many SSA countries might witness drastic swings from fiscal and external current account surpluses to prolong deficits. Second, the global credit crunch could also translate to restricted access to international (trade) credit. Already, many SSA countries are witnessing massive reduction in foreign direct investment (FDI) inflows while domestic stock markets are recording outflow of foreign investments and collapse in the value of stocks.

[1] In broad terms, the crisis could be described as a financial crisis and a recession. Morris (2008), Eichengreen et al. (2009) and Taylor (2009) provide detailed review and analysis of the crisis.

These are new challenges to the recent growth recorded in the sub-continent and can significantly constraint the achievement of the MDGs. As a result, the sub-continent that is expected to gradually reduce aid dependency may suddenly become in dire need of aid. Thus, the major concern is that the crisis may have far reaching development implications. The source of concern is that SSA countries are now more integrated than before with the global economy through bilateral and multilateral trade arrangements, regional integration arrangements, FDI, and remittances. Consequently, the crisis is expected to significantly impacts SSA countries through reduced demand for their exports and sharp decline in commodity prices. Many SSA countries are likely to be hard hit by lower remittances and FDI while aid flows are under threat (IMF, 2009). Therefore, there are serious concerns that the crisis has grave implications for development.

However, with appropriate counter-cyclical policy measures it may be possible for SSA countries to ameliorate the impact of the crisis and come out of the slowdown faster than expected. Although export is necessary for sustained growth and development financing, the current crisis raises further questions about the nature of African production, export, and relationship with the global trading system in general. The crisis did not originate from the continent but SSA countries seem to have borne a disproportionate amount of the impact. Nevertheless, the recovery of SSA countries is tied to the full recovery in the advanced economies. This is because the resumption of growth in SSA countries seems to be conditional on the speed of recovery in the advanced economies. Should this be so? Are SSA countries responding appropriately to the crisis and in their best interest? How best can macroeconomic policy measures be put in place to shield the highly vulnerable members of the society who are primary victims of this crisis? What should be the post-conflict relationship and role of SSA countries with whatever new global financial and trading architectures that may emerge? These and other related questions require urgent answers.

Consequently, this study sets out to examine the expected channels through which the global financial and economic crisis can impact on Africa countries, examine if such impacts are actually existing, highlights what lessons are (and can be) learnt and considers possible emergency/short-run policy response. In addition, we seek to consider desirable regulatory proposals and long-term responses, which should be designed and implemented to ameliorate the impact of the crises and possibly insulate the sub-continent from future crises. The sequence of this study is clear. Section two discusses some of the major and significant expected channels through which the financial crisis and recession are expected to impact on SSA countries. Section three goes ahead to examine if these expected channels of transmission are already impacting on SSA countries and thus link them to

trade and growth performance of SSA countries. Examinations of the policy responses of SSA countries so far in dealing with the crises and review the effectiveness or otherwise of such police measures are carried out in section four. Section five proposes some important long-term policy measures that can be implemented by SSA countries in order to reduce the impact of the crises, while section six concludes.

EXPECTED CHANNELS OF TRANSMISSION OF THE FINANCIAL CRISIS AND RECESSION

There are several potential direct and indirect channels through which the identified dimensions of the crisis can affect any given economy. The severity of the direct and indirect channels through which the identified dimensions of the crisis can affect any given economy will depend on several factors such as the level of (financial) integration of the economy with the rest of the world, extent of export diversification/primary commodity dependence, major trading partners, extent of aid dependence, nature and mode of domestic production and exchange, some initial conditions (level of external reserves), etc.

Given the nature and characteristics of exports of SSA countries and the level of financial integration with the rest of the global financial system, the initial direct impact is not likely to be from the financial (credit and liquidity) crisis but rather the collapse in global commodity trade arising from the economic slowdown (recession) in the advanced countries. Nevertheless, it should be noted that the financial crisis precedes (but also led to) the economic slowdown, however, the economic slowdown in the real sector of the advanced economies is what is likely to impact immediately on SSA countries through fall in foreign demand for SSA exports and subsequent collapse of the prices of these commodities. As aggregate demand shrinks in advanced economies the prices of traditional commodity exports of SSA countries will collapse. Figure 1 traces and describes the potential transmission channel and the likely impact that the financial crisis and recession will have on a typical SSA country. In broad terms, it demonstrates that there are four major aspects of the economy that will be immediately affected—fiscal balance, external balance, FDI flows, and remittances.

Commodity prices/Quantity-induced effects

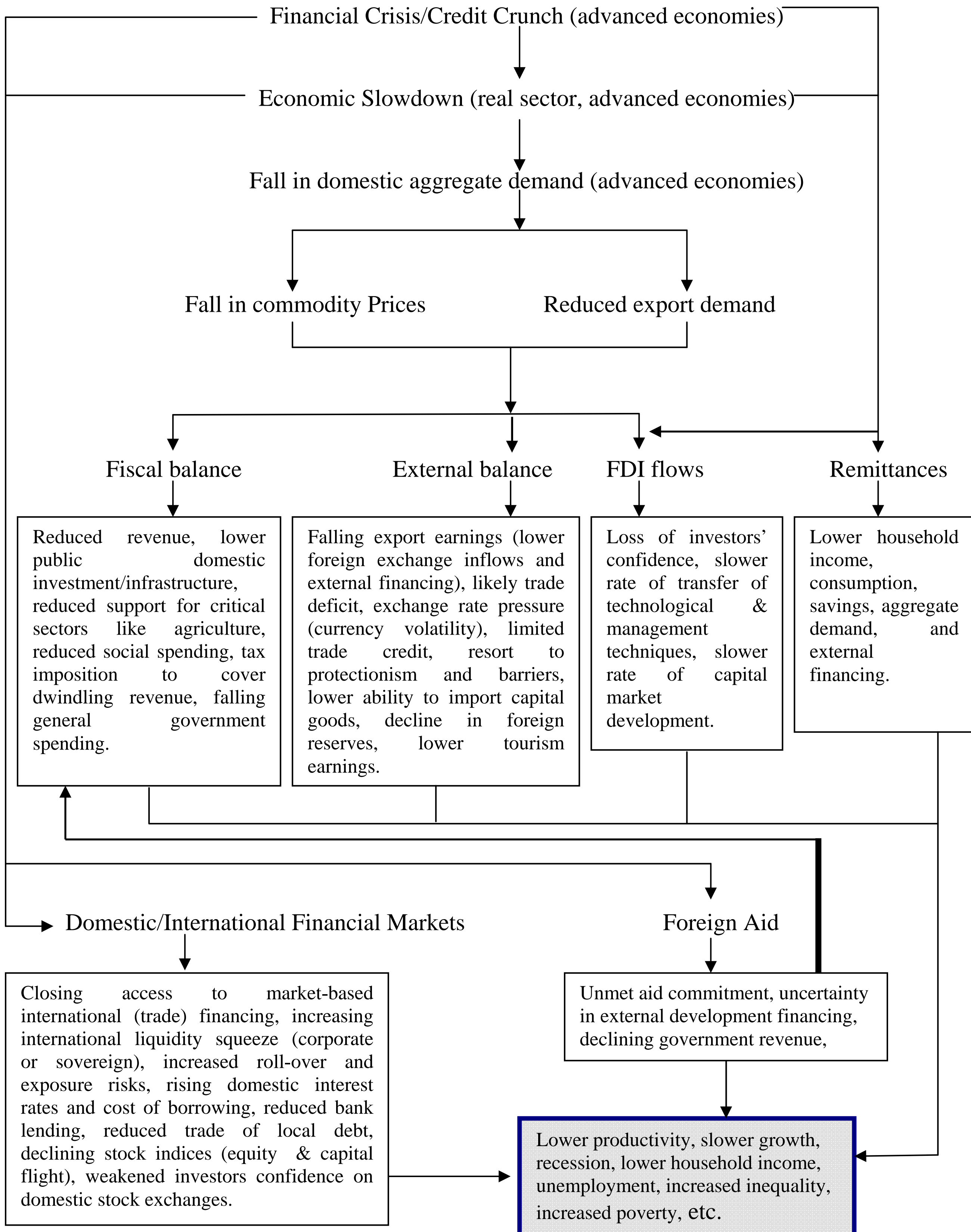
Theoretically, in terms of fiscal balance, it is expected that the fall in commodity prices will reduce government revenue leading to fall in public investment in infrastructure, reduced spending support on critical sectors such as agriculture, reduced spending on social services, etc. The fall in

international prices of primary commodities will lead to reduced export earnings which imply lower foreign exchange inflows which are vital to development financing. In the extreme, countries can face trade deficit. All these are likely to put pressure on the domestic currencies of the various SSA countries. In general, countries might be tempted to impose trade restrictions in order to protect their external current account positions and the local currency. The ability to import intermediate capital goods will be constrained. Also, since most FDI inflow to Africa is in natural resources, fall in the prices of these goods will discourage foreign investment in these sub-sectors. Some of the expected advantages of FDI such as technology transfer and the use of better management styles may be not be realized. Also, due to the global recession, there may be drastic fall in tourism—trade in services—as tourists find cheaper places to go or cancel the travel plan out-rightly. This will therefore affect the flow of foreign exchange and impact negatively on external balance.

Net resource flow-induced effects

Apart from the fact that the crisis can lead to fall in international prices of primary commodities which will then impact on the economies of these countries, there are some effects that are non price-induced. They are as a result of the financial crisis and recession. For example, economic slowdowns in advanced economies will reduce the flow of FDI to SSA countries even if prices of natural resources are not falling. Foreign direct investment (FDI) flows depend, among other things, on the good condition of the economies of the parent companies' countries. Another impact, which is not price-induced, is the issue of remittances. Due to the recession in advanced economies, employment will fall which implies that remittances by Africans living in the advanced economies will reduce. Lower remittances implies lower household income, lower income implies lower consumption and savings that will negatively impact on aggregate demand of the recipient economies. Remittances is a veritable source of external financing, thus lower remittances will imply reduced external financing. Domestic household recipients of remittances also use it to finance education, health expenditure, and limited asset holdings. All of these are expected to be adversely affected.

Figure 1: Possible Channels of the Impact of the Global Crisis on SSA Countries



Source: Authors' Expression

The financial crisis and the credit crunch can impact negatively on the domestic financial system depending on the level of financial integration with the global financial system. The crisis reduces SSA countries' access to market-based international financing. Rollover risks is also expected to increase as there are likely to be credit defaults. With increasing international illiquidity, domestic interest rates are expected to rise which will increase domestic cost of borrowing in SSA countries. For countries with developed capital markets and stock exchanges, there are likely to be drastic decline in stock indices thereby significantly reducing the market value of many firms. This can lead to equity flight. Another non-price impact is the expected fall in the amount of aid flows to SSA countries. Due to the financial crisis and recession, aid commitments are not likely to be fulfilled by donor countries thus leading to shortfalls in external financing. External debt is not likely to be an alternative source due to the international credit crunch. Many countries are likely to witness short falls in both aid-financed fiscal support and development financing thus slowing the pace of economic transformation.

In sum, the global financial crisis and recession are expected to affect SSA countries through the impact on the demand and prices of their major primary commodities of export and also through non-price effects which is mainly through (net) resource flow to the continent. Both sources ultimately can translate to slower growth.

ACTUAL AND PREDICTED IMPACT ON SSA COUNTRIES

Financial/Credit Shock

A sizable number of predictions have been made regarding the expected impact of the crisis and recession on SSA countries. All economic and financial indicators point to the fact that difficult times still lie ahead. Although the impact of the financial crisis and recession on SSA countries is expected to be less severe than in the advanced economies, the sub-continent is not immune. Studies such as Macias and Massa (2009), IMF (2009), and Actionaid (2009) argue that the implication of the financial crisis was not felt in SSA countries until around the third quarter of 2008. Nevertheless, two broad factors can be identified as responsible for the fall in direct and portfolio investments in SSA countries. The first being reduced capacity to invest and the second being the reduced propensity to invest (Macias and Massa, 2009). Both are attributed to the tight credit market, poor growth prospects, increased risk aversion, and reduced investors' appetite for risk. This is evidenced that the average growth rate of SSA countries fell from 6.9 percent in 2007 to 5.5 percent in 2008 and by January 2009, the International Monetary Fund (IMF) further reduced its forecast for growth

for 2009 by 1.6 percentage points to 3.5 percent. By April 2009, the IMF finds itself further revising its forecast to a new projection of 1.7 percent for SSA countries.

Already, it is reported that, given the tight global financial market conditions, Ghana has abandoned its plan for a US$300 million debt issue, while Kenya is delaying the implementation of efforts aimed at securing a US$500 million Eurobond. Also, Tanzania has postponed plans to issue Eurobond of about US$500 million, while Uganda has abandoned plans to issue Eurobond to fund infrastructure projects (Macias and Massa, 2009). The IMF (2008) reports that the value of SSA foreign currency denominated bond (Eurobond) in 2007 was US$6.5 billion, while in 2008, no single one of them entered the market. Further evidence suggests that bank lending has been the hardest hit of all financial flows to developing countries. Macias and Massa (2009) point out that banks total foreign claims on Zambia declined from $2908 million in June 2008 to $2607 million in September 2008, and Ghana experienced a similar drop over the same period. According to Actionaid (2009), bank lending to developing countries in 2008 was about 40 percent of the 2007 level and projections for 2009 suggest that it could drop by as much as 100 percent. This suggests that in 2009, instead of developing countries, witnessing positive net flows, there will be negative net flows.

Prominent fallout of the financial crisis is the rising cost of borrowing through bond issues by developing countries. Actionaid (2009) noted that due to the financial crisis, international lenders are increasingly looking for less and less risky assets to invest in.[2] The reason is that the interest rates charged to the US government when it borrows money through the issuance of bonds—which is regarded as the least risky of all loans—and the rate charged to developing countries when they try to borrow by issuing their own sovereign bonds—which is regarded as more risky—has increased from over 2.5 percent in 2007 to about 7.5 percent in 2008. In 2009, it averaged about 7 percent. Thus, it is reported by Actionaid (2009:5), "the financial crisis is making borrowing more expensive to those countries that bear least responsibility for the crisis, while reducing borrowing costs in those countries that were actually responsible."

The impact of reduced net flows is also being felt in economies with equities market. Also, evidence suggests international traders are moving away in good numbers from stocks that appear risky (IIF, 2009). The risk rating of African financial systems has deteriorated and this has encouraged the flight of international equities traders. One major implication is that some countries have witnessed

[2] The cost of borrowing though bond issues for poor countries has increased.

significant fall in their stock markets (see Table 1). It is reported that in the year 2008, investors withdrew $6.1 billion in South Africa and there are significant evidence of portfolio inflows reversal and capital flight in Kenya, Tanzania and Nigeria (IMF, 2009). According to AfDB (2009b), South Africa, Nigeria, Kenya, Mauritius and Côte d'Ivoire were among the most hit countries in 2008.[3] It is reported that there are no indications that the situation has significantly improved in 2009. Consequently, evidence suggests that portfolio equity flows has significantly slowed down in many countries and some countries are actually witnessing reverse flows.

Table 1: Stock index change in 2008 in selected SSA countries (%)

Index	% change in 2008
Nigeria All Share Index	-45.90
Mauritius All Share Indices	-36.20
NSE 20-Share Index	-34.10
JSE All Share Index	-25.70
BRVM Composite Index	-10.70

Source: AfDB (2009b).

Furthermore, observers are of the opinion that the growth of FDI flows might reduce significantly, however, the subcontinent is not likely to witness significant out flow of non-equity foreign investment. The predictions of UNCTAD (2009) is that FDI inflows to Africa is expected to continue to grow but at a lower rate of about 16.8 percent compared to an average of 22 percent before the crisis. The IMF (2009) predicts that FDI to developing countries is likely to shrink significantly in 2009 and cited projections from World Economic Outlook (WEO) (2008) which indicates that FDI inflows for 2009 is expected to fall by as much as 20 percent from their 2008 levels, compared to over 10 percent growth that was projected in April 2008 by WEO. IMF (2009) argues that reduced profit margin of Multinational Corporations, difficult financing conditions, and volatile commodity prices are some of the factors that will hinder the inflow of FDI to Africa. Due to the concentration of FDI in the natural resource sectors in Africa, it is expected that FDI flows can be delayed or even cancelled due to falling commodity prices.[4]

[3] In Kenya, the Nairobi Stock Exchange (NSE) All-Share Index fell by 21.36 percent from 30 January to 27 February and stock market capitalization dropped by 21.35 percent over the same period. In turn, the Nigeria Stock Exchange All Share Index fell by 30.64 percent in January and increased by just 7.2 percentage points in February. In Côte d'Ivoire, the BRVM Composite Index has continued to fall to date (AfDB, 2009b).

[4] IMF (2009) reports FDI related to expansions of hydroelectric and mining projects has been delayed or suspended in Mozambique.

Macias and Massa (2009) report that the expected takeover of a South African mining conglomerate by Xstrata has been abandoned due to the economic crisis and fall in commodity prices. It is reported that in the Democratic Republic of Congo (DRC), most of the foreign mining companies have scaled back, postponed or completely abandoned their investment plans (AfDB, 2009b). AfDB (2009a: 5) reports that "due to the decline in global demand, copper production in the Democratic Republic of Congo (DRC) declined from 34,215 tons in June 2008 to 23,562 tons in October 2008. A similar trend is observed for cobalt and diamonds. As a result, 40 companies in the DRC extractive sector closed at the end of 2008 and over 300,000 jobs were lost." It is also noted that Arcelor Mittal, regarded as the world's leading steel company, has deferred indefinitely an Iron-ore project in Liberia. Currently, Malawi is on the verge of missing out on a gigantic uranium project. Also, IDS (2009) reports that the Ethiopian Electric Power Corporation is concerned that her investment plans are likely to be severely affected by the crisis. Macias and Massa (2009) reveals that in Tanzania, a US$3.5 billion investment in aluminum smelting had been postponed and a US$165 million nickel mining and extraction project had been rescheduled.

The financial crisis and economic slowdown have also been observed to have significantly lowered the flow of foreign aid to SSA countries. Thus, it is not just private capital flows that have been affected, but also official flows. Before the crisis, poverty-reducing initiatives being implemented by most SSA countries have led to significant inflow of official development assistance and other official aid to support poverty alleviation programmes. The Heavily Indebted Poor Countries (HIPC) initiative and the Multilateral Debt Relieved Initiative (MDRI) also provided avenue for significant flow of foreign official assistance to SSA countries. However, aid projections for 2009 have witnessed significant downward revision. Fosu and Naudé (2009) reports that the value of aid from the United Kingdom (UK) has been reduced by as much as US$41 billion over the next seven years due to the shrinking of the UK economy. The implication is that several aid commitments will not be fulfilled and will therefore have negative impact on SSA countries whose fiscal budget have significant aid content.

Commodity Prices/Trade Shock

The shock coming directly from the recession in the advanced economies has led to lower aggregate demand and employment thereby reducing demand for exports of SSA countries leading to a decline in prices. Exports of SSA countries have performed well some years prior to the crisis due to strong growth in countries such as China and India. In fact, the observed rapid growth of SSA economies

prior to the crisis has been fuel by impressive export performance. The growth has been largely export-led. However, with the collapse of aggregate demand in the advanced economies, many SSA countries have witnessed significant impact on current account balance, government revenue, and economic growth.

The major oil exporting SSA countries suffered significant drop in the international prices of their oil exports. The World Bank (2009) reports that oil prices dropped drastically from $133/barrel in July 2008 to $41/barrel in December 2008. However, by August 2009 some recovery could be observed as the price rose to above $70/barrel due to OPEC production restraint and expected demand increases occasioned by expected global recovery. In general, for most of the second half of 2009, oil prices have been between $66/barrel and $72/barrel. The AfDB (2009a:1) reports that "exports from the continent are expected to fall by more than USD 250 billion in 2009. Oil and mineral exports will suffer the largest losses. Nigeria and Angola alone could experience a combined shortfall of USD 76.8 billion in exports receipts while Zambia and the DRC together could lose about USD 6 billion in 2009". [5] It is also reported that Uganda, a major coffee exporter, suffered a 34 percent decline in coffee export in March 2009 when compared to the same period in 2008—amounting to a revenue decline from USD 36.3 million to USD 23.9 million (AfDB, 2009a). Thus, it could be observed that the impact of the crisis on major exports of SSA countries is through both price and quantity.

Immediate fallout of this export revenue decline is the decline in trade tax revenue. AfDB (2009a) predicts that the continent is likely to suffer trade tax revenue shortfall to the tune of US$ 15 billion which will be in the neighborhood of about 1 percent of the continent's GDP and about 4.6 percent of government revenue. It is predicted that major oil exporting countries will experience significant losses with Nigerian and Algeria suffering about USD 4.6 billion trade revenue shortfall. As a group, trade revenue shortfall for major exporters is expected to be in the neighborhood of about USD 8.2 billion—representing 4 percent of government revenue—compared to USD 6.8 billion for non-oil exporters—representing 5 percent of government revenue. Thus, these trade tax revenue shortfalls will significantly impact on fiscal balance of the governments of SSA countries putting pressure on government spending on social support and other growth-inducing sectors.

Furthermore, prior to the global financial crisis and recession, many SSA countries had witnessed significant growth in trade in services, particularly tourism. The share of services in the total trade of

[5] http://www.carnegieendowment.org/publications/index.cfm?fa=view&id=22995

countries like Cape Verde, Mauritius, Kenya, Uganda, Tunisia, and Morocco had witnessed significant increases over time. However, AfDB (2009a) reports that hotel operators and travel companies are already registering losses due to travel cancellations. Furthermore, the report indicates that in Mauritius and Tanzania, there have been significant reductions in the growth of tourism. For example, in Mauritius, the tourism industry contributes about 15 percent of the GDP and tourism revenues were down by about 15 percent in the last quarter of 2008 when compared to the same period in 2007. In Tanzania, tourism contributes about 17.2 to GDP and safari companies have reported up to 60 percent cancellation in November 2008. There are no concrete evidences to suggest that things will improve in 2009 unless there are rapid recoveries in the advanced economies. Thus, for countries with high contribution of tourism to foreign exchange earnings, one will expect significant negative impact on government revenue (and thus spending) and the external current account balance. Consequently, the implications of the commodity prices/trade shock will largely be on the international current account, the fiscal balance of the government and FDI flows. With significant reduction in export growth compared to import growth, the current account position is expected to deteriorate further, leading to large reductions in foreign exchange reserves thus cancelling the gains of the immediate pre-crisis era.

Growth Implications of the Shocks for SSA Countries.

Figure 1 depicts that the final implication of both the financial and economic crises would be on economic growth with attendant implications for other variable that are directly and indirectly related with economic performance—employment, poverty, inequality, etc. First, the source of growth of SSA countries in the recent pre-crisis years have been largely due to favorable international prices of major primary commodities of exports (price effect) and increased demand for these goods (quantity effect). With limited capacity for diversification and value-addition in productions and exports, the growth performance of SSA countries will continue to depend on the pace of recovery in other parts of the globe. Although as of September 2009, there are sign of fragile recovery in countries like Japan, Germany, and even France, while it is believed that the worst is over in the USA, these are not sufficient to generate immediate and strong demand for the exports of SSA countries. Thus, expectations of early growth resumption for SSA countries are still being met with caution.

There are several forecasts that have been made about the expected growth performance of Africa in 2009 and even 2010. The, UN Economic Commission for Africa (UNECA), in May 2009, posited that Africa's growth rate would slow to a 20-year low of 2 percent in 2009, from 5.1 percent in 2008

and 6 percent in 2007.[6] Also, the IMF in his May edition of African Economic Outlook (AEO) predicts that sub Saharan African will grow by about 1.5 percent in 2009 before making a slight recovery to 4 percent in 2010. There are also predictions that the entire continent should only look forward to achieving a growth rate of 2.8 percent in 2009 in contrast to the pre-crisis expected growth rate of 5.1 percent. Of this value, it is predicted that growth in oil-exporting countries in Africa will fall to 2.4 percent compared to 3.3 percent for the net oil importers.[7]

Already there are indication that South Africa's economy will contrast by about 1.5 percent in 2009, the lowest in 17 years while Rwanda's economic growth rate will drop to about 5.3 percent for 2009 and 2009 compared to an impressive rate of 11.2 percent for 2008. There are expectations that small and open economies such as Botswana and Seychelles are going to be significantly impacted upon. The predictions are that gross domestic product in Botswana and Seychelles will probably fall 8 percent and 10 percent respectively (see footnote 4). Furthermore, due to lower oil output and weaker global energy prices, federal government revenues of Nigeria declined 32 percent below target in the first three months of 2009. Thus, the more a SSA country is integrated into the global financial system and the more commodity-dependent it is, the more it will suffer the effects of the crises.

A worrisome feedback aspect in the whole crisis is that given decreasing export revenue, falling capacity to earn foreign exchange, declining capital inflows (such as remittances and earnings from tourism), it is easy for countries to dangerously plummet external reserves. For example, AfDB (2009c) reports that Democratic Republic of Congo (DRC) has only few weeks of import cover. Thus, the capacity to import capital and intermediate goods for further production will be jeopardized—further constraining economic growth.

POLICY RESPONSES TO THE CRISIS

Prior to the global crisis, many SSA countries are already implementing far reaching reform measures to usher in sound macroeconomic conditions, attract FDI, promote private investment, reduce inflation, etc. These reform measures assisted in mitigating the impact of the crisis on SSA countries. Therefore, the impact could be described as less than expected. However, the situation does not suggest that all is well. Government revenues have declined significantly due to trade

[6] http://news.yahoo.com/s/afp/20090918/wl_africa_afp/africaeconomyun
[7] http://news.xinhuanet.com/english/2009-06/30/content_11627443.htm

contraction and fall in the price of those primary commodities of exports. So how have African countries coped with the global financial crisis and the recession so far?

- *Revised Budgeting*

Most governments made significant revisions to budgeted government spending in the face of dwindling government revenue. Many development projects have also been suspended while in some cases there have been outright cancellations. This policy response, though expected, has the potential of delaying achieving the MDGs and slowing the pace of development. Social spending has also been significantly affected in many countries.

- *Expansionary Monetary Policy*

In many SSA countries, the regulatory monetary authorities embarked on expansionary monetary policy in order to stimulate aggregated demand. This has come largely in form of direct increase in money supply and cutting of interest rates. These are aimed at boosting government revenue through seignorage and stimulating aggregate demand.

- *Banking and Equities Market Regulations*

Many SSA countries have introduced new regulations in the banking system to protect the sector and avoid a collapse. Countries that have large and international integrated banking sectors like South Africa and Nigeria have had to introduce stringent regulations to protect the system from contagion and systemic risks.

- *Sector Specific Interventions and Assistance*

Many countries carried out direct interventions in some key sectors such as agriculture by providing assistance to farmers. Also, in many countries, the banking system received financial supports from the apex bank to prevent liquidity crisis and restore confidence.

- *Foreign Exchange Controls*

A few countries have had to engage in foreign exchange controls to protect the value of their domestic currencies against major international currencies and also to prevent capital flight.

- *Countercyclical Fiscal Stimulus Packages*

Many countries in Africa were able to inject some funds into their economies through a relatively modest fiscal stimulus package. Some of the funds have come in form of higher government deficit, support for the financial/banking system, etc. However, analysts are of the opinion that the effectiveness of the stimulus will depend on factors like the source of the funds, on what they are spent on, the size of the package, etc.[8]

- *Short-term borrowing from Bretton Woods Institutions.*

As of May 2009, new IMF lending to Africa reached $US1.6 billion, doubling the figure for 2008.[9] The IMF has approved a total of $545 million in emergency funding for Kenya and Tanzania, while some other African countries have also expressed their interest to seek financial support from the IMF. However, based on the nature of the impact of the crisis on the economies of poor countries, the IMF is exploring new lending instruments that will not require governments to utilize IMF loan immediately, but only when it is required.

- *Economic Monitoring Units*

Countries have also responded by setting up crisis-specific economic intelligence and monitoring units to monitor the trend in the global economic system and evaluate how such activities are transmitting to the domestic economy and what policy responses are appropriate. The units are to provide advices to the relevant authorities on how best to design and implement policies to mitigate the impact of the global crisis on the economy and the citizens.

BEYOND THE CRISIS: LESSONS AND WAY FORWARD FOR AFRICA

Immediate Pre-Crisis conditions

The impact of the crisis on SSA countries seems to have been milder than expected. A major reason attributed for this is that, prior to the crisis, many SSA countries have started putting in place sound macroeconomic environment and other reform measures that made economic fundamentals stronger than before. Many governments succeeded in setting up measures that helps to nurture the private sector and enhance business climate indicators. Various kinds of business risks reduced considerably in many countries and hitherto business-unfriendly countries became very attractive to investors and also more competitive. The nature of this lesson is on the importance of reform measures that promotes private entrepreneurship, sound macroeconomic management and stability, growth and development in general. Also, the fact that SSA countries are not too integrated into the global

[8] http://blogs.worldbank.org/africacan/a-fiscal-stimulus-for-africa
[9] http://www.reuters.com/article/latestCrisis/idUSN31397825

financial system also helped reduce the impact of the financial crisis. Banking systems in many SSA countries are still largely regulated which partly insulates them from the impact of the financial crisis. Although the financial crisis increased the stress index of many banks in Africa, a general banking crisis is not envisaged. Furthermore, the impact of the global financial crisis on Africa has been cushioned by its limited holdings of stock share capital.

Also, with the HIPC initiative and MDRI, African countries have almost totally exited external liabilities which had freed resources for development financing. Most essential credit lies with secure multi and bilateral structures like the World Bank and IMF, Governments and non-profit institutions. The impact of the crisis would have been unimaginable if it had occurred at the time when most SSA countries were still heavily indebted to various bilateral and multilateral foreign lending institutions. Consequently, the rate of capital outflow can be regarded as much lower due to the lower debt burden. Much of the outflows witnessed are equity flight. The nature of this lesson is on how SSA countries want to integrate with the global financial system and the need for less reliance on foreign debt (and other foreign sources) for development financing.

It should also be mentioned that SSA countries became more politically stable prior to the crisis. Although there are still patches of fragile political regimes, the political landscape of the continent has become more conducive to growth and development. This again contributes to cushioning the effect of the crisis on the continent. Again, lessons are learnt on the need for good governance and a stable polity that ensures that a development-oriented state is created and entrenched.

Furthermore, the immediate pre-crisis era witnessed a more globally integrated Africa in terms of the direction of trade than in the previous decades. While Africa became less dependent on traditional OECD markets, trade with China, India, and Latin America increased significantly. Consequently, this market diversification contributed to mitigating the effect of the crisis on African countries. This does not discount the importance of OECD markets, but suggest the cushioning impact of market diversification. Though, at a later stage, when economies like China and India witnessed significant recession, SSA countries immediately felt the impact of the crisis. However, a lesson has been learnt on the importance of market creation and diversification.

Lessons and Issues for Consideration

Given the characteristics of most SSA economies and the impact of the crisis on government revenue, countercyclical fiscal response will likely have limited impact. At best, countercyclical

policy responses will be emergency measures meant only for the short-run. Most SSA countries do not have the kind of external reserves that can sustain any meaningful stimulus package into the medium term. The crisis severely impacted on SSA countries because of the structure of their economies—aid dependency, primary commodity dependency, etc. Also, suggesting increase in foreign aid to SSA countries at this time is tantamount to looking for ice cubes in the desert. Furthermore, so far the advanced economies have not fully recovered, FDI flows will not likely improve significantly.

Therefore, requests for increased FDI flows at this time will be futile. It is also not interesting to note that it may be increasingly difficult for SSA countries to gain trade access to the advanced countries. This is because some of them are already introducing measures to keep out foreign trade. Given the downturn in global markets, many investors will be reluctant to increase their investment in Africa or explore trade relationships in a climate of declining international credit. Ultimately, what Africa needs is an endogenously driven rapid structural transformation of her various economies from rudimentary primary commodity dependent economies to sustainable wealth-creating knowledge-driven economies. Short-run policy responses, though required as urgent interventions, will not achieve long-term objectives of moving the majority of the citizens out of poverty and ignorance. Thus, any long-term policy response will have to address these structural rigidities and deficiencies. Hence, the following issues would require urgent consideration by SSA countries.

- *Level of Integration into the Global Financial System: China vs. South Africa Scenario*

China and South Africa present two classic cases of the factors that can determine the extent of vulnerability of a country to the global financial crisis. Both are members of the G20 but pursue different policies since the early 1990s. China has historically been less open to the global economy than many other developing countries and retains capital controls. Its financial system is also relatively closed. South Africa is at the other end of the spectrum. Since 1994, the government has adopted a strategy of extreme openness to the global economy. Foreign buyers largely dominate the South Africa equity market and banking system. China is largely hit by the recession while South Africa—also a major exporter of goods—is being hit both by the financial and economic crises. As actionaid (2009: 10) noted "while China is already being hit by the recession, its financial system looks resilient enough to survive more or less intact. However South Africa, more integrated into precisely those global financial markets most affected by the crisis, is likely to be hit by both the recession and even more by the financial crisis, as those external sources of development finance on which it is most dependent dry up."

It is predicted that the total drop in Chinese export earnings between 2007 and the end of 2009 will be around 18 percent, which is estimated at 7 percent of the pre-crisis GDP. Due to the relatively low international financial inflows, large domestic financial sector, high rate of domestic investment and high rate of domestic sourcing of development financing, it is predicted that losses to China's financial system between 2007 and 2009 will be just over 2 percent of the country's pre-crisis GDP (WEO, 2008). The projections are that export earnings in South Africa will be down by about 7 percent from their 2007 levels or the equivalent of about 9 percent of pre-crisis GDP. However, fall in flows due to the financial crisis—mainly accounted for by dramatic drops in bank lending and the value of equities—is predicted to be more than 15 percent of pre-crisis GDP (Actionaid, 2009). This suggests that the exposure of the South African equity market and financial sector will make the impact more pronounced in South Africa than in China with a larger economy.

Consequently, what lessons can African countries draw from this and what are the appropriate policy implications?

- First, it must be confessed that the whole issue of financial globalization has been more of risk than benefits to SSA countries. Globalization promised massive inflow of development funds into developing countries. Much of these funds did not come as expected and now some countries risk development reversal as equities take their flight due to the crisis. Agreed, with limited capacity to mobilize domestic resources (in the short run), poor SSA countries will require external financing. The post-crisis global financial framework that will emerge should ensure that countries can get more productive and development-oriented external financing devoid of the kind of risks these countries are witnessing. International financial regulators must design a new system that effectively controls and manage risks and sudden shocks due to international financial flows. The current situation is a bitter lesson for a country like South Africa. SSA countries should exercise some caution in terms of the extent of integration of their financial system with the global financial system.
- Another lesson here is the issue of wholesome liberalization. Africa might have to re-think this neoliberal policy, particularly in relation to the international capital account. The rate and speed at which equities flew out of Africa due to the global crisis is alarming. Should SSA countries fully liberalize the international capital account? The current experience suggests that this will continue to expose SSA countries to speculative capital flows, tax

evasion and increased capital flight. This has a depressing impact on domestic savings and increases dependency on external finance for development.

- *Need for Domestic Resource Mobilization and Efficient Utilization*

SSA countries must have realized the importance of domestic sources of development financing. International financial flows have gradually dried up and SSA countries are yet to record any meaningful success in terms of achieving the MDGs. Consequently, how best do SSA countries think they can finance development if not by exploring domestic sources? Again, the experience of China comes handy. China has succeeded to a large extent because it has relied on domestic resource mobilization for development. There are evidences that domestic capital is the most stable source of development financing and has the highest pay-off in terms of development. External financing should be seen as complementary rather than the main source of development financing. While the advanced economies mobilized over US$4 trillion to bail out various financial institutions and industries in the immediate period of the crisis, aid commitments to SSA countries remained unfulfilled. The reality therefore is that it has become increasingly difficult to rely on external development partners.

- The basic lesson to be learnt is the importance of diversified sources of development financing and financial flows. SSA countries must design appropriate mix of sources of development financing. Shocks to the economy are inevitable and unpredictable; however, coping with shocks is not expected to be ad-hoc. Predictable and reliable sources of development financing should be explored. Of course, how resources are deployed and used are also important. Corruption, waste, and mismanagement of resources must be curtailed.
- SSA countries also need to re-orientate their financial system towards the financing of productive investment and enterprises. In many SSA countries, the financial system finances mainly imports and other short-term speculative activities. The real sector hardly benefits from the financial system. The financial system must be made to provide funds to promote entrepreneurship and initiative in enterprises within a sustainable development framework.
- Another important lesson here is that SSA countries must reclaim the debate on economic development. Economic development must be made endogenous in all respect—concept, strategies, tools, financing, implementation, etc. Economic development must be homegrown, based on domestic investment and consumption.

- *Domestic Market Development and Market Diversification*

The recession in the advanced economies affected SSA countries significantly because the advanced economies are the main markets for SSA primary exports. It is important for SSA countries to develop their internal markets and also hasten the various regional integration schemes. Currently, less than 10 percent of SSA trade is regional. It is important that SSA countries explore the opportunities that regional integration can provide. This will reduce vulnerability to demand volatility coming from advanced economies. Domestic market development and regional integration are important if SSA countries are to shield themselves from global economic slowdown.

- The important lesson to be learnt is that SSA countries need to reduce their dependency, not only on primary commodity exports, but also on traditional OECD markets. Also, there is the need to diversify on the range of commodities offered for exports and to improve on value-addition. There must be economic diversity if SSA countries are to cope effectively with the global crisis. SSA countries need to pay more attention to the issue of regional integration as a veritable source of market diversion. The fact that some countries produce and export similar products is not sufficient to partly disregard the issue of regional integration. The global crisis should be sufficient to galvanize the necessary political will to hasten regional integration and enhance South-South trade and cooperation. Meegan (2009) points out that "one of the key elements to the exponential success of South Americas moving out of poverty into middle income economies has been its economic diversity. South East Asia also moved from poverty in the 1950s and 1960s into highly effective diversified markets by the early 1980s."[10]

- *Continued Structural Reforms, Political Stability and Good Governance.*

It is important that SSA countries continue to implement several structural reforms if domestic resources are to be effectively and efficiently mobilized and allocated. These reform measures are essential to overcoming infrastructure huddles and improving business environment. There is need for tax reforms that will make tax administration more efficient and increase government revenue; the need to put in place financial regulatory measures to control risks and reduce capital flight, the need to engage and partner the private sector in infrastructure provision; the need to relax business regulations; the need to put in place measures to reduce cost of intra-African trade, and etc. Structural reforms that ensure investment in infrastructure are crucial to sustaining growth. This is one area that is generally deficient in SSA countries.

[10] http://windyharbor.wordpress.com/2008/10/12/africa-and-the-global-financial-crisis-disaster-or-opportunity/

It is also important that SSA countries continue to ensure that there is political stability so as not to discourage private investment. The relative stability within the continent should be sustained and consolidated. SSA countries will also have to improve on governance. All these will provide the required conducive environment for capital mobilization for development. Africa countries have now realized more than ever that there is need for development to be homegrown. They have to take ownership of their development strategies and tools. Therefore, the necessary reforms have to be put in place to ensure that investment is profitable and with little risks. Political instability and bad governance are not conducive to homegrown development.

- Again, an important lesson to be learnt here is the limitation of the market and the need for the state to be more involved in the development process. The state should partner all relevant stakeholders, like the private sector, civil society, and so on, in the development process. The global crisis reveals that there are still important roles to be played by the state, alongside the market, in the development process. The current global situation suggests that market failure is not significantly different from state failure, if not more costly. In fact, the current global crisis—which is due to market failure—is now being solved by the various states affected. SSA countries must wakeup to their development responsibilities. The market is not sufficient in the development process, and development should not be left to the market alone.

- *Learning from the Experience of other Regions*

SSA countries have a lot to learn from the experience of other countries in Asia and Latin America. There is enormous gain in human capital development. This is evident in the rapid growth of China, India, Vietnam, Malaysia, Indonesia, Thailand, Philippines, etc. The enduring asset of a country is the skills and knowledge of her people. A country like Philippines ensures that her labor force is prepared for international opportunities and globally competitiveness not only through relevant and up-to-date curricula, but also ability to speak and write in English. Similar to India, the Philippines ensure that its development strategy and vision, particularly human capital development, is outwardly oriented. Also, it is important that SSA countries learn from the strategy of India in terms of information and communication technology. African countries must proactively nurture information technology, computer and communication industries. These industries have the ability to open up new opportunities as evident from Asia.

- *Having a Meaningful Voice in the Post-crisis Global Financial System.*

SSA countries seem not to be in the centre with respect to designing a post-crisis global financial system. Meetings, grouping arrangements, and international governance institutions have largely excluded SSA countries (except South Africa in the G20). SSA countries are seemingly voiceless before and during the crisis, and now it is like after the crisis too. It is just too likely that the post-crisis global financial system will not adequately take care of the interest of SSA countries. The impact of the crisis on SSA countries implies that Africa deserves a better stake in the global economy. There should be increased and effective continental representation and active participation in the various multilateral financial arrangements and institutions. Thus, it is important that SSA countries strongly define and articulate their interest and press for adequate representation in whatever post-crisis global arrangements that are being made.

- *Continued Sector-specific targeting and assistance.*

The agricultural sector in most SSA countries engages about 60 to 90 percent of the active labor force. However, this sector has been badly hit by the global recession and has suffered significant reduction in output and income. Farm income has reduced significantly and this will affect a large percentage of the active labor force. The consequences can be grave in terms of unemployment, poverty, and inequality, which could have significant negative political consequences. Therefore, governments may be required to intervene in this and other strategic sectors. Price/income support measures may be required despite falling government revenue. If this is not done, resources may move to other (speculative) sectors and when the global system recovers, it may be difficult to re-allocate resource back to this strategic sector. Thus, countries that are leading exporters of such products may lose their competitiveness. Although, in many SSA countries, the banking system is not badly hit by the crisis, it is important that governments continue to support the system and ensure that prudent supervisory and regulatory measures are in place to prevent the banking system and the financial sector from unnecessary exposures.

CONCLUSION

The global crisis should be seen in the context of development challenge rather than economic stabilization. What is required now is a complete shift in the SSA countries development strategy. Reliance on external sources of development finance, primary commodity exports, and traditional OECD markets should be re-examined. It is important that the continent empower its citizens economically so that a large domestic market can be created in the continent. Despite the fact that most of the advanced economies are shrinking, China, India, and Brazil have growing economies.

This is largely due to the fact that development is domestically cultivated and the populations are economically empowered to create adequate domestic demand. SSA countries must start looking inward if it is to minimize the impact of future external shocks on their economies.

However, the way out for SSA countries is conditioned on the pace of recovery of the advanced economies. There is need for rapid structural transformation of the economies of SSA countries. They are regarded as weak, fragile, and vulnerable. The nature, composition, and direction of exports have not changed significantly in the past four or five decades. Efforts at enhancing regional integration to create larger markets are at best rhetorical. It has become imperative that SSA countries should be more sincere in this respect. There is definitely a strong need for a change in development strategies.

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