



Number 4  
March 2010

Introduction

Implications  
for Growth and  
Development of  
Africa's Financial  
System

Macroeconomic,  
Sectoral and Social  
Impact and Policy  
Response

Impact on Africa's  
Trade and Policy  
Response Options

Impact of the  
Crisis on SSA: An  
International Private  
Sector View

Global Causes,  
Consequences and  
Policy Responses to  
the Crisis

Overall Policy  
Priorities

[www.aercafrica.org](http://www.aercafrica.org)

**Foreword** by William Lyakurwa, *AERC Executive Director*

## The Global Financial Crisis: Implications for Africa

In mid-2008, a financial crisis hit the global economy and the African continent, reducing Africa's growth rate by 4% in 2009. All the major regional and international organizations (African Development Bank, Economic Commission for Africa, G-8, G-20, International Monetary Fund and World Bank) have committed to assisting us to weather the storm, but we cannot leave this crisis to the rich world to clean up: we need to take our own anti-crisis measures.

As a result, AERC organized its eleventh senior policy seminar on The Global Financial Crisis and its Implications for African Economies. It was held in Lusaka, Zambia, over three intense days in April 2009, and attracted 92 participants from 24 countries, including three ministers, six central bank governors, and three permanent secretaries, as well as special advisors, parliamentarians, senior scholars and research institute directors.

The Senior Policy Seminars are annual forums convened by African Economic Research Consortium (AERC), to give African policy makers the opportunity to come together to learn about the results of AERC research, exchange policy experiences and interact with AERC researchers. They help to inform the implementation of policy, by encouraging policymakers to realise the value of high-quality African research. They provide an opportunity for uninterrupted deliberations on key policy issues, insulating policy makers from day-to-day pressures and creating an environment for lively professional discourse. They also promote cooperation between policy makers and researchers at national level, by making policy makers more aware of the applicability of research techniques to national problems. As a result, policy makers have found the seminars very useful to update knowledge and analyse crucial policy issues for their countries, improving their capacity to plan policies and negotiate with international institutions.

This policy brief has been distilled from the seminar discussions, to transmit their key messages. Along with a full seminar report and a volume containing the seminar papers, it will be published and shared widely with policy makers to inform policy decisions, and within the AERC network to encourage researchers to respond to key policy issues. The publications will also be available on the AERC website at [www.aercafrica.org](http://www.aercafrica.org).

This eleventh seminar was notable for looking in detail at the impact of the financial crisis on growth and the real sectors, the financial systems of Africa, macroeconomic policies, and trade policy options. It also combined Africa-focussed with global perspectives, and saw presentations by private sector and government representatives as well as AERC researchers from Africa and the diaspora. As a result, participants described the seminar's analysis and discussions as the most informative of many they attended on these issues in 2008-09, and urged AERC to continue its work in this area.

In addition, though the G-20 meeting of March 2009 responded somewhat to African governments' concerns, it will be vital that these are heard even more loudly in future, and that they are based on high-quality research. A key contribution of this seminar was to show that Africa has the capacity to analyse these issues for itself, providing an excellent basis for support to African policymakers in G-20 and other negotiations over how to combat global crises, so Africa can reach the Millennium Development Goals.

## Introduction

The global financial crisis is already having a huge impact on Africa's development, undermining progress on growth, poverty reduction and the Millennium Development Goals. This will increase sharply as 2009 continues, making this year vital for Africa, both to respond with its own policies, and to influence global discussions on anti-crisis assistance for developing countries.

As a result, the opening session of the seminar emphasized the urgency of its deliberations. Welcoming the participants, William Lyakurwa, Executive Director of AERC, underlined that all global and regional institutions are predicting for 2009 a severe negative impact of the crisis on Africa, through reduced trade, investment, remittances and aid. This brings a real risk that millions will be thrown back into poverty. However, the crisis also presents opportunities for African economies to increase their competitiveness and diversify their economies, especially by improving infrastructure and reducing its costs. Africa needs to be proactive in reviewing its national and regional policies, and making its demands felt globally, to cope with the economic tsunami, and the SPS can help identify the best policy responses to sustain African development.

In the official opening address, Caleb Fundanga, Governor of the Bank of Zambia, said the seminar could not be more opportune, to avoid the threat of a reversal of Africa's hard-earned recent economic and social gains. He emphasized that the effects of the crisis were human as well as financial, causing massive job losses as well as falls in foreign investment and export earnings, and volatility of African currencies and stock markets. In Zambia, mining, tourism and horticulture had all been hit hard. To complement the measures being taken at global level, Africans need to be part of the solution by reinforcing their own policies, taking strong measures to maintain financial market confidence and enhancing social protection and services for the poorest, to ensure a rapid return to growth and poverty reduction.

### *The remaining sessions organized their discussions around papers on 5 themes:*

- Implications for Growth and Development of Africa's Financial System
- Macroeconomic, Sectoral and Social Impact of the Crisis: Issues and Policy Options
- Impact on Africa's Trade and Policy Response Options
- International Financial Flows to Sub-Saharan Africa
- Global Causes, Consequences and Policy Responses to the Crisis

### *Thereafter participants summarized the policy lessons of the seminar in terms of:*

- The impact of the crisis on African development
- Policy responses needed nationally, regionally and globally
- Key issues for the policy research agenda

"No one will be immune from this crisis: Africa may be among the last to feel the impact, but will be hard hit"

"The challenges arising from the crisis are surmountable if we remain committed to pursuing strong socio-economic policies, to sustain our recent economic gains."

"Most African banks and capital markets are vulnerable to contagion effects of the financial crisis, unless we take urgent corrective actions."

## Implications for Growth and Development of Africa's Financial System

The global financial crisis is likely to affect Africa's financial systems via contagion effects through lower banking, foreign exchange and investment flows. Based on lessons from past crises, this could have three impacts: i) a credit squeeze or collapse in lending; ii) a collateral squeeze or fall in the prices of real assets; and iii) a savings squeeze due to lower interest rates. Although the largest African economies have undertaken comprehensive financial reforms, and achieved a high degree of bank competitiveness and financial intermediation, contagion remains a major risk in most African economies.

However, few banks in Africa are directly exposed to off-balance sheet transactions such as securitization or derivatives, so Africa is likely mainly to escape the sub-prime and banking crises, and not to require bank rescue plans as a result of the crisis. Even though many countries' banking sectors are dominated by foreign banks, whose headquarters are hard hit by these factors, the rapid and strong measures taken in OECD countries to protect and recapitalize banks look likely to protect their African subsidiaries.

On the other hand, the wider capital markets are already being hard hit. Stock and bond markets have fallen sharply, as have exchange rates, as foreign portfolio investors pull back from economies perceived as risky. FDI is falling sharply for the same reason and due to a lack of global loan facilities to support equity investors. The effects of the crisis have therefore been strongest on those economies most dependent on foreign capital.

African governments need to monitor developments constantly, and develop contingency plans for supporting financial institutions, including deposit insurance, enhanced regulation and supervision, and liquidity injections from central banks, with regional and global financial and technical support. In the longer term, it is vital to manage financial sector reform through strong regulation to reduce risks especially from derivatives; further improve the legal security of investments and financial sector competitiveness, reduce corporate dependence on foreign borrowing, and especially make African financial systems more dependent on domestic savings and connected to local small entrepreneurs, and therefore less vulnerable to global trends, by enhancing microfinance and rural financial markets.

### *Policymakers concluded in this session that Africa should:*

- Monitor the impact of the crisis on financial flows and markets on a much more timely and comprehensive basis.
- Refocus financial sector reform to focus on long-term financing for medium-scale enterprises, microfinance, and rural savings and investment, especially for women.
- Reorient fiscal incentives for investment to reduce dependence on debt financing
- Mobilise regional and international institutions to cofinance equity investments and long-term bank loans as well as trade finance
- Design better strategies for stabilizing foreign exchange markets, stock and bond exchanges, and interest rates, through tighter regulatory policies.
- Identify their "monetary policy space" to undertake stimulus to credit markets.

"The crisis has exacerbated the failure of the financial system to fund long-term investment by Africa's entrepreneurs. Our response needs to tackle this fundamental problem".

## Macroeconomic, Sectoral and Social Impact and Policy Response

The crisis is likely to reduce Africa's growth by at least 3%, increase current account deficits by reducing commodity exports, hit reserves by reducing financial flows, and lead to currency depreciation. It will hit the agricultural, oil and mining sectors especially hard due to falling commodity prices, but may also exacerbate deforestation as a coping strategy by the poorest. Unemployment and social crisis is also burgeoning, and there is a risk that, with lower budget revenues, governments will be forced to cut health, education, social protection and food security spending.

African countries need to take strong and regionally-coordinated policy measures to respond to the crisis, as well as to continue to promote growth and poverty reduction. Fiscal space needs to be fully used by enhancing spending on anti-crisis measures, as well as investing in infrastructure and human resources. So does monetary stimulus, to maintain private sector demand and investment. However, if external funding declines, adjustment measures may be necessary, even though they risk exacerbating the negative impact of the crisis on the real economy and social indicators. It is, therefore, vital that Africa develop a strong regional anti-crisis strategy and express this strongly through greater representation in the G-20.

### *Policy recommendations that stemmed from the deliberations included:*

- Greater analysis of transmission mechanisms through which volatility in international financial and trade markets can cause domestic macroeconomic problems
- More flexible conditionalities by international and donor organizations to ensure maximum scope for using fiscal and monetary stimulus to combat the crisis
- Higher investment in infrastructure and human capital development in order to emerge stronger and more competitive from the crisis
- More communication among African governments about potential knock-on effects from intra-African investment, remittances and trade.
- Slower capital account and inward portfolio investment liberalisation (where this was not already complete), and closer monitoring of such investments in liberalized economies, in order to reduce vulnerability to global capital flow movements.

"The crisis may weaken our macroeconomic base, aggravate the impact of high food and fuel prices, hit commodity exporting sectors, and annihilate the progress made towards achieving the MDGs."

"We need a strong fiscal stimulus in the poorest countries in order to stabilize economies and offset the massive social fallout of the crisis."

## Impact on Africa's Trade and Policy Response

### Options

Sub-Saharan Africa's recent robust growth has been underpinned by strong export performance, especially high commodity prices. The crisis is affecting African economies through a fall in global commodity prices, but also through a wider drop in demand for all (including non-commodity) exports due to recession in export markets. Insofar as Europe and North America still buy two-thirds of Africa's exports, their recessions sharply reduce demand. Commodity prices are also likely to fall by 25% in 2009, offsetting the rise in 2006-08, leading to income losses of 2-9% of GDP.

Policy responses will need to involve a mixture of adjustment (reducing imports) and financing where this is available, including running down reserves accumulated in 2006-08, and advocating much greater levels of trade and development financing from G-20 and other sources. Beyond the crisis, African governments need to build stabilization funds to protect their economies against shocks, to diversify their exports through industrialization and infrastructure/human capital development to reduce the commodity price effect, to encourage intra-African trade to make them less vulnerable to OECD economy shocks, and to press for a successful completion of the Doha development round of multilateral trade negotiations.

#### *The discussions among policymakers recommended that:*

- Enhancing trade financing flows could boost global trade demand rapidly
- Regional integration and trade promotion should be given equal priority with global trade negotiations
- Pro-poor trade framework such as fair trade and labour-intensive export production would be vital to ensure that trade policy combats the impact of the crisis on the poor.
- There is need for analysis of individual commodity markets to distinguish the impact of the crisis from longer-term structural overproduction (e.g. in cotton).
- Falling trade is having a major impact on fiscal revenue in some countries, so trade recovery is essential to fiscal stimulus.
- "Aid for trade" should focus much more on diversification, and domestic and regional trade promotion, rather than producing commodity exports for G-20 economies.

"A collapse in demand for all exports due to global recession is more problematic, and requires Africa to work for global reflation, anti-protection measures and regulation of the world economy, to avoid a recurrence."

"We need a pro-poor trade agenda to ensure that a global stimulus through trade reaches those who are most vulnerable to the crisis".

## Impact of the Crisis on SSA: An International Private Sector View

This session produced some sharp disagreements. The international private sector perspective was that growth might slow somewhat, but the effects on Africa would be limited, with the main determinants of African growth remaining domestic policies. Currency and stock exchange falls had been limited and due to country-specific and transitory factors. There might well be a commodity price fall, and slowing of investment, aid, tourism and remittances. This would require SSA governments to rethink their borrowing plans, turning more to domestic bonds to fund deficits and continue infrastructure spending. The priority would be to reinforce commitment to the right policies, including especially reducing inflation back to single digits.

On the other hand, African researchers and policymakers were much more pessimistic about the potential impact of the crisis on their economies. They pointed to much sharper falls in currencies and stock exchanges early in 2009, as well as evidence of sharp commodity price, investment and remittance falls, and urged more attention to the human impact on employment, poverty, health, education and the MDGs. While warning against “apocalyptic” voices, they judged that global speculation would have a major negative impact on their economies in the absence of a coordinated global policy response.

### *Policy recommendations arising from the ensuing discussions were to:*

- Analyse the impact of the crisis in more detail at a sub-regional and national level, as well as the degree to which currency and stock exchange falls were transitory and market-specific, or driven by a more fundamental global investor caution
- Adjust “correct policies” and inflation targets for the need to respond to the crisis through fiscal and monetary stimulus
- Enhance national financial market regulation and promote regional development ties.
- Continue with pre-crisis changes in policies which had emphasized higher investment in infrastructure, as well as on secondary and vocational education to enhance skills.
- Make sure borrowing policies keep debt sustainable and do not overload domestic financial markets with government debt, crowding out private investment
- information from early warning systems on future trends.

“While trends in the global economy do have some impact on SSA, the main issue is still getting politics and domestic economic policy correct.”

“Policies have been vastly improved in recent years: the issue is now that global financial sector speculation could drive us off track from the MDGs and undermine commitment to those policies.”

"Crises are endemic to financial systems: so even the best regulation will only reduce their frequency and severity. African countries cannot escape globalization, and need to build their capacity to reduce and manage its risks."

"Who regulates the regulators and stops them from being sucked into the market euphoria?"

"The G20 financial response is welcome but too little, too late. The key will be whether African countries are allowed the policy space to stimulate their own economies and keep spending money on the MDGs."

## Global Causes, Consequences and Policy Responses to the Crisis

The global crisis has revealed serious regulatory gaps and lack of accountability at global and national level. Most of the response so far has been short-term (bank bailouts, fiscal and monetary stimulus) rather than systemic or longer-term to reduce the likelihood and severity of future crises. The roots of the crisis lay in distorted incentives and poor corporate governance, housing and credit bubbles, easy money and cheap credit, and inadequate credit rating checks, leading to increasingly complex and opaque financial instruments. The consequences have been massive risks of failure for financial institutions and government sponsored enterprises, most of which have been bailed out rather than allowed to fail. Africa has suffered "collateral damage", especially through falls in stock markets and financial flows.

At a global level it is clear that the market cannot solve the problem: and that lenders and investors of last resort are needed to assist low-income countries. Africa could also benefit from improving global regulation, deposit insurance and corporate governance, as well as building government capacity for risk oversight and management, though these will not eliminate future crises. However, the G-20 response to the crisis has focused mainly on middle-income and emerging markets, and on providing finance for trade and the private sector. The short-term response for low-income countries falls well short of their additional financial needs, and will not allow them to fund sufficient fiscal stimulus to maintain progress towards the MDGs. There has also been very little progress on systemic issues of regulation and corporate governance, or on reforming the global financial architecture, in which Africa remains extremely under-represented.

### *Participants suggested the following policy measures:*

- Increase monitoring and exchange of information on global, regional and sub-regional trends as early warning systems for African countries
- Analyse more closely prospects for global markets and external financing flows as part of an overall national policy, including the design of policies to stabilize and increase flows
- Accelerate reform of the international architecture for crisis resolution, regulation and corporate governance, as well as coordinated stimulus and early warning systems
- Deliver G-20 promises, ensure they are additional to existing flows, and provide them based on need/vulnerability, and via macroeconomic support to the budget/reserves
- Reduce conditionality and provide policy space for national anti-crisis stimulus
- Increase African voice through networks of economic policymakers in the G-20, and ensure a stronger role for more global and legitimate forums like the United Nations
- Continue to focus on the best policies for long-term development rather than being excessively diverted onto anti-crisis measures

## Overall Policy Priorities

At the end of the seminar, policymakers concluded that the impact of the crisis is hitting Africa hard already, not through banking crises (though these are still a strong risk in some countries), but via sharp falls in remittances, FDI, portfolio flows to stock markets and bonds, and lower commodity prices and export demand. In turn this is translating into sharp cuts in budget revenue and GDP, increased budget deficits, job losses and higher levels of poverty, and falls in exchange rates (making external debt service more expensive) and reserves.

So how should Africa respond? At the national level, two types of responses are urgent. The short-term responses include fiscal and monetary stimulus; making full use of reserves and stabilization funds; closely monitoring trends in external financial flows and of the health of financial sector institutions, and designing contingency plans to restore their health if necessary; seeking new markets for commodities and exports in countries which recover faster from the crisis; enhancing social protection and investment in infrastructure and human capital; and increasing absorption of aid.

However, longer-term responses are equally important so as to enhance Africa's resilience in the face of future crises. These include: improving regulation and supervision of financial institutions and markets, and of corporate governance; increasing risk analysis and management capacity, in both public and private sectors; diversifying and adding value to products (especially exports) and markets; increasing agricultural productivity; ensuring greater intermediation of remittances into investment; increasing microfinancing for small-scale and rural enterprises; increasing domestic savings and investment to reduce dependence on external capital, especially foreign aid; and integrating anti-climate change policy measures into the recovery from the crisis.

At the regional level, Africa needs to establish mechanisms and networks to exchange information more regularly and rapidly among countries about the impact of the crisis, as well as the design of stimulus plans and, in the longer-term, of plans to relaunch development and progress towards the MDGs. It also needs to develop more regional financing markets, trade links, infrastructure, and pooled reserves and payment agreements, to reduce dependence on global income sources and financial channels.

"We need a handbook of dos and don'ts for stimulus packages."

"We must take urgent measures to stop the economic crisis from provoking national social and political crises."



At the global level, Africa needs to ensure the G-20 delivers on its promises, whether by delivering rapid additional financing with low or no conditionality, by restructuring international financial institutions like the International Monetary Fund and the World Bank so that the voices of low income countries are heard, or by taking steps to close down tax havens, end banking secrecy to encourage repatriation of flight capital, and regulate global finance better to avert future crises. It also needs to collect and circulate much more information on global market trends for “early warning” of any crises, and to continue to push for maximum progress in the Doha Development Round of trade talks.

**“Aid needs to work better to mobilize and stabilize foreign and especially local investment, and thereby work itself out of a job.”**

Finally, what are the key policy research issues? They include: establishing information exchange networks to continue to track the impact of the crisis; understanding the vulnerabilities of the African financial sector, and how to improve regulation, supervision and corporate governance; how to design fiscal and monetary policy responses to external shocks (fiscal stimulus), especially in ways which promote poverty reduction, social protection and development of infrastructure and human capital; promoting agricultural productivity, trade diversification and regional trade; encouraging domestic resource mobilization, especially for small- and medium-enterprise development; and supporting African advocacy for change in the global financial architecture.

## AERC Policy Brief

Number 4  
March 2010



### AFRICAN ECONOMIC RESEARCH CONSORTIUM (AERC) CONSORTIUM POUR LA RECHERCHE ECONOMIQUE EN AFRIQUE

The African Economic Research Consortium (AERC), established in 1988, is a public not-for-profit organization devoted to advanced policy research and training. The principal objective is to strengthen local capacity for conducting independent, rigorous inquiry into problems pertinent to the management of economies in sub-Saharan Africa. In response to special needs of the region, the AERC Research Programme has adopted a flexible approach to improve the technical skills of local researchers, allow for regional determination of research priorities, strengthen national institutions concerned with economic policy research, and facilitate closer ties between researchers and policy makers. The Training Programme augments the pool of economic researchers in sub-Saharan Africa by supporting graduate studies in economics, as well as improving the capacities of departments of economics in local public universities. AERC is supported by donor governments, private foundations and international organizations. Further information concerning AERC and its programmes can be obtained from:

THE EXECUTIVE DIRECTOR  
AFRICAN ECONOMIC RESEARCH CONSORTIUM  
MIDDLE EAST BANK TOWERS, 3RD FLOOR  
MILIMANI ROAD  
TEL: (254-20) 273-4150 (PILOT LINE) / 273-4157 / 273-4163  
FAX: (254-20) 273-4173  
EMAIL: EXEC.DIR@AERCAFRICA.ORG  
WEBSITE: WWW.AERCAFRICA.ORG

[www.aercafrica.org](http://www.aercafrica.org)