

AFRICA AND THE GLOBAL ECONOMIC CRISIS: IMPACTS, POLICY RESPONSES, AND POLITICAL ECONOMY

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1. Introduction

While the severe global recession seems to be bottoming out and the global economic outlook is turning more positive, the impact of the crisis on many African countries continues to deepen. The crisis hit the continent with a lag, but has caused serious setbacks to its growth momentum and jeopardized hard-won development gains of recent years. Even though most African countries are likely to avoid recession, the sharp drop in growth rates can have serious, long-term consequences, especially for poor and vulnerable Africans. Furthermore, the speed of the continent's recovery and longer term growth rates remain uncertain.

At the same time, the response of most African governments has been to continue with the prudent macroeconomic policies of the past decade, policies that gave these countries fiscal space with which to cushion the impact of the global crisis and avoid an even deeper recession. The emergency rescue packages that some countries introduced are also carefully designed to maintain reform momentum in the medium-term. Finally, a few countries have used the crisis as an opportunity to accelerate reforms, leaving them in a better position to take advantage of a recovery in the global economy.

In short, while the global crisis has wreaked havoc on African economies, the policy response of most governments demonstrates that the overall policy environment in Africa remains sound. The combination indicates that the case for additional aid to Africa is stronger than ever: not only is there a huge need, in order to avoid the permanent effects of the temporary shock, but the productivity of aid is probably as high as it has ever been.

2. Overview of growth and poverty trends prior to the crisis

2.1 Africa among the fastest growing regions during 2000 – 08

Since the early 2000s until mid-2008, many African countries grew at unprecedented rates. Prudent macroeconomic policies and improved political climate, together with a benign external environment, which included a commodity boom and foreign investors' search for new markets, led to the region's highest growth over the past 30 years. In fact, with real GDP growth at or above 5 percent every year since 2001, the continent was among the fastest-growing regions in the world (Table 1).¹

¹ However, countries' relative positions in the world distribution of per capita income changed. For example, countries that drove growth in 1960s, such as Kenya, Cote D'Ivoire, or South Africa, among others, were slowing it down in 2000s (Fosu, 2009).

While this growth was widely-shared, differences in growth rates persisted among subgroups and individual countries. For example, with an average growth rate of 5.7 percent in 2000-08 the oil exporters recorded higher rates than the oil importers, who grew on average by 4.5 percent. However, it should be noted that 22 oil-importers recorded faster-than-four-percent growth for over a decade. If you add to this the oil exporters, some 70 percent of the African population was living in fast-growing countries (Table 2).

In contrast to earlier commodity booms, this time the high growth of oil-rich countries reflected prudent macroeconomic policies and structural reforms, in addition to high prices. A growth gap emerged between fragile and post conflict countries on the one hand and the rest of the continent on the other. This underscores the importance of maintaining political stability and strengthening economic fundamentals. While these fundamentals are necessary for high and sustainable growth in any economy, they are particularly important in the post-conflict countries that strive to restore private sector confidence and reap peace dividends.²

Africa's growth performance during the 2000s was more subdued when measured in terms of growth of GDP per capita. From that perspective, Africa's growth was still below that of most other regions. Consequently, the income inequality between Africa and the developed countries, especially the Euro area, has remained almost unchanged (Table 3 and Figure 1), perhaps also due to unrealized gains from deeper regional integration. In terms of poverty reduction, 73 percent of the SSA population was still living on less than \$2 a day in 2005 compared to 76 percent in 1990.³ It should be noted however that Africa's \$1.25-a-day poverty rate fell from 58 percent to 50.8 percent between 1995 and 2005, precisely the period when the continent was experiencing relatively rapid growth.

3. How did the global crisis affect Africa?

3.1 Most countries were shielded from the financial crisis, but not all

On the eve of the global financial crisis, most of the African economies had only limited links with the global financial system. The trade-based and investment-based measures of financial integration reveal that the continent's emerging and frontier markets were less

² Moreover, domestic efforts of post-conflict countries need to be supplemented by timely and well-phased aid (Collier and Hoeffler, 2004; Collier and Gunning, 1995).

³ Similarly, while in 1990 55 percent of the East Asian population lived on less than 1.25\$ a day (PPP adjusted), only 17 percent did in 2005. In contrast, 51 percent of the SSA population was still living on less than 1.25\$ a day in 2005. As Ravallion (2008) noted: "...in 1981 China's poor outnumbered Africa's by almost 4:1. Yet by 1996, SSA had overtaken China in the total count of the poor."

linked with the global system than their European peers, albeit the extent of their integration was comparable to that of some of the Latin American countries (Figure 2). However, due to generally low financial depth and less developed financial systems among the majority of the low income and fragile African countries, the continent's overall financial integration is still limited (Figure 3). The global financial crisis that originated in the US financial market and quickly spilled over to other advanced economies thus left most African countries largely unaffected. The exceptions were some of Africa's middle-income countries such as South Africa and Mauritius. However, given that financial regulations in these countries are quite strong, their banking sectors were spared the crises that affected other emerging markets. Also, the external vulnerability of many African countries to external financial shocks has also been markedly reduced due to prudent policies and debt relief during the run up to the crisis (see below for the examples of Uganda and Tanzania).

Even countries with a strong foreign-bank presence had not accumulated large external private sector debts (denominated in foreign currency) and thus avoided deterioration of net investment positions that characterized some European emerging market economies.⁴ With net liabilities amounting to over 100 percent of GDP throughout 2000s, Tunisia is an exception. Its low short term debt and relatively closed capital account with restrictions on outflows has so far protected the financial sector from systemic risk. However, even emerging and frontier African countries with liberalized capital accounts avoided the severe boom-bust cycles propagated by the financial system in some European emerging market economies. This is because the housing finance and real estate markets, key channels in the European economies, continue to be absent in most of Africa. As a result of these factors, Africa as a continent has experienced much lower reduction in net private capital flows from the crisis than the rest of the developing world (Figure 4).

While the direct aggregate impact of the financial crisis on Africa was limited, not all countries were immune. For example:

- Some of the emerging and frontier markets such as South Africa and Kenya, among others, experienced “sudden stops” of capital flows already in 2008. South Africa's external equity and bond issuance reached about USD 20 billion in 2007 only to decline to less than 4 billion in 2008 (IMF, 2009).
- Several countries saw their stock market indices plummet at the end of 2008 and the first quarter of 2009. Specifically, the indices of South Africa and Egypt suffered losses similar to those of emerging market economies (EMEs) in other regions, but as other EMEs they have been slowly recovering since the second quarter of 2009.

⁴ In fact, due to prudent macroeconomic policies during the commodity boom, Botswana's net external position was positive throughout 2000s and Namibia's turned positive in mid-2000s. In contrast, net international positions of some of the emerging European countries markedly deteriorated.

- Nigerian banks suffered from the global credit crunch when they faced difficulties obtaining trade credit lines in the United States and in Europe. In August 2009 the Central Bank of Nigeria injected funds into the banking system, when five leading Nigerian banks posted losses from non-performing loans due to excessive lending to the energy sector and the bursting of the stock market bubble.

Finally, the financial sectors of some countries suffered from the second-round effects of the real sector's impact on the financial sector. For example, the banking sector in Ghana has shown signs of strain with declining profitability and rising non-performing assets, which reached almost 10 percent of total assets in March 2009. In addition, Ghana's Cocoa Board, the state-run company responsible for exports and marketing of cocoa, faced reduced interest among international commercial banks to provide trade credit for this year's cocoa exports. Likewise, some Nigerian banks that were highly leveraged in the oil and gas sectors saw a rise in NPLs. Since August 2009, five banks have had to be re-capitalized.

3.2 The global economic crisis halted Africa's boom

3.2.1 Aggregate Growth in 2009 and 2010

From a comparative perspective, Africa seems to be weathering this crisis well relative to both other regions as well as to its own past records. During this global slump, the continent will retain one of the highest growth rates in the world, with real output declining in only 6 out of Africa's 51 countries in 2009 (African Development Bank, 2009a). This is a marked contrast to the OECD countries, where all countries' GDPs are projected to contract in 2009 (OECD, 2009). Unlike in the developed world where the crisis is transmitted largely through financial channels such as contagion and tightened credit conditions, Africa has been affected mostly through the real channel such as exports, FDI, aid and remittances. However, even though Africa was hit with a lag and the continent has avoided recession, the size of the external shock it needs to absorb is enormous and its effects could be long-lasting.

At the onset of the crisis in 2008, many economists underestimated its likely impact on Africa, on the premise that advanced and developing countries had decoupled. However, already by mid-2009 hopes that Africa would be mostly unaffected by the crisis have proven false. Even initially cautious forecasts of Africa's economic outlook have continued to be revised downwards throughout the year. Specifically, the African Development Bank's October 2009 estimates project the 2009 real GDP growth to reach only 2 percent, a downward revision from 2.8 percent projected in February and a sharp decline from 5.2 percent in 2008. In terms of real GDP per capita the continent will thus record its first, albeit slight, decline in a decade. The 2009 outlook for sub-Saharan Africa is even more subdued, with real GDP growing by 1.1 percent, down from 2.4 percent

projected in February (Figure 5).⁵ The early optimism of policymakers and analysts about Africa's resilience thus soon gave way to realization that the crisis has caused serious setbacks.⁶

The October 2009 update of the African Development Outlook projects that real GDP growth for the continent will pick up to 4.1 percent in 2010, fueled by the global recovery and domestic policy responses. Nevertheless, the recovery will be gradual with growth well below the rapid rates of recent years. Moreover, risks of the outlook are tilted to the downside, as the speed and size of the global recovery, which is the key factor behind Africa's prospects, also face downside risks. An additional risk is that if there are cuts or delays in the delivery of financial aid to Africa, the continent will not benefit fully from the global recovery in 2010. On the positive side, since growth prospects of both China and India have improved, the deepened trade and investment linkages with these Asian rising economic powers, established before the crisis, could help Africa's recovery.

3.2.2 Varied Impacts on Growth across Countries

The aggregate figures mask substantial differences across groups and among countries. Since the crisis is an external shock, it is not surprising that countries that were more open to trade and capital flows and grew rapidly in 2008 have suffered the sharpest growth falls in 2009 (Figure 6). The ADB's October 2009 projections thus show that two groups have taken a particularly large hit: (i) the emerging and frontier markets and (ii) the resource-rich countries (Figure 7). A few examples are highlighted:

- In Botswana, which is one of Africa's prominent success stories, growth is projected to collapse from 2.9 percent in 2008 to a contraction of 7.3 percent in 2009. Good governance notwithstanding, Botswana has been hit particularly severely because of its undiversified export and production structures.
- Outputs of oil exporters, such as Angola and Equatorial Guinea, have also collapsed.⁷ The growth rate has declined from 14 percent in 2008 to stagnation in 2009 in Angola, and from positive 12 percent in 2008 to negative 4.1 percent in 2009 in Equatorial Guinea.
- With plummeting prices of food and oil, the oil importers were exposed to milder terms-of-trade shocks. The fall of commodity prices eased pressure on current

⁵ The impact varies quite substantially across countries. While many countries have experienced a sharp deterioration of growth prospects, some others continue to record improvements in growth (Republic of Congo, Angola, Chad, among others).

⁶ The IMF has also revised its forecasts downwards; the October 2009 World Economic Outlook showed that the Africa's reduction of real GDP growth in 2009 could be close to that of developed economies. In April, the IMF projected the 2008-09 loss of GDP growth rate for developed economies amount to 4.6 percentage points, for Africa to 3.2 percentage points and for sub-Saharan Africa to 3.8 percentage points.

⁷ The growth rates declined from 14 percent in 2008 to stagnation in 2009 in Angola and from positive 12 percent in 2008 to negative 4 percent decline in 2009 in Equatorial Guinea.

accounts and household budgets of countries heavily dependent on agricultural and/or fuel imports, such as Sierra Leone.

- Among African emerging and frontier markets, South Africa in particular was severely exposed to the first round effect of the crisis through “sudden stops” of capital flows, and contraction of demand (Figure 8).

When analyzed on the basis of income levels, the real GDP of the upper-middle-income countries (un-weighted average) is projected to contract by 0.5 percent, which constitutes a five percentage point decline from their 2008 growth of 4.5 percent.⁸ The deterioration is driven by contractions in South Africa, Botswana, and the Seychelles. The lower-middle income countries are projected to fare better, reaching growth of 3.8 percent in 2009. Still, this represents a substantial decline (by 2.1 percentage points) relative to 2008. Due to their limited integration into the global economy, low income and fragile countries are to have the smallest declines in growth in 2009.

- Only 7 African countries (Djibouti, Ethiopia, Malawi, Morocco, and Republic of Congo, Uganda and Tanzania) are projected to grow at 5 percent and above, and four of those are low income countries.⁹ One of the sharpest declines for 2009 is projected in Rwanda, due to contracting industrial and services sectors.
- Low income countries are coping relatively well with the crisis also partly because they continue to benefit from increased public investments in 2009, mostly financed by overseas development assistance (ODA). For example, in Burkina Faso about 80 percent of public investment is financed by ODA. Since most of 2009 ODA was already committed, public investment is projected to increase by more than 40 percent.
- The subgroup of fragile states (excluding Eritrea), which, with the exception of Côte d’Ivoire and São Tomé Príncipe, constitutes low income countries, has also fared relatively well. The real GDP growth rate for this group (un-weighted average) is projected to decline by only 1.2 percentage points and reach 2.7 percent. Nevertheless, a slowdown of growth is particularly harmful in this group, given widespread poverty and the risk of policy reversal and resurgence of fragility.¹⁰

3.2.3 Other macroeconomic variables

⁸ All upper-middle income economies, except South Africa, rely heavily on exports of oil or minerals, whose prices have been adversely affected by the crisis.

⁹ Djibouti is projected to grow by 5.0 percent, Ethiopia by 6.2 percent, Malawi by 5.7 percent, Morocco by 5.1 percent, Republic of Congo by 9.5 percent, Tanzania by 5 percent, and Uganda by 6.5 percent.

¹⁰ This is because the post-conflict and fragile countries need urgently to restore their capital stocks before they can reap meaningful peace dividends (Collier and Gunning, 1995). Clearly, without adequate financial aid, the slowdown of growth will hamper these efforts.

In addition and in part due to the growth slowdown, other key macroeconomic indicators have markedly deteriorated as well. When the global financial crisis turned into a global *economic* crisis, it arrived to Africa in the form of a massive external shock. Because of their mostly undiversified economies and heavy dependence on exports and aid, the real channel (trade, remittances and aid) has been of far greater importance to the continent than the financial one. In fact, the trade channel was the most important. The global recession, reduced import demand in advanced countries, and worsened terms of trade imply that Africa as a continent is likely to lose 30 percent of its 2008 export revenues (measured in current US\$) in 2009 (Figure 9). Due to the external shock, and despite some relief on import bills, the overall trade balance will deteriorate in 2009, and many countries have experienced a double hit through deteriorating current account and fiscal balances (Figure 10).

Overall, the continent is projected to move from a current account surplus of 3.4 percent of GDP in 2008 to a deficit of 4.2 percent in 2009. However, once again there are substantial disparities across the pre-crisis macroeconomic outcomes of different groups, and the contrast was most striking between oil exporters and oil importers. As the terms of trade for sub-Saharan oil exporters are projected to decline by 29 percent between 2008 and 2009, their external balances took the hardest hit. They are expected to run a deficit of 1.4 percent of GDP, which is a major deterioration from a surplus of 11 percent in 2008. Nevertheless, in spite of more favorable terms-of-trade which are projected to increase marginally by 1.1 percent, exports of several oil importers have also collapsed due to the contraction of demand in advanced economies. Examples of oil-importers with projected falling exports in 2009 and 2010 include:

- Mozambique, whose export receipts are expected to decline in 2009 by about 30 percent from 2008 levels. This is because global demand for aluminum, which constitutes nearly half of the country's export receipts, is expected to decline in both 2009 and 2010, even though prices have collapsed by about 50 percent. Mozambique's aluminum export volumes already declined by 10 percent in 2008 due to the energy cuts and sharp depreciation of the South African rand.
- East African coffee exporters, such as Ethiopia, Kenya, and Uganda are projected to suffer from export declines. Uganda's coffee market prices for the first half of 2009 remained below average of past years, even after having declined by about 40 percent in 2008. Similar trends are observed in Ethiopia and Kenya.

Besides trade, aid and remittances are channels of shock transmission specific to developing countries, with aid being particularly important in Africa. Historically, aid tends to decline during recessions, even though no such decline is so far projected in the IMF's October 2009 World Economic Outlook. Furthermore, during the banking crises of the 1990s in Norway, Sweden and Finland, aid from each of these countries declined by about 13 percent and took about five years to recover to pre-crisis levels. In short, a substantial risk exists that the recessions of developed countries will put them in a strained position to deliver aid as promised to Africa. Should this risk materialize, it

could lead to a prolonged growth slowdown in the region and derail reaching the MDGs. It is thus crucial that commitments of the advanced economies made so far are met in a timely and predictable manner. There are already examples of slippages on commitments. In Mozambique, while aid flows are projected to increase from 13.3 percent of GDP in 2008 to 15.7 percent in 2009, this increase is smaller than the originally envisaged scaling up by 2 percentage points of GDP. Moreover, the disbursements on the existing commitments are already being delayed due to financial difficulties in donor countries.

As a result of the crisis, African countries will also need to deal with cuts in remittance inflows. About 75 percent of Africa's remittances come from the U.S. and Western Europe, the epicenter of the global crisis. The World Bank projects a drop in remittances to the region by about 5-8 percent in 2009.¹¹ In addition to foreign exchange shortages, such a decline could mean that some of the poorer segments of the population will lose a substantial share of their income and become even more vulnerable to poverty. To the extent that in the past remittances were used for funding of physical and human capital investment, private sector development would be also negatively affected, with adverse implications for jobs and poverty.

The collapsed export revenues, amplified by reduced aid and remittances, are putting pressures on current account balances and exchange rates, with currencies of many African countries depreciating relative to the dollar.¹² In oil-exporting countries, the resulting lower monetary base has led to sharp cuts in credit and money supply in 2009 (Figure 11). Unless sufficient FDI and aid are available to cover the external deficits, Africa's foreign reserves, which took years to accumulate, may be seriously jeopardized soon. For example:

- Among oil exporters, official reserves in Angola are projected to decrease from 15 months of imports in 2008 to 9 months in 2010, on the back of collapsing oil revenues. Similarly in Chad, reserves are projected to fall from 4 months of imports in 2008 to mere 2 in 2010. Moreover, Chad's net foreign assets are projected to fall by a half between 2008 and 2009, while credit growth will slow to 6 percent in 2009, down from 41 percent in 2008.
- Ghana's reserves have been at precarious levels of at or below 2 months of imports for the past 12 months, which contributed to a deterioration of the cedi by 45 percent between October 2008 and 2009. The limited reserves, together with past expansionary and unsustainable fiscal policies, have prevented the

¹¹ During 2000-2008, African countries benefited from relatively high and increasing remittances. In Nigeria, the largest absolute recipient of remittances in Sub-Saharan Africa, remittances amounted to about \$12 billion (7 percent of its GDP) in 2007.

¹² The highest depreciation between July 2008 and October 2009 was experienced by the Congolese Franc (-47.1 percent), the Seychelles ruppee (-32 percent) the Zambia kwacha (-24 percent).

government to intervene in the forex market and/or implement a fiscal stimulus, as was done in East Africa. Public investment has therefore declined slightly in 2009. While some upturn due to oil production is expected in 2010, public investment is projected to slow as Ghana implements the comprehensive debt management strategy.

In addition to the external sector, the region's fiscal balance is projected to worsen as a surplus of 3.3 percent of GDP in 2008 is likely to turn into a deficit of 3.7 percent in 2009. More specifically, the crisis has affected the fiscal space through two channels: (i) directly through revenue losses from lower exports and (ii) indirectly through lower direct and indirect taxes due to automatic stabilizers associated with slower domestic activity. Commodity-related revenues and especially oil revenues have been affected the most as commodity exporters face drops in export prices and lower demand for their exports. In several countries, commodity-related revenues account for a significant share of government revenues (e.g., Angola, Botswana, Chad, Gabon, Republic of Congo, and Nigeria). The fiscal balance in oil exporting countries will deteriorate into deficit of 4.3 percent of GDP in 2009 compared to a surplus of 6.8 percent in 2008. Fiscal deficits of oil-importing countries will rise from 1.3 percent of GDP in 2008 to 3 percent in 2009. Such deteriorations not only constrain pro-poor expenditures and space for accommodating fiscal policy, but would undermine long-run growth if infrastructure and R&D outlays take a hit.

3.2.4 Social consequences

What started as a financial crisis in the developed world has quickly turned first into a global financial crisis, then into a global economic crisis and in the third and current stage into an employment and social crisis. In terms of the human cost of the crisis, OECD estimates that the unemployment could rise by about 25 million people in advanced countries by 2010, while the ILO estimates it will increase by at least 40 million people worldwide. In Africa, unemployment is projected to increase by more than 10 percent between 2008 and 2009, from 31.4 million people in 2008 to up to 35.4 million in 2009 (ILO, 2009). Lower import demand in main markets has already brought about substantial job losses in export sectors. For example:

- The declining activity in Congo Democratic Republic in the mining sector caused 100,000 lost jobs (Kamara, Ndikumana, and Kandiero, 2009).
- According to Statistics South Africa, the job losses in the formal non-agricultural sector amounted to 67, 000 from the 1st to 2nd quarter of 2009, following the reduction of 186,000 jobs in the first quarter of 2009.

Parallel to rising unemployment, the number of the working poor and vulnerable employment (workers without formal arrangement) could reach unprecedented levels in Africa in 2009 and beyond. Regarding the impact of the crisis, the ILO warned in early 2009 that the number of the African working poor could increase by 35 million people and vulnerable employment by 31 million people during 2007 – 2010. While in most world regions the unemployment constitutes one of the key risks to poverty, the

predominance of low-productivity/low-paid employment, i.e., the working poor, has been the main risk in sub-Saharan Africa.¹³ In 2007, more than half of the sub-Saharan Africa employed workers lived in extreme poverty (on less than US\$1.25 a day) and 85 percent on less than US\$ 2 a day, the highest shares of all regions (Figure 12). Equally disturbing is the increase in total number of working poor on both levels that occurred during 1997 – 2007, despite the high growth rates. More specifically, there were 27 million more working poor at the US\$1.25 a day level and 55.5 million more at the US\$2 a day level in 2007 than in 1997.

Beyond unemployment and under-employment, growth slowdowns can have an impact on human capital accumulation. Children get pulled out of school, and infants face higher mortality rates due to worse nutrition and poor water and sanitation. Friedman and Schady [2009] estimate that, given the growth shortfall in Sub-Saharan Africa in 2009, an additional 30-50,000 infants, most of whom will be girls, are likely to die before their first birthday.

4. Policy responses, reforms and longer-term growth

4.1. Domestic policy responses

At the onset of the crisis, the region was in a markedly stronger macroeconomic position, especially in terms of fiscal balances, external debt, and stock of foreign exchange reserves in 2007 than prior to the previous global recession (Figure 13). While to some extent the good growth performance in recent years was due to a favorable global environment, prudent macroeconomic policies have played an important role. For instance, median inflation in Africa in the mid-2000s was half its level in the mid-1990s. Policies of recent years have not only increased growth but they increased the capacity of governments to soften the impact of the crisis on their economies.

Analysis according to resource endowments reveals that for the four years before the crisis (2005 – 08), African oil exporters posted a substantial current account surplus of 11 percent of GDP and fiscal surplus of 6.7 percent. In contrast, oil importers recorded current account deficits of 5 percent of GDP and fiscal deficits of 0.6 percent. Some countries, especially the fragile and post-conflict states, still lack the policy space for counter-cyclical measures that could ease recovery, which makes them particularly vulnerable to any shortfalls in aid and remittance inflows.

The continent has adopted a variety of measures to cushion the impact of the crisis. These included setting up special monitoring units to identify causes and responses to the crisis,

¹³ Unemployment has plagued African countries – it amounted to about around 8 percent of the labor force in sub-Saharan Africa in 2007 and about 10 percent in Northern Africa.

fiscal stimulus packages, targeted sectoral assistance, capital and exchange controls, and new regulations in the banking sector. Several middle-income countries have applied expansionary monetary policies such as lowering policy interest rates. Specifically, the stimulus policies included:

- In Kenya, government expenditures in 2009/10 increased by 25 percent relative to the previous year, while the fiscal deficit (after grants) is targeted to reach 6 percent of GDP, of which two-thirds will be financed by the proceeds from local infrastructure bond and the rest from foreign aid. Measures to stimulate the economy included a 25% reduction of VAT on electricity, the removal of duties on maize and related products, as well as a public works program. The central bank pursued more accommodative monetary policy, including through cutting the policy rate (Rand Merchant Bank, 2009).
- In Tanzania the increased fiscal space (low public debt and adequate reserves) also allowed accommodating policies. Government expenditures on infrastructure (road and energy projects) increased in the 2009/10 budget by 31 percent. At the same time, the country adopted some pro-cyclical fiscal measures to increase tax revenues, including widening the tax base and revoking various exemptions. The net effect is expansionary – over the two fiscal years (2008/09 and 2009/10), the total fiscal stimulus is projected to reach about 4 percent of GDP. The package will rely partly on domestic financing of the deficit, thus deviating from the pro-cyclical past stance of zero net domestic financing. Tanzania’s central bank also increased the growth of money supply by several percentage points, taking advantage of reduced inflationary expectations due to low food prices (Rand Merchant Bank, 2009). Finally, Tanzania introduced an emergency program to provide loan guarantees to the banking sector, but these guarantees are strictly time-bound—two years—a feature that is lacking in comparable programs in the U.S. and Europe.
- In Uganda, past prudent economic policies also provided scope to implement counter-cyclical fiscal policies, and in particular to raise expenditures in the 2009/10 budget by 19 percent relative to the previous year. The objective of the package is to support infrastructure and the agricultural sector. This stimulus is to be accompanied by an improved business environment to enhance competitiveness. Due to the lower revenue collection, the share of donor financing of the budget is up from previous years. Monetary policy was gradually relaxed (IMF, 2009). Significantly, as a precautionary measure, the government devalued the shilling before the crisis hit.
- In Zambia, the government is running a modest fiscal deficit (2.6 percent of GDP), mostly as a result of a shortfall in revenues. The medium-term expenditure program, which had been put in place earlier, is being maintained, especially where pro-poor expenditures are concerned.
- In South Africa, the government has adopted a countercyclical fiscal stimulus amounting to R 787 billion (about USD 100 billion) for public investment during

2010-12. The South African Reserve Bank eased monetary policy between December 2008 and May 2009, when it cut its policy rate by a cumulative 450 basis points.

- In Tunisia, public investment increased by more than 20 percent in 2009 relative to the 2008 budget, to compensate for the 35 percent decrease in FDI.
- In Morocco, public investment is expected to increase from 3.4 percent to 3.6 percent, as the government seeks to sustain growth, support structural reforms, and strengthen sectoral policies.
- Nigeria is using the low world oil prices to deregulate its downstream petroleum sector and reduce gasoline subsidies, reforms that will leave the economy better able to benefit from a recovery in the global economy.

The measures outlined above, in particular the comprehensive packages adopted in East African countries and South Africa, seem timely, as they have been introduced shortly after the first signs of the negative impact of the global crisis. The measures are well-targeted as they will stimulate domestic demand (thus somewhat offsetting declining exports) while supporting businesses as well. As most of the measures are temporary, they should not interfere with medium-term fiscal targets

Moreover, the above measures also support longer-term growth. First, the measures aim primarily at the supply side and are accompanied by efforts to improve the business environment. Such steps are likely to encourage longer term production potential and boost investor confidence. Second, while some of the packages contain demand measures (reduction of VAT rates, for example) they are limited, and populist measures seem minimal. Third, with the exception of Morocco, the absence of a significant foreign debt (or debt denominated in foreign currencies) makes the devaluation of the currencies less of a concern. The risk of future inflation is of a secondary importance at this point and can be addressed later. Fourth, the governments have made maintaining debt sustainability one of the key priorities and are aware that the short-term stimulus measures do not replace the need for longer-term structural reforms.

Not all African countries were in the position to implement expansionary policies when the crisis hit. The macroeconomic situation in Ghana, for example, requires the country to focus on macroeconomic stability. Specifically, in 2009 the country is projected to post twin deficits (fiscal deficit exceeding 10 percent of GDP and a current account deficit of almost 15 percent of GDP, both with grants included); high inflation (16 percent annual average), and low reserves. To reach high and sustainable growth, Ghana's policy challenge is to consolidate its fiscal position so as to prevent the crowding-out of private sector credit due to bank financing of large deficits and to maintain debt sustainability.

5. Political economy of the policy responses to the crisis

Although they were differentially affected by the global crisis, the policy response of most African countries has been broadly similar—maintaining a prudent macroeconomic stance, cautiously rescuing failing financial institutions, and in some cases accelerating reforms to prepare for the post-crisis era. In particular, those that had some fiscal space, thanks to prudent macroeconomic policies in the past, such as Uganda, Tanzania and Burkina Faso, were able to run modest fiscal deficits that helped to cushion the economy from an even steeper decline. Furthermore, these countries have maintained their medium-term public expenditure programs, thereby protecting priority expenditures such as the social sectors and infrastructure maintenance. Countries that did not have fiscal space, such as Ghana, have embarked on a program of lowering their fiscal deficit in a modulated fashion over the next several years. Programs to rescue failing financial institutions, such as Tanzania's, demonstrate a cautious approach to government's role in the financial sector—a role that was once dominant and has been gradually declining with increased private-sector participation in the sector. Finally, some government such as Nigeria, have used the crisis as an opportunity to accelerate certain reforms, in this case the deregulation of the downstream petroleum sector, because lower oil prices provided an opening for the reform.

The central question is: What explains this policy response, which stands in some contrast with African governments' responses to previous crises? Several hypotheses can be suggested. First, the prudent macroeconomic stance taken by these countries is simply a reflection of their access to capital markets and thin domestic financial markets. For such countries, the size of the fiscal stimulus is dictated by the availability of external resources (using domestic resources would simply crowd out private spending and hence not have the stimulating effect). Under this hypothesis, the policy response of the African governments was driven by the extent of external resources available to them, mostly from international financial institutions such as the ADB and the World Bank. While there is some truth to this interpretation, it does not explain why, during previous crises, African governments elected to ignore the financing constraint, and ran the printing press to finance government deficits, often resulting in unsustainable inflation rates. Clearly the message that all governments have an intertemporal budget constraint that has to be respected has now permeated the halls of most Finance Ministries and Central Banks.

A second hypothesis is that the experience of the past decade, where prudent macroeconomic policies resulted in countries' being better able to respond to the crisis, created an environment where governments were reluctant to deviate too far from their macroeconomic stance, lest they be left vulnerable during the next crisis. Certainly, the contrast with countries like Ghana, who had not followed the same cautious macroeconomic policies before the crisis, served as a sobering reminder to the other countries. Under this hypothesis, policymakers were simply applying the lessons learned from the recent past. While compelling, this interpretation does not explain why African

policymakers continued with prudent policies when OECD countries were running massive fiscal deficits (of the order of 10 percent of GDP) and nationalizing their banking systems. That African policymakers chose to ignore the example being set by developed countries, and select the more conservative stance that they had been pursuing before the crisis means the explanation has to go beyond “lessons learned.”

The third hypothesis is that there has been a shift in the public’s attitude towards economic reforms, and African policymakers were reflecting this shift in their policy responses to the crisis. This shift is the result of dissatisfaction with the state-led interventionist policies of the past—most of which led to sluggish growth and rising poverty—and the fact that pro-market reforms, especially in the past decade, were beginning to show results in terms of faster growth and poverty reduction. Having tasted the fruits of economic reforms, the public was demanding more, not less. Even though the payoffs of these reforms had just started to decline (as a result of the global crisis), the public did not want to abandon the reform program. To see this, note that the major political parties of every recent election ran on a reform platform. Hence there is public support for a time-bound emergency rescue package for Tanzanian banks. Likewise, the Nigerian public recognizes that the gasoline subsidy is both inefficient and inequitable, and will by and large support its replacement with something that targets poor people.

If this third hypothesis is the most likely one, it bodes well for Africa’s future, despite the global crisis. For it means that economic reforms in Africa will continue and will unlikely be reversed, even with a sluggish global economy, because the public’s mindset has shifted.

6. Conclusions and recommendations

The global crisis has caused significant, and possibly long-lasting collateral damage to the African economies, which needs to be resolved through a global partnership. To prevent a development crisis, the international community needs to continue to work in partnership with African countries to mitigate the effects of the crisis, which threatens the achievements in terms of higher growth and greater macroeconomic resilience, which have translated into some gains in poverty reduction over the past decade. On their part, African policymakers have recognized the need to make their domestic economies even stronger and more resilient to weather similar external shocks in the future. Their actions need to be supplemented by measures taken by developed countries, including through adequate and timely financial assistance. Only a true global partnership can protect Africa’s poor against losing hard-won but still modest gains in their living standards.

African countries have already undertaken a number of effective measures to minimize the impacts of the crisis. Taking a longer-term perspective, African countries could turn the crisis into an opportunity to restore their economic potentials and return to high and sustainable growth rates. Policies should focus on improving domestic fundamentals and enhancing economic diversification. Longer-term growth would be further enhanced if African countries maintain macroeconomic stability, deregulate labor markets, improve the business environment, develop financial markets and strengthen governance. Encouraging private sector development to spur investment is one of the key medium

term challenges, which would also provide a base for a more diversified growth strategy. Underdeveloped financial markets are another growth bottleneck that needs to be addressed. African countries, and especially sub-Saharan African countries, could also gradually phase out pro-cyclical fiscal policies and move towards a rule-based counter-cyclical stance to promote high and sustainable growth. That the prudent macroeconomic policy response to the crisis appears to have popular support makes us optimistic that the prospects for second-generation reforms in Africa are as strong as they have ever been.

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Annex I – Tables and Graphs

Table 1. Growth of real GDP by regions, 1980 – 2008

	1980-89	1990-99	2000-08	Average 1980 - 2008
	(annual average, in percent)			
World	3.2	2.9	4.0	3.3
Advanced economies	3.0	2.7	2.3	2.7
<i>of which:</i>				
Newly industrialized Asian economies	7.7	6.1	4.6	6.2
Emerging and developing economies	3.5	3.3	6.4	4.3
Africa	2.7	2.3	5.6	3.5
<i>Of which:</i> Sub-Saharan Africa	2.6	2.3	6.0	3.5
Central and Eastern Europe	2.1	1.5	4.8	2.7
CIS and Mongolia	3.5	-4.8	7.3	1.8
Developing Asia	6.8	7.2	8.2	7.4
Middle East	1.2	4.3	5.4	3.6
Western Hemisphere	2.1	2.9	3.8	2.9

Source: IMF WEO database.

Table 2

Average Annual GDP growth between 1998-2008

Slow growing countries 30% of population		Moderate to good growing countries 40% of population		Oil countries 30% of population	
Kenya	3.8	Liberia	7.8	Equatorial Guinea	23.1
Malawi	3.7	Mozambique	7.7	Angola	10.9
South Africa	3.6	Rwanda	7.6	Chad	7.4
Guinea	3.6	Sierra Leone	7.6	Sudan	6.9
Lesotho	3.4	Uganda	7.1	Nigeria	5.2
Swaziland	3.3	Sao Tome and Principe	6.8	Cameroon	3.9
Seychelles	2.8	Ethiopia	6.7	Congo, Rep.	3.7
Burundi	2.5	Cape Verde	6.1	Gabon	0.9
Congo, Dem. Rep.	2.5	Tanzania	6.1		
Comoros	1.9	Burkina Faso	5.5		
Togo	1.6	Mali	5.5		
Central African Republic	1.6	Botswana	5.3		
Cote d'Ivoire	0.7	Ghana	5.2		
Eritrea	0.4	Gambia, The	5.1		
Guinea-Bissau	-1.7	Mauritius	4.6		
Zimbabwe	-4.4	Mauritania	4.5		
		Namibia	4.5		
		Senegal	4.4		
		Benin	4.4		
		Niger	4.4		
		Zambia	4.2		
		Madagascar	4.0		
Simple average	1.5		5.6		7.7
Median	2.2		5.3		6.0

Sources: WB WDI.

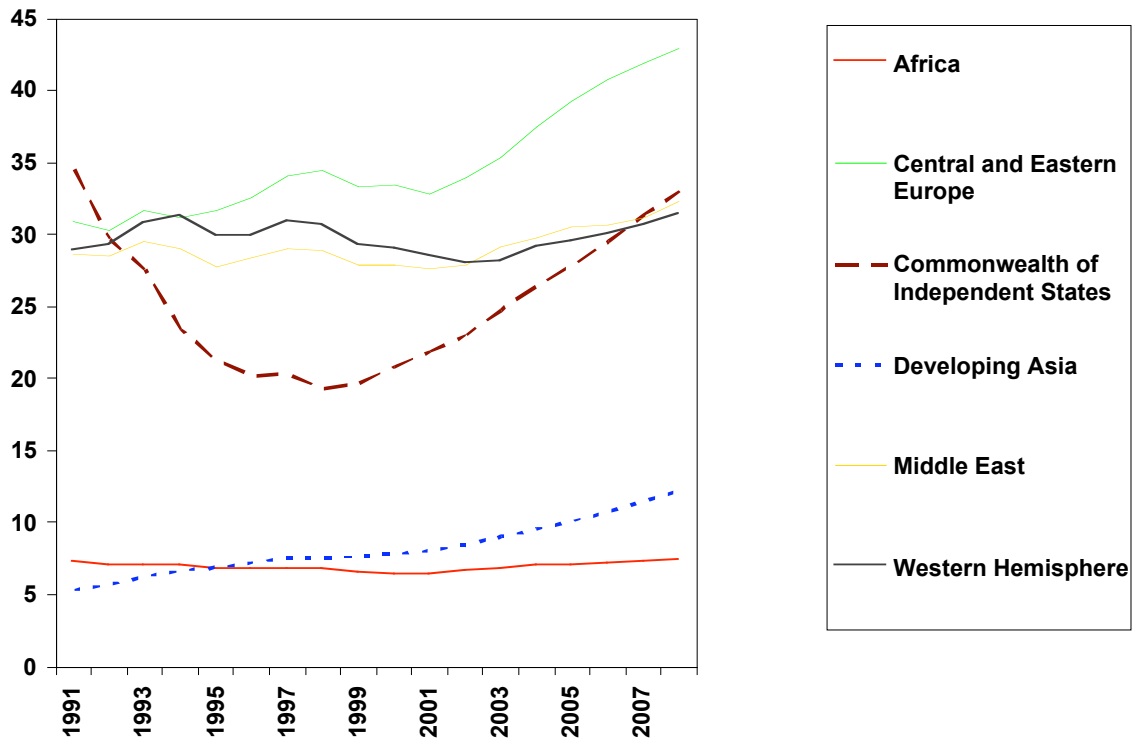
Note: Somalia is not presented for growth rate, and is not included as the denominator for population.

Table 3. GDP per capita (PPP) of Africa, China, and India relative to the US, 1980 – 2008 1/

	1980	1990	2000	2008
Africa	963	1,278	1,627	2,530
<i>% of US GDP per capita</i>	<i>7.9</i>	<i>5.5</i>	<i>4.7</i>	<i>5.4</i>
China	251	796	2,372	5,963
<i>% of US GDP per capita</i>	<i>2.1</i>	<i>3.4</i>	<i>6.8</i>	<i>12.7</i>
India	392	834	1,627	2,762
<i>% of US GDP per capita</i>	<i>3.2</i>	<i>3.6</i>	<i>4.7</i>	<i>5.9</i>
United States	12,255	23,208	34,776	46,859

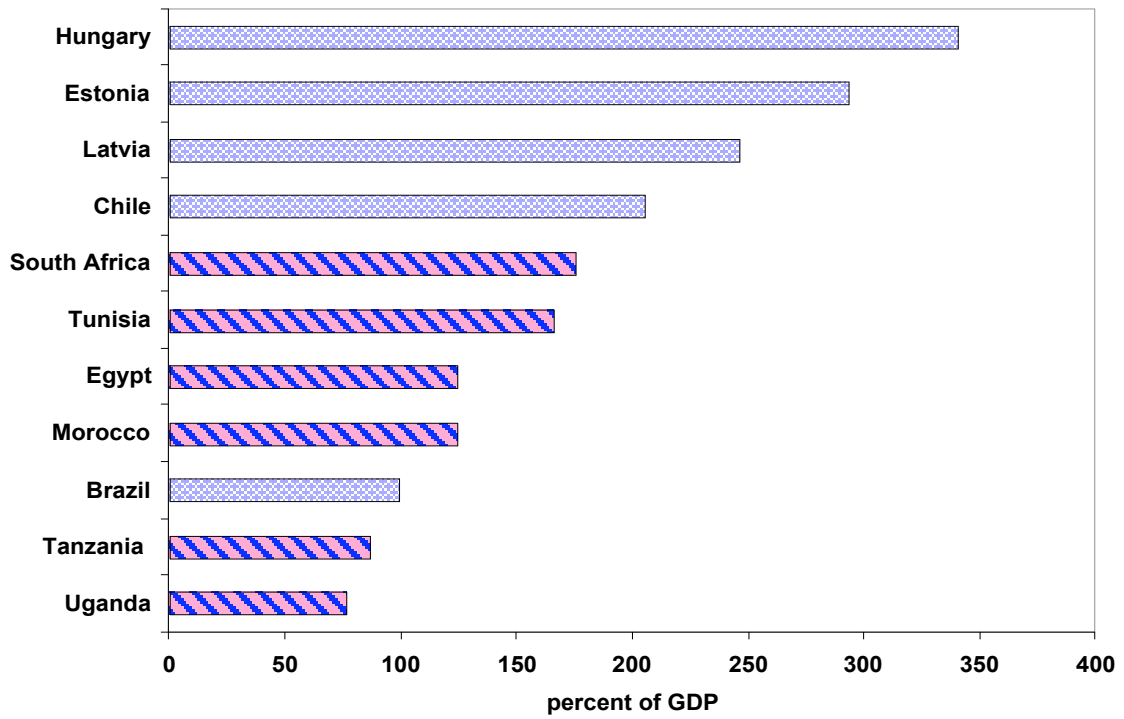
1/ In current prices, unless otherwise indicated. Source: IMF WEO database.

Figure 1. Regional GDP (PPP) per capita relative to the Euro area, 1991 – 2008 (in %)



Source: IMF WEO database.

Figure 2. International financial assets and liabilities of selected countries, 2007



Source: IMF World Economic Outlook database and staff calculations.

Figure 3a. External equity issuance, 2006 – 2008, in mln of US\$

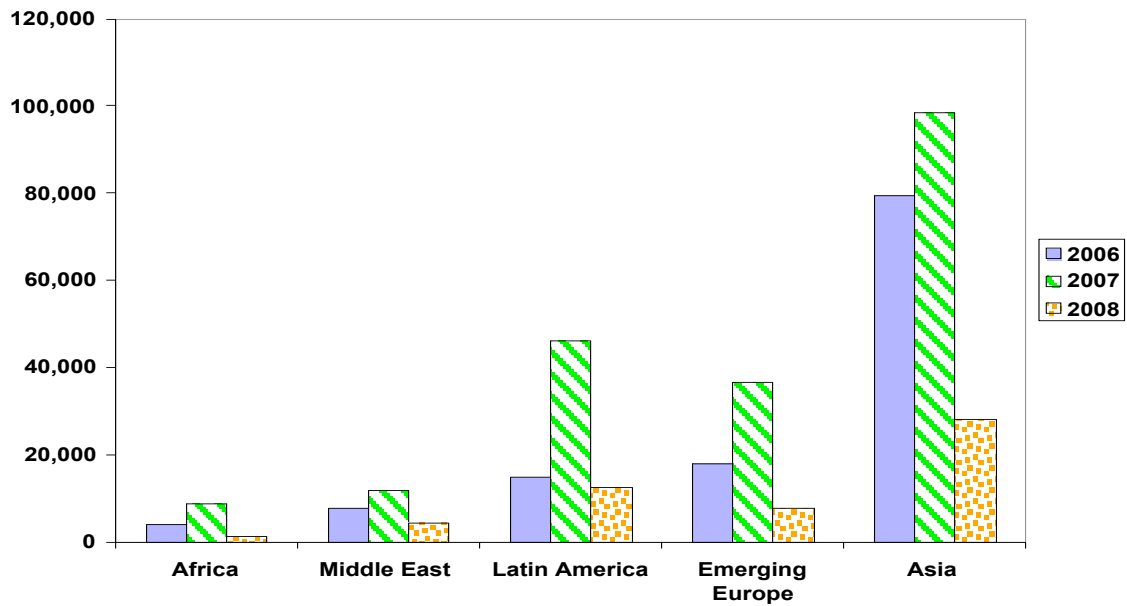
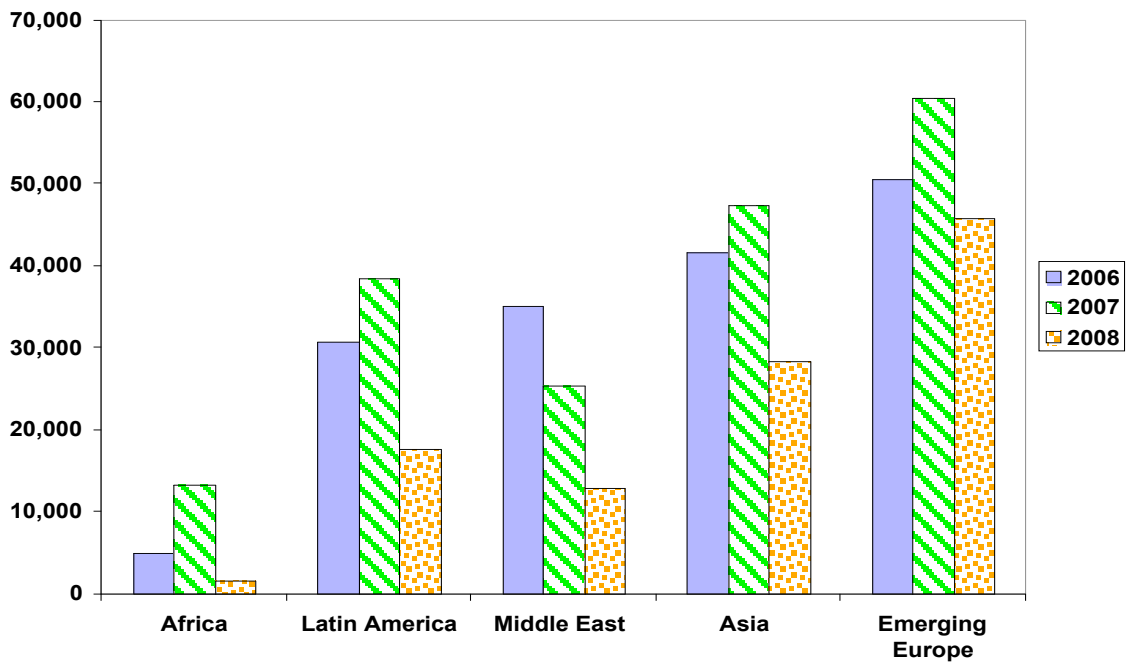
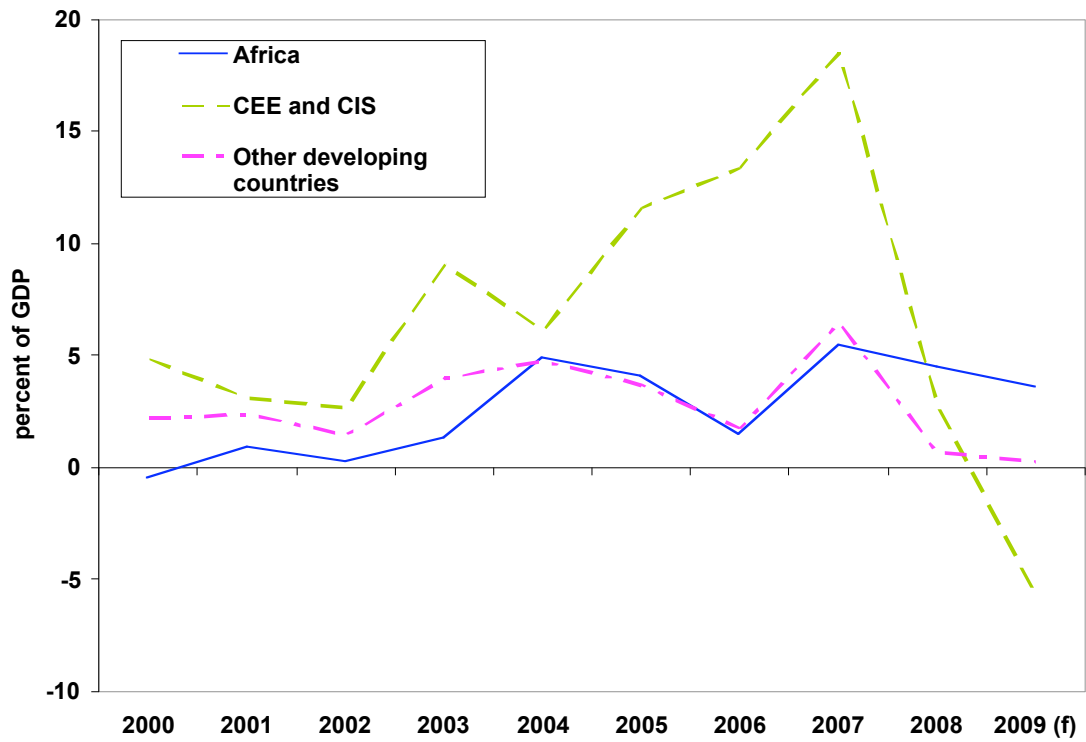


Figure 3b. External bond issuance, 2006 – 2008, in mln of US\$



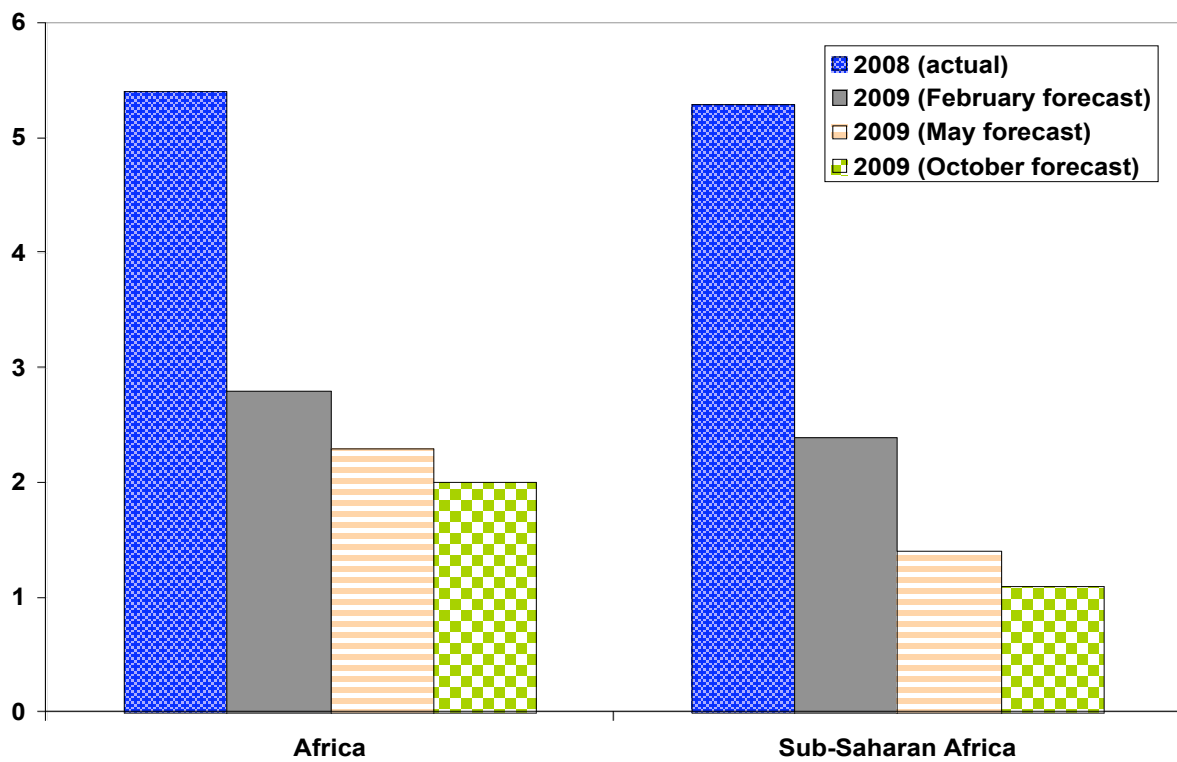
Source: IMF Global Financial Stability Report (April 2009).

Figure 4. Net private capital flows in Africa and other regions, 2000-2009 (f)



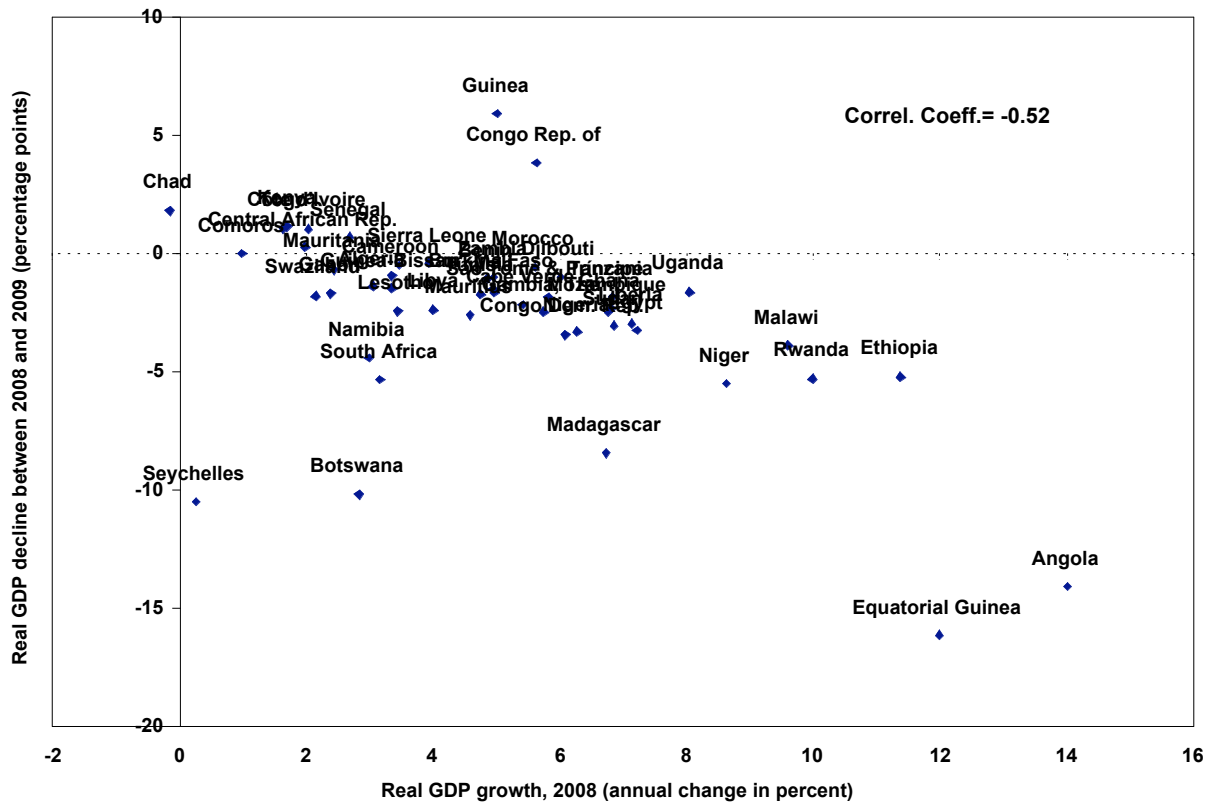
Source: IMF, World Economic Outlook database (October 2009) and the Bank staff calculations.

Figure 5. Real GDP growth in Africa and Sub-Saharan Africa, annual change in percent



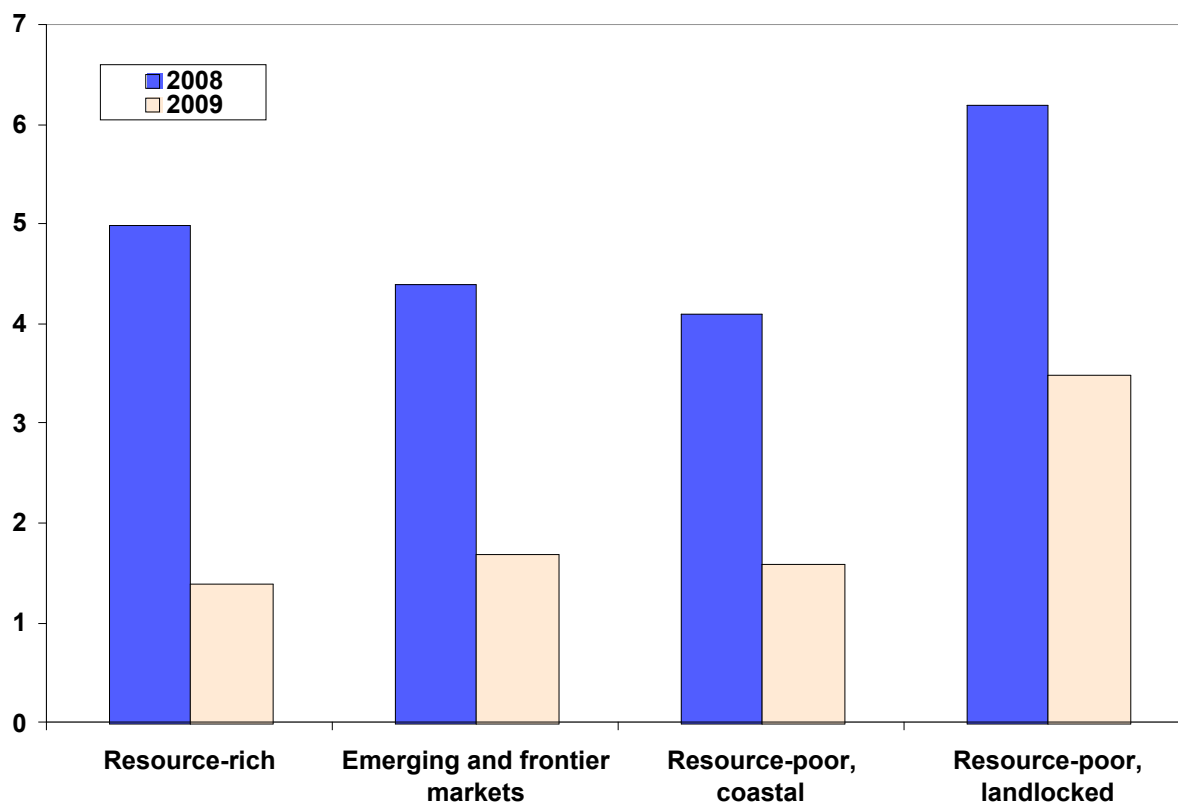
Source: African Economic Outlook database.

Figure 6. Africa: Pre-crisis (2008) real GDP growth and projected (2009) decline



Source: African Economic Outlook database (October 2009) and staff calculations.

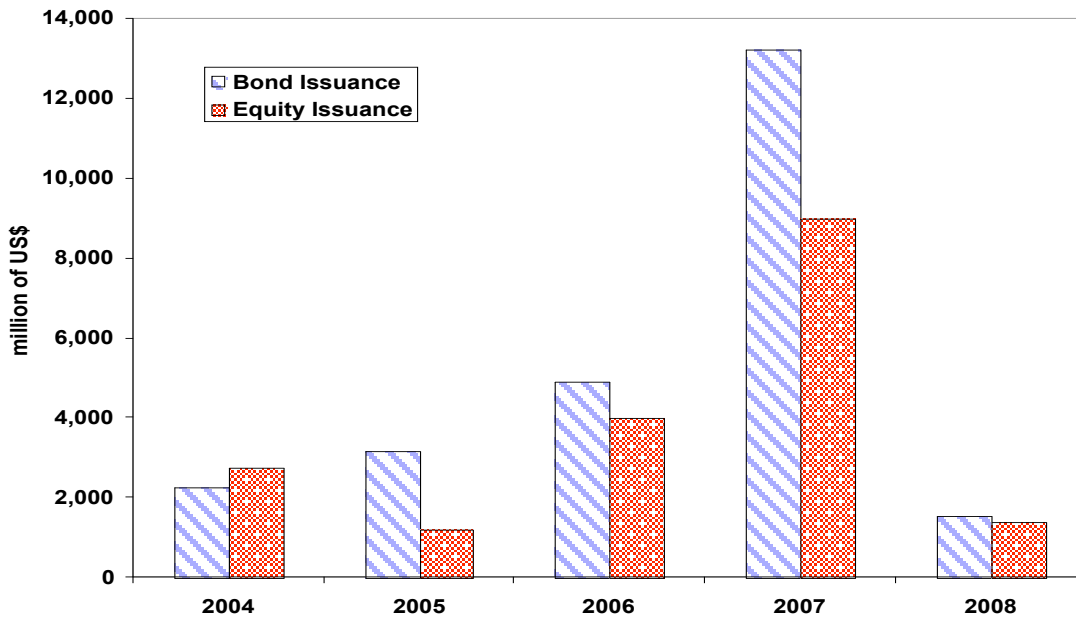
Figure 7. Actual and projected real GDP growth by sub-groups, annual change in percent 1/



Source: African Economic Outlook database (October 2009) and staff calculations.

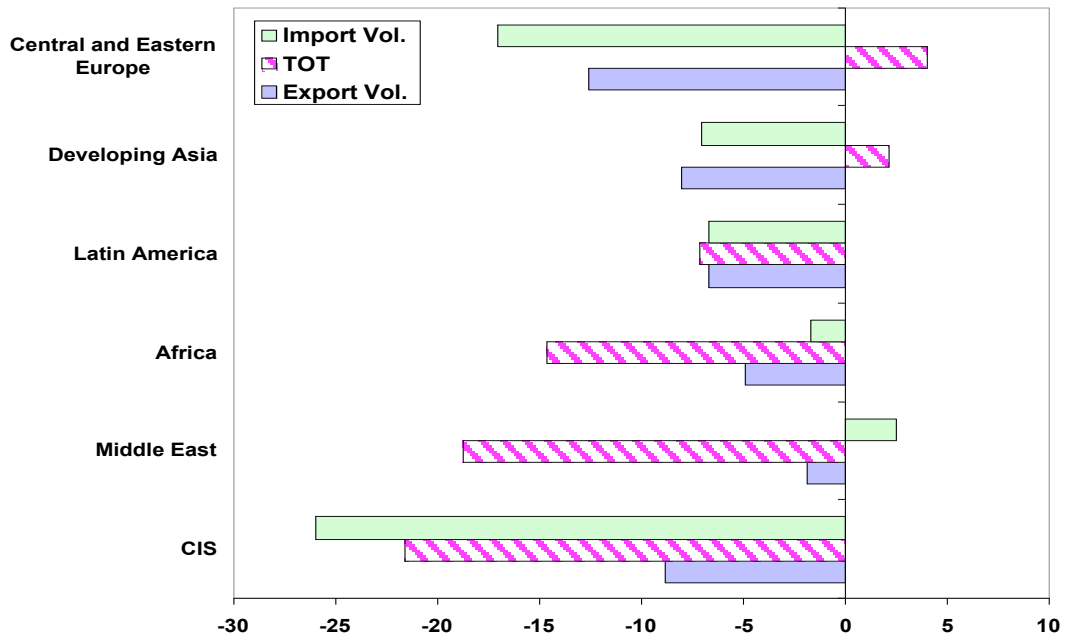
1/ Unweighed averages. Emerging and frontier markets are: South Africa, Algeria, Tunisia, Morocco, Egypt, Botswana, Namibia, Cape Verde, Mauritius, Nigeria, Ghana, Kenya, Seychelles, Tanzania, Uganda, Mozambique and Zambia.

Figure 8. South Africa: External Finance by Bond and Equity Issuance, 2004 – 08



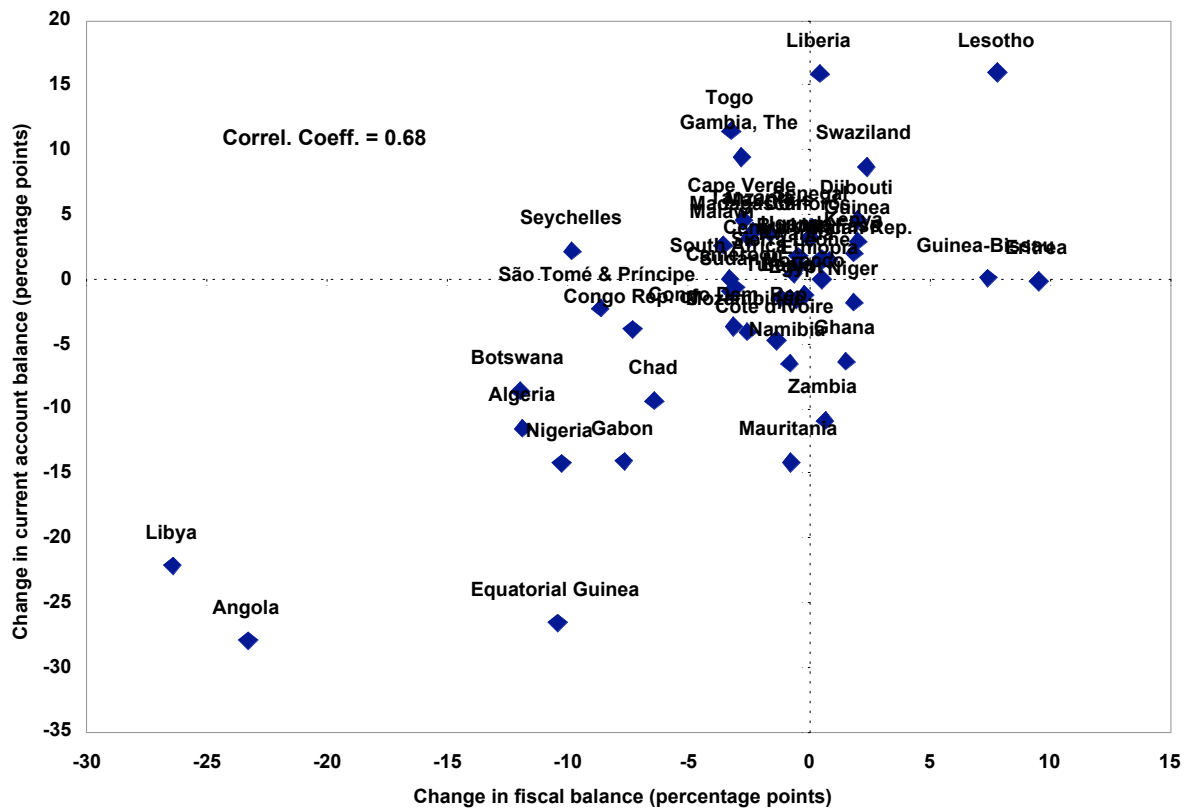
Source: IMF Financial Stability Report (April 2009).

Figure 9. The Impact of the Crisis -- Trade Channel



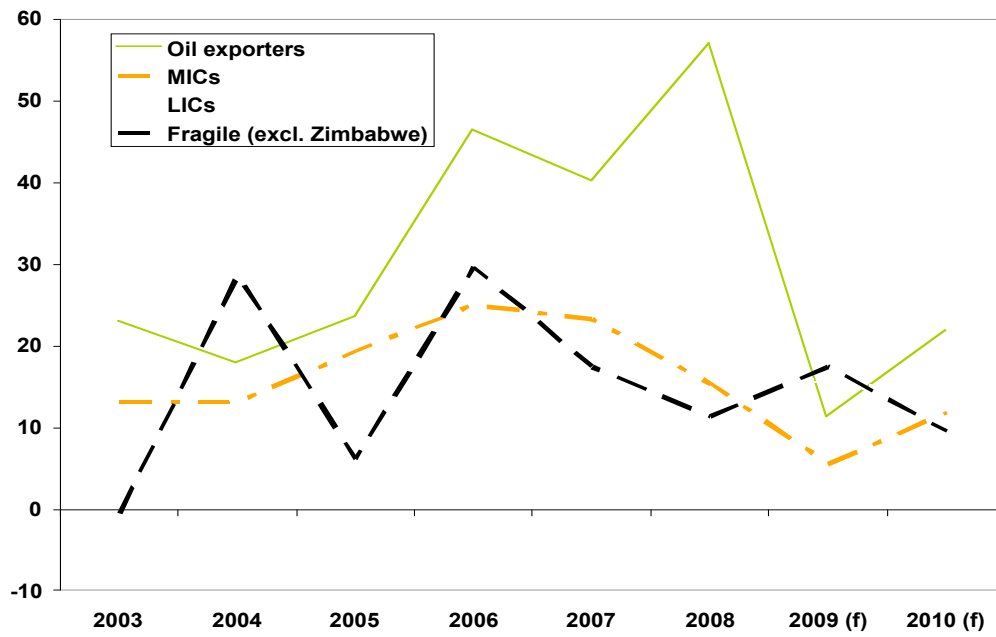
Source: IMF World Economic Outlook database, October 2009.

Figure 10. The “twin deficits”: changes in fiscal and current account balances, 2009 1/



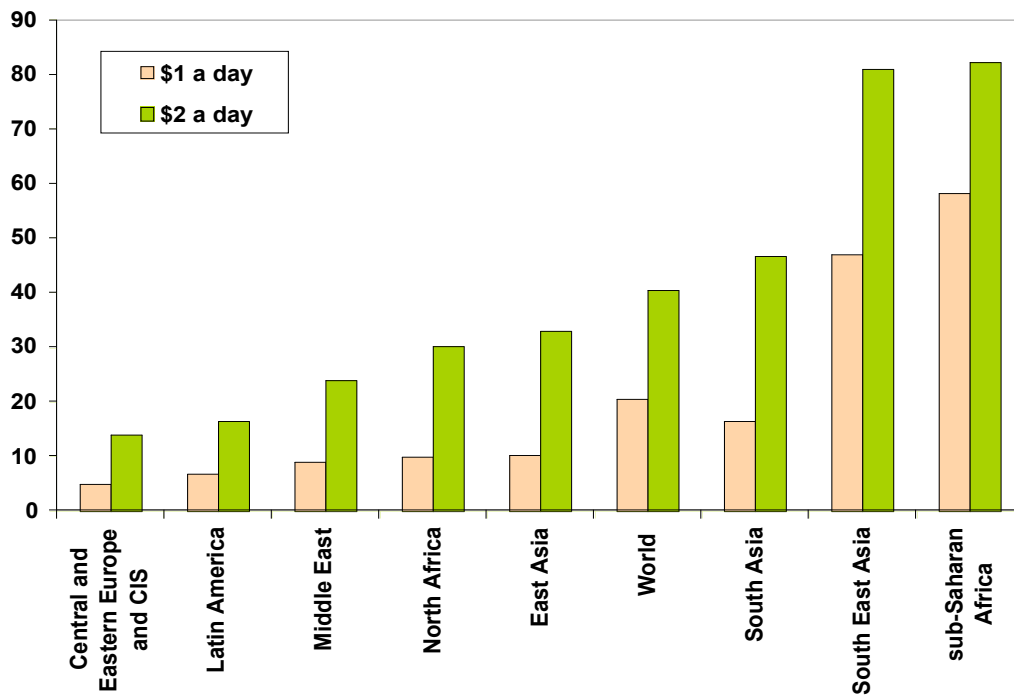
Source: African Economic Outlook database (October 2009) and staff calculations. 1/ Negative sign means deterioration in 2009. Both fiscal and current account balances include grants. The change is calculated as balance in as a share of GDP (in percent) in 2009 minus balance in 2008.

Figure 11 Broad Money in Sub-Saharan Africa, annual change in%, 2003 - 2010 (f)



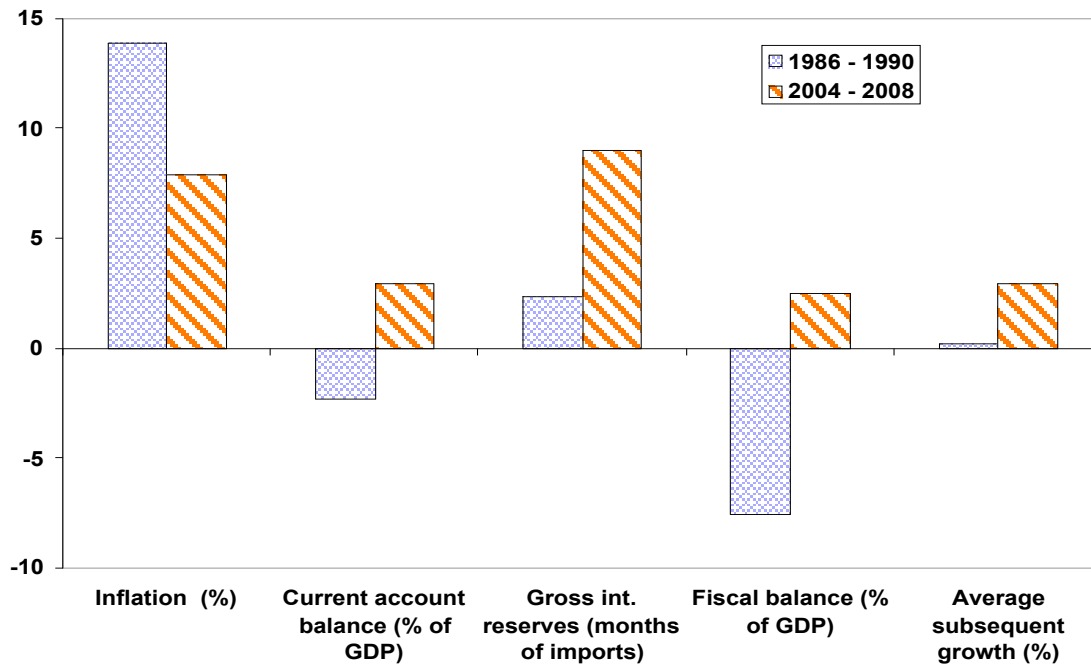
Source: IMF Regional Outlook for sub-Saharan Africa (October 2009).

Figure 12. Share of employed workers living in poverty in 2007, by world regions (%)



Source: ILO (2009), Table A7.

Figure 13. Africa's macroeconomic indicators before the two latest crises



Source: African Economic Outlook database (October 2009). 1/ Fiscal and current account balances include grants. 2/ Average of actual growth rates in 1991 and 1992 for the first recession and of forecasted growth rates for 2009 and 2010 for the second recession.

Figure 14. GDP per capita and rule of law index, 2007

