RESPONSES BY AFRICAN GOVERNMENTS TO THE GLOBAL ECONOMIC AND FINANCIAL CRISIS AND LESSONS

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Abstract

The paper focuses on the responses by African governments to the financial crisis and lessons. The authors blame the failure of the neo-liberal (laissez faire) policies of the multilateral institutions (World Bank and IMF) and excessive government regulation for the crisis. We also noted that the crisis is taking its toll on the African continent, as many countries continue to experience decline in their exports and exports revenues, limited inflow of international capital and remittances, widening current account and budget deficits, companies reporting huge losses and cutting jobs, to mention just few. Although individual country has taken measures it deemed fit to reduce the impact of the crisis on its economy and people, a lot still has to be done. Thus, we propose among other things: government regulate financial markets in order to prevent or check market failure; governments should employ fiscal stimulus that restores banks capacity to lend so as to enhance production and restore the waning confidence in the banking sector, as well as invest in public works so as to create employment opportunities for their teeming population; monetary authorities should reduce the cash reserve and liquidity ratios so as to increase liquidity within the systems; government officials and political office holders should avoid corrupt practices and embrace transparency and accountability in government transactions; African countries should increase trade among themselves and other developing countries in other part of the world in order to increase trade volume and export revenue; it is high time Africa play an important role in decision-making of the World Bank and IMF, since the decision taken by these institutions have lasting impact on their people; and the development and regional banks should increase their investment in infrastructure in order to create an enabling environment and attract foreign investment to the continent.

Introduction

The laissez faire doctrine of the classical school of thought has once again been brought under scrutiny, as the world faces the worst economic and financial crisis in decades. The crisis has led to near-collapse of major
financial institutions and firms across the globe including the AIG, Fannie Mae, Freddie Mac and automobile giants (General Motors) that are now benefitting from the American government’s bail-out. For instance, recently, the AIG benefited a bail-out to the tune of US$152billion. Besides, global demand and production continue to fall and world leading companies reporting huge losses. Couple with these, are rising unemployment rates, low savings rates, and falling standard of living of the people. Even though (initially) some countries like Nigeria claimed that its financial sector was insulated from the crisis, it is now evident that it was just a matter of time as the Nigerian government (through the Central Bank) recently announced a bail-out of N420 billion to save five commercial banks with huge debt and non-performing loans. In addition, the former managements of the respective banks have been sacked while new ones have been put in place. Earlier, the textile industry had enjoyed government bail-out as it has witnessed a near collapse. Earlier on, South Africa, the largest economy in African had been engulfed by the crisis, while Ghana has also obtained some loans to reduce the negative impact of the crisis on its economy.

For example, the global economic slowdown has contributed to lower demand and falling prices of South Africa exports. In the midst of the crisis, the monetary authority employed a restrictive monetary policy that further raised the lending rate, thereby reducing private consumption and investment. The South African economic downturn has spread to other countries (such as Lesotho, Namibia, Swaziland, and Botswana) in the region. Elsewhere, countries like Burkina Faso, Mali and Guinea experienced good harvest, which has helped them to reduce the impact of the crisis on their economies.
On the causes of the crisis, whereas some economists/analysts point to market failure as a major cause of the crisis, others argued that the interference by the monetary authorities and governments in the developed countries (especially in the United States) is to be blamed for the current economic and financial crisis. For instance, Oluba (2008) pointed out that inadequate or loose monetary policy is responsible for previous and present global economic and financial crises. He argued that since financial institutions (particularly banks) have the assurance that the central bank would always make cheap funds available to ensure liquidity in the system and prevent them from collapsing, they do resort to reckless spending and embark on high risk investments without making provision for an efficient and effective risks management mechanism.

On the other hand, in an attempt to prevent the ‘so-called’ market failure, government regulation sometimes hinders the proper working of the market. The advocates of the free market system argued among others that: the market guarantees efficiency in resource allocation; increases productivity; and facilitates the attainment of high standard of living of the citizens of a country. They argued further that, government interference in the market impedes the achievement of the benefits mentioned above.

Reacting to the current economic and financial crisis, Dembele (2009) opined that it is the failure of the neo-liberal policies and lack of self-correcting mechanism in most markets that led to the recent crisis that is taking its tolls on the African continent. The author stressed further that, while international institutions like the International Monetary Fund (IMF)
and World Bank advise African governments (through the introduction of SAP) to reduce expenditure and subsidies, privatize state owned enterprises, and employ policies of trade liberalization, among others, they support authorities in United States and Europe to employ expansionary fiscal policy (stimulus) and other assistance to help develop their economies and raise the standard of living of their people. For example, in 2007, these institutions voted US$4 trillion to assist in reducing the problems of the financial crisis in European countries and the United States. Dembele advised that African governments should reverse the policies of privatization, trade policies, and that the state (government) should assume its role in facilitating economic growth and development. Moreover, African governments should be careful when implementing policies of IMF and the World Bank.

The effects of the economic and financial crisis

As stated earlier, the economic and financial crisis has reduced world output and demand, and has brought far-reaching severe consequences on the African continent. For instance, demand for African exports and commodity prices have been falling, while remittances continue to decline. Moreover, foreign investors are becoming risk averse as they are reluctant to invest in Africa as they continue to withdraw their investment, especially in the equity markets. In addition, the increased credit risks and non-performing (loans) assets have led to the weakening of some financial institutions and/or banks. The impact of the crisis is reflected in the economic performance of African economies. For instance, the IMF (2009) projected that 1 percentage decline in world growth (trade-weighted by partner countries) causes the growth of GDP to fall by 0.5 percentage point. The Fund also revealed that Sub-
Saharan African (SSA) economic growth has declined from about 7.0 percent in 2007 to less than 5.5 percent in 2008. Even though, the AfDB (2009) projected Africa’s economic growth to be 2.8 percent, it has now revised it downward to 2.3 percent. Thus, it is expected that income per capita will reduce in some African countries in 2009.

In terms of exports, AfDB (2009) projected that the continent’s exports revenues will fall by more than $250 billion in 2009. For major oil producers and exporters like Nigeria and Angola, it is projected that they will have a combined shortfall in exports revenue to the tune of $76.8 billion in 2009. Zambia and Democratic Republic of Congo (DRC) was projected to have a combined loss of $6 billion in exports revenue, Uganda’s export receipts is expected to decline by 34 percent in (March) 2009 to $23.9 million from $36.3 million in 2008. For Nigeria, oil revenue is expected to fall by 34 percent in 2009 compared to 2007 as a result of 5 percent reduction in production and 31 percent decline in oil price.

Since economic crisis shrinks the volume of trade, it is expected to have a negative impact on Africa’s trade taxes, as the AfDB has projected. For example, in 2009, the continent is expected to lose $15 billion in trade taxes. This represents 1 percent of GDP and 4.6 percent of government revenue, respectively. Unfortunately, oil exporters will be hard hit as both Algeria and Nigeria are expected to have a combined loss of $4.6 billion in trade tax receipts. Moreover, the group of oil exporters will have a sharp drop in taxes to the tune of $8.2 billion compare to $6.8 billion for non-oil exporters.
In the same manner, the financial crisis will have its toll on the flows of international (private) capital to the African continent. Also, the lost of confidence of foreign investors in Africa many markets will contribute to a large extent the decline in international capital to the continent. Although the AfDB projected a reduction in private capital in 2009, it is however expected to improve in 2010 when the world economy would have gradually moved out of recession (recovery phase). The impact of the crisis on remittances is expected to be less on Sub-Sahara African and North African countries, as it account for a very small fraction of incomes of the two regions. Unfortunately, there appear to be imbalance in the flows of international capital among the various countries in Africa. For example, the AfDB (2009) reported that only the top 10 countries account for 46 percent of Foreign Direct Investment (FDI), 32 percent of Overseas Development Assistance (ODA), and 34 percent of remittances. The Bank also reported that North African accounts for the largest percentage of remittances, while middle-income and natural resource-rich countries enjoy the highest percentage of FDI.

In some countries, remittances have been shown to contribute meaningfully to the GDP, as it accounts for over 20 percent of GDP of Comoros and Lesotho. However, remittances account for 5 percent of GDP for Nigeria. Overall, remittances accounts for more than 2 percent of the GDP of Sub-Saharan Africa and more than 4 percent of the GDP of North African countries (IMF, 2009). In a simulation analysis conducted by the IMF (2009), it projected an additional 20 percent reduction in foreign direct investment, private transfers, and external grants.
Furthermore, the reduction in trade and commodity prices would have a lasting impact on African countries foreign exchange receipts as well as foreign exchange reserves. For instance, the foreign exchange reserve of Nigeria has declined from over $62billion in 2008 to less $40billion in the first half of 2009. The decline in foreign exchange reserves comes with adverse effect because it reduces the import capacity of the countries concerned, since they will be unable to acquire essential inputs, raw materials and capital goods needed for expansion of production, employment creation and accelerating economic growth.

Apart from these problems, Africa faces severe macroeconomic instability, with current account and budget deficits worsening over time. The AfDB (2009) projected the continent’s budget deficits to be 5.4 percent of GDP as compared to 2.8 percent budget surplus of GDP in 2008. In the same fashion, current account balance is expected to deteriorate from 2.7 percent of GDP in 2008 to a deficits of 4.3 percent and 5.3 percent of GDP for February and May forecast, respectively. In a separate study, IMF (2009) projected that about 30 percent of Sub-Saharan African countries would experience a decline in overall balance of payments by more than 4 percent of GDP. These tend to limit the capacity of governments to execute their development projects or programmes.

**Review of global economic and financial crisis**

In his paper titled “Global Financial Crisis: Nature, Origin and Lessons for Nigeria’s Monetary Policy” Oluba (2009) stressed that the great depression of 1930s, the United States stock market crash of 1987, the Japanese asset
bubble which later collapsed and the Asian financial crisis of 1997, all have their root in unnecessary government interference and cheap/loose monetary policy. For instance, Oluba pointed out that the restrictive monetary policy employed by the United States Federal Reserve to check the excess liquidity in the system in the face of a stock market boom led to the slowdown of economic activity, and a reversal of the stock market boom at that time, thereby leading to recession. Examining the stock market crash of 1987, Oluba again blamed United States cheap monetary policy in the early 1980s. The increased liquidity in the system consequently raised the rates of inflation and interest. The higher interest rate soon facilitated the stock market crash.

The current economic and financial crisis cannot be isolated from the reckless policies of the United States government and the Federal Reserve that assured all financial institutions and banks that they would not allow them to fail. Following the announcement, banks and mortgage institutions began to finance high risks investments which ordinarily they would not have done. The step taken by banks was not surprising since they were promised a lifeline should they find themselves in liquidity problems. The availability of cheap money only raises the demand and consumption of imports while production and real savings declined continuously (Oluba, 2009). Besides, the demand for housing sky-rocketed as those who could not have afforded a house of their own applied for mortgage loans (the case of the US subprime loans). This led to a boom in the housing and real estate sectors of the economy. The boom attracted investment/finance firms who bought shares and securities of these mortgage operators. Given this, the prices of these securities soared and the stock market boom continued.
However, borrowers and those who collected mortgage loans defaulted and banks began to experience high illiquidity.

Besides, some banks could no longer meet depositors’ demand, as many queue for hours and days. Perceiving dangers, depositors embarked on massive withdrawals, which further increased the liquidity problem within the system. This soon spilled to other sectors, and financial institutions and banks as well as automobile giants began to declare huge losses. The crisis spread to other regions including developed countries in Europe and emerging economies, as well as developing countries including Africa.

In summary, where monetary policy makes cheap funds available, it raises the rates of inflation and interest, thus promoting and encouraging consumption rather than production. This among other things reduces productivity and employment level, as well as profitability. In order to check the slowdown in the economy, appropriate policies have to be employed. However, experience has shown that, employment of inappropriate monetary and/or fiscal policies to correct and improve the workings of market would further aggravate economic and financial crisis, and ultimately lead to recession or depression.

**Measures taken so far by some African countries to reduce the impact of the global financial crisis**

In March 21st 2009, the committee of African Finance Ministers and Central Bank Governors established to monitor the crisis came up with its report on the impact of the financial crisis on African economies as well as measures
taken by some countries to reduce the impact of the crisis. Some of the measures employed so far country-by-country to mitigate the impact of the crisis on individual economy and its people are highlighted below:

**Botswana**
The Central Bank of Botswana cuts its interest rate by 50 basis points to 15 percent in December 2008. Given the uncertainty about the foreign exchange reserves to reduce the impact of the crisis on the economy, the government has made provision for borrowing when the need arise. Moreover, government recurrent expenditure on items like personnel emoluments and cost of travel, and expenditure on development projects have been reduced.

**Cape Verde**
The government of Cape Verde has ordered a careful management of the interest rates and the budget so as to ameliorate the impact of the crisis on the economy.

**Egypt**
In Egypt, the ministry of trade and industry is to promote exports and enhance domestic production with the injection of 7 billion Egyptian pounds. The tourism sector is also being encouraged among other things, via tax-exemptions on charter flights and free nights in hotels. In order to boost the confidence of depositors, authorities have created the Deposit Insurance Fund. In addition, the parliament has approved integrated supervision of non-bank financial institutions like capital market, insurance, mortgage and so on. The central bank has also reduced overnight deposit rate by 100 basis
points to 10.5 percent, while the lending rate has been cut down to 12.5 percent.

Kenya
The Central Bank of Kenya has reduced the threshold for investments in treasury bills (TBs) in the primary market from 1 million Kenyan shillings to 0.1 million Kenyan shillings in order to encourage small investors from January 2009. Moreover, the government has issued infrastructure bond to the tune Kshs18.5billion with a 12 year maturity in early 2009.

Mauritius
The government of Mauritius is to provide a stimulus package worth 10.4 billion rupees (3 percent of the GDP) in order to foster economic growth, create more jobs as well as enhance the purchasing power of its citizens.

Morocco
In Morocco, the government has given firms the permission to buy-back their own shares, should their price fall below a certain level. Besides, insurance firms can hold up to 60 percent of their listed shares so as to cover their liabilities as compared to the previous 50 percent.

Nigeria
The Nigerian government is to use the 2009 budget and the country’s foreign exchange reserves (which now stands at less than US$50 billion) as stimulus package to reduce the impact of the crisis and to promote economic growth. The federal and state governments are expected to borrow N1.6 trillion (stimulus) to meets their expenditure for the 2009 fiscal year. In
addition, the government has established a presidential committee in January 2009 to develop a framework in response to the impact of financial crisis. Besides, in February 2009, the government injected 70 billion naira into the textile industry to revive ailing companies.

Also, Soludo (2009) reported that, in response to the global financial crisis, the monetary authorities have adopted various measures for proper supervision and regulation, as well as ensure soundness of the financial (and banking) system. For instance, in an attempt to manage liquidity within the economy, the Central Bank of Nigeria (CBN) reduced the MPR from 10.25 % to 9.75 % and now to 8.0 % (below inflation rate), CRR from 4.0 % to 2.0 % and now to 1.0 %, and the liquidity ratio from 40.0 % to 30.0 % and now to 25.0 %. The CBN also expanded the discount window which allows banks to borrow for up 360 days (at an interest rate not exceeding 500 basis points above the MPR). It also suspended the aggressive mop-up of liquidity since late 2008.

Under foreign exchange and exchange rate management, the CBN adopted an exchange rate adjustment that would help to preserve the country’s foreign exchange reserves. To this end, it has moved from the Whole Sale Dutch Auction System (WDAS) to Retail Dutch Auction System (RDAS) and to checking the speculative demand for foreign exchange, as well as introducing a band of plus or minus 3 % to ensure stability. Also, the CBN has embarked on the restructuring of the Bureaux de Change (BDC) operations by categorizing them into Classes ‘A’, ‘B’ and ‘C’. In addition, is the sale of cash Foreign exchange only through bank operated BDC, and the
revision and enlargement of transactions that are eligible under the RDAS window.

In order to properly regulate and supervise the banks, the CBN has deployed resident examiners to the banks with effect from January 2009. There is also ‘standby teams’ of target examiners that may be deploy to any bank at any time to fish out those that do not observe the code of corporate governance, in order to inject discipline and restore confidence in the system. The CBN is rendering advisory service to banks on risk management. This includes extra conservation during time of crisis, capital conservation, cost minimization, de-emphasis on size, salaries and or bonuses, to mention just few. Furthermore, the CBN is also strengthening institutional coordination through the Financial Sector Regulatory Coordinating Committee (FSRCC). The CBN has continued to emphasis the use of e-FASS as a tool for banks’ returns analysis for speedy identification of early warning signals. Henceforth, ‘Consolidated teams’ rather than the current fragmented one are to examine and supervise the financial sector in 2009, while a common accounting year end has been adopted for all banks with effect from end-December 2009. The objective here is to improve data integrity and comparability of the status and soundness of every bank, as well as the adoption of International Financial Reporting Standards (IFRS). Finally, the CBN will continue to review the BOFIA in order to strengthen regulatory capacity.

In an attempt to reduce pressure on inter-bank rates, the CBN reduced the Expanded Discount Window (EDW) rate to a maximum of 500 basis points above MPR beginning from March 16, 2009. This measure is expected to
help reduce the problems of banks facing temporary liquidity crisis. Moreover, the bankers’ committee has pegged the maximum deposit and lending rates at 15% and 22% respectively, effective from April 1 2009 until end of 2009, so as to promote the growth of real sectors of the economy. In the area of confidence building, CBN has repeatedly emphasized that Government and the monetary authorities will ensure that all banks remain sound and no bank would be allowed to fail. In fact, in the last two months the CBN has disbursed over N700 billion to banks facing liquidity problems.

South Africa

In South Africa, the government has prepared a stimulus package of R690 billion to be injected into public investment (or projects) over the next three years, so as to encourage and sustain public sector employment programmes. In addition, the government is to support the financing of industries, as well as to give incentives in order to bring back to life distressed companies. Moreover, government is set to sustain and expand public sector social expenditure. In an effort to reduce the impact of the crisis particularly on the middle and lower income earners, government has given a tax relief of R13.6 billion. On its part, the Federal Reserve Bank of South Africa has cut the interest rate (i.e. the repurchase rate) by 100 basis points to 10.5 percent.

Sudan

In Sudan, the regional government has announced a 10 percent salary reduction for senior government officials, as it also attempts to reduce the burden of housing her officials in hotels.
Tunisia

The Tunisian government has created a commission to monitor the (impact of) crisis. In addition, the 2009 budget makes provisions for expansion of public investment, promotion of external competiveness as well as creation of employment. Couple with these, is the reduction in money market rate from 5.2 percent in December 2008 to 4.65 percent in January 2009. Lastly, the key interest rate has been cut down from 5.25 percent to 4.50 percent in February 2009.

Responses by African governments and Lessons

Given the adverse effects of the global economic and financial crisis, African governments and policy makers need to respond quickly in order to reduce the impact of the crisis on the continent. Thus, we suggest the following measures:

First, since African financial markets are becoming increasingly integrated with world financial markets, there is need for serious oversight and control of the ‘too big to fail’ institutions. African governments should regulate financial markets so as to prevent or check failure associated with market. Recent experience shows that correction mechanisms associated with market and the neo-liberal policies (no government intervention) of leading world international institutions like the International Monetary Fund and World Bank do not serve the best interest of African people. To this end, various governments should revisit their privatization policies as it relate to some strategic state-owned enterprises. In addition, governments should employ fiscal stimulus that restores banks capacity to lend so as to enhance
production, increase employment opportunity and foster economic growth. Moreover, monetary authorities should employ policies that would restore the proper functioning of the financial markets (systems) in order to restore the waning confidence in the markets. Also, monetary authorities should reduce the cash reserve and liquidity ratios so as to increase liquidity within the systems. This will assist in raising consumption and production. In addition, the adoption of a flexible exchange rate will help African countries to absorb external shocks, thereby reducing the adverse effects of the crisis on their economies. Even though we advocate for government intervention, there should be a timeframe and an exit plan for this. This is very important because, as mentioned earlier, excessive government interference in the market often distorts and/or hinders the proper workings of the market in terms of efficiency of resource allocation and productivity, which in turn may lead to another round of crisis.

Secondly, there is need for African governments to create an enabling environment where businesses can strive. This should include among others: reducing costs of doing business (via improvement and increased provision of infrastructures like transport, school, hospital, power, information and communication technology, etc.), as well as those factors that impede the profitability of firms. Prior to selection of a project, a careful cost-benefit analysis should be conducted in order to ensure prudent use of declining government’s resources. It is also important that public investment is done in a manner that it does not distort or crowd out private (sector) investment. In addition, government officials and political office holders should embrace transparency and accountability in government transactions, as these tend to have lasting impact on private investment. This will help to promote and
encourage the inflow of foreign investment to African countries, where the confidence of foreign investors is being eroded away.

- Thirdly, since trade between Africa and developed countries has declined substantially, African countries should increase trade among themselves, and developing countries in other parts of the world (south-south cooperation). Trade (in merchandise) has been shown to have increased tremendously between developing economies in the last couple of years, accounting for about 1/5 of total world trade (Neil Balchin, 2009). Thus, trade policies that would facilitate and expand trade between African countries and other developing countries should be encouraged. It is also important that African countries do not embark on aggressive policy of trade protection because it may compel others to retaliate, the consequences of which may not augur well for the continent. To this end, African countries should further open their economies (carefully) in order to reap the benefit of trade but should take advantage of the special safeguard mechanism under discussion in the Doha Round to make these measures benefit Africans more. It has been reported by OECD (2009) that a 10 percent increase in trade leads to 4 percent increase in per capita income. Moreover, further tariffs liberalization of agricultural and industrial goods may raise world’s welfare by $200 billion. Couple with this, African governments should persuade leaders of developed countries and emerging markets not to increase trade protection further, since foreign demand for the continent’s exports has reduced sharply.

Fourth, given that there is little prospect for more foreign investment to the continent, regional development banks and the African Development Bank should increase their funding of productive (real) sectors of the economies.
In addition, the bank should invest in infrastructural development like transport, energy, power, communications, schools, and so on. Besides, country members should be made to increase their contribution so as to raise the capital base of both regional and development banks. This will help to increase the funding and financing of strategic and important sectors of the economies, as well as reduce their exposure to bail-out during recession. Moreover, these banks and various governments should promote and increase funding of Small and Medium Enterprises, as they have been recognized as major employers of labour across the globe. Furthermore, the time has come for Africa to play an important role in the decision making and actions of international institutions like the International Monetary Fund, World Trade Organization and the World Bank, since decisions made by these bodies usually have lasting effects on the wellbeing of the African people. It is high time the African continent determined its own destiny and be cautious while accepting and implementing policies of the Bretton woods institutions, even if the policies undermine the growth and development of these economies.

Besides, for those countries with huge foreign exchange reserves and are facing limited inflow of international capital, they can draw on their reserves to finance public works or projects that would lead to employment creation and accelerate economic growth. In addition, various governments should employ (fiscal) policy of tax reduction and increased expenditure in order to raise both consumption and production. These measures would lead to more employment creation as well as facilitate economic growth.
African governments should employ appropriate labour market policies that would encourage and raise human capital development through training and education of workers. These would in turn increase labour productivity and enhance their chances of getting employment as African economies recover from the crisis. Similarly, various governments should provide safety nets for highly vulnerable groups such as low income earners and the unemployed, so as to ameliorate the impact of the economic crisis.

Finally, Africa countries should embrace the spirit of ‘be your brother’s keeper’, where countries with adequate resources can help those that have been hard hit. For instance, major oil exporters with huge reserves can buy the debt of smaller (poor) economies in order to help them raise funds to invest in public works and ultimately recover quickly from the crisis. In addition, governments’ efforts should be geared towards monetary stability, fiscal sustainability and fiscal consolidation. To achieve this, various governments should broaden their tax base in order to increase their revenues, and cushion the effects of any downturn or slowdown in the economy.

Reference


