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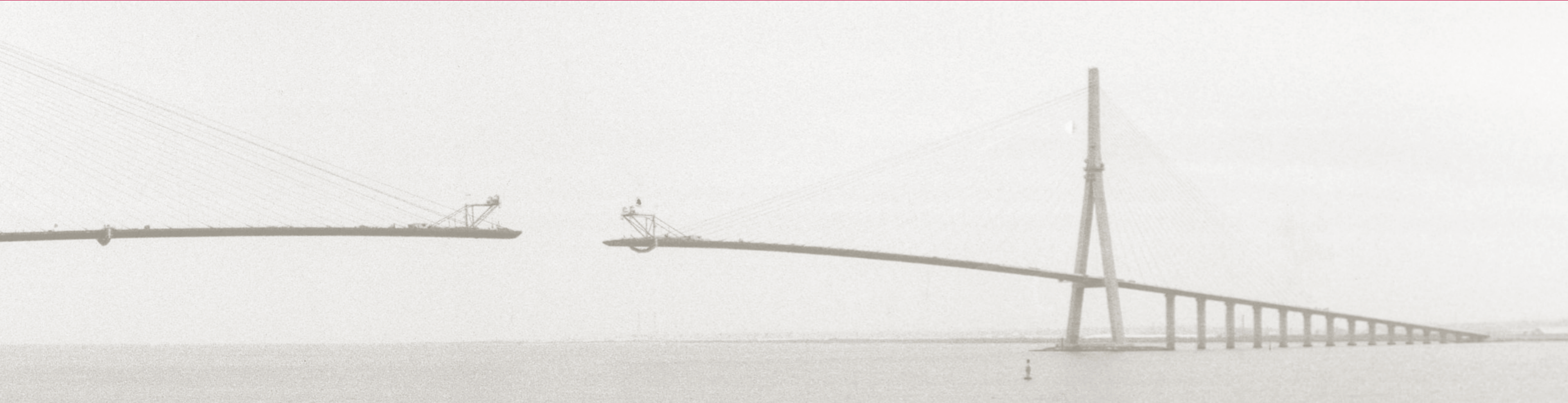


Briefing Paper 10/2011

African Development Trends: Lessons Learnt from the Global Financial Crisis

Summary

2011 has been an important year for Africa. It marked the 50th anniversary of independence for 17 African countries and the 10th anniversary of the Millennium Declaration. It has also been around a decade since steps toward creating the AU und NEPAD were taken. In a series of DIE Briefing Papers, researchers from Europe and Africa look into African Developments a decade after the revival of the African Agenda to take stock and identify the challenges facing the continent in the years to come.

Contrary to initial expectations, the global financial crisis has had relatively little impact on most sub-Saharan African countries, unlike other regions of the world. While the consequences for most of these countries in terms of economic growth, exports and capital flows have been low, it remains unclear how serious the humanitarian consequences of the crisis have been, since the effects on the achievement of the Millennium Development Goals, for example, will become apparent only with something of a time-lag, and appropriate data are not yet available.

Despite the relatively limited impact of the crisis, sub-Saharan Africa remains particularly susceptible to a variety of exogenous shocks, such as volatile raw material prices, natural disasters and currency fluctuations, which occur more frequently in developing countries than in industrialised countries.

This is due to major structural weaknesses, especially a lack of diversification in the structure of the economy and exports and the dominance of primary commodities.

The adverse effects of exogenous shocks are more pronounced in low-income countries, a category to which most countries of the region belong. Inadequate social systems and underdeveloped financial and capital markets mean that they have neither suitable instruments for cushioning exogenous shocks, nor the capacity to mobilise sufficient internal resources to finance them.

The greatest economic challenge in the medium term is therefore to install suitable economic policy instruments that can be used preventively to cushion exogenous shocks. These internal measures include a sound fiscal policy and effective debt management, the expansion of social protection systems and the long-term diversification of exports.

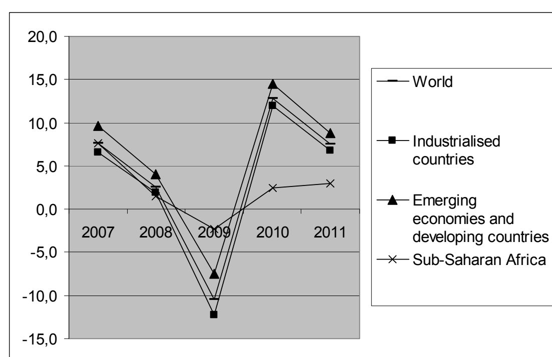
The poorer sections of the population are particularly hard hit by exogenous shocks. This is primarily true of energy and food price shocks, because the poor spend a large proportion of their disposable income on food and energy. What is needed now, then, is the development of suitable institutions to absorb exogenous shocks, like the African Development Bank's Food Emergency Facility, and such social policy instruments as expanded cash transfer programmes. At international level there should be better regulation and supervision of speculation in raw materials to prevent extreme price fluctuations. The G20 have proposals for solving this problem on their agenda.

Effects of the crisis on exports

As its financial markets are underdeveloped, sub-Saharan Africa has felt the impact of the financial crisis very largely along non-monetary transmission channels. The volume of exports from the region fell by 3 per cent in 2009 (Fig. 1). Export prices, too, sank with the decline in demand for exports that accompanied poor world economic growth.

Sub-Saharan Africa's exports fell less sharply during the crisis than those of other regions, because it is less well integrated into the world market. The relatively early recovery of its exports also received a particular boost from the reorientation of trade to China and other emerging economies in Asia and Latin America, whose relatively high growth rates mean that they need more raw materials than many western industrialised countries. For a time such middle-income sub-Saharan Africa countries as Botswana, Cape Verde, Lesotho, Mauritius, the Seychelles, South Africa und Swaziland suffered the worst decline in exports, since they are more deeply integrated into world trade (Berensmann 2010; IMF 2011).

Fig. 1: Change in the export volumes of various groups of countries , 2007-2011 (change from previous year in %)



Source: IMF, World Economic Outlook Database, 28.07.2011: 2011 Estimates

Effects of the crisis on capital flows to sub-Saharan Africa

Private capital flows to sub-Saharan Africa fell less sharply than to other regions following the global financial crisis. The 57 per cent decline in total capital flows between 2007 and 2009 compared favourably with the 72 per cent drop in global capital flows to all developing countries and emerging economies in the same period.

Capital flows differed significantly in nature. Long-term foreign direct investment, which finances about 20 per cent of the capital stock in sub-Saharan Africa, accounts for the bulk of capital flows to the region. Having fallen by 12.3 per cent in 2009, it rose again by 6 per cent in 2010.

Compared to direct investment, short-term capital flows (portfolio investments) fell more sharply in 2009, by almost 42 per cent.

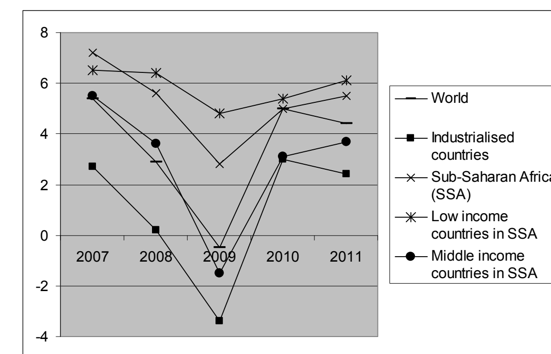
As, however, these capital flows are relatively limited owing to the underdeveloped financial markets of most sub-Saharan African countries and their consequent lack of integration into the international financial markets, the effects are appreciable in only a few countries with relatively open capital markets, into which most of the portfolio investments flowed, examples being Ghana, Kenya, Nigeria und South Africa.

Remittances from migrant workers have hardly changed as a result of the financial crisis, falling from USD 21.3 billion in 2008 to USD 20.8 billion in 2009. The international financial institutions estimate that they rose again in the following two years to USD 21.0 billion and USD 22.0 billion (IMF 2010, 48–50; World Bank 2011, 116).

Effects on growth

Initial forecasts by experts of serious adverse effects on sub-Saharan Africa turned out to be true of only certain countries and categories of country in sub-Saharan Africa. Compared to earlier global financial crises, like the one in the late 1990s, the decline in growth rates in many sub-Saharan African countries was less pronounced than in many industrialised countries and, what is more, the sub-Saharan African countries recovered more quickly. While in 2010/2011 most low-income countries in sub-Saharan Africa have again risen to the average growth rates in the period 2000-2008, some middle-income countries, such as Cape Verde, Mauritius, Namibia, South Africa und Swaziland, have yet to achieve their pre-crisis growth rates (Fig. 2).

Fig. 2: Growth rates in various regions and groups of countries in sub-Saharan Africa , 2007-2011 (change from previous year in %)

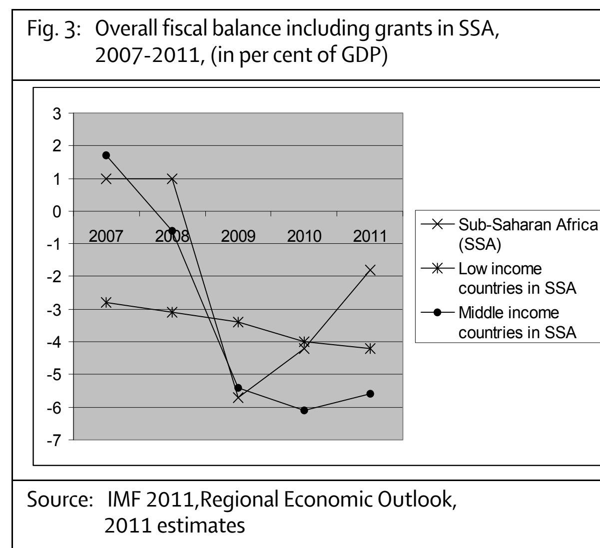


Source: IMF 2011, Regional Economic Outlook und World Economic Outlook Database, 2011 Estimates

The rapid recovery in sub-Saharan Africa has been due to both external and internal factors. The most important of the external factors has been the relatively early recovery of the whole global economy and world trade. The prices of most raw materials have also risen again since early and mid-2009. A significant internal cause of the rapid recovery has been the sound monetary and fiscal policies pursued by most countries of the region before the crisis. When the crisis began, they had no more than small budget deficits

or even surpluses. This gave them some fiscal room for manoeuvre, enabling them to adopt an anti-cyclical fiscal policy during the crisis. The other side of the coin, however, is that the budgetary situation in many of the sub-Saharan African countries deteriorated badly because of their anti-cyclical fiscal policies. The middle-income countries had, as a whole, a budget surplus equivalent to 1.7 per cent of Gross Domestic product (GDP) in 2007, but a deficit of –5.4 per cent of GDP in 2009 (Fig. 3). On the one hand, revenue fell because of the decline in economic activity; on the other hand, government spending rose (IMF 2011).

Fig. 3: Overall fiscal balance including grants in SSA, 2007-2011, (in per cent of GDP)



Source: IMF 2011,Regional Economic Outlook, 2011 estimates

Humanitarian consequences of the financial crisis

Although these macroeconomic data paint a relatively positive economic picture, the recent global financial crisis has had humanitarian consequences in sub-Saharan Africa. Although it is difficult for the moment to distinguish the humanitarian consequences of the financial crisis from those of the crises in food and commodity prices, this trio of crises has put an extreme strain on the reserves of the countries affected and their public budgets and made them more susceptible to fresh exogenous shocks.

It is also difficult to assess such humanitarian consequences of the financial crisis as its impact on the achievement of the Millennium Development Goals (MDGs). For one thing, not all the data needed for this purpose have yet been collected. For another, the effects will not be discernible for a number of years, because poor nutrition today due to the financial crisis will lead to higher mortality rates in the future. Similarly, reduced school attendance today due to the lower disposable incomes of poor households will mean smaller numbers graduating a few years from now.

According to World Bank and IMF estimates, although the global financial crisis has not led to a substantial rise in poverty levels in sub-Saharan Africa, the rate at which poverty is being reduced has slowed. Before the crisis the poor would have accounted for 35.9 per cent of the total sub-Saharan African population by 2015, but because of the crisis, the figure is likely to be 38 per cent. The financial crisis will force some 20 million more poor people to manage on less than USD 1.25 a day by 2015. According to estimates of the World Bank / IMF about 30.000–50.000 children additionally died in SSA in 2009 as a consequence of the global financial crisis. (Berensmann 2010; IMF / World Bank 2010).

Great potential for foreign direct investment

Foreign direct investment has risen in six of the past eight years, reflecting the growing interest in investment in the region. What is also interesting in this context is that, according to UNCTAD surveys, the returns on direct investment are higher in Africa than anywhere else in the world.

The financial crisis has hardly affected this potential for foreign direct investment in sub-Saharan Africa. In fact, it continues to exist for a number of reasons. First, the investment climate has improved in many sub-Saharan African countries, macroeconomic policy is more stable, and foreign indebtedness has fallen. Second, global investors see some sub-Saharan African countries as having relatively large and growing markets. Third, this region has attracted foreign direct investment in new segments of the service sector, such as telecommunications and banking. Foreign direct investment is also rising because of the improvement in investment and trade relations within the region (intraregional) and among the regions (interregional) – South-South investment largely from China, Brazil, India and Malaysia.

This considerable potential for investment in sub-Saharan Africa is also exposed to a number of risks, since it depends partly on the quality of growth, political stability and the continuation of economic and institutional reforms.

It is also questionable whether the region's absorptive capacity is adequate and whether, given their relatively limited experience of handling large capital flows, countries will be able to cope with any difficulties to which volatile flows may give rise (World Bank 2011, 8).

Lessons learnt

The greatest economic challenge facing this region is the need to take suitable economic policy measures in the medium term to cushion exogenous shocks. First, the region is particularly susceptible to exogenous shocks because of the limited diversification of the structure of its economy and exports and the dominance of primary commodities. Second, as its social systems are not extensive or well developed and its financial and capital markets are underdeveloped, sub-Saharan Africa has neither suitable instruments for absorbing exogenous shocks nor sufficient internal resources.

The global financial crisis has shown once again that room for manoeuvre in economic policy based on sound fiscal and monetary policies continues to be necessary

if anticyclical action is to be taken in response to future crises, i.e. if expansive fiscal and monetary policies are to be pursued at times of crisis. Equally, good management of internal and external indebtedness needs to be developed to guarantee sufficient financial room for manoeuvre when exogenous shocks occur.

Although the economic consequences of the global financial crisis for most countries in the region have been fairly limited, the social effects of the threefold crisis on the poor in sub-Saharan Africa have been severe. The challenge is therefore to develop suitable instruments for absorbing exogenous shocks, including the expansion of such food funds as the African Development Bank's Food Emergency Facility. This might act as a model for the creation of stabilisation funds to provide resources in the event of a crisis. Further expansion of social protection systems in sub-Saharan Africa is also needed.

Particularly successful in sub-Saharan Africa during the crisis were the cash transfer programmes for poorer sections of the population. They can be targeted and used at short notice, and they take effect quickly. Although they are being used by a growing number of countries in the region, they are both relatively small in scale and frequently no more than pilot programmes (IMF 2010, 37–40)

To prevent extreme fluctuations in raw material prices, speculation should be better regulated and supervised at international level, since a large proportion of raw material derivatives has hitherto been unsupervised and fluctuations in these markets may spread to physical markets.

The proposed reforms include, for example, the recording of derivative transactions in a trading database, guidelines for European supervision of this market and the creation of a separate authority on the model of the USA's Commodity Futures Trading Commission. The G20 have already considered this problem under the French presidency.

As the developing countries themselves will be unable to cushion exogenous shocks adequately in the medium term, the donor community has an important role to play in closing financing gaps and should therefore have suitable instruments available in case a crisis occurs. Following the recent crises, the World Bank, IMF and African Development Bank have reformed their instruments. When exogenous shocks occur, they will now be able to provide developing countries with resources quickly, on a relatively large scale and with comparatively few conditions attached.

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