UNITED NATIONS UNIVERSITY

Policy Brief

NUMBER 3, 2009

Overview

Africa is the developing region most at risk from the global economic crisis. Its recent strong growth has been interrupted. Already home to the largest number of low-income countries in the world, the region is now likely to experience higher unemployment and poverty; increases in infant mortality; and difficulty coping with longer-lasting effects such as higher school drop-out rates, reductions in health care, environmental degradation and a rise in conflict. Africa therefore needs to recover as quickly as possible. In this policy brief we draw on a number of recent UNU-WIDER studies to discuss the policy options for recovery.

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ISBN 978-92-808-3071-2
ISSN 1814-8026

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UNU-WIDER
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Policy Responses to the Global Economic Crisis in Africa

THE GLOBAL ECONOMIC CRISIS OF 2008 HAS INDUCED two negative external shocks in African countries. The first is a financial shock with the availability of credit declining and the cost of international credit increasing (a financial crisis); and the second is a shock relating to the demand for and price of exports, as most of Africa's important markets went into recession and commodity prices tumbled (an economic crisis).

These two simultaneous crises pose a huge risk to African growth and development as shown in Figure 1. They have hit precisely at the midpoint of the period given to achieve the Millennium Development Goals (MDGs), when various assessments had concluded that African countries were behind schedule and when African countries had begun to grow strongly. The real risk now is that progress will be further derailed.

As Figure 1 suggests, the two crises will depress demand, which will lower investment and growth and in turn result in higher unemployment and poverty as well as increase adverse coping, prolonging the continent's development crisis.

Although economic growth is not a perfect development indicator, there is a fair consensus that economic growth is necessary for development. In the case of Africa, it has been estimated that an annual average growth rate of 7 per cent should be maintained in order for the continent to achieve at least MDG number one, which is to halve the number of people living on less than $1 per day. As a result of the financial and economic crises, Africa's expected growth rate for 2009 and 2010 has been substantially revised downwards by international financial institutions. The International Monetary Fund (IMF) has revised Africa's economic growth forecasts for 2009 down from 5 per cent in October 2008, to 3.5 per cent in January 2009, and to 1.7 per cent in April 2009. And the World Bank has revised African growth prospects down to 2.4 per cent for 2009.

As shown in Figure 1, the consequences of such a reduction in growth in a region that is already home to the largest number of low-income countries in the world are likely to be higher unemployment and poverty; increases in infant mortality; and adverse coping with long-lasting effects such as higher school drop-out rates, reductions in health care, environmental degradation and a rise in conflict.

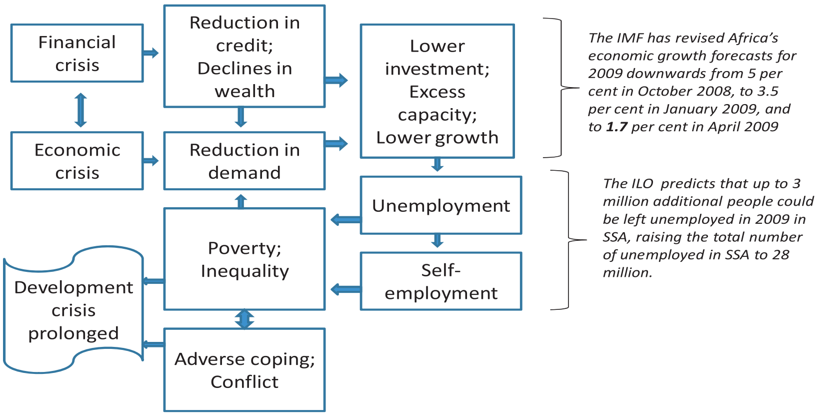

Figure 1: Impact of the Financial and Economic Crises on African Growth and Development
Source: The authors

Africa therefore needs to recover as quickly as possible. What are the policy options for such recovery? In this policy brief we draw on a number of recent UNU-WIDER studies (see **About this Policy Brief**) to address this question.

Policy Responses

How much Africa is at risk from the above crisis will depend on how vulnerable its countries are and also how resilient they are. Vulnerability in this case depends on how exposed countries are to adverse changes in global finance and trade. This may be largely, at least over the short-term, outside of their control. Resilience refers to the capacity to cope with adverse shocks, and may depend on a country's macroeconomic management, institutions and leadership: aspects which are primarily under a country's control. Minimizing the risk of the global economic crisis therefore means addressing both vulnerability and resilience. The global community as well as African countries will need to act in this regard, specifically in terms of mitigating the impact of the shocks (here the international community should assume a larger responsibility); coping with the effects of the crisis (here African countries will have to bear the brunt); and reducing risk by instituting proper measures to limit vulnerability and build resilience over the longer-term (with both countries and the international community playing a role).

The various policy responses under the categories (i) mitigation, (ii) coping and (iii) risk reduction are summarized in Table 1. Note that these are generic policy responses and would need to be adjusted to the context of each individual country to allow for different circumstances. However, we do not have the space here to consider the most appropriate responses at individual country level and can thus only discuss a number of generic actions and considerations.

Mitigation measures, to be undertaken by both the international community and African countries, include:

- Monitoring the impact of the crisis;
- Restoring confidence in, and continuing to monitor and regulate banks;
- Expanding trade (also through aid-for-trade programmes) and avoiding creeping protectionism; and
- Expanding trade finance.

Of the foregoing measures, the expansion of trade is perhaps the most crucial, as much of the adverse shock to Africa and the Least Developed Countries (LDCs) is due to a decline in exports. Expanding trade is, however, largely dependent on the international community. Here, first of all, efforts undertaken to restore growth in the advanced economies are vital. The sooner industrialized countries recover, the better for Africa. Moreover, this needs to be done without resorting to protectionism, now identified as a hazard to global trade. Efforts to expand trade finance through regional multilateral financial institutions such as the African Development Bank, for instance, could complement trade-for-aid programmes by donors and enable preferential trade access for African products.

The role of African governments in mitigation would be to:

- Monitor the impact of the crisis;
- Monitor and regulate their own banking systems and check for early signs of bank difficulties;

environment more accessible and through public works programmes;

- Utilizing technical assistance in the design and implementation of programmes, and
- Expanding peacekeeping operations where needed, given the potential for escalating conflict in times of economic hardship.

The international community's role in mitigation measures is to facili-

The sooner industrialized countries recover, the better for Africa

- Maintain or promote a positive stance towards trade liberalization and open markets;
- Lobby for a satisfactory conclusion of a more appropriate, development-oriented Doha Round;
- Work towards improving the supply capacity of African countries, for instance through public works programmes targeted towards infrastructure and transport services; and
- Maintain competitive real exchange rates and encourage further regional integration and regional trade facilitation measures.

Coping actions, largely the responsibility of individual countries but supported by assistance from donors, would include:

- Expanding domestic demand through fiscal and monetary stimuli, where possible, in a manner that does not lead to unsustainable debt accumulation;
- Absorbing financial losses through establishing foreign reserves in countries with means and competitive exchange rates;
- Supporting the vulnerable through appropriate social safety nets with the help of aid;
- Expanding self-employment, for example, by making the business

tate the demand for Africa's exports, which is a general and cross-cutting task. Whereas, in measures designed to help countries cope with the effects of the crisis, the international community needs to be more alert to country-level differences. This is where it is important to be able to identify countries most at risk, and to ensure that assistance is tailored to specific circumstances. Such assistance would be twofold: assisting African governments with financial resources so as to alleviate poverty and maximize the level of such aid's effectiveness (ascertaining that aid is appropriately utilized and that it does not divert local production); and providing technical assistance or even peacekeeping operations, if necessary. African governments, in turn, should take care that expansionary policies do not lead to unsustainable budget deficits or debt burdens, and that the appeal of private sector activity is improved.

Finally, as indicated in Table 1, African countries need to reduce risk; it is not enough to merely mitigate risk or cope with risk. Given the nature of the crisis, this implies that what is required is diversification of economies, improvement of the environment to enable successful business, and reform

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Table 1: Mitigation, Coping and Risk Reduction Policies

Objectives	Action
MITIGATION ACTION	
Restore financial confidence	• Monitoring, supervision and regulation of financial institutions • Recapitalization of banks where needed
Expand trade	• Avoid protectionism • Maintain competitive exchange rate policies • Obtain balance-of-payments support • Obtain trade finance support • Aid-for-trade
Expand finance	• Increase aid and accelerate aid disbursement • Attract foreign direct investment (FDI) • Facilitate remittances • Stop and return illicit funds/flight capital
COPING ACTION	
Expand domestic demand	• Undertake public works programmes • Prevent unemployment escalating • Provide social security, e.g. cash transfers, school feeding programmes • Consider tax reductions
Absorb financial losses	• Draw down reserves and utilize short-term international financial assistance
Expand self-employment	• Relax business regulations
Technical assistance	• Obtain assistance in planning and co-ordinating responses • Ensure the targeting and distribution of assistance • Provide information and monitor the impact
Peacekeeping	• Monitor violent conflict • Address grievances • Contain violence and spillovers • Plan for displacements and migrations
RISK REDUCTION STRATEGIES	
Export and production diversification	• Expand South-South trade • Promote manufacturing (e.g., through agro-industries) • Promote tourism • Invest in infrastructure
Banking system strengthening and financial deepening	• Expand access to finance • Encourage financial innovation • Maintain adequate bank capital requirements • Encourage domestic banking expansion

of the global financial and aid architecture. There is an important role for the international community here as well. Many African economies currently face a major problem with diversification, in part because their manufacturing capacity is being eroded by cheap imports, mainly from other developing countries. African countries must, of course, improve their competitiveness through infrastructure improvement, inter alia. In the meantime, however, they should also be allowed policy space under the World Trade Organization (WTO) to temporarily limit such imports. In all of these recommendations, the strengthening of governance is a prerequisite. The good news is that many countries in Africa have over the past decade, on average, improved governance through institutional reform, but it is also true that many others are still lagging behind. An important concern for a number of these countries is that such reform can be fraught with potential political disorder, requiring appropriate support to be given in order to reduce the likelihood of conflict. Conversely, we must also be cognizant of the need to preserve the achievements of the countries that have succeeded with reforms. This requires appropriate support to reduce the potential for political opportunism during crises, which could reverse the success achieved to date. Some of Africa's high-risk countries fall into this category.

Finally, stronger domestic governance in Africa will go a long way towards complementing improved international governance of the global economic and financial systems. This complementarity, in turn, will contribute to longer-term economic development.

Pitfalls in Policy Responses

This is not the first time that African countries have had to respond to negative external shocks. Looking at African countries' past records, it is clear that there exist certain pitfalls to be avoided in the selection and implementation of policies.

Boom-and-bust cycles

The current contraction in African growth comes after a period of high growth, and in fact follows the continent's post-war record of boom-and-bust episodes, a record that has been detrimental to growth over the longer term. Thus another boom-bust cycle should be avoided. That means the pursuit of prudent fiscal and monetary policies in order to forestall subsequent fiscal difficulties. Despite the downturn, Africa is in general not expected to enter into recession, and may have increased resilience for recovery sufficiently enough to avoid an unsustainable boom.

Unsustainable debt

Generating another debt crisis is a grave danger. The continent's boom-and-bust cycles of the past have often been accompanied by episodes of sovereign indebtedness, snaring many African countries and LDCs into a debt trap in the 1980s and 1990s. While many of these nations have benefitted from the Heavily Indebted Poor Countries (HIPC) initiative and the Multilateral Debt Relief Initiative (MDRI), the current crisis is likely to put pressure on both developing country expenditure (given the global calls for fiscal expansion) and revenue (due to a decline in tax income declines as a result of a reduction in trade and economic activity), with the likelihood of increased debts. As sovereign bond issues become more difficult and expensive due to the global credit crunch, many countries may be tempted to increase lending from regional banks and the Bretton Woods institutions. Unsustainable debts and irresponsible lending are hazards to be avoided. Preventing another debt crisis may require deeper

Table 1: (continued)

Objectives	Action
Social cohesion	• End conflicts/promote peace • Participatory and inclusive governance • Protect minorities • Nation-building
Good governance and institutional development	• Build strong and effective governments • Strengthen basic institutions, i.e. property rights, rule of law, contract enforcement, independent judiciary
Reform of international financial architecture	• Give a greater voice to Sub-Saharan Africa (SSA) • Advance the Doha Round, with more development content • Reform Bretton Woods institutions • More development role for G-20 • Reform aid architecture: volume and effectiveness • Address global imbalances

Source: Augustin Kwasi Fosu and Wim Naudé (2009), *The Global Economic Crisis: Towards Syndrome-Free Recovery for Africa*, UNU-WIDER Discussion paper, DP2009/03.

African governments should take care that expansionary policies do not lead to unsustainable budget deficits or debt burdens

debt cancellation, as well as greater efforts to improve domestic resource mobilization.

Adverse coping

A considerable challenge in the face of this crisis is preventing households from engaging in adverse coping strategies. There is a risk that the most vulnerable will be left to fend for themselves, and that inequality and polarization will increase, threatening stability. Therefore, what is required in Africa is not just fiscal stimuli, but also government expenditure that is of the right type and is specifically targeted. Indeed, it may be argued that now is an opportunity for many countries to implement and/or strengthen their social safety nets. Safety net programmes should include unconditional as well as conditional cash transfers to poor households, and public works programmes.

In addition, where resources permit, expenditures related to public works such as trade and transport infrastructure should be increased. This would not only offer relief by creating short-term jobs, but would also contribute to improving production capacity in the economy by strengthening needed infrastructure. In the past, investment expenditures were often substantially reduced during crises, delaying recovery and depressing longer-term growth.

Strengthening of governance is a prerequisite

Reversing liberalization

A third hazard that needs to be avoided by African countries in responding to the crisis is the reversal of gains made in recent years through economic liberalization. Many countries may contemplate the reintroduction of crippling state controls, prohibitively high tariffs and inefficient sectoral subsidies. While these may provide short-term relief, they may also return African countries to counter-productive policies in the form of anti-growth 'policy syndromes' in the longer term.

Many African countries have some scope within the WTO to apply safeguard mechanisms to provide, amongst others, credit to domestic firms and to engage in government procurement programmes to stimulate the domestic economy. But we caution against the return to the 'bad old days' of proliferating rent-seeking opportunities. However, we also recognize that the WTO itself needs reform so that it provides a wider policy space for low-income countries; this reform should be an

About this Policy Brief

This policy brief is published as part of UNU-WIDER's ongoing work on the global economic crisis within its project 'New Directions in Economic Development' directed by Augustin Kwasi Fosu. More detailed findings are set out in a series of WIDER research papers and WIDER Angle Newsletter articles (available to download free at www.wider.unu.edu):

Wim Naudé (2009), *The Financial Crisis of 2008 and the Developing Countries*, UNU-WIDER Discussion paper, DP2009/01.

Augustin Kwasi Fosu and Wim Naudé (2009), *The Global Economic Crisis: Towards Syndrome-Free Recovery for Africa*, UNU-WIDER Discussion paper, DP2009/03.

Augustin Kwasi Fosu and Wim Naudé (2009), *Africa's Recovery from the Global Economic Crisis*, WIDER Angle, June 2009.

Imed Drine (2009), *Impact of the Global Economic Crisis on the Arab Region*, WIDER Angle, June 2009.

Wim Naudé and James C. MacGee (2009), *Wealth Distribution, the Financial Crisis and Entrepreneurship*, WIDER Angle, March 2009.

important aspect of the longer-term responses to reduce the risks for African nations.

political contestability have improved significantly across the continent. There is also the urgency in the world

What is required in Africa is not just fiscal stimuli, but also government expenditure that is of the right type and is specifically targeted

Concluding Remarks

It is not only up to African countries themselves to avoid pitfalls in policy responses to the crisis. Advanced countries also have the responsibility to fix the global financial system and to equitably address the harm already done.

Will African governments be able to sidestep pitfalls and will the international community be able to sufficiently reform the global financial and aid architecture? We are optimistic, for unlike in the 1970s governance and economy — perhaps unlike any other time in the past — to reform global institutions. The UN Conference on the World Financial and Economic Crisis and Its Impact on Development (held in New York, 24-30 June 2009) again emphasized the need for such reform. There is, therefore, an opportunity to align Africa's development needs even closer to those of the global economy, and to herald in a new era in multilateral development co-operation.

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UNU World Institute for Development Economics Research (UNU-WIDER) is a research and training centre of the United Nations University. UNU-WIDER was established by the United Nations University (UNU) as its first research and training centre and started work in Helsinki, Finland in 1985. The Institute undertakes applied research and policy analysis on structural changes affecting the developing and transitional economies, provides a forum for the advocacy of policies leading to robust, equitable and environmentally sustainable growth, and promotes capacity strengthening and training in the field of economic and social policy making. Work is carried out by staff researchers and visiting scholars in Helsinki and through networks of collaborating scholars and institutions around the world.

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Policy Brief

'Policy Responses to the Global Economic Crisis in Africa'

Africa is the developing region perhaps most at risk from the global economic crisis and in need of quick recovery. This policy brief draws on a number of recent UNU-WIDER studies to discuss the policy options for recovery.

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