Mitigating the Impacts of Financial Crisis
Increased Cooperation among African Countries

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Introduction

The current financial crisis, starting 2007 and popularly known as mortgage crisis in the US, is unique in its depth, breadth, and devastating in its impact for both advanced and developing economies. It has created a situation of complete loss of confidence among consumers and the investing class. Least developed countries, which were thus far struggling with their subsistence living, are equally affected. One important issue that has come to the fore and which requires focused attention is the issue relating to restoration of confidence in the financial and other markets through regulation and other measures. Moreover, there are additional challenges such as deeply entrenched hunger and poverty in a large section of global populace across continents, behind-the-border policies that hinder investment; trade agreements which create complexities for traders and investors; numerous border and transit disputes which stymie the flow of goods especially to landlocked countries, and also the protectionist policy followed by developed countries. Global presence of these characteristics which influence a country's current economic policy lead to further distortion in the economic activities, in turn impacting the recovery process and its duration.

The depth and intensity of the current crisis on different countries widely vary for the developed, developing and least developed countries (LDCs). The real impact of the current financial recession has negated all the earlier belief that developing countries – especially the emerging economies – and LDCs would be least affected. The current economic indicators indicate quite the opposite. The nature of impact is different for different countries, especially the three sets of countries, developing, developed and the least developed countries (LDCs). Impacts are different even in the developing countries, for example, while Sub-Saharan Africa has one type of impact, developing economies in Asia have other types of impacts. Impact also vary from country to country within the same area – for landlocked and coastal countries. The imapct is expected to be more severe on those developing countries and LDCs which have developed internal inetia for external support and high concentration of exports to countries, which are epicentre of the current financial crisis.

This paper intends to explore the ways through which African countries can mitigate the impacts of global recession of which two, regionalism and diversification of markets away from traditional ones, are more critical. The paper is divided into five sections. Section I focuses on the major financial crises witnessed after the 1930s. It also highlights different types and nature of financial crises. Section II attempts to analyse the impact of the present financial crisis on African countries. Section III analyses the current trend in regional economic cooperation among African countries, especially in terms of international trade, FDI inflows, remittances. Section IV deals

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with policy responses actually made and required by these countries to mitigate the impact of the crisis. Section V concludes.

I. Nature and genesis of financial crisis

Financial crises, witnessed after the Great Depression of 1930, in both developing and developed countries are of many types and dimensions. Some of the major types of crises include; (a) stock market crisis, (b) savings and loan crisis, (c) mortgage crisis, (d) currency crisis, (d) debt crisis, (e) oil price crisis, (f) asset price bubble crisis, (g) balance of payment crisis, and (h) banking and financial institutions' crisis. The impact of all of these crises varied widely in depth and dimensions. Some got confined to their place of origin (India's balance of payment crisis), some others trespassed regional boundaries, and some engulfed the entire global economic system. A distinguishing feature of the different types of crises in developing and developed countries is that while most of the crises in developing countries emerged due to strict regulation of economy and sectors, in developed countries, most of the crises have been due to sustained deregulation, untimely policy measures and manipulation of the market forces. Sometimes such policy changes have also led to distorted performance of market forces in the medium and long term. The depth and dimensions of the crises and their implications also depended on the global positioning of the country of origin and also the type of sector in which the crisis originated. Global crises and recessions possess the wherewithal to encompass the whole of global economic system, and has devastating effects in virtually every country, rich and poor.

Global financial crises, leading to economic recessions and depressionary conditions, have one thing in common, while these are cuased by distortion and/or malfunctioing of one or a combination of various economic factors, the ultimate victim is one, and that is reduced demand across different segments and sectors[1]. The Great Depression of 1930s, triggered by a sudden, total collapse in the stock market (known as Black Monday), led to slackening of consumer demand for products covering almost the whole of economy.

[1] This, however, does not hold true in the case of forced crisis arising as a result of conflict of interest between countries (oil crisis of 1973).

Box 1

List and types of some major financial crises since the Great Depression

Financial Crises originating in the US

- 1930s – The Great Depression – the largest economic depression in the 20th century
- 1987 – Black Monday (1987) – the largest one-day percentage decline in stock market history
- 1989-91 – United States Savings and Loan crisis
- 2007-09 – The American financial (mortgage) crisis of 2007–2009 leading to global financial crisis of 2008–2009

Financial Crises originating in Europe

- 1992-93 – Black Wednesday – speculative attacks on currencies in the European exchange rate Mechanism

Financial Crises originating in Latin America

- 1980s – Latin American debt crisis – beginning in Mexico
- 1994-95 – 1994 economic crisis in Mexico – default on Mexican debt

Financial Crises originating in the Middle East

- 1973 – oil crisis – rise in oil prices caused the 1973–1974 stock market crash, related to conflict of interest between the **OAPEC** and the **US**

Financial Crises originating in Asia

- 1990s – Japanese asset price bubble collapsed
- 1991 – 1991 balance of payment crisis – India
- 1997-98 – 1997 Asian Financial Crisis – devaluations and banking crises across Asia

The financial crisis that led to recession of 2008 is no different from the earlier ones, except that (i) it has a larger number of countries in its fold, and (ii) while the crisis 1930s was caused by liquidity crunch in the U.S. due to an inadequate monetary policy, the current crisis, also originating in the U.S., has led to liquidity crunch. It has now penetrated into all parts of the real economy. The current crisis, called "once-in-a-century credit tsunami" has surged from sector to sector, first from housing into banking and other financial markets, across the public-private boundary, and has imposed heavy demands on the public sector's finances. It has also surged across national borders and has swamped emerging markets and other developing countries and has neutralised the considerable economic gains made during the last few years. The economic crisis is severely affecting many areas of people's lives and livelihoods, including employment, food prices, interest rates and the money people earn abroad and send back home.

Out of the total major crises (as listed in the Box 1), four originated in the US, one in Europe, two in Latin America, one in the Middle East and three in Asia. Seven of the listed crises took place in developed markets, while four happened in developing world. A significant number of the crises, originating in the developed markets, were due to speculation and wrong monetary policy(4), and excessive deregulation(2), whereas in other countries, these were due to untimely policy decisions and regulations, requiring rapid industrialisation and to meet increasing demand for poverty reduction employment generation. In other words, most crises in developed countries (current financial crisis is a glaring example) can be attributed to undue manipulation of market forces. On the contrary, LDCs have been made a part of the crises because of their heavy dependence on other countries where the crises originated. A distinguishing feature of the crises witnessed so far is that none of the crises originated in the LDCs. The LDCs' economic problems are frequently caused by a host of other external factors – inflation, declining demand for commodities, deteriorating terms of trade and protectionism, rising real rates of interest on foreign debt, and poor harvests – beyond LDCs control.

II. Impacts of financial crisis on African countries

The crisis has impacted export volumes, manufacturing sector performance, remittances, foreign direct investments, commodity prices, tourism, and foreign aid**.** All of the African countries, as the case of other developing countries, are affected by slowdown in demand for their manufactured products arising out of reduced global demand, weak domestic market, and reduced inflows of foreign capital. Post financial crisis issues in these countries is neither loss of confidence nor reduced domestic demand, but an already aggravated issue of survival. The primary concern of these countries is managing survival.

In the existing circumstances of global slowdown in economic growth resulting from reduced economic activities, qualitatively, the African countries most impacted by global financial crisis include:

- countries with significant exports to the US and the EU market
- countries exporting high income elasticities' products
- countries dependent on remittances and foreign capital (FDIs)
- countries with weakly regulated markets for securities
- countries dependent on aid
- big producers with small domestic market
- countries with poor infrastructure for sustaining internal growth
- countries with small savings' rate

Projections made by international institutions such as IMF and the World Bank indicate that 2009 will be the worst year in terms of economic growth for African and other developing countries. One projection after other continue to be revised downward to accommodate the second round impacts of financial crisis on African and other developing countries. Economic growth in Africa will be worst hit as the real GDP growth for 2009 is projected to decline to almost half at 3.3% from a growth of 6.3% in the preceding year. It is expected that, due to the current financial crisis, Africa might experience an increase in the number of its poor citizens and a decrease in the living standards of the most vulnerable segments of its population.

Table 1
World Economic Outlook Projections (GDP growth %)

Countries by Groups	Actual		Projections	
	2007	**2008**	**2009**	**2010**
Emerging and developing economies	8.3	6.3	3.3	5.0
Africa	6.2	5.2	3.4	4.9
Central and eastern Europe	5.4	3.2	-0.4	2.5
Commonwealth of Independent States	8.6	6.0	-0.4	2.2
Developing Asia	10.6	7.8	5.5	6.9
Middle East	6.4	6.1	3.9	4.7
Western Hemisphere	5.7	4.6	1.1	3.0

Most of the African countries will pass through the declining growth syndrome in the coming period, especially during 2009, and if corrective appropriate measures are not taken, this declining and in some cases negative growth will characterise the economic outlook of these countries. Projections carried out by various international institutions demonstrate that while for some African economies, the GDP growth would be substantially low compared to earlier periods, some of the countries would feature in the negative growth list (as shown in Figure 1).

Some five African countries will realise a negative growth compared to two countries which would grow by less than 1%. The expected growth rate for another 15 countries would be in the range of 3 to 4%. Only 15 of the total African countries would realise a growth rate exceeding 5%.

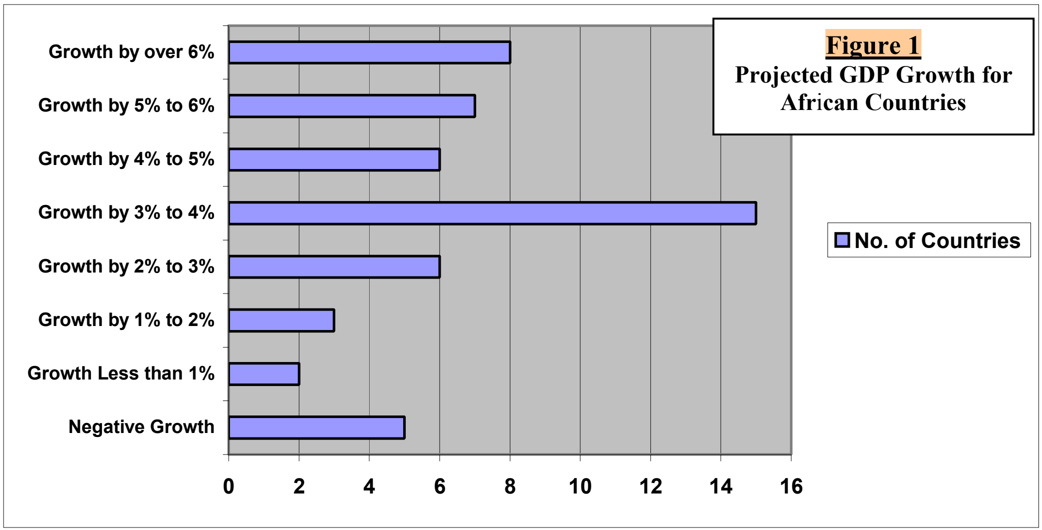


Figure 1
Projected GDP Growth for African Countries

African countries are also be adversely impacted by the decline in remittances. Remittance flows to developing countries grew by 7% to $283 billion in 2008, up from $265 billion in 2007. The increase in remittances was strongest in South Asia, followed by the Middle East, North Africa and sub-Saharan Africa (SSA). However, this increase was much slower than in previous years due to the growing unemployment and weakening economies in industrialized countries. Overall remittance flows to African countries are expected to decline in 2009.

Greater degree of economic and financial exposure – higher dependence on exports to developed market, high dependence on foreign aid and remittances and also increased FDI inflows – of African countries over the last one and half a decade has made the continent more vulnerable to the shocks of the present financial crisis. Data show that a large number of African countries have attained vulnerability status since the beginning of the financial crisis.

Table 2
Vulnerability Table for some SSA Countries

Countries	Reserves (in Months of Imports: 2009 less 2008)	Vulnerability Overall Assessment
Angola	-1.0	H
Burundi	-0.6	H
Central African Rep.	-0.9	H
Congo, Dem. Rep. of	0.6	H
Côte d'Ivoire	0.0	H
Djibouti	0.2	H
Ghana	-1.2	H
Lesotho	-0.8	H
Liberia	0.0	H
Mauritania	-0.3	H
Nigeria	-3.9	H
Papua New Guinea	-0.9	H
Sudan	0.2	H
Zambia	0.2	H

H = High risk; M=Medium risk
Sources: Extracted from **The Implications of the Global Financial Crisis for Low-Income Countries, IMF, March 2009**

III. Trend in regional economic cooperation

Over the past 20 years, intraregional trade in all developing regions has expanded faster than extraregional trade. It has expanded most rapidly among the developing countries of East Asia, where today it represents almost half of that region´s total trade. In Latin America it has grown significantly since the late 1980s, and is now close to 30% of total trade. Despite the proliferation of regional trade arrangements in Africa and Sub-Saharan Africa (SSA) in the past two decades, intra-African trade is still very limited and has hardly grown over time. It accounts for less than 10% of Africa's overall trade.

Over the period 2004–2006, intra-African exports represented 8.7 per cent of the region's total exports. Intra-African imports, on the other hand, represented 9.6 per cent of total imports. This proportion was substantially higher for sub-Saharan Africa (around 12 per cent) than for North Africa (around 3 per cent). Nonetheless, even the sub-Saharan African proportion of intra-regional trade remains far below other regions.

Table 3 Intra-regional imports and exports as a proportion of total trade (2004–2006 averages in %)		
Region	*Imports*	*Exports*
Africa	9.6	8.7
Developing America	20.9	18.5
Developing Asia	48.1	45.5
Developed America	23.3	39.8
Developed Europe	68.1	71.4

Source: UNCTAD, 2008c.

It is observed that since 2000, the proportion of intra-African merchandise trade has stabilized at about 10%, with a slight decline towards 2008. This is despite the fact that the absolute value of intra-African trade has increased during the period. The stagnation of the proportion is due to the fact that Africa's trade with the rest of the world increased much faster than intra-African trade. While intra-African trade increased by 13.64 per cent per year on average, between 1999 and 2006, the average yearly increases in Africa's trade with the United States was 27.57%, and trade with China at 60.85% over the same period.

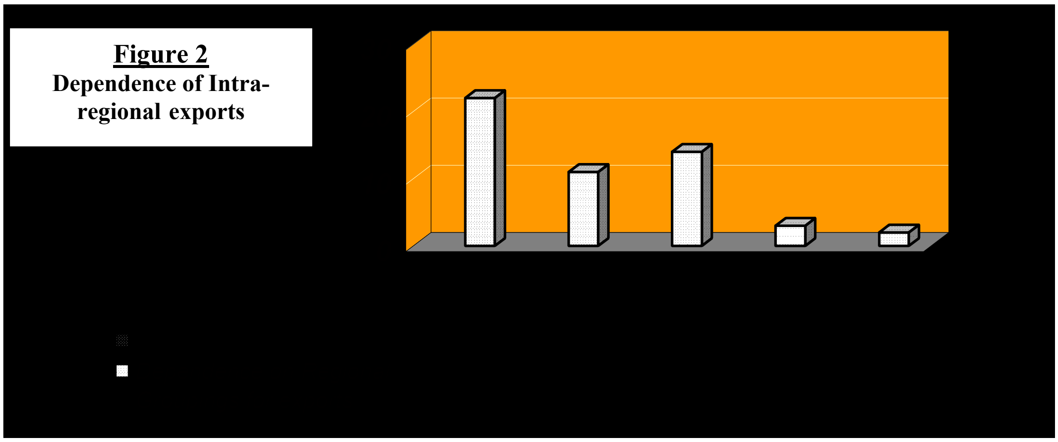


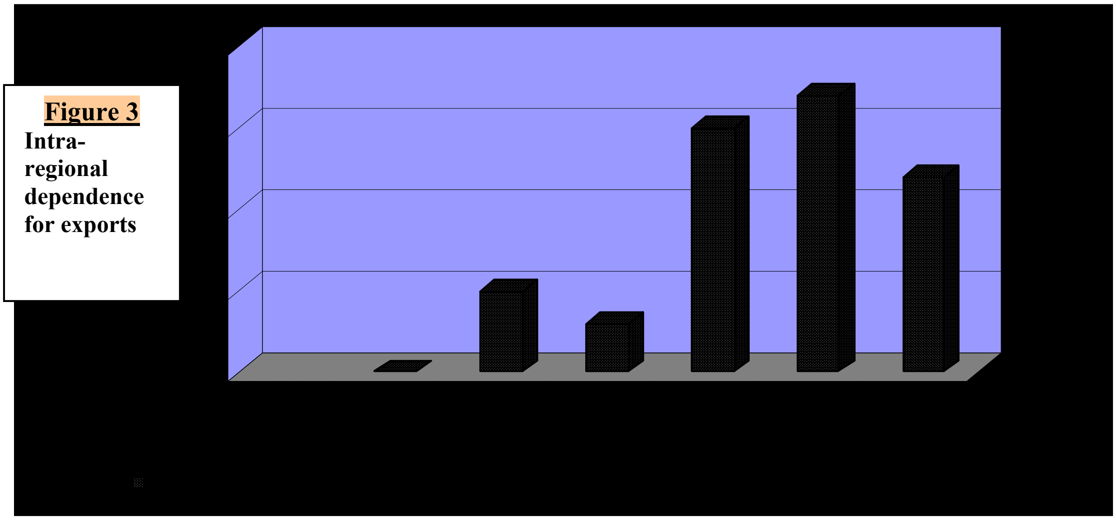
Figure 2
Dependence of Intra-regional exports

The level of exports between the African countries is one of the lowest. Only two of the total African countries are dependent on others for over 75% of their exports, and another 3 countries for 25 to 50% of their total exports. For a majority of countries (22), exports within Africa is less than 10%. The proliferation of regional and sub-regional blocks has been totally ineffective in promotion of intra-regional trade. not helped these countries in integrating.

Data further show that most of the export market based on major bilateral trade relations for intra-regional products from Africa are concentrated in a few products and are not diversified. Of the 25 top intra-African trade relations by value[2], which together account for over half of total intra-African exports, 11 are strongly concentrated on one single product. For seven of these it is petroleum while gold and gas make up the four others. The 14 other trade relations in the list are made up of a

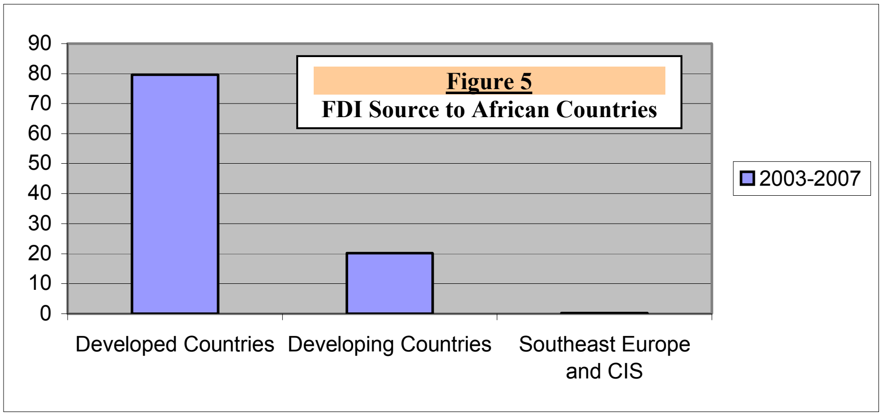
[2] United Nations, Economic Development in Africa, Report 2009

more varied list of products. Seven are export flows from South Africa, and five are from other Southern African countries to South Africa. This suggests that intra-African trade, though it is more diversified in terms of products traded than Africa's trade with the rest of the world, remains highly concentrated with respect to a few strategic commodities. These all will have bearing on the recovery prospects of African economies.

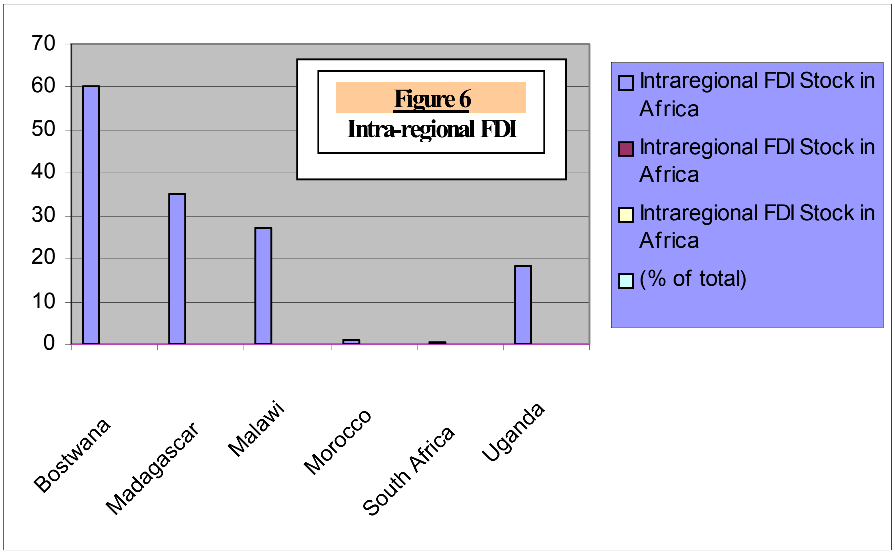


Dependence of African countries for exports on economies relatively less impacted by the current financial crisis in Asia such as India and China is also not significant from the recovery point of view. However, in the recent few years, trade and economic relations of African countries with Asian economies have improved considerably. It is observed from the available data that there are only seven countries in Africa which are dependent on emerging Asia for roughly over 30% of their total exports. Sudan and Guinea Bissau are the two countries whose export dependence on Asian economies are way above the rest, 76.5% and 71.5% respectively. These two appear to have a better prospects of recovery than others.

The indirect effects of the financial crisis are also expected to be significant, with falling FDI, ODA flows and lower remittances. Even if industrialized countries keep aid as a percentage of gross national income (GNI) constant, the recession in those countries will result in lower absolute aid flows. The financial crisis will weaken many African countries, especially mineral exporters.



In terms of FDI inflows developed countries (USA and the UK), the epicentre of the current financial crisis, are the largest contributor, having a share of 80% in the total FDIs inflows in Africa. Data on intraregional flows of FDIs show that very few African countries are dependent on regional sourcing. This low regional share wiould further aggravate the problems faced by African countries since most of the developed countries are under recession.



Dependence on developed and other developing countries outside Africa has been a feature of African countries for quite a long time now. Over-reliance on external investment is the result of African countries' inability to mobilize sizable financial resources to invest in other African countries until very recently. During the period 2002–2004, intra-African FDI was estimated at only $2 billion annually on average.

This represented about 13% of total inward FDI (See UNCTAD, 2006b). In comparison, intra-regional FDI in countries from the Association of South-east Asian Nations (ASEAN) is estimated at 30% of total FDI. However, According to a UNCTAD (2008 Report), in 2007, the flow of intra-African investment increased to $6 billion. This raised the accumulated stock to $73 billion (See UNCTAD, 2008g).

The low level of intra-regional FDI in Africa can be attributed to several factors. Key among these is the lack of adequate transport and communication infrastructure, skilled labour, and weak economic links and contacts among investors within the region. Moreover, there is a strong correlation between foreign and domestic investment because foreign investors view the behaviour of the local investors as important information signals. The low level of domestic investment in Africa is can be said to be partly responsible for the limited intra-regional investment.

IV. Conclusion

The experience of the Great Recession of 1930s and other crises demonstrate that countries take varying duration of time to overcome the crisis. This will true in the present case also. Complete recovery from depressionary conditions and recessions of African countries would depend on various factors which include,

- degree of openness or liberaralisation,
- inherent strength of the domestic economy,
- business and trade relations with countries relatively less impacted by the current financial crisis,
- level andintensity of intra-regional trade and economic cooperation
- technological strength and infrastructure,
- level of dependence on other countries for capital and knowledge resources,
- nature of economy – planned/unplanned, and lastly
- economic policy from other countries, which needs to complement domestic economic policy.

There is explicit evidences that suggest that trade is an engine for economic growth and prosperity. However, in response to mitigate the impacts of financial recession, countries have turned inward looking and more regional in approach. Trade data over the last few years demonstrate that economies which have diversified their exports and less dependent on few major global economies for their exports, are relatively less impacted by the current global crisis. The data also show that volume of regional trade in Africa and other developing countries has increased over the last one and half decade. This needs to be sustained and further strengthened. Not surprisingly, world trade polices now are being largely influenced by regional trade arrangements. It is therefore more important for the developing countries to be more focused on regional and extra regional trade with other developing countries in the existing economic dynamics, where developed economies – especially North American and the EU – are finding it increasingly difficult to absorb exportable goods from other developed and developing countries. It is essential that developing countries create a more conducive regional environment and cooperate with other countries in promoting economic growth and trade. This can be done through identifying product complementarities between developing countries in the region as well as outside the region. African countries need to further diversify their export destinations.

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