The Global Financial Meltdown of 2008, Sub-Saharan Africa, and the Way Forward for Sustainable Economic Growth and Development

Ashford C. Chea, PhD

School of Business, Kentucky Wesleyan College

4721 Covert Avenue, Evansville, IN 47714, USA

Tel: 812-471-9341 E-mail: Achea@ix.netcom.com

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Abstract

The author began the paper with a brief historical perspective of the global financial crisis. This was followed by the review of the literature. Next, the researcher outlined his findings preceded by some policy analyses and implications of the crisis for sub-Saharan African economies. The writer ended the paper with recommendations for both sub-Saharan African policymakers and the international finance and development community.

Keywords: Global financial crisis, Sub-Saharan Africa, Economic effects, Public policies

1. Introduction

The 2008 financial crisis was more global than any other period of financial turmoil in the past 60 years. The extent and severity of the crisis that began with the bursting of the housing bubble in the USA reflected the confluence of several factors, some were familiar from previous crises, others were new. First, as in previous times of financial turmoil, the pre-crisis period was characterized by (1) surging asset prices that proved unsustainable; (2) a prolonged credit expansion leading to accumulation of debt; (3) the emergence of new types of financial instruments; and (4) the inability of regulators to keep up. Second, new this time was the rapid expansion of securitization (not itself a new phenomenon), which changed incentives for lenders and lowered credit standards. Systems became fragile because balance sheets became increasingly complex (further complicated by increased use of off-balance-sheet instruments); financial market players were highly leveraged; and they relied on wholesale funding and external risk assessments. Cross-border spillovers intensified after the crisis broke because financial institutions and markets across borders were closely linked and risks highly correlated. As the result of the financial crisis, the world economy went into a tailspin (IMF African Department, 2009).

2. SSA before the Financial Meltdown

Before the global financial meltdown, some Sub-Saharan African (SSA) countries had started to attract new investment inflows and had begun borrowing on international capital markets. Research by the International Monetary Fund (IMF) in September 2008 identified eight countries, beyond South Africa, which could become emerging or frontier markets: Botswana, Ghana, Kenya, Mozambique, Nigeria, Tanzania, Uganda, and Zambia. All these countries had experienced a takeoff in growth, led by the private sector, and had public policies in place that embraced market-led growth, as well as financial markets that attracted foreign investors (Anonymous, 2009).

SSA was seen as less integrated in the global financial markets and the direct impact of global financial turmoil was less severe than in the advanced and emerging economies. But SSA was not totally immune from global events. This was because many countries in SSA were more vulnerable since the food and fuel price shock caused higher inflation and rising current account deficits (Sayeh, 2008).

There is no doubt that the global financial crisis had a devastating short-term impact on foreign direct investment (FDI) in SSA. FDI in SSA economies fell by an average of 14 percent between 2009 and 2010, undermining the economic forecasts of almost all governments in SSA (Ford, 2011).

SSA was also affected by the global financial crisis through a fall in import demand from key markets such as European Union, the United States, and Asia, and through a slump in commodity prices and scarcer financial flows (Anonymous, 2009).

3. Literature Review

3.1 The Global Economy and Emerging Markets

As a result of the global financial meltdown which started in 2008, the global economy when into a severe crisis. For example, January 2009 update of the World Economic Outlook projected global growth to slow from just under

3 ½ percent in 2008 to about ½ percent in 2009 before recovering somewhat in 2010. However, risks to this outlook remained on the downside. Advanced economies were suffering their worst downturn since World War II, with economic output contracted by over 1 ¾ percent in 2009. With the help of monetary and fiscal stimulus and slowly improving financial conditions, growth resumed gradually in 2010—but there was a significant risk that the downturn could be deeper than anticipated. Growth was also expected to fall in China, India, Brazil, and other emerging market economies, to be dragged down from 6 ¼ percent in 2008 to about 3 ¼ percent in 2009 by falling export demand, subdued capital inflows, and lower commodity prices. Similarly, growth in all emerging market and developing economies, including SSA, was expected to slow to 3 1/3 percent in 2009 from 6 1/3 percent in 2008, and then gradually pick up with world demand in 2010 (IMF African Department, 2009).

3.2 Global Financial Meltdown and SSA

Many countries in SSA enjoyed robust economic growth in the years preceding the financial crisis that strengthened their balance sheets. Sound economic policies were important factors, as was the favorable external environment and increased external support in the form of debt relief and higher inflows. But the food and fuel price shock of 2007-2008 that preceded the global financial crisis weakened the external position of net importers of food and fuel, caused inflation to accelerate, and dampened growth prospects. The financial crisis greatly compounded the policy challenges confronted by the region as it strived to consolidate its economic gains and meet Millennium Development Goals (MDGs) (African Business, 2011).

In SSA, frontier and emerging markets were hit first followed by all countries, and risks were mounting that other channels might gain in importance, especially in the financial sector. First were the frontier and emerging markets. For example, through their financial links with other regions in the world, South Africa, Nigeria, Ghana, and Kenya were hit first, suffering falling equity markets, capital flow reversals, and pressures on exchange rates. Ghana and Kenya had to postpone planned borrowing, and in South Africa and Nigeria external financing for corporations and banks was becoming scarce.

Second, all countries were affected. The global slowdown in economic activity pushed commodity price down, with negative effects on export earnings and the external current account, fiscal revenues, and household incomes. Commodity exporters faced major terms of trade deterioration. IMF research showed that in the past a 1 percentage point slowdown in global growth led to an estimated ½ percentage point slowdown in SSA. The effects were more pronounced this crisis because the tightening of global credit compounded the impact of the slowdown, exacerbating risks for trade finance and other capital flows.

Third, there were fragile states whose political and social situations were inherently vulnerable. For instance, countries like Burundi, Guinea-Bissau, and Liberia were dependent on every concessional financing that were affected (IMF African Department, 2009).

3.3 East Africa

The impact of the crisis on the overall financial condition of banks in East Africa was modest. For example, in Kenya, total banking system assets and liabilities increased by 24.4 percent between December 2007 and 2008. In Tanzania, the banking sector's assets and liabilities both grew by 21 percent during the same period; while Uganda recorded asset growth of 28.4 percent and liability grow of 29 percent. In all three countries, the growth in assets was underwritten by an expansion in the loan portfolio, which took place mainly in the first half of the year before the impact of the global financial crisis started to affect access to credit. Notwithstanding the strong growth in loan portfolio, asset quality improved in Kenya and Uganda. In Kenya, the ratio of nonperforming loans to gross loans improved from 10.6 percent in 2007 to 9 percent in 2008, while Uganda, the nonperforming loans ratio was more than halved, from around 4 percent in December 2007 to 2.2 percent in 2008. In both countries data for 2009 showed that the trend was largely maintained. However, for Tanzania, some deterioration became evident in 2009. Nevertheless, the banking system in all three countries remain well-capitalized and profitable (Masha, 2010).

3.4 West Africa

As in most of SSA, the countries in West Africa fared relatively well during the global financial meltdown. The slowdown was mild and growth rates appear to have already bounced back to their pre-crisis levels. However, there was intriguing long-term difference between West Africa and other part of SSA. West Africa had not been able to move into, and sustain, the higher rates of economic growth needed to make serious inroads in job creation and poverty reduction. While experience varied among these countries, over the past fifteen years per capita income grew, on average, by less than 1 percent each year. In SSA as a whole, the growth rate was more than twice that; and more than four times that in the region's highest growers. The reasons for West Africa's slower growth were complex. No single factor or simple story emerged. But it was certainly not just because of initial income levels,

natural resource endowments, or the location of these countries. Nor were global forces, namely world trade or prices, primarily to blame (Plant, 2010).

So, if external developments were not the main problem, there was room for the sub-region to improve its own performance. Four factors contributed to the impeding lasting growth. First, periods of political instability were associated with particular lackluster performance in the slower growth in the sub-region—Ivory Coast, Guinea-Bissau, Niger, and Togo. This reflected, in part, political instability and the difficulties for macroeconomic management. Second, private investment rates in West African countries had been noticeably lower than other SSA countries—in both the public and private sectors—with relatively little foreign direct investment. Third, the sub-region had less success than SSA best performers in establishing the right conditions for economic activity. For example, perceptions of governance remain weak. West African countries ranked relatively low in the World Banking Doing Business Survey and other composite indicators. Fourth, inadequate physical infrastructure and weak public services, especially in education and health, also played a role. Underinvestment in physical and human capital undermined the private sectors ability to produce goods and services efficiently (Plant, 2010).

3.5 Southern Africa Custom Union (SACU)

Prior to 2009, all the SACU countries had several years of strong fiscal performance. This was largely underpinned by a vibrant mining sector in the case of Botswana and Namibia and large SACU transfers for Lesotho and Swaziland that helped finance rising spending as a percent of GDP (Senatha, Chankuluba, and Chepete, 2010). The increase in SACU transfers between the fiscal years 2004-2005 and 2007-2008 was considered a permanent increase and was thus used mostly to finance recurrent expenditures, including civil service wage increases. The overall fiscal surpluses resulted in comfortable gross international reserve positions, particularly for Botswana and Lesotho. Debt and the debt-service burden were rather moderate in Botswana, Namibia, and Swaziland (Mongardini et al, 2011).

However, the global financial crisis had a large impact on SACU imports. Following the onset of the crisis, the dollar value of SACU imports declined at an annual rate of 28.1 percent in 2009. This reflected the contraction of economic activity in the sub-region. Notwithstanding an incipient recovery in the sub-region in 2010, imports were not expected to return to the 2008 peak until 2012 and would grow broadly in line with world real GDP growth thereafter. Moreover, the impact of the import decline of SACU revenue was larger for the smaller members on the union. First, the decline in custom revenue implied a smaller common revenue pool to be shared across SACU members (Mihe and Hartman, 2006).

3.6 SSA Currencies

The currencies of many SSA countries, like those of many emerging and developing economies, suffered large depreciations with the onset of the global financial crisis. Collapsing trade and financial flows led to substantial balance of payments gaps, triggering fast depreciations and higher exchange rate volatility, beginning in mid-2008. The exchange rate losses varied largely, reading as high as 40 percent (Ghana, Kenya, Nigeria, Uganda, and Zambia) for some currencies and less than 10 percent for others (Tanzania and Rwanda). Domestic as well as external factors distinguished the impact. In the years preceding the crisis, most of the currencies that depreciated had enjoyed strong gains triggered by strong macroeconomic performance and favorable global economic and financial conditions. In addition, declining interest rates in advanced countries led to an emergence of significant carry trade operations to many African countries, which thanks to their strong economic situations and stable exchange rates, attracted significant foreign direct investment and portfolio flows. Currencies, however, grew mixed with respect to other major currencies. The five currencies that registered a large depreciation against the U.S. dollar also depreciated vis-à-vis the euro between June 2008 and March 2009; the other two appreciated with respect to the euro. All currencies except for the Zambian Kwacha appreciated vis-à-vis the British pound (Ltaifa et al 2009).

3.7 SSA Exchange Rates

In most countries, the post-crisis movements in exchange rates only erased part of the appreciation registered in the previous period. Prior to the crisis, all currencies except Tanzanian shilling had appreciated in real terms. From end-2003 to June 2008, the real effective exchange rate for Zambia averaged the highest appreciation (reflecting largely positive terms-of-trade effects) followed by Kenya and Nigeria. At the other end of the spectrum, the Tanzania shilling depreciated over that period partly on account of efforts by the monetary authorities to preserve competitiveness. The crisis period erased part of the previous real gains in most cases. Exceptions included the Rwandan and Kenyan currencies, which continued to appreciate, and the Tanzania shilling, which fully offset the depreciation of the pre-crisis period (IMF Survey, 2010).

The first factors that affected the value of exchange rates were external, reflecting the transmission of the global crisis through trade and financial channels as well as the volatility of the U.S. dollar, the main international reserve currency. This impact was commensurate with the extent and nature of each country's exposure to trade and global financial markets. At the same time, domestic policies played a role in shaping the nature and magnitude of the impact (Ltaifa, et al 2009).

Moreover, trade had, as expected, an adverse impact on the region's currencies, but the magnitude of this impact seems to have varied significantly across countries. Terms-of-trade movements were likely the main factor underlying movements in the exchange rates of Nigeria and Zambia, both of which were large commodities exporters. The swift and rapid collapse of copper prices in the case of Zambia and oil prices in Nigeria led to substantial deterioration of these countries' trade balances, precipitating pressure on their currencies. Conversely, the rebound in copper and oil prices in the latter part of the period supported the recovery of the kwacha and a stabilization of the naira, respectively. The trade impact was more modest in the other countries, reflecting their terms-of-trade gains as oil importers, together with, in some cases, increases in the prices of some of their exports (gold, cocoa), and in the case of Uganda benefited from increased regional trade (IMF African Department, 2009).

Abrupt fluctuation in capital flows also contributed to exchange rate movements. A tightening of credit conditions in global financial markets and decline of confidence triggered a frantic race to safety by private investors at the onset of the crisis. As expected, the resulting depreciation was more pronounced in those countries that had received large portfolio inflows prior to the crisis (Ghana, Kenya, Nigeria, Uganda, and Zambia). These countries registered faster and larger exchange rate movements together with sharper increases in volatility (Plant, 2010).

The volatility of the U.S. dollar as a reserve currency also had a strong effect on SSA currencies. The dollar rose sharply against all currencies, amplifying the depreciations that were triggered by other external factors. The dollar gained 11 percent vis-à-vis the euro between June 2008 and March 2009, which accounted for slightly more than half the depreciation in Nigeria, Uganda, and Kenya; about 40 percent of the depreciation of the Ghanaian cedi; and about a quarter of the depreciation of the Zambian kwacha. Subsequently, the U.S. dollar fell, shedding 6 percent by September from its March peak with respect to the euro; this matched almost all the appreciation in the Kenyan and Ugandan shillings and about 30 percent of the gains in the Zambia kwacha (Berg et al, 2009).

In sum, SSA was affected through three principal transmission channels: (1) Lower global growth reduced the demand for the region's exports, exerted downward pressure on commodities prices, and curtailed the flow of remittances from abroad; (2) The tightening of global credit conditions led to lower foreign direct investment flows and reduced or reversed portfolio inflows as investors fled into more liquid or safer assets. Trade finance flows was also affected and; (3) The banking systems was weakened through a decline in the quality of their credit portfolio, losses on other financial assets, such as deposits with troubled foreign correspondent banks, or capital repatriations by troubled parent banks—which are often foreign-owned (Sayeh, 2008).

3.8 Government Policy Responses

Domestic policy mix adopted in response to the external crisis also played a role in explaining exchange rate dynamics. In the free floaters, exchange rate depreciation reflected an explicit policy choice to use the resulting change in relative prices as a tool to facilitate adjustment to the crisis. Most countries also boosted fiscal spending to prop weakening aggregate demand, and some countries adopted an accommodative monetary policy stance. For example, in the case of Ghana, the increase in the fiscal deficit and loosening of monetary policy were initiated before the crisis. A loosening of aggregate demand policies amplified exchange rate depreciation and led to higher inflation, lower domestic interest rates and lower confidence. While the direct impact on inflation was expected to be modest given the weak aggregate demand, there likely was a second-round inflationary impact in countries with more flexible exchange rate policies; this impact was hard to discern in the data given the protracted effects of fuel and food prices hikes. Lower domestic interest rates may have reduced arbitrage margins, although this impact was likely to have been small given the low prevailing international interest rates (Ltaifa et al, 2009).

Most countries intervened in their foreign exchange markets in an effort to stem the shock to their currencies. However, intervention policies fell into two distinct categories: some (including Kenya and Uganda) intervened only in a sporadic and rather modest manner to restore confidence and smooth the movement of the exchange rate, while others (including Nigeria, Tanzania, and Rwanda)intervened in a more regular and extensive manner to halt the depreciation. As a result, nominal exchange rates in these countries have tended to be more stable. Intervention by the Nigerian central bank was, however, unsuccessful in preventing a large steep depreciation of the currency by the end of 2008, in the face of the large turnaround in trade and capital flows (IMF Survey, 2010).

Finally, restrictions on external transactions and payments may have helped minimized currency fluctuation. Restrictions on the financial and capital account were imposed in most countries with varying degrees; they included

acquisition of stake in banks (Ghana), purchase of government securities (Kenya), investment in stock markets (Tanzania), purchase of money market and debt instruments (Ghana and Nigeria), and the repatriation of foreign direct investment proceeds (Ghana, Nigeria, Rwanda, and Tanzania). As expected, the countries with the least restriction (Uganda and Zambia) registered the largest exchange rate fluctuations. It was difficult, however, to quantify the effectiveness of such restrictions in countries where they existed. Rwanda and Tanzania, for example, had to intervene extensively to counter exchange rate pressures in spite of extensive restrictions on capital transactions (Ltaifa et al, 2009).

4. Findings

The shock faced by countries in SSA was to some degree different from the shock confronted by developed countries. In developed countries, the shock was predominantly in the form of a decline in domestic demand, while in SSA countries it was mostly an external shock—a shock to the terms of trade, export demand, remittances, and capital flows. The mainly external nature of the shock gave rise to balance of payments constraints, which was relaxed temporarily through sustainable external financing and running down reserves (Berg et al, 2009).

Financial sectors in SSA were also vulnerable to several risks. Unlike developed economies, there had been no systemic banking crisis in SSA. Commercial banks and other financial institutions there so far remained largely sound. Cross-border banking system linkages were minimal; there was less exposure to complex financial products, and financial systems were not well integrated with other global financial markets (IMF African Department, 2009)

Improved economic policies, market-oriented reforms, and the reduction in the number of armed conflicts contributed to strong performance. Rapid growth was facilitated by improvements in terms of trade, growth of exports, debt relief under different initiatives, and increasing aid flows and private inflows. However, these conditions were adversely affected by the global financial crisis. The negative effects in SSA were felt first in emerging and frontier markets, where financial sector linkages were better established, but later reached most countries (Sayeh, 2008).

The fiscal effects of the crisis were large and operated predominantly via revenue losses, in part as a result of the operation of automatic stabilizers associated with slower economic growth. Revenue losses took place even though revenue ratios to GDP were constant, owning to lower economic activity. First, revenue from consumption taxes declined as economic activity slow. Pressures on remittances from abroad took a toll on consumption. Tourism, an important source of revenue in some countries was affected. Declines in foreign direct investment were also cutting into government revenues. Second, commodity-related revenues were particularly affected as commodity exporters faced major drops in export prices and lower demand for their exports. In several SSA countries, commodity-related revenues accounted for a significant share of budgetary revenue (e.g., Angola, Botswana, Chad, Gabon, Republic of Congo, and Nigeria) (Berg et al, 2009).

5. Analysis and Discussion

5.1 Financial Linkages and Channels of Transmission

Weaker financial linkages with the rest of the world may have limited the impact of the systemic banking sector crisis in advanced economies on SSA, but the region was hard hit by the effects of the slowdown in global economic growth. There were several channels through which the effects of the crisis were transmitted to SSA's economies. First, the harsh reality of lower global growth reduced demand for SSA's exports, pushed commodity prices downward, and curtailed the flow of remittances from abroad. Second, the tightening of global credit reduced capital inflows and curtailed the availability of trade finance, and eventually caused donors to reduce their aid to SSA. Third, an economic slowdown affected the quality of credit portfolio of financial institutions and imposed losses on other financial assets, such as deposits with troubled foreign correspondent banks, or capital repatriations by troubled parent banks—which were often foreign owned. Fourth, the slowdown in trade reduced government revenues, thereby worsening the fiscal position in many countries. Fewer resources meant that SSA's governments were unable to meet the heightened expectations of their populations for progress in reducing poverty and investing in infrastructure (Kato, 2009).

Similarly, there was a need to strengthen financial stability by reinforcing prudential regulation and supervision. One important aspect was to extend supervision to key nonbank institutions, such as the fast-growing pension funds. More generally, promoting the early identification of vulnerabilities and improving the monitoring of risks was critical. Financial stability assessment was a useful vehicle for this purpose. Financial sector reforms were aimed at enhancing the contribution of the financial sector to private sector development. Establishing an operational credit reference databank, for instance, facilitated a healthy expansion of credit, and promoted further financial deepening—a critical ingredient for sustained high growth (Sayeh, 2008).

5.2 Need for Safety Nets

This implied that countries needed to expand safety nets and pro-poor spending to address rising poverty levels. By contrast, countries that increased subsidies for fuel and food products during the 2007-2008 price spike were able to scale back these subsidies. Countries that had already phased out temporary suspensions of customs duties and taxes include Burkina Faso, Mozambique, Niger, and Senegal. Currency depreciation and rising interest rates also added to spending pressures. Depreciation increased external debt servicing costs—but taxes collected at the border (including import duties and VAT on imports) and resource-related revenues also increased. Countries able to access international capital markets had to pay higher interest costs because of flight to safety and increased risk aversion by lenders (Berg et al, 2009).

5.3 SSA Exports

The growing dependence of SSA on export receipts from tourism and transportation services, which also tended to be procyclical, heightened the region's exposure to the global recession. The slump in global growth persisted longer and the impact of the slowdown was more pronounced than expected, negatively affecting SSA's internal and external equilibrium. In some countries the global crisis had a spillover effect on external competitiveness. For instance, countries with fixed exchange rate pegged to the U.S. dollar were adversely affected by the dollar's strength. Foreign inflows to the region slowed. Remittances were affected because the majority originated in advanced economies where the economic slowdown was most pronounced. External aid was also affected; aid had been found to be procyclical with both donor and recipient incomes. The actual decline in FDI and portfolio inflows also exceeded expectations (Thornton, 2008)

Falling commodities prices led to pressures to keep producer prices at previous levels, higher than the corresponding export prices. In particular, commodity marketing boards came under pressure to cover the difference, putting budgets at risk. There was a need in some countries for government support to domestic financial institutions and depositors. The economic slowdown and exchange rate volatility in some countries were likely to increase credit risk and nonperforming assets and weaken financial institutions' balance sheet. Domestic financial sectors were particularly exposed to the crisis because credit to domestic commodity exports was sizable (Berg et al, 2009).

5.4 Exchange Rate and Interest Rate Shocks

Although risks and vulnerabilities to exchange rate and interest rate shocks remain, certain policies contributed to the less benign outcomes. In Tanzania and Uganda, for example, the central banks were able to meet increased demand for foreign exchange in an orderly manner without disrupting the markets. The policy of nonintervention in the foreign exchange market allowed markets to adjust in response to market signals, as official policy did not give implicit guarantees to the path of the exchange rate. In addition, the use of reserves that had been accumulated helped the adjustment process. Public sector debt management policy assisted in reducing Kenya's debt-to-GDP ratio in the middle of the decade, contributing to reduced vulnerability to interest rate shocks. At the height of the crisis, accommodative monetary policy also assisted in keeping the interest rate regime supportive of an early recovery from the crisis and reduced balance sheet vulnerabilities across all sectors. A more proactive supervisory and regulatory framework was introduced by the central banks (Masha, 2010).

5.5 The Role of Prudential Policies

Several significant factors helped SSA weather the crisis. First, improved policies were important. Many SSA countries, from the late 1990s onward, ran better policies than in the past, which mitigated the impact of the downturn—with strengthened fiscal positions, reduced debt burdens, lower inflation, and better cushions of foreign exchange reserves. Second, fiscal space was important. Because fiscal deficits and debt positions had improved dramatically, many countries were able to use fiscal policy to counteract the crisis, rather than making it worse. They strived to preserve—and sometimes even increase—public spending, at a time when revenue was falling rapidly. Fiscal policy was countercyclical in two-thirds of SSA countries in 2009. Third, there was room for interest rate cuts. Because inflation had come under control, they were also able to use interest rate policy and reduce interest rates as another means of mitigating the impact of the crisis, and where exchange rates were flexible, countries let them adjust and helped them deal with the shocks, contributing to their resilience. Fourth, countries generally protected social spending during the crisis, using a variety of strategies. In particular, countries maintained health and education expenditures at pre-crisis levels, with most countries increasing expenditures. A growing number of countries had also put in place conditional cash transfers and an increasing number were focusing on a more developmental approach to social protection, including public works programs and food security initiatives. Last but not least, protectionism was avoided. SSA countries did not begin to put up barriers and look inwards and instead continued to pursue policies broadly encouraging foreign investment and trade (Clift, 2010).

5.6 Mitigating the Impact of Short-Term External Volatility

Still, additional measures could be explored to mitigate the impact of external volatility in the short term: (1) Intervention on foreign exchange markets has been used with different degrees of success. Intervention has costs both if used to stem appreciation (sterilization costs) or to stem depreciation (external financing costs). Thus, to be successful, intervention must be limited in time and backed by credible monetary and fiscal policies (2) Capital controls are attracting renewed interest, either through outright limitations of foreign purchases of certain financial instruments or through price-based measures like taxes on selected inflows. It is difficult to judge the effectiveness of capital restrictions in countries where they exist and the extent to which they reduce the cost and frequency of intervention. Price-based controls such as capital transaction taxes entails significant requirements in terms of enforcement capacity and sizable risks of domestic disintermediation, which makes them a challenge option at best for most SSA economies (3) Increased regional trade could reduce the adverse impact of volatility in the rest of the world. The elimination of intraregional tariff and non-tariff barriers would help broaden demand at a time when traditional markets are expected to show only subdued growth. However, trade integration would also need to be supported by a gradual harmonization of exchange rate policies within the region, which may be challenging given the diverging preferences shown across countries since the onset of the global crisis (Ltaifa et al 2009).

5.7 Economic Resilience of SSA

The global financial meltdown was also felt in the region's capital and foreign exchange markets. Exchange rates in many SSA countries, came under severe pressure, and equity markets fell sharply in some countries, including in Cote d'Ivoire, Kenya, Nigeria, and Mauritius. But there were also some resilience on the part of SSA: (1) In spite of the reduced demand for the region's exports which dampen growth, there was a strong underlying growth trend that reflected in part improving domestic fundamentals—fewer conflicts, liberalization and reform, macroeconomic stability, and debt relief; (2) while lower commodity prices produced negative income shocks in exporting countries, they also helped reduced the import bill for net importers; and (3) financial systems in SSA were less integrated with global financial markets and thus less vulnerable to deleveraging. They were generally not exposed to risks arising from complex derivative instruments and had not relied substantially on foreign borrowing to finance their operations. As a result, financial institutions in the region had by and large remained relatively unaffected and domestic money markets were generally functioning normally (Sayeh, 2008).

5.8 Framework for Fiscal Policy for SSA

As in other parts of the world, the appropriate fiscal policy response to a negative demand shock in SSA depended on the size and nature of the shock, as well as country-specific characteristics. Fiscal policy was able to help smooth the impact of the crisis, maintaining critical government services and investment programs and providing countercyclical support to domestic demand. Countries that had macroeconomic stability and fiscal space (i.e., sufficiently strong fiscal accounts that allowed them access to financing at sustainable rates) ran expansionary fiscal policy by allowing automatic stabilizers to work and through additional discretionary fiscal stimulus, when appropriate, to contain the impact of a sharp decline in private sector demand in the short run. However, when countries were constrained by a lack of financing or high level of debt distress, then the scope for an expansionary fiscal policy was limited and there was no alternative to tightening fiscal policies in the near term. The appropriate speed of adjustment again depended on debt levels and the availability of financing on sustainable terms (Berg et al, 2009).

6. Implications for Public Policy and Sustainable Economic Growth and Development of SSA

While the impact of sub-Saharan Africa was less severe, the risks are important and macroeconomic stability is at a premium. Circumstances differ sharply across countries and there is no single recipe. But three key principles for economic policy makers are required. First, policy makers should seize the opportunity to bring inflation down. Inflation remains above most countries' comfort levels as the impact of the global food and fuel price surge continues to linger. In principle, the sharp decline of commodity prices will provide a disinflationary impulse, reducing the need for monetary policy tightening. However, price rigidities and the build-up of inflationary expectations in some countries require that the process will not be automatic. Second, governments need to use available fiscal space judiciously. Many SSA countries have created fiscal space in recent years through debt reduction and strong policies. Thus, where fiscal sustainability and financing are not immediate concerns and demand conditions are weak, some stimulus or smoothing of negative demand shocks may be in order. But where external financing for public spending is falling, or commodity price changes threaten medium-term fiscal sustainability, restraint is required. Third, policy makers should increase their vigilance and stand ready to react flexibly. The liquidity and usability of reserve assets and the availability of trade credit need to be monitored

carefully. And governments should seek to identify banking system vulnerabilities, and develop plans on how to react should a banking crisis erupt (Sayeh, 2008).

6.1 Tighter Global Financial Conditions and Its Negative Effects on SSA

Tighter global financial conditions will have a negative effect, and foreign aid flows may be under threat. This is because of two factors. First, the global financial crisis is hindering SSA countries' abilities to raise funds in capital markets. For example, some countries postponed bond offering and were expected to rely on domestic financing. Second, potential reductions in aid flows (given difficult budgetary conditions in donor countries) were a serious concern in many recipient countries, particularly in those where aid finances a substantial share of the budget. Fragile states were likely to be most affected as they depend heavily on such financing (e.g., Burundi, Guinea-Bissau, and Liberia). On the other hand, currency depreciation in real terms raised the domestic currency value of aid flows (Berb et al, 2009).

6.2 Monetary and Exchange Rates Policies

As inflation falls, monetary policy could be eased. The plunge in global fuel prices, along with the more modest decline in food prices, is providing a disinflationary impulse that in many countries has reduced the need to tighten monetary policy and in others has allowed monetary easing, as has happened in several advanced economies. On the other hand, countries still experiencing demand pressure and excessive inflation may need to tighten monetary policy (IMF African Department, 2009). Stronger monetary and budget policies , together with structural reform in many SSA countries, helped SSA came through the global financial crisis better than in the past (IMF Survey, 2010).

Exchange rate changes may help to restore competitiveness and growth should commodity price fall proved permanent. In countries with flexible exchange rate regimes that have experienced an adverse terms of trade shock, real exchange rates should be allowed to depreciate to keep the economy stable. Careful coordination with monetary and fiscal policy is needed to avoid a devaluation-inflation spiral. For countries such as those in CFA franc zone, the decline in the euro against the U.S. dollar has already contributed to real effective exchange rate depreciation. Countries should avoid sliding into protracted exchange rate overvaluation, which would impair longer-term growth and could eventually trigger a disorderly adjustment (IMF African Department, 2009).

6.3 Fiscal Policy

As evidence emerges that economic recovery is gaining traction, the emphasis of fiscal policy will need to shift much more toward medium-term considerations—and in particular growth and debt sustainability issues. In countries where financing constraint are more binding, policies should remain geared to containing macroeconomic imbalances to avoid further undermining economic growth. The case for monetary policy to remain supportive in the coming years is even stronger. Inflation in most countries has reverted to single digit, the amount of monetary policy easing to date has been relatively modest, and the likelihood of a significant liquidity overhang is minimal. Countries need to continue monitoring financial sector developments closely. As the experience of countries with apparently more capable regulatory agencies has shown, financial sector problems can have severe consequences for the real economy (IMF Survey, 2009).

In designing a fiscal stimulus, policymakers should be mindful of how different types of expenditure will affect the country's external position and economic activity. For instance, any countercyclical fiscal policy should not exacerbate the loss of foreign exchange reserves. Unlike in advanced economies, government purchases of the machinery and equipments associated with infrastructure spending is likely to have a heavy import component that could cause leakage of foreign reserves. Also, the slowdown in demand does not originate domestically, as in advanced economies, but externally. Given SSA's heavy reliance on commodity exports, an expansionary fiscal policy cannot substitute for the decline in external demand. In any case, spending priorities and effectiveness should be reassessed to achieve maximum value for money (IMF African Department, 2009).

6.4 Financial Sector Policy

Likewise, there is a need to strengthen supervision and enhance contingency planning. SSA has not faced a systemic financial crisis in recent times and its banks have few direct linkages with the toxic assets affecting major financial centers. However, monetary authorities need to safeguard against financial vulnerabilities like rising credit risk and possible cross-border contagion, considering that many financial institutions in SSA are foreign-owned. Moreover, supervisory and regulatory oversight should be extended to encompass the entire financial sector. The following steps should be taken. First, monetary authorities should identify banking system vulnerabilities. For this, they should first identify the banks that are most likely to experience difficulties in the current environment. Banking supervision should also insist on high-frequency data to continually assess bank liquidity and solvency and conduct

credit risk diagnostics and stress testing. Supervision should be comprehensive as possible, covering foreign currency risk, bank risk management practices, lending standards, and funding reliability. It should extend to all deposit-taking and credit-creating institutions, including nonbank financial institutions. Second, procedure for handling a systemic crisis or failures within all the financial services markets should be drawn up promptly in preparation for contingencies. Third, the region should track current G20 initiative to strengthen regulation of cross-border financial flows and restore investor confidence in order to unfreeze international credit markets and encourage capital inflows and intraregional lending (IMF African Department, 2009).

7. Policy Recommendations

Deepening domestic financial market is key to enhancing their capacity to handle external financial volatility over the long term. As mentioned, interbank, capital, and foreign exchange markets are still shallow in most SSA economies. Strong regulatory and supervisory frameworks could help reduce inefficiencies and enhance competition. There is also scope for reforms to encourage the development of stock markets by putting in place frameworks that will allow better risk assessment, reduce market uncertainty, and improve transparency. Broader bond markets will allow diversification into longer-term investment instruments—important for long-term investors. Developing forward hedging instruments would also generate some stability in the foreign exchange market by reducing forward settlement risks (Ltaifa et al 2009).

Some countries, which have created fiscal space in recent years through debt reduction and strong policies, may have scope for fiscal stimulus. But in others, this scope is limited by debt sustainability or financing constraints. The challenge for policy makers is to maintain stability so as not to jeopardize hard-won gains of recent years. Domestic financial sectors have fortunately not faced a systemic crisis in SSA as a result of global financial turmoil. But supervisors need to be prepared, identify vulnerabilities, and have contingency plan in place (IMF Press Release, 2009).

Countries that have poverty reduction strategies in place should use them to identify areas for discretionary spending measures. One area for additional spending would be infrastructure, given pressing needs. In particular, roads, electricity, and telecommunications are three areas where improved infrastructure has been identified as having the largest positive impact on growth (World Bank, 2007; and Straub, 2008). The emphasis should be on bringing forward approved investment projects—new projects or programs should be approached with caution due to weaknesses in implementation capacity. Domestic activity would be supported in particular by projects that bolster employment and have low import content. Existing infrastructure should be preserved by protecting operations and maintenance, which are typically labor intensive (Berg et al, 2009).

The drive for economic transformation should be the focus for governments working with, and supporting, a revitalized private sector (Amoako, 2011).

Protecting spending in sectors related to the Millennium Development Goals (MDGs), such as health, education, water and sanitation, and social protection, can help cushion the impact of the crisis on vulnerable households and preserve the momentum toward the MDGs. Also expanding targeted social safety net program should also be given priority as needed (Berg et al, 2009).

Macroeconomic stability and steady progress toward medium-term development goals are both vital for sustaining growth in SSA. Thus, in responding to the crisis countries should strive to maintain stability and consolidate their hard-won gains while being mindful of general development goals. Countries should also seize the opportunity to advance their structural reform agenda in order to boost prospects for growth (IMF Survey, 2010).

Governments need to walk a tightrope to conserve gains in economic stability without aggravating the impact of the slowing external demand on domestic activity and especially on the poor. In countries that have created fiscal space in recent years, automatic stabilizers should be allowed to work. In low-income countries, stabilizers work mostly on the revenue side. A slowdown in economic activity tends to lead to lower tax revenue, but on the expenditure side there are few automatic stabilizers, such as well-functioning social safety nets. If countries try to keep expenditure at budgetary levels, the fiscal balance will deteriorate. Moreover, a few countries may have scope for discretionary fiscal easing to sustain aggregate demand depending on the availability of domestic and external financing. All this must be done carefully so as not to crowd out the private sector through excessive domestic borrowing in the often thin financial markets (IMF African Department, 2009).

In sum, policy advise for the SSA policy makers are (a) maintain stability and support demand amid reduced external financing; (b) reduce vulnerability to financial turmoil; and (c) Keep medium-term goals in sight (IMF Press Release, 2009).

8. The Role of The Global Financial Community in Sustaining SSA Growth and Development

In its World Economic Outlook Update, the IMF said most countries in SSA have recovered quickly from the global financial crisis, with the region projected to grow 5 ½ percent in 2011. One major concern though is that rising global fuel and food prices will have a significant impact on SSA during and after the recovery. While the effects of recent increases in world food prices have so far been relatively small in SSA, because of the good local harvests, the urban poor remain very vulnerable to rising food prices because of the high share of food in their consumption basket. This may increase pressure for additional support from government budget (African Business, 2011).

Therefore, the international community needs to at least maintain its assistance for SSA to make progress towards the Millennium Development Goals. The current situation makes it even more important to ensure that aid is predictable, transparent, and aligned with the policy priorities of the recipients (IMF Survey, 2009).

The IMF should meet the diverse and evolving needs of low-income countries. It should continue to consider further major reforms of the architecture of its financing facilities, higher access limits to Fund resources, and additional concessional assistance, as well as more flexibility to finance infrastructure projects and other critical investments.

The World Bank should also continue to provide extensive technical assistance to strength public sector capacity in SSA, because over the long-term SSA countries need efficient and careful public financial management to ensure that their development priorities can be met (IMF African Department, 2009).

SSA will need additional financial resources in that it needs at least the doubling of the aid promised by the G-8 Heads of States at the Gleneagles Summit in 2005. Without additional donor support, poverty reduction and economic development in SSA could be set back by several years and political stability might even be endangered in some countries (Anonymous, 2009).

9. Concluding Remarks

The IMF reckons that the top seven economic performers over the next few years will come from SSA (Anonymous, 2011). Therefore, to support this growth and create fiscal space, all countries would be well-advised to persevere with structural fiscal reforms. Broadening the tax base would allow growth-boosting reductions in the most distortionary tax rates; efficiency-enhancing tax administration reforms would reduce both collection costs for the state and compliance costs for the private sector. Better cash and debt management would also provide fiscal savings (IMF African Department, 2009).

But first and foremost, political stability is a necessary precondition for macroeconomic stability and sustaining improved performance. Countries in SSA also need to upgrade weak energy and transport infrastructure, and improve health and education standards. A more competitive, or efficient, private sector will require the assurance of good governance, including market-friendly regulations, effective financial sector supervision, and enforcement of laws. Second, countries in SSA will also need to make room for higher pro-growth government expenditures. This will require increasing revenues so critical so that crucial investments can be made, building the capacity to safely attract and manage private finance, and improving the quality of spending. An important first step in this direction, already taken by some countries in the region, is to improve budget institutions, focusing particularly on improving financial management, prioritizing expenditures, and ensuring their high quality (Plant, 2010).

This means that the priority for all SSA countries must be to deal with the adverse impact of the crisis on growth and poverty, while preserving the hard-won gains of recent years, including economic stability and debt sustainability. The appropriate policy response will depend on country specific conditions (IMF Press Release, 2009).

With the expansion in global output set to continue, the International Monetary Fund country teams are projecting that, barring shocks, most SSA countries will maintain strong growth throughout 2012. Fiscal balances are also expected to improve somewhat in 2011 relative to 2010. SSA's growth performance will hinge in part on official and private financing flows staying at their recent elevated levels. If extended risk aversion or fiscal retrenchment in advanced economies was to lead to a sharp drop-off in donor support, this would almost certainly hamper the envisaged acceleration in gross domestic product growth (IMF Survey, 2010).

Finally, over the next decade, SSA will continue to benefit from the super cycle in commodity prices--providing funds for infrastructure and social projects. If trends continue, several decades of robust growth appears a likely scenario for SSA, which in turn, will enhance its role in the global economy (Siddiqi, 2011).

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