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# The Impact of the Global Financial Crisis on Sub-Saharan Africa

Odinakachi J. Anyanwu

The purpose of this paper is to examine the impact of the global financial crisis on the growth and development of sub-Saharan Africa and to discuss the policy implications of the crisis. Understanding the impact of the global financial crisis on sub-Saharan Africa is of critical importance because of the continent's severe volatility. Sub-Saharan Africa is home to the largest number of low-income countries in the world; more than fifty percent of the population lives on less than US \$1.25 per day.<sup>1</sup> The region is also plagued with country-specific political problems, which are at risk of exacerbation by increasing levels of poverty. However, it is important to note that conditions in sub-Saharan Africa are not uniform; they vary by country. The World Bank reports that the sum GDP per capita of the top ten wealthiest countries in Africa is 25.2 times the GDP per capita of the poorest ten countries.<sup>2</sup> The economic disparity between countries highlights the variability in the experiences of individual countries, as well as the necessity for country-specific policy responses to the impacts of the global financial crisis.

A number of economic institutions including the World Bank and International Monetary Fund (IMF) had unanimously projected that the financial crisis would have an acute negative effect on various socio-economic indicators in sub-Saharan Africa.<sup>3</sup> Levels of unemployment, poverty and infant mortality were expected to increase and a decrease in health levels, leading to a higher risk for conflict and strife, was anticipated.<sup>4</sup> Foreign direct investment, foreign aid, remittances, and export revenue – all major sources of income in Africa – were also expected to suffer. The

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potential effect of depletion in income sources in the various economies in Sub-Saharan Africa was also a concern. Unfortunately, many of these fears materialized in 2009 and 2010.

These negative impacts on sub-Saharan Africa proved to be the more disheartening because Africa had experienced consistent regional economic growth prior to the crash. Sub-Saharan African countries had maintained relatively high growth rates in the last decade leading into 2007; the average growth rate was 6.1 percent.<sup>5</sup> According to the IMF, this was the highest growth rate Africa has seen in more than thirty years.<sup>6</sup> Though the progressive growth rate in sub-Saharan Africa was a welcome improvement, it was still below the targeted rate set by the UN's Millennium Development Goals (MDGs).<sup>7</sup> The MDGs include: lowering the number of people living on less than \$1.00 a day and the percentage of people suffering from hunger, both by 50 percent, and achieving full and productive employment. These goals are set to be accomplished by 2015.<sup>8</sup> The target growth rate set by the MDGs commission, under the United Nations, is 7 percent; the financial crisis was clearly a detraction to the moderate progress of sub-Saharan Africa's growth rate.

#### THE DEPTH OF THE CRISIS IN SUB-SAHARAN AFRICA

The previous section briefly discussed the global financial crisis' projected impact on sub-Saharan Africa. This section will explore in more detail the actual impact of the global financial crisis on economic growth; the financial sector; the terms of trade; foreign direct investment; capital inflows; remittances; official development aid; poverty; and unemployment.

As expected, the GDP growth rate in sub-Saharan Africa declined from 6.1 percent in 2007 to 4.9 percent in 2008, and then dipped to 1.6 percent in 2009.<sup>9</sup> The variation in the economic conditions of sub-Saharan African countries is also manifested in the GDP growth rate. Oil producing and exporting countries experienced 2.5 percent GDP growth, while non-oil producing countries experienced 0.5 percent GDP growth in 2009.<sup>10</sup> Since expectations were that the global economy would begin to stabilize, GDP growth for sub-Saharan Africa was expected to rebound to 4.3 percent in 2010.<sup>11</sup> In actuality, due to recent recovery in the global economy, the GDP

growth for sub-Saharan Africa rebounded to 5.0 percent in 2010, and is expected to grow at 5.5 percent in 2011.<sup>12</sup>

One sector that is important to consider in this study is commodity exports, as it provides an integral source of revenue for African economies. Some countries are overly dependent on commodity exports. In 2009, the world economy contracted by 2.2 percent and developed economies experienced a 3.5 percent decline in GDP.<sup>13</sup> As a result of the economic ailments of the financial crisis, export demand in Africa experienced a sharp decline. Total world trade volume decreased by 12.4 percent in 2009, and consequentially, African commodity prices fell.<sup>14</sup> Commodity prices in sub-Saharan Africa had been experiencing a boom in the pre-crisis period, due to the relatively high growth in the region during that period. In sub-Saharan Africa, energy, food, and metal prices increased by 329 percent, 102 percent, and 230 percent, respectively between June 2003 and July 2008, but then decreased by 64 percent, 30 percent, and 46 percent respectively between June 2008 and February 2009 as a result of the financial crisis.<sup>15</sup>

The region as a whole experienced a negative export growth of 4.9 percent in 2009.<sup>16</sup> Sub-Saharan Africa has had a current account deficit, because exports have declined by 30 percent relative to imports. Africa's current account balance for 2009 was a deficit of 3.2 percent, charting new territory for a region that participates heavily in trade.<sup>17</sup> The spread in the shared current account deficit among countries in Africa varied: land locked countries experienced an 8.9 percent deficit and oil importing countries experienced a 6.2 percent deficit, while oil-exporting countries only experienced a 0.7 percent deficit in their current account.<sup>18</sup> A restoration of trade and exports will require gains in the global economy, because exports and trade are dependent on demand. As countries begin to experience recovery from the financial crisis, trade volume export demand and commodity prices will rebound.

A global economic crisis is, by its nature and as indicated by its name, primarily financial. Developed countries experienced a more direct impact on their financial sector as a result of the crisis because of their deep integration with global financial markets. The financial sector in sub-Saharan Africa, however, is less developed, which has led to minimal

exposure to the ailments of complex financial instruments, distressed assets, and the implosion of the sub-prime mortgage lending market that ignited the crisis.<sup>19</sup> Only the very few sub-Saharan African countries with more globally integrated financial sectors experienced direct shocks to their financial system. Sub-Saharan Africa as a whole experienced shock more directly in “real” areas. The decrease in global economic growth resulted in a reduction in demand for sub-Saharan African exports, which in turn drove commodity prices and export revenue down. Sub-Saharan African countries are heavily dependent on exports and export revenue. As highlighted above, this shift in export demand and commodity prices is not favorable for African economies in the least.

The crisis also had an adverse effect on the inflow of capital in sub-Saharan Africa, similar to its effects on trade. In 2007, prior to the global economic crisis, net foreign direct investment (FDI) inflows to sub-Saharan Africa were approximately \$25 billion, and they continued to grow during 2008.<sup>20</sup> In fact, 2008 saw a record high in FDI inflow of \$87.6 billion, up from \$69.2 billion in 2007.<sup>21</sup> The United Nations Conference on Trade and Development (UNCTAD) reports that FDI inflows to the sub-Saharan African region had declined by 67 percent in 2009.<sup>22</sup> FDI flows in sub-Saharan Africa have been directed mostly towards service sectors with high diversification opportunities, which have been a great contributor to growth in Africa.<sup>23</sup> Yet, with liquidity drying up in the global economy, FDI and overall capital inflows will likely decline. The IMF reports that risk aversion has reduced FDI and reverses portfolio inflows as investors flee to more liquid assets. An upward change in FDI inflows into sub-Saharan Africa will also depend heavily on the recovery of advanced economies.

As advanced economies become more inwardly focused, responding internally to the shocks of the financial crisis, aid to sub-Saharan Africa has decreased. Official Development Assistance (ODA) aid is extremely important in African economies. Decreases in ODA flow adversely impact countries in sub-Saharan Africa: more than ten percent of Gross National Income (GNI) in twenty-three sub-Saharan African countries is accounted for by ODA flows during 2004-2008, and more than twenty percent of GNI in ten countries.<sup>24</sup> Though discussion surrounding the apparent problem of

aid dependency in sub-Saharan Africa is not the focus of this paper, these countries' dependence on aid is reason for worry, as the financial crisis is expected to have caused a decrease of \$22 billion in ODA flows in 2009.<sup>25</sup> The lack of fully developed social welfare programs makes the prospect of lost aid to sub-Saharan African countries in such a volatile time calamitous.

Just as other forms of capital inflow in sub-Saharan Africa suffered, the flow of remittances into the region was also affected. It is apparent that as the entire global economy contracted, remittances to Africa saw an incidental decrease. In conjunction with pre-crisis growth in sub-Saharan Africa, remittances had also experienced significant growth; they grew from \$11.2 billion in 2000 to \$40.8 billion in 2008.<sup>26</sup> The significance of remittances for Africa is indisputable, as they have been proven to be a powerful poverty reduction mechanism for many countries in the region. The importance of remittances in sub-Saharan Africa is manifested in the high degree of their dependency in a number of African countries. In ten of these countries, remittances accounted for five percent of their GDP in 2008, and the spread varied among those countries: Lesotho (27.3 percent), Togo (10.1 percent), Senegal (9.8 percent), Cape Verde (7.7 percent), Liberia and Guinea-Bissau (7 percent), and the Sudan (5 percent).<sup>27</sup> Recent data indicates that these inflows to Africa declined by seven percent in 2009.<sup>28</sup> This decline is problematic because many countries use the remittances directly for food purchase, school fees, and health care.

Due to limited data on poverty rates, it is difficult to gauge the actual impact of the financial crisis on poverty.<sup>29</sup> However, the IMF reported the financial crisis would have caused the number of people living below \$1.25 a day to increase by an additional seven million, and a further three million in 2010.<sup>30</sup> Additionally, it was also estimated that there would be 30,000 to 50,000 additional infant deaths in sub-Saharan Africa as a result of the global economic crisis.<sup>31</sup> The projection of an increase in infant death is expected to result from the decline in provisions, and lack of necessary nutrition, due to the contraction in economic growth and the consequent decrease in income per capita. In addition to high poverty rates, the unemployment rate in sub-Saharan Africa is excessively high as well, having risen above ten percent in 2009.<sup>32</sup> This sobering reality sheds light on the very tangible

effects of the financial crisis on the socioeconomic plight of the people living in Africa. The vital necessity for adequate and effective policy responses to the impact of the financial crisis for sub-Saharan Africa is evident.

#### POLICY RECOMMENDATIONS

The previous section discusses select areas that have been affected by the global financial crisis, though other sectors have suffered as well. In the midst of the changing economic conditions in sub-Saharan Africa, it is necessary that policies be implemented in order to absorb the short-run shock of the crisis and to ensure growth and recovery in the long run. Though, due to the unique nature of individual countries and their economies, it is difficult to prescribe what should be done in Africa to ensure economic growth in the entire region, some generally applicable policy recommendations can be made.

First, it is imperative that protectionist trade policies not be adopted in sub-Saharan Africa as a temporary economic development measure. These policies may appear attractive in the short run, as a means of sheltering specific economies in the sub-Saharan African region from further external harm. However, changes in commodity prices and export demand will be dependent on the recovery of the entire global economy. Therefore, policies that close out the rest of the global economy in trade would be harmful in the long run, when the global economy recovers.

Arguments in favor of protectionist policies may stem from the assessment that it was due to the region's burgeoning openness that sub-Saharan Africa was infected by the financial crisis—a crisis that stemmed from developed countries' conflict with the sub-prime mortgage lending implosion and not from any activity in less developed countries. Sub-Saharan Africa's economic activity was not a contributing factor to the financial crisis, yet it suffered its ills. While the argument for protectionism in light of the financial crisis may appear to be logically sound, it is flawed economic policy for a region that wishes to see long-term economic growth. In the long run, any reduction of the liberalization of sub-Saharan African economies, which are already volatile, will have additional long-term effects on the recent pre-crisis growth that Africa has experienced.



Second, it is also important to implement policies in the region that target the high unemployment rate, which has been exacerbated by the economic crisis. Focusing on employment will not only serve as a mechanism to reduce poverty in the face of the financial crisis, but it will also guarantee long-term economic growth as the economy is stimulated by those already employed. Policies that result in the creation of labor-intensive jobs would be optimal for growth and recovery in the economies of sub-Saharan African countries.

Finally, policies that address the impact of the global economic crisis on human development and social welfare should also be a primal focus. Every form of aid is extremely necessary in this period of time and should be maintained for the sake of softening the harsh impact of the crisis on Africa. Furthermore, indigenous social safety nets need to be developed, which can be tapped into during potential crises similar to this one. The welfare of Africa's children and poor should not be solely dependent on aid from other countries that have a responsibility to attend to the negative impact of the global economic crisis in their respective economies. A reserve should be developed by individual African economies in preparation for crises large and small that might have an adverse effect on the already poor within the region. Overall, policies generated by individual countries, and those suggested by non-governmental organizations, must be tailored to the particular needs, characteristics, and conditions in each country in order absorb the shocks of the global financial crisis and prepare for the eventual restoration of the global economy.

#### CONCLUSION

The global financial crisis, as we have seen, has had a significant impact on the region of sub-Saharan Africa. The impact of the global financial crisis on sub-Saharan Africa is a poignant case because of the present volatility that exists within the region. Africa had experienced relatively substantial economic growth before the global financial crisis, and it is important that Africa continue to grow in order to meet MDGs and further alleviate poverty. While the bulk of its recovery will be dependent on recovery on the global scale, this present lull in the economy provides an



opportunity for Africa to implement effective economic policies that are specific to each country in order to ensure internal long-term economic growth. It is important that African countries steer away from protectionist policies, that they target the high unemployment in the region, stimulate domestic economic growth, and implement long-term economic policies that guarantee the continuation of growth once the global economy has recovered. However, it is clear that recovery in sub-Saharan Africa is linked to recovery in the global economy. Once the global is economy is restored, sub-Saharan Africa will also rebound.

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