Notes complementing the PPT Presentation for the lecture given to Students of "International Finance and Development", Department of Economics, Friedrich August Universität Erlangen, 2nd February 2011

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Title: Impact of the World Financial Crisis on Poor Countries – Examples from Sub-Saharan Africa

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Because of Africa’s generally weak financial integration with the rest of the global economic system, it was believed that the financial sectors of many African countries would not be directly affected by the crisis.

There are exceptions to the rule: South Africa, Kenya, Ghana and some other countries

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This is largely true: The African Banking Sector relies on domestic deposits and lending and usually does not have derivatives or asset-based securities among their portfolio.

Even though some banks have significant foreign ownership, the parent banks are typically not from the US and the foreign ownership share relatively small – 5% compared to 46% for developing countries.

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But: African Countries were indirectly affected: Poor countries suffered most from the consequences resulting from the direct effects of the Crisis on advanced or emerging countries.

In other words: Poor countries suffered not by the credit crunch and lack of liquidity but through the recession that followed the crisis in advanced and emerging countries.

Even though indirect, the impact was nevertheless severe because of the general vulnerability of African Economies to even minor external shocks.

According to the World Bank Chief Economist for Africa, Shanta Devarajan, the most severe impacts on African countries were in the following areas:

1) **“A slow down in *private capital flows* adversely affecting economies that had been relying on these flows to finance much needed investment, particularly infrastructure investment. Already Ghana and Kenya postponed sovereign bond issues worth about $800 million” he said**

2) ***Commodity prices* are falling which hurts exporters in poor countries and helps importers in rich countries. He also adds, “Commodity dependent economies are**

exposed to considerable external shocks stemming from price booms and busts in international commodity markets"

3) ***Remittances,*** **which run about $15 Billion a year to Africa are likely to decline**

4) ***Foreign Aid*** **or** ***Official Development Aid*** **is likely to be downgraded**

5) ***Tourist revenues*** **are likely to substantially decline as recession in developed countries deepens**

Consequently,

- **The World Bank downgraded the growth prospects of Africa from 7.9% to 0.1% for 2008 and from 6.9% to -1.1% for 2009.**

But: Africa is a large and very diverse continent. Therefore it is always worthwhile looking at individual examples. In our case Ethiopia and Kenya.

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Example Ethiopia[1]

- Very poor: Average income 120US$/person/year (average Sub Saharan Africa is 600 US$). The distance between very poor and very rich is not too bad: The Gini index was at 0,3% in 2000[2]
- 44-50% of population below poverty line
- Semi authoritarian one party government, but very little corruption
- Large state bank (controls 74% of assets) **only 6 private banks controlling 21.3% of the assets, quite outside the global financial system**

Das Land ist mit einem Pro-Kopf-Einkommen von etwa 120 US-Dollar (2005) eines der Ärmsten der Welt; hingegen liegt der Durchschnittswert für Afrika südlich der Sahara bei über 600 US-Dollar. Etwa ein Viertel hat ein Einkommen von weniger als einem US-Dollar am Tag, vier Fünftel haben weniger als zwei US-Dollar täglich zur Verfügung.[4] Etwa die Hälfte der Bevölkerung (44–50%) lebt unterhalb der Armutsgrenze.

Ethiopia is known as an Empire and as a very repressive communist dictatorship which was toppled in 1991 by the rebel group Ehiopian Peoples Revolutionary Democratic Front (EPRDF), headed by Meles Zenawi after a lengthy civil war. Now the EPRDF is ruling party and still governs quite authoritarian. In theory, Ethiopia is a parliamentarian federal

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[1] Country dates taken from Alex Ochumbos lectures "The Situation of Poor Countries after the World Economic Crisis", presented in Nürnberg in May 2010, http://www.steuer-gegen-armut.org/fileadmin/Bildgalerie/Kampagnen-Seite/Unterstuetzung_Wissenschaft/Fachkonferenzen/1005_Nuernberg/Ochumbo.pdf. Also: Wikipedia, also: Capital Markets Authority, Nairobi: Annual Reports and Statement of Accounts for the Year ended 30 June 2009.

[2] GINI 0,3 im Jahr 2000, ähnlich wie Deutschland 2007 (GINI ist Abstand innerhalb der Einkommensverteilung zwischen ganz arm und ganz reich: 0 ist, wenn alles gleichmäßig verteilt, 1 ist wenn einer alles hat, d.h. je näher zur 1 desto schlechter). Brasilien und Südafrika 0,6

democracy, but the EPRRDF and its allies won 99,6% of all seats in parliament (545 of 547 seats) at the 2010 election. Just 1 seat belongs the opposition, another seat belongs to an independent candidate. There are rumors of widespread fraud happening at the elections, but there is no proof.

Even though there are six private banks in Ethiopia which administer 21,3% of the deposits, the state owned Commercial Bank of Ethiopia administers the remained 74,17%. Ethiopia is even today quite isolated from the flows of international finance. It truly is a country whose financial institutions are not part of the global financial system. Ethiopia therefore is a good example for a country which is affected indirectly by the World Financial Crisis.

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Largely indirect economic effects: It affected Ethiopia for the following reasons:

- About one third of the government **budget is donor dependent.** According to the 2009 budget, grants were about 28.4 % of total federal government revenue or 4.5% of GDP. Therefore, even a slight decrease in donor support could lead to a sizeable decline in Revenue in Ethiopia. In particular, external loans are about 14% of the total capital expenditure which could constraint completion of Capital projects underway (the electric dams in progress, for instance)

- Ethiopia's **export** declined both in volume and value. As recession spread around the developed economies and the emerging ones, it was expected the **demand for exports** would decrease. For Example, the world price of coffee decreased by a significant margin (about 25 -30%) while volume also decreased by about 5% in October 2009.

- Further, according to June 2008 investment figures, 53.1% of the total capital flows was of foreign origin. Hence a decrease in investment activity due to recession abroad has affected both FDI and hence, unemployment

- **Remittances** and **Tourism revenue** had been on the increase, the country got less as the recession deepened. **Remittances** and to a lesser extent **tourism** were becoming an important source of foreign exchange. According to the National Bank of Ethiopia report, remittances from abroad were about $1 billion according to some sources[3]. Both are threatened by the present downturn.[4]

Summing up: Therefore, all the above suggests that even though financial crisis did not affect Ethiopia directly (thanks for its lack of integration to the world) its indirect impact through the channels stated above and others has been unmistakable.

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Different is Kenya

- Wide gap between very poor and very rich (GINI of 0,43), esp. in Nairobi between the neighbourhoods such as Karen and Kibera

[3] East Africa Forum, 23.8.2008 http://www.eastafricaforum.net/2008/08/27/remittances-reach-one-bln-usd/
[4] Not by all: According to a World Bank Study, Remittances for Ethiopia are around 3,2 billion US$, whereas the National Bank of Ethiopia puts the figure still at around 1 billion US$ http://www.eastafricaforum.net/2010/10/30/ethiopia-high-remittance-figures-from-world-bank-ridicule-national-statistics/

- Multiparty presidential democracy along ethnic divides
- A lot of corruption and fraud
- Marked based economy, private banking sector, Stock Exchange 4th largest in Africa
- „financial hub of Eastern and Central Africa“

"The urban poor are fast being pushed from accessing basic services. A draft report by the government shows that the gap between the rich and poor urban residents is widening at an alarming rate. .. In the poor neighborhoods, taps run dry for many days, coupled with power outages and dusty roads. The reverse is true in affluent residential zones." [Daily Nation, 28.1.2010]

Kenya is a republic with a strong focus on the president who at the same time is head of government. It is a multi party democracy, and the parties are more often than not aligned with ethnic or other particular interests, hence label like "liberal" or "conservative" don't mean a lot and parties who strive on the basis of a program to united people from different ethnic groups don't really flourish. Whoever is in power uses the means provided by the state to remain there, e.g. by corruption or manipulating elections. For that reason, the last presidential elections 2007 were followed by heavy ethnic violence, especially since also election observers from outside attested widespread fraud both in the towns and the countryside. Remarkable on that background is the peaceful adoption of the new constitution in 2010, which, e.g. limits each president to two terms in office only.

Kenya's economy is market-based, with a few state-owned infrastructure enterprises, and maintains a liberalized external trade system. The country is generally perceived as Eastern and Central Africa's hub for Financial, Communication and Transportation services. As at May 2010, economic prospects are positive with 4-5% GDP growth expected, largely because of expansions in tourism, telecommunications, transport, construction and a recovery in agriculture. The World Bank predicts growth of 4% in 2010 and a potential of 4.9% growth in 2011.

The government is generally perceived as investment friendly and has enacted several regulatory reforms to simplify both foreign and local investment. An increasingly significant portion of Kenya's foreign inflows is from remittances by non-resident Kenyans who work in the US, Middle East, Europe and Asia. Compared to its neighbors, Kenya has a well developed social and physical infrastructure making it an attractive alternative location to South Africa, for major corporations seeking entry into the African continent.

Nairobi continues to be the primary communication and financial hub of East Africa. The Nairobi Stock Exchange (NSE) is ranked 4th in Africa in terms of Market capitalization. It enjoys the region's best transportation linkages, communications infrastructure, and trained personnel. A wide range of foreign firms maintain regional branch or representative offices in the city.

The Kenya banking system is supervised by the Central Bank of Kenya (CBK). As of late July 2004, the system consisted of 43 commercial banks (down from 48 in 2001), several non-bank financial institutions, including mortgage companies, four savings and loan associations, and several score foreign-exchange bureaus.[53]

For all that reasons is the impact of the World Economic Crisis on Kenya is both direct and indirect

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Direct Effects: Capital Market

- *Portfolio flows have however adversely affected the stock market, with foreign sales exceeding foreign buys in many counters, as foreign portfolio investors diversify from the market (Kibaara, 2008).*
- *The NSE 20-share index has taken a hit since mid-2008 on the back of the post-election violence and the* ***global financial crisis****. In 2008, the NSE-20 index slumped by 35%, 25% since July 2008 e.g. because of the slowdown of investments by* hedge funds
- ***International Investment and Trading was also afflicted by the Strengthening of US Dollar against Kenya Shilling after the crisis: The Shilling was depreciated and this had an impact on imports and Foreign Debt Service is more expensive (more Kshs to pay), exports earn less.***

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Indirect Effects

- **Exports**, especially horticulture (Flowers, tea, coffee), went down
- **Reduced foreign direct investment**
- **slowdown of the tourism** sector: Revenue from tourism, which is the country's main foreign exchange earner, last year fell by 54 per cent compared with 2007, a year which saw a record two million tourists visit Kenya.

  → Main source of foreign currency, impacts again on Foreign Debt Service which needs to be paid in US$, i.e. requires more money which then lacks in infrastructure, health and education
- Downturn in remittances only 8,4% (Jan-July 2009 (342 Mio US$) compared to Jan-July 2008 373 Mio US$) and still 10% higher than 2007[5], which is also due to the surge in remittances following the post-election violence. This proves that remittances remain strong in times of crisis.

  → Good news for consumer: Less money comes in but is able to buy more. Stronger US$ and depreciation of Kenyan Shilling increases Purchasing Power.

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Illustration on development in net cash flow by foreign direct investors, all figures in Million Kenyan Shilling.[6]

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[5] Central Bank of Kenya, Press Release September 2009

[6] Capital Markets Authority

Summing up: Different from Ethiopia, Kenya suffers directly and indirectly from the World Economic Crisis

- ***The explained impacts have adversely affected the Kenya growth rate. In 2007, the country experienced a growth rate of 7%, the highest growth in over two decades.***
- ***In 2008, the growth was expected to be 4% (IMF) due to the post-election violence in the first quarter of the year, drought and the global financial crisis.***
- ***In 2009, growth is expected to be about 3% (AIG).***

From the perspective of a developmental agency such as the Jesuit Mission the really interesting question is: What is, from our point of view, the most severe and most enduring damage the World Economic Crisis has afflicted on poor countries? To my mind it is in the field of employment, decent jobs and opportunities to make a decent living.

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1. As far as statistics can capture it, the World Economic Crisis deleted worldwide around 30 million of good, well paid jobs worldwide, afflicting more than 100 000 000 family members. Highest was the drop where there were jobs in the first place, e.g. developed countries.[7] All this seems to be better than originally feared[8]
2. In poor countries, maybe less good jobs were destroyed, but the overall consequences of the crisis were still more drastic. First of all, more young people are there to look for work. Therefore even though employment is on the up, unemployment as well. And whatever happens on the labor market takes place without any form of social security.
3. **"With more than three-quarters** (80%) **of workers in Sub-Saharan Africa in vulnerable employment and around four out of five workers living with their families on less than US$ 2 a day, sub-Saharan African economies faced daunting decent work challenges prior to the onset of the crisis.** Gender inequalities are evident in the much higher share of women in vulnerable employment in comparison to men and with female working poverty rates exceeding male rates in 22 out of 27 countries with available data. **Economic growth is projected to recover to a precrisis rate of 5.5 per cent in 2011, with little change expected in the unemployment rate.** The economic outlook is subject to considerable uncertainty, particularly in middle-income countries and oil exporters, and will be dependent on the recovery of the global economy.
4. Most hit were export oriented economies, e.g. Zambia: 2009, 8500 of 30 000 jobs in the Zambian copper industry were lost, small number at first sight, but each

[7] IMF/ILO paper "The Challenges of Growth, Employment and Social Cohesion", 2010, p.4 and United Nations World Economic Situation and Prospects 2011 (WESP). And: Global Employment Trends 2011, International Labour Office (ILO), Genf, 24.1.2011. Nachfolgend im Text die Seitenzahlen aus diesem Report. Internetressource unter http://www.ilo.org/global/publications/ilo-bookstore/order-online/books/WCMS_150440/lang--en/index.htm

[8] BBC 2009

worker sustained around 10-25 people AND there is no social security or unemployment benefit[9] And: Good jobs once lost won't necessarily come back but may emerge elsewhere, once the economic recovery gathers speed. For example: When the Chinese resumed investment where western owned enterprises left, wages were lower, trade unionist influence was less, taxes and social insurance contributions were less than in earlier years.

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Global Employment Trends 2011, published 25.1.2011 (cf. FN 6)

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In consequence: The situation has an impact on household and public spending:

- The crisis had an impact on household spending: In an industrial country, the proportion of expenditure for food in a typical household budget amounts to 10% - 20 %, whereas it is between 60% and 80% in the LDCs (FAO 2008). According to a U.S. Department for Agriculture calculation, **a 50% price increase on basic food leads to a mere 6% rise in expenditure for a high income country, but it amounts to 21% for a food importing country of low income (U.S. Department for Agriculture. Economic Research Service. 2008: p. 25).[10]**

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- And Food Prices are continuing to rise, as the following chart shows.[11] This has to do with weather and subsequent harvest problems in 2010, but also with a new wave of speculation on "agrar commodities", especially following the bad harvest in Russia as a consequences of last years heat wave. That’s why hunger worldwide went up to record heights in January 2011 because of various food crises beginning 2007, the depreciation of local currencies towards the US$ and the decrease in household income. For the first time ever hunger, which should be halved by 2015[12], surpassed the one billion limit in 2009 and, down to 925 Mio in 2010 and rising again because of the record prices in January towards one billion again[13]
- There is, however, a silver lining at the horizon: Since jobs in developed countries and emerging markets improve, the amount of remittances by legal and illegal migrants back home is almost back to pre-crisis level. Even 2009, remittances to Ethiopia seem

[9] Vgl. Green, D. (2009) A Copper Bottomed Crisis. The Impact of the Global Economic Meltdown on Zambia. Oxfam International Discussion Paper, December 2009 Internetressource <http://www.oxfam.org.uk/resources/policy/economic_crisis/downloads/impact_economic_crisis_%20zambia.pdf> sowie Global Policy Forum/Terre des Hommes (Hrsg.) Die globale Entwicklungskrise. Auswirkungen – Reaktionen – Konsequenzen. Bonn, Osnabrück, Dezember 2009, S. 9

[10] See: Wahl, P. (2008) Food Speculation: The Main Factor behind the Price Bubble in 2008. WEED, Briefing Paper. Internetressource http://www2.weed-online.org/uploads/weed_food_speculation.pdf

[11] http://www.fao.org/worldfoodsituation/FoodPricesIndex/en/.

[12] "The number of people living in extreme poverty will, according to estimates from the World Bank, in 2015 still be 267 million greater at 1.132 billion than would have been the case without the crisis." Terre des hommes, Deutsche Welthungerhilfe: The Reality of Developmental Aid 2010 http://www.welthungerhilfe.de/fileadmin/media/pdf/Wirklichkeit_Entwicklungshilfe/Wirklichkeit_englisch-Kurzfassung_18_2010_Internet.pdf

[13] Global Hunger Index http://www.ifpri.org/sites/default/files/publications/ghi10.pdf, but also new figures on http://www.fao.org/worldfoodsituation/FoodPricesIndex/en/

to be higher than expected: Whereas the Ethiopian National Bank assumes that the inflow of remittances right now is back to 1 billion US$ per year, the World Bank puts this figure to 3,2 billion US$.[14] Also in Kenya, remittances slumped not too bad and were 2008, 2009 and 2010 above the amount of 2007, the year when everything started.[15] But, as far as remittances are concerned: There is no really reliable way of measuring these flows who are often outside the official banking system, especially in Eastern Africa.

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- The crisis impacted also on state budgets and public spending: State Revenues for LICs fell 60% in 2009, with dire consequences on the ability of states to cushion the crisis impact for their populations or continue progress towards the achievement of the MDGs, e.g. its possibilities to invest in education, health care, clean water and other essential things connected with the MDGs[16]

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As a reminder, the Millennium Development Goals were adopted in 2000 and should bring worldwide dramatic improvements in the following areas:

1. Eradication of Extreme Poverty and Hunger
2. Universal Primary Education
3. Gender Equality
4. Child Health
5. Maternal Health
6. Combat HIV/AIDS
7. Environmental Sustainability
8. Global Partnership

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Again it is difficult to assess a global tendency since the implementation of these goals depends on many factors such as money, governance, resources available on the ground or involvement of citizens.

- According to UNDP, mixed progress within regions demonstrates that MDG progress is country specific. Sub-Saharan Africa, for example, has seen volatile fluctuations in

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[14] EastAfrica Review

[15] http://www.centralbank.go.ke/forex/Diaspora_Remit.aspx

[16] "Revenues fell in 60 per cent of LICs in 2009. For almost half of them (46 per cent), revenues will still be below 2008 levels by the end of 2010. Even if the rich world recovers, the crisis will still be wreaking havoc in the poorer countries, due to the time lag in transmission." The Impact of the Global Economic Crisis on the Budgets of Low- Income Countries. July 2010

poverty: falling in Ghana between 1999 and 2006, but increasing in Uganda between 2000 and 2003, despite comparable GDP growth.

- Performance varies even among fragile states: poverty has fallen in Ethiopia and Cambodia, but risen in Niger, Nigeria and Zimbabwe. The mixed performance on MDGs reflects a complex combination of specific country contexts.

Again it is important to look carefully into the contexts before coming up with evaluation.

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But: in one area progress was achieved across very different countries namely in the field of reaching the goal of Universal Primary Education.

- Burundi, DRC, **Ethiopia,** Ghana, **Kenya**, Malawi, Mozambique, Tanzania and Uganda have abolished school fees which has led to a surge of enrolment. → **GUESS, who made up for the money lacking because of abolishing school fees? State and donors!** More specifically in the case of Kenya:

- In **Kenya** 1.2 million additional pupils in 2003, by 2004 climbed to 7.2 Million of which 84% were of primary school age. Challenges exist in providing sufficient school building and teachers

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- In **Ethiopia** (UNDP report) during 2007/2008 total primary enrolment reached 15, 341,121 pupils which brought up the Gross Enrolment ratio (GER) to 96.7% from its level of 91.6% in 2006/2007.

- During the same period 1,992 primary schools have been constructed which brought total number of primary schools in the country to 23,235.

- This progress is supplemented by the fact that 80% of the constructed schools are located in rural areas and with improved awareness of the community towards girl education.

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But, as you might guess: Progress in the field of the MDGs is also dependent on the flow of real money. In the case of our example:

- **Although aid directed to basic education for low income countries increased from $1.6 billion in 1999 to 5 Billion in 2006, it is even then still well below the estimated $11 billion in aid required annually to reach universal primary education by 2015.**

- And, as you might guess: The amount of available resources was of course affected by the Global financial crisis. In both Kenya and Ethiopia the budget had to be adjusted given the reduction in government revenue.

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Now: What about the road ahead:

Recalling my phrase that money might not be everything but without money a lot comes to nothing, I want to ask: How is it now, after the World Financial Crisis with the availability of resources for the achievement of the MDGs until 2015?

The Committee of African Finance Ministers and Central Bank Governors said in their paper "Impact f the Crisis on African Economies" in March 2009

“Although African countries were growing faster before the crisis, the growth rates were still not sufficient to achieve the MDGs. …. At least USD117 billion are needed to propel the continent on a higher growth path to give it a chance to reach the MDGs.”

So much for the needs.

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And what is the reality considering the promises and declarations given by the international community regarding?

“The 2005 Gleneagles Summit committed to raising aid to Africa by USD25 billion per year until 2010. This is virtually half the amounts needed to only allow African countries to maintain their pre-crisis growth rates, which is definitely not sufficient to bring the continent anywhere closer to meeting the MDGs.”

So much so bad. But this was 2009. Maybe things developed not that bad after all now, 1 year later?

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As this OECD slide shows, prognoses in 2005 were much more optimistic than the current projections. For 2010, OECD members pledged to spend 0,51 of their Gross National Income for ODA, and had, the World Financial Crisis not occurred, most countries would probably have lived up to this promise. Right now, however, not too many states are living up to this pledge.

Germany spent[17]

- 2008: 9,7 billion
- 2009 8,6
- 2010 8,9
- 2011 6,07

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[17] http://www.welthungerhilfe.de/fileadmin/media/pdf/Wirklichkeit_Entwicklungshilfe/Wirklichkeit_englisch-Kurzfassung_18_2010_Internet.pdf and http://www.tagesschau.de/inland/oecdentwicklungshilfe100.html

And that’s where a Financial Transaction Tax could come handy: Even a 0,01% tax on financial transactions within the European Union could raise billions of US$:

	France		Germany		United Kingdom		Europe		World	
	In % of GDP	In bill. US$	In % of GDP	In bill. US$	In % of GDP	In bill. US$	In % of GDP	In bill. US$	In % of GDP	**In bill. US$**
0.10 %	0,843	18,8	1,488	43,3	8,612	204,4	2,109	321,3	1,523	**734,8**
0.05 %	0,612	13,7	1,070	31,2	6,352	150,8	1,528	232,8	1,097	**529,1**
0.01 %	**0,273**	**6,1**	**0,473**	**13,8**	**2,901**	**68,9**	**0,682**	**103,9**	**0,485**	**234,0**

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And that’s why the Campaign "Tax Against Poverty" will continue its labour to get somewhere near the implementation of this tax within the European Union.