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## **The Global Economic Crisis**

Towards Syndrome-Free Recovery for Africa

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### **Abstract**

This paper outlines the impact of the global economic crisis on Africa. Recovery requires coordinated and consistent efforts to assist individual countries in mitigating (reducing) the risk, coping with the impact, and reducing risk over the longer term. Care should be exercised to maintain and improve good governance, which is essential for African countries to avoid introducing various ‘anti-growth policy syndromes’ into their economies. These could arise if responses to the crisis result in (i) further boom-bust cycles and flaming the historically high volatility of African growth, including inflation, (ii) another debt crisis, (iii) household engaging in adverse coping strategies with lasting impacts; (iv) reversal of gains made in opening up African economies and re-introducing crippling state controls; and (v) entrenchment of inequities and inefficiencies in the global financial and aid architecture.

Keywords: Africa, least developed countries, global economic crisis, financial crisis, governance

JEL classification: G01, F42, O11, O55

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## Acronyms

FDI foreign direct investment  
HIPC highly-indebted poor countries initiative  
LDCs least developed countries  
MDRI multilateral debt relief initiative  
ODA official development assistance  
SF syndrome free  
SSA Sub-Saharan Africa

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## Summary

It has been estimated that African countries need economic growth of around 7 per cent per annum in order to halve the number of people living on less than one dollar a day. However, as a result of the global economic crisis, Africa's average growth prognosis has been revised downwards from the projected 5 per cent for 2009 to only 1.7 per cent. Many countries will, in fact, see growth contracting substantially in 2009. This is the direct outcome of falling export demand and tourism receipts, declining commodity prices, reductions in the availability of credit and trade finance, and less inflows of remittances, private portfolio flows and foreign direct investment. These in 2009 could amount to a reduction of US\$60 billion in financial inflows to the continent. Countries most at risk are those depending on oil exports, experiencing fiscal and current account deficits, lacking adequate foreign exchange reserves, suffering from debt overhangs and crippled by weak governance.

Recovery from the crisis would require appropriate and timely short-term measures that are consistent with the long-term imperative of strengthening country resilience through the diversification of economies, improvement of governance, including the environment for doing business, and reform of the global financial and aid architecture. Short-term measures should focus on mitigation and coping. Mitigation, largely a task for the international community, should include up-to-date monitoring of the impact of the crisis, restoring confidence in banks, and expanding trade and trade finance. Coping actions, largely the responsibility of individual countries albeit with the assistance of the donors, should include expanding domestic demand and absorbing the financial losses in countries with the means, targeting vulnerable households, expanding self-employment, utilizing technical assistance, and enlarging peacekeeping operations, if necessary.

In pursuing these short-term measures, African countries and the international community should avoid five pitfalls, which could result in these nations slipping into anti-growth 'policy syndromes'. These are (i) creation of another boom-bust cycle and enflaming the historically high volatility of African growth, including inflation, (ii) the generation of another debt crisis, (iii) failure to prevent, either through adverse redistribution or state failure, households from engaging in adverse coping strategies with lasting impacts; (iv) reversal of the gains made in opening up African economies and re-introduction of crippling state controls; and (v) entrenching inequities and inefficiencies in the global financial and aid architecture. The latter is a particular risk inherent in the reaction of the G-20 nations to the crisis, and requires a more inclusive response on the level of the UN.

## 1 Introduction

Sub-Saharan Africa<sup>1</sup> is one of the world's developing regions most at risk from the current global economic crisis. In this paper we show why African countries are at risk

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<sup>1</sup> 'Africa' in this paper will imply Sub-Saharan Africa (SSA). The assessment and arguments we make generally also apply to the group of countries described as the 'least developed countries' (LDCs), given that 33 of the 50 LDCs are in Africa. Karshenas (2009), however, deals in greater depth with the impact of the crisis on the LDCs.

and what can be done about it. Based on recent UNU-WIDER work<sup>2</sup> we set out a framework for considering recovery measures, and argue that these measures should comply with the longer-term need to strengthen governance and keep policy environment ‘syndrome free’ (SF).

Before proceeding, let us explain consistent and ‘syndrome free’ (SF) policy environment. By consistent, we mean that the affected countries as well as the international community should align short-term measures to support recovery in Africa. But given that we are facing a global downturn, we also recognize that advanced economies need short-term measures to revive their own economies. All three sets of short-term measures (*by* African governments, *for* African countries by the international community, and *by* advanced economies for their own recovery) ought to be consistent with the long-term development needs of Africa. Indeed, in the past, short-term expediency in Africa in the face of external shocks has led to the adoption of suboptimal long-term policies.

The long-term development needs of Africa are best attained by keeping policy environment ‘syndrome free’ (Fosu and O’Connell 2006). A policy environment is perceived to be ‘SF’ if it is largely free from anti-growth policy ‘syndromes’ (combination of various policies with adverse effects), such as state controls, adverse redistribution, suboptimal intertemporal allocation, and state breakdown (Fosu 2007). *State controls* involve the control of resource allocation by the state, including direct and indirect controls of prices and actual state production and distribution, supplanting the role of markets. Under *adverse redistribution*, government officials redistribute resources to their cronies and in favour of their regional constituencies, usually with ethnic undertones, in a manner that exacerbates polarization. In the case of *suboptimal intertemporal allocation*, excessive public spending overshoots the inter-temporal optimal allocation of resources, so that when a ‘bust’ invariably occurs, incomes will fall faster than they should have. The final policy syndrome, *state breakdown*, would constitute a situation involving violent conflict such as a civil war or a *coup d’état*, leading to a breakdown in the rule of law. Fosu (2009c) finds that the absence of such policy syndromes could increase annual per capita GDP growth in Africa by nearly 3.0 percentage points.

Indeed, much of the historically high growth in Africa in recent years has been accompanied by an increase in the prevalence of SF policy environment. Consider, for instance, that between 1961 and 1975 Africa experienced an average annual GDP growth of 4.5 per cent. As shown by Fosu (2009c:15), the immediate post-independence period of robust growth was characterized by a high prevalence (50 per cent) of SF policy environment. Growth declined to 2.1 per cent over the next ten years as SF policy environments were gradually eroded. After the cold war, many African economies in the mid to late 1990s experienced some progress in consolidating economic and political reforms. Average annual GDP growth during 1995-99 rose to 3.4 per cent and accelerated even further between 2003 and 2006 to an average of 8.1 per cent—the highest of any region after East Asia and the Pacific.

Although momentum in the world economy and high commodity prices contributed to this improved growth record, better governance that led to SF policy environment and

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<sup>2</sup> See Fosu (2009a, 2009b, 2009c) and Naudé (2009a, 2009b).

stimulated increases in total factor productivity were also important. As commodity prices tumble down and the world economy is likely to recover rather slowly, the need in Africa for SF policy environment to allow mitigation, coping and risk reduction is greater than ever.

Moreover, the need is greater still, given the justifiably grave concerns that the current global economic downturn will reverse development on the continent that has experienced its best post-independence growth. However, the urgency to implement short-term measures to address what has been termed a ‘development emergency’ (World Bank 2009) should avoid compromising SF policy environment. This could result in countries slipping into the anti-growth policy syndromes mentioned above.

In this paper we point to five pitfalls that should, in particular, be avoided. These include the hazards of (i) creating a boom-bust cycle and enflaming the historically high volatility of African growth and inflation, (ii) generating another debt crisis, (iii) failing to prevent, either through adverse redistribution or state failure, households from engaging in adverse coping strategies with lasting impacts; (iv) reversing gains made in opening up African economies or re-introducing crippling state controls; and (v) entrenching inequities and inefficiencies in the global financial and aid architecture. The latter is a particular risk inherent in the reaction to the crisis by the G-20 and requires a more inclusive response from the UN (see Naudé 2009b).

If a set of short-term policies can be crafted that are globally consistent, it would make a significant contribution towards eventually reducing the degree to which African countries are at risk from future global economic shocks.

The remainder of this paper is structured as follows. First, in section 2 we assess the vulnerability of African countries to the shocks induced by the global economic crisis. In section 3 we examine how resilient African countries are, given that a country’s degree of risk to an external shock depends not only on its vulnerability, but also on its resilience. We put particular emphasis on governance and SF policy environment as the vital ingredients of resilience. Then, in section 4 we discuss policy options to facilitate recovery, making a distinction between risk mitigation, risk coping and risk reduction measures. In section 5, we identify the risks to development triggered by the crisis and responses to it. Section 6 concludes.

## **2 Africa’s vulnerability**

### **2.1 Brief background**

The financial crisis, erupting in the US financial markets in October 2008,<sup>3</sup> and quickly spreading to affect financial institutions in Europe, has its roots in a combination of factors. These include easy and cheap credit (especially after the dot-com bubble burst in 2000), a bubble in house prices, excessive deregulation and inadequate supervision of financial institutions, rapid innovation in highly leveraged financial derivative instruments that only a few people understood (e.g., CDSs, CDOs, CMOs), expansion of sub-prime mortgage lending via predatory lending practices and skewed incentives,

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<sup>3</sup> A timeline of the financial crisis is provided by Guillén (2009).

among others, that encouraged inappropriate risk-taking by financiers and traders as well as inappropriate ratings being awarded to securities. Reviews and analyses of the causes of the crisis are contained in Morris (2008), Eichengreen et al. (2009) and Taylor (2009).

In early December 2008, the National Bureau of Economic Research (NBER) confirmed that the US economy was in recession, and a week later estimates were released showing that the UK economy was also contracting. Soon it became clear that other members of the EU, such as France, Germany, Ireland and Sweden amongst others, and other major markets such as Japan and Singapore, were also in recession.

Initially, because of three factors, many had hoped that the African countries might be spared the fallout from the crisis: first, the crisis originated in the financial sector of the United States whereas African banks had limited exposure to US-originated securities; second, the initial expansionary fiscal and monetary policies implemented by US and European governments were sufficient to stimulate their economies to prevent a slump in demand and a decline in aid to Africa, and third, given the expansion of trade between Africa and Asia in recent years, there might have been some de-coupling of the dependency of African growth rates on US and European momentum.

By the end of the first quarter of 2009, there was a growing awareness that these hopes were too optimistic. For one, it started to become obvious that Africa's financial markets would not escape unharmed, and that the effect would be more subtle, and perhaps longer in duration. By and large, the continent's major economies have not had serious banking problems, although they are, as indicated by the IMF's financial stress index (IMF 2009b), experiencing stress.

Second, despite financial sector bailout programmes as well as fiscal and monetary stimulus packages being adopted by the US, EU and other countries as early as November 2008, it was obvious by the end of the first quarter of 2009 that these economies had failed to respond. For instance, between October and December 2008 approximately US\$2 trillion had been allocated towards financial sector bailouts (e.g., in the form of bank recapitalizations and guarantees), and approximately US\$800 billion for fiscal expansion (in the UK, EU and also China and India). Interest rates were cut significantly by the European Central Bank, the Federal Reserve Bank, the Bank of England, and central banks in Canada, China, Denmark, Japan Sweden and South Korea—in many instances, to the lowest level in 50 years. In spite of these schemes, growth prospects continued to worsen,<sup>4</sup> reducing at the same time the demand for exports to such an extent that IMF forecasts in April 2009 predicted 11 per cent drop in global trade for 2009. This is a significant revision of their October 2008 estimate of a 2.8 per cent decline. Simultaneously, the worldwide gap in trade finance had increased from the initial estimate of US\$25 billion in November 2008 to US\$100 billion by March 2009.

As bailout and stimulus plans failed to stem the decline in world trade and trade finance, there were fears foreign aid (official development assistance, ODA) to African countries

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<sup>4</sup> According to Taylor (2009), the pumping of liquidity into global markets is based on a misdiagnosis and the crisis is one of counterparty risk rather than the shortage of liquidity. As such, he argues, that 'government actions and interventions caused, prolonged and worsened the financial crisis' (ibid.: .

could decline: Ireland, Italy and Latvia have cut their aid budgets.<sup>5</sup> Given that aid always tends to decline during recessions, it may not be unreasonable to expect further declines—even if this goes against the commitments made by the advanced countries at the International Conference on Financing for Development in Doha in December 2008.

Third, the hope that African countries might be able to avoid the worst of the financial and economic crisis in the west because of a decoupling of growth rates was also overly optimistic. Africa's growth rates and expected future growth patterns came down with an amazing speed after the crisis erupted in September 2008. And the slim hope that Africa's stronger trade and investment ties with China and India may have provided some protection was dashed when it became clear that also these economies were adversely hit by the crisis. It is thus obvious that African countries cannot escape the global economic crisis. In the next section we discuss nature of the impact.

## 2.2 Nature of the impact

The global economic crisis has induced two negative external shocks for African countries:

- A financial shock, as the availability of credit declined (the credit crunch) and the cost of international credit increased (a financial shock); and
- A shock to the demand for exports, as most of Africa's important markets went into recession (a trade shock).

The extent to which African countries are at risk from these two negative impacts depends on (i) how vulnerable they are to external trade and financial shocks and (ii) how resilient they are in terms of coping with the impact of the crisis. Often the fact that African countries have become more resilient in recent years (as witnessed, for instance, in the greater prevalence of SF policy environment) is forgotten. Even if a country is vulnerable, its resilience will be an important element in crisis coping and recovery.

Vulnerability to trade and financial shocks is determined by Africa's high dependency on exports, undiversified commodity exports, external financial inflows and rapid expansion in private sector credit in recent years. As such, the crisis implies that revenue from these sources will decline: US\$251 billion in export revenue for Africa in 2009, as estimated by the Committee of African Finance Ministers and Central Bank Governors (2009), and according to Naudé (2009b), US\$50-60 billion in external financial inflows. Let us consider, for instance, each of these in turn.

### *Export dependency*

The average export-to-GDP ratio of the African countries is 35 per cent. Around 69 per cent of the exports from the continent are destined for advanced economies; about 30 per cent to the Euro area alone. This suggests that the initial belief of Africa's growth being 'decoupled' from that of the US and Europe is unlikely to be borne out.

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<sup>5</sup> Ireland reduced its aid budget by 10 per cent (€5 million), Italy by 65 per cent and Latvia by 100 per cent (see 'Less and Worse Aid' at <http://www.eurodad.org/whatsnew/articles.aspx?id=3285>).

As can be expected, exports from Africa to the US and Europe started to fall as a result of the downturn in these economies. Globally, the IMF forecasts a 11 per cent contraction in trade and an 8 per cent decline in the share of exports in African GDP.

Moreover, African exports tend to be concentrated in commodities, with oil, metals and minerals and agricultural commodities the most notable. Commodity prices were in a boom phase in the pre-crisis period, reaching record levels by June 2008, but dropping precipitously since then. Between January 2003 and July 2008, energy, food and metal price indices rose, respectively, by 329, 102 and 230 per cent, and then fell by respectively 64, 30 and 46 per cent between June 2008 and February 2009 (IMF 2009a). Moreover, food prices are still relatively high (more than 40 per cent higher than in 2003) and will continue to pose in the foreseeable future serious difficulties for countries dependent on importing food .

#### *External financial inflows*

External financial inflows include aid, foreign direct investment (FDI), remittances, and private portfolio flows. In 2006, aid, FDI and remittances together were equivalent to more than 10 per cent of Africa's GDP.

By early 2009 there were signs that all these flows had been adversely affected. First, private portfolio outflows resulted in declining African stock markets. Between 2007 and 2008, South Africa's equity market index fell by 40 per cent, and during the first quarter of 2009 the all share index of the Nigerian stock market had fallen a record 37 per cent. Also, trade finance decreased. The worldwide gap in trade finance had expanded from the initial estimate of US\$25 billion in November 2008 to US\$100 billion by March 2009 according to the World Trade Organization (WTO). Remittances and FDI dropped, and aid was also negatively affected, in part by exchange rate changes<sup>6</sup> but also by growing expectations that aid budgets would be negatively impacted.<sup>7</sup>

#### *Growth in credit to the private sector*

Although African countries to date have not had bank failures (as opposed to the 35-odd bank collapses in the United States), they are not yet out of danger. As the IMF points out, African banks are under considerable financial stress. Their capital bases are at risk of being eroded as the crisis continues to weakened African stock markets, stifling innovation and leading to less conservative lending practices, resulting in significant losses to central banks' reserve assets, entrenching government ownership in the financial sector, and weakening bank balance sheets to the point where bank failure could occur (Maimbo 2008).

Vulnerability of the African countries to a global credit crunch is evidenced by the importance and growth of credit to the private sector, the role of foreign banks, and growing prominence of the stock markets. Credit to the private sector has been

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<sup>6</sup> The value of aid from the UK has been reduced by as much as US\$41 billion over the next seven years due to the shrinking of the UK economy and the depreciation of the pound sterling)

<sup>7</sup> The US President suggested in March that his administration may not achieve its target of doubling foreign aid. Other countries such as Ireland, Italy and Latvia have decreased their aid budgets, despite commitments made in December 2008 by the advanced countries at Doha.



expanding rapidly in recent years. On average, domestic credit to the private sector in Africa now totals more than 70 per cent of GDP. Foreign banks own more than 50 per cent of local banking assets in more than half of African countries. In recent years, stock markets on the continent have also started to develop rapidly, with stock market capitalization by 2007 reaching per cent of GDP, a ratio higher than in any other developing or emerging region.

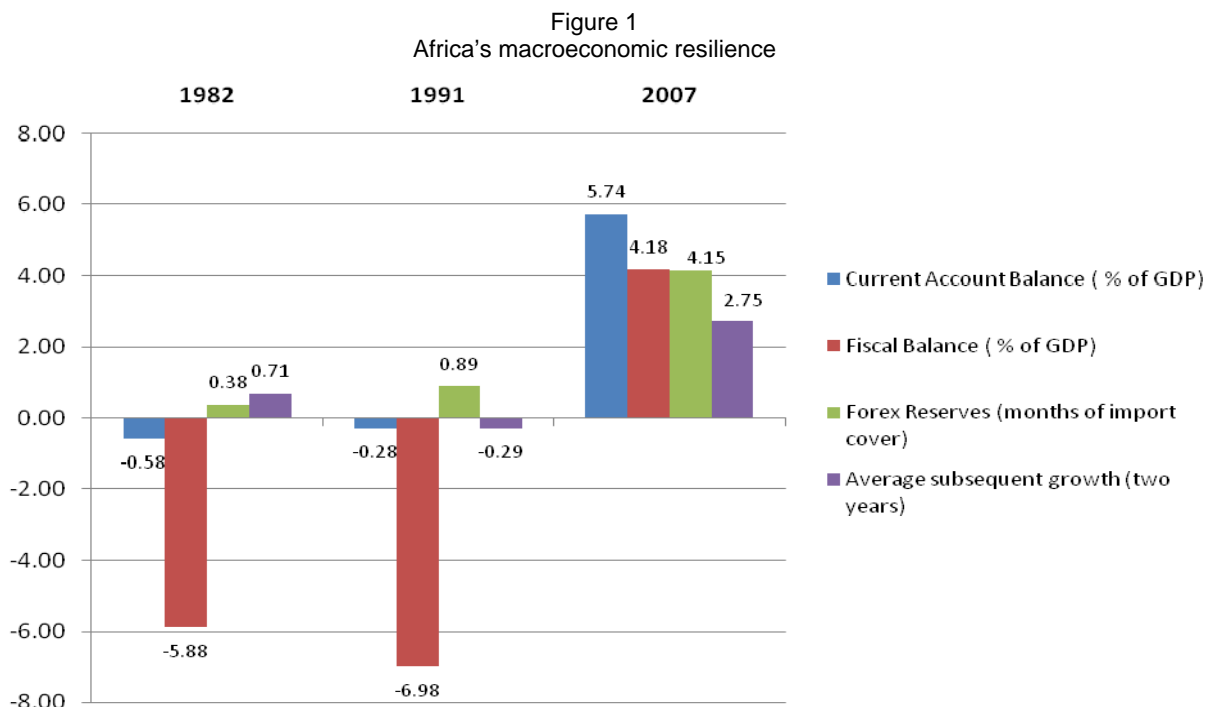
### 3 Africa's resilience

The vulnerability of a country should be weighted against its resilience, i.e., its coping ability or capacity to recover from shock. Resilience can be nurtured, and depends, inter alia, on good economic management and good governance. In this section we briefly scrutinize the state of macroeconomic management and governance in Africa during crises, noting that a large and growing literature exists on these topics.

A positive aspect of Africa, even in the current crisis, is the fact that some progress has been achieved in recent years in good economic management and governance, although much still needs to be done.

#### 3.1 Macroeconomic management

Let us consider macroeconomic management first. This is best measured with fiscal and current account balances. Figure 1 compares Africa's position one year prior to the current crisis with the corresponding period for previous global recessions (1983 and 1992). The figure clearly highlights that Africa is in a better position to ward off the effects of the current crisis, and as a consequence, IMF is predicting that the impact on the continent will not be as severe this time as in previous recessions.



Note: Average subsequent growth for 2007 is the average of IMF's forecasts for 2009 and 2010 growth.

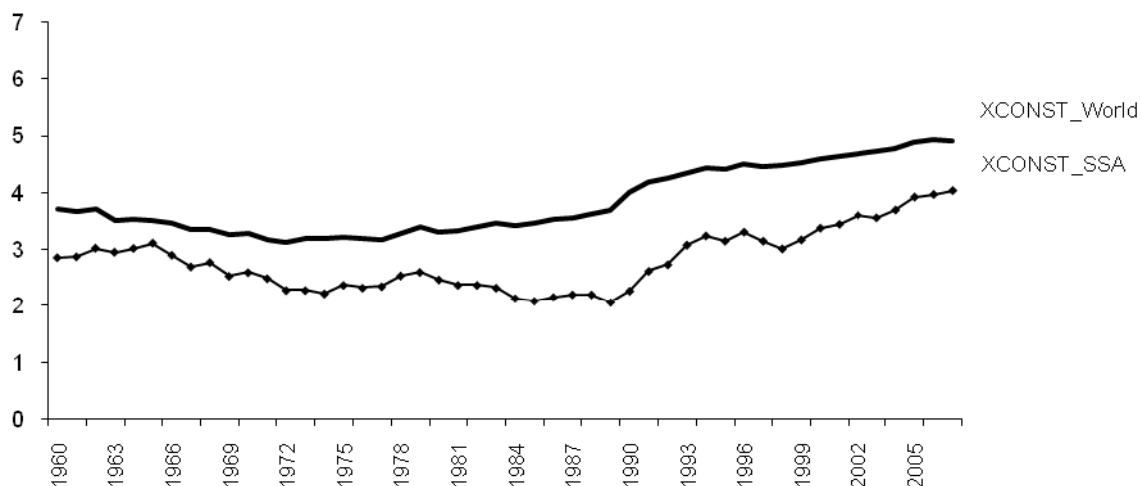
Source of data: IMF (2009a); World Bank (WDI, on line).

As Figure 1 depicts, many African countries have been faced with the ‘twin’ constraint of a deficit in both fiscal and current accounts. This meant that during previous economic slumps, the countries generally had no leeway to use countercyclical fiscal and monetary policy. Indeed, many had to adopt further austerity measures (lower spending, higher interest rates). However, as Figure 1 indicates, fiscal balance of the countries has improved substantially and Africa’s cover of foreign reserves has increased ten-fold over the levels evident during earlier crises.

### 3.2 Good governance

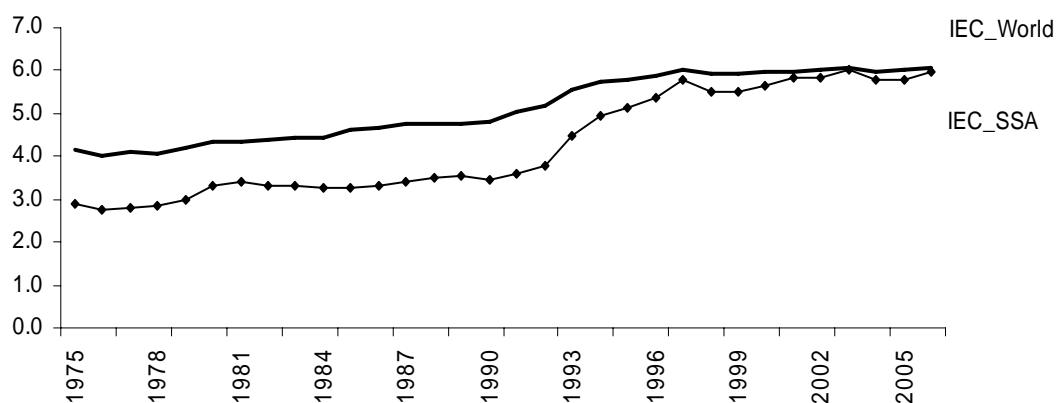
Next, we consider improved governance. Here, the evidence points to a considerable improvement in political governance, especially since the 1980s. For example, the measure of executive constraint which had deteriorated in the 1970s has improved substantially (Figure 2). As Fosu argues (2009a), this measure of governance has a powerful positive effect on the prevalence of growth-enhancing policies.

Figure 2  
Political governance in Sub-Saharan Africa, 1960-2007



Source: Fosu (2009b).

Figure 3  
Political contestability in Sub-Saharan Africa, 1975-2007



Source: Fosu (2009b).

Similarly, African countries appear to have substantially progressed with the incidence of multiparty democracy. The measure of political contestability has risen from an average of about 3.0 in the mid-1970s to equal, by 2007, the world's mean of 6.0 (Figure 3). This is an important development, as Africa has now surpassed the threshold above which further progress with democratization is likely to be growth-generating (Fosu 2008).

Africa's vulnerability was examined in section 2 and its resilience in this section; the potential policy responses are discussed in the following section.

## **4 The policy response**

The above analysis shows that while Africa is still highly vulnerable, resilience has improved. In addition it needs to be mentioned that the advanced economies' reaction to the crisis has been significant in terms of mobilized funding for getting their economies back on a growth path and restoring confidence in their financial sectors. Responses to mobilize resources for developing countries have also gathered momentum.<sup>8</sup>

Globally coordinated measures, regional responses and country efforts to lift Africa out of the crisis will need to focus on (i) mitigation, (ii) coping and (iii) risk reduction within the context of each individual country, as circumstances differ in each country. Here, we do not have the space to consider the most appropriate responses at individual country level and can thus only raise a number of generic actions and considerations.

Table 1, taken from Naudé (2009c), summarizes the policy responses that could be followed. Next, we briefly discuss the proposed policies outlined in Table 1.

### **4.1 Mitigation and coping action**

Consistent short-term measures should focus on action aimed at mitigation and actions aimed at helping countries to cope.

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

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

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<sup>8</sup> For instance, the G-20 meeting in April 2009 agreed to provide or channel at least US\$1.1 trillion towards global recovery, of which an additional US\$500 billion will go towards trebling the resources of the IMF (to the level of US\$750 billion). Of this package, US\$50 billion has been set aside specifically for low-income countries. The G-20 nations also reaffirmed their commitment to ODA (Naudé 2009b).

Table 1  
Policy responses to the global economic crisis in Africa

Objectives	Action
<b>MITIGATION ACTION</b>	
Restore financial confidence	<ul style="list-style-type: none"> <li>• Monitoring, supervision and regulation of financial institutions</li> <li>• Recapitalization of banks where needed</li> </ul>
Expand trade	<ul style="list-style-type: none"> <li>• Avoid protectionism</li> <li>• Maintain competitive exchange rate policies</li> <li>• Obtain balance-of-payments support</li> <li>• Obtain trade finance support</li> <li>• Aid for trade</li> </ul>
Expand finance	<ul style="list-style-type: none"> <li>• Increase aid and accelerate aid disbursement</li> <li>• Attract FDI</li> <li>• Facilitate remittances</li> <li>• Stop and return illicit funds/flight capital</li> </ul>
<b>COPING ACTION</b>	
Expand domestic demand	<ul style="list-style-type: none"> <li>• Undertake public works programmes</li> <li>• Prevent unemployment escalating</li> <li>• Provide social security, e.g., cash transfers, school feeding programmes</li> <li>• Consider tax reductions</li> </ul>
Absorb financial losses	<ul style="list-style-type: none"> <li>• Draw down reserves and utilize short-term international financial assistance</li> </ul>
Expand self-employment	<ul style="list-style-type: none"> <li>• Relax business regulations</li> </ul>
Technical assistance	<ul style="list-style-type: none"> <li>• Obtain assistance in planning and coordinating responses</li> <li>• Ensure the targeting and distribution of assistance</li> <li>• Provision of information and monitoring of the impact</li> </ul>
Peacekeeping	<ul style="list-style-type: none"> <li>• Monitor violent conflict</li> <li>• Address grievances</li> <li>• Contain violence and spillovers</li> <li>• Plan for displacements and migrations</li> </ul>
<b>RISK REDUCTION STRATEGIES</b>	
Export and production diversification	<ul style="list-style-type: none"> <li>• Expand south-south trade</li> <li>• Promote manufacturing (e.g., through agro-industries)</li> <li>• Promote tourism</li> <li>• Invest in infrastructure</li> </ul>
Banking system strengthen and financial deepening	<ul style="list-style-type: none"> <li>• Expand access to finance</li> <li>• Encourage financial innovation</li> <li>• Maintain adequate bank capital requirements</li> <li>• Encourage domestic banking expansion</li> </ul>
Social cohesion	<ul style="list-style-type: none"> <li>• End conflicts/promote peace</li> <li>• Participatory and inclusive governance</li> <li>• Protect minorities</li> <li>• Nation-building</li> </ul>
Good governance and institutional development	<ul style="list-style-type: none"> <li>• Build strong and effective government</li> <li>• Strengthen basic institutions, i.e., property rights, rule of law, contract enforcement, independent judiciary</li> </ul>
Reform of international financial architecture	<ul style="list-style-type: none"> <li>• Give greater voice to SSA</li> <li>• Advance the Doha Round, with more development content</li> <li>• Reform Bretton Woods</li> <li>• More development role for G-20</li> <li>• Reform aid architecture: volumes and effectiveness</li> <li>• Address global imbalances</li> </ul>

Source: Naudé (2009c)

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

The role of African governments in mitigation would be to;

- Monitor the impact of the crisis;
- Monitor and regulate their own banking systems and check for early signs of bank difficulty;
- Maintain or promote a positive stance towards trade liberalization and open markets;
- Lobby for a satisfactory conclusion of a more appropriate, development oriented Doha Round;
- Work towards improving the supply capacity of African countries, for instance through public works programmes targeted to infrastructure and transport services; and
- Maintain competitive real exchange rates and encourage further regional integration and regional trade facilitation measures.

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

- Expanding domestic demand through fiscal and monetary stimulus, where possible, in a manner that does not lead to unsustainable debt accumulation;
- Absorbing financial losses through foreign reserves in countries that have the means and permitting competitive exchange rates to be established;
- Targeting the vulnerable through appropriate social safety nets supported by aid;
- Expanding self-employment, for example, by making the business environment easier and through public works programmes;
- Utilizing technical assistance in the design and implementation of programmes, and
- Expanding peacekeeping operations where needed, given the potential for escalating conflict in times of economic hardship.

The international community's role in mitigation measures is to facilitate the demand for Africa's exports, which is more general and cross-cutting, whereas in measures designed to help countries cope with the effect of the crisis, the international community needs to be more alert to country-level differences. This is where it is important to be able to identify countries most at risk, and to ensure that assistance is tailor-made to

specific circumstances. Such assistance would be twofold: assisting African governments with financial resources so as to alleviate poverty and to maximize the level of such aid's effectiveness (ascertaining that aid is appropriately utilized and that it does not divert local production), and to provide technical assistance or even peacekeeping operations, if necessary. African governments, in turn, should take care that expansionary policies do not lead to unsustainable budget deficits or debt burdens, and that the appeal of private sector activity is improved.

#### **4.2 Risk reduction through improved governance**

African countries need to reduce risk; it is not enough to merely mitigate risk or to cope with risk. Given the nature of the crisis, this implies that what is required is diversification of the economies, improvement of the environment for doing business, and reform of the global financial and aid architecture. In all of these, the strengthening of governance is a prerequisite. As Fosu (2009b; 2009c) indicates, improvement in governance has gone hand in hand with the establishment of SF policy environment in Africa.

As the evidence in section 2 suggests, many countries in Africa have, on average, improved governance through institutional reform, but it is also true that many others are still lagging behind. An important concern for a number of these countries is that such reform can be fraught with potential political disorder, requiring appropriate support to these countries in order to reduce the likelihood of conflict (Fosu 2008). Conversely, we must also be cognizant of the need to preserve the achievements of the countries that have succeeded with reforms. This would require appropriate support to reduce the potential for political opportunism during crises, which could reverse the success achieved to date. Some of Africa's high-risk countries fall in this category.

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

### **5 Risks to Africa's development**

Given the vulnerability of Africa (section 2), and our argument that the continent's resilience has improved (section 3) as a result of better economic management and governance, we can examine the risks posed by the global economic crisis, particularly in terms of the nature of the shocks (section 2.2).

#### **5.1 Consequences of the crisis for growth and development**

First, given the impact and nature of the crisis, we have to recognize that the global economic crisis does pose a huge, but not insurmountable, risk to the growth and development of Africa. Frustratingly, the adverse impact came at a time when Africa was growing strongly, with an overall per capita growth rate exceeding that of the world each year for the last several years. The shocks will substantially reduce African economic momentum.

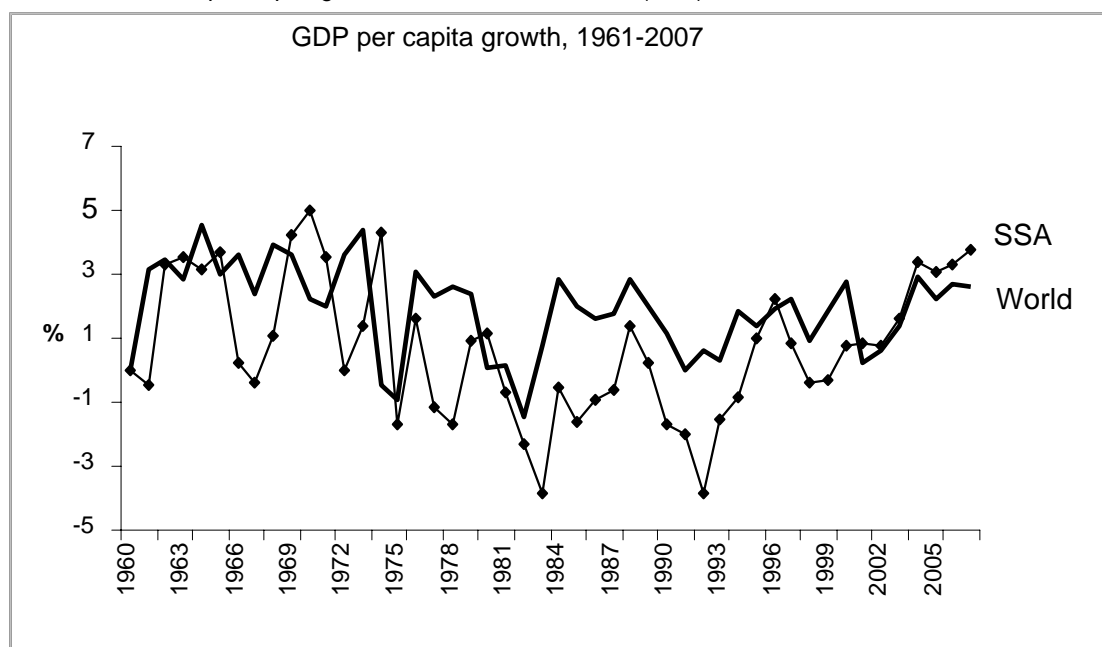
Economic growth may not be the perfect indicator of progress, but the consensus is that economic growth is necessary for development. In the case of Africa, it has been estimated that an annual average growth rate of 7 per cent needs to be maintained if the continent is to achieve at least the first of the Millennium Development Goals, i.e., to halve the number of people living on less than one dollar a day. Africa's growth projections for 2009 and 2010 have been reduced substantially by international financial institutions to reflect the effects of the financial and economic crisis. For instance, the IMF has revised Africa's economic forecasts for 2009 downwards from 5 per cent in October 2008, to 3.5 per cent in January 2009 to 1.7 per cent in April 2009. The World Bank also modified its growth prospects for the continent to 2.4 per cent for 2009. Note, however, that contrary to previous global recessions, African GDP will not contract this time.

The consequences of a reduction in growth, even if African economies can avoid shrinking, are likely to be higher unemployment and poverty, increases in infant mortality, and adverse coping with long-lasting impacts such as higher school dropout rates, reductions in healthcare, and environmental degradation, inter alia.

To assess the risk to Africa's development in context, it is necessary to briefly review the continent's growth performance and relate this to the policy-syndromes defined in the introduction.

Figure 4, depicting GDP per capita growth in Africa and the world economy between 1961 and 2007, highlights SSA's good recent growth record.

Figure 4  
GDP per capita growth in Sub-Saharan Africa (SSA) and the world, 1961-2007



Source: Fosu (2009b).

The figure also shows that African growth has been very volatile. Indeed, according to Fosu (2007: 2), the standard deviation of African GDP growth over the period 1961-2001 has been the highest among all regions. This reflects the fact that SSA growth has been characterized by 'boom-and-bust' episodes and exposure to shocks, many of which

were external, like the current crisis. Often, these adverse circumstances led countries to adopt anti-growth policy syndromes, stifling in the process long-term growth and development.

As Fosu documents (2009c: 20-1), negative as well as positive external shocks often resulted in poor policy responses. Consider, for instance, negative shocks. As net importers of oil, most African countries experienced the negative petroleum supply shocks of the 1970s as they did again in 2008. Others were also afflicted by drought in the 1970s which led to diminished food supplies, as were many countries hit by the 2008 food price crisis. In the 1970s, however, the response was sub-optimal: governments fixed prices in the face of these shocks in order to keep goods and services affordable to the citizenry at large, particularly to the urban elites who seemed to form the political support base for these governments (Bates 1981). But such a policy led to more and/or stricter *state controls*, which repressed longer-term recover.

Furthermore, governments did not fare very well either in the face of positive external shocks. For instance, the 1970s (similarly to more recent times) were characterized by commodity booms, which, as Fosu (2009c) documents, gave rise to the *suboptimal inter-temporal resource allocation syndrome*. This involved exuberant spending during booms and subsequent underspending during the fiscal difficulties, as exemplified by phosphate in Togo, 1974-89 (Gouge and Evlo 2004); oil in Cameroon, 1982-93 (Kobou and Njinkeu 2004); phosphates and groundnuts in Senegal, 1974-79 (Ndiaye 2004); bauxite in Guinea, 1973-84 (Dombouya and Camara 2003); coffee in Burundi, 1975-85 (Nkurunziza and Ngaruko 2003); uranium in Niger, 1974-85 (Mamadou and Yakoubou 2006); and oil in Nigeria, 1974-86 (Iyoha and Oriakhi 2004). Moreover, many governments in the past used boom-time revenues to reward their cronies and ethnic constituencies, and during bust periods tended to maintain such a redistribution at the expense of the rest of the population, a phenomenon termed as the *adverse redistribution policy syndrome*. In some cases, adverse redistribution obstructed long-term development through increased polarization, and eventually state failure as in Angola (1973-2002), Burundi (1988-2000), Chad (1979-84), DRC (1996-2005), Sierra Leone (1991-2000), Togo (1991-93), and Uganda (1979-86), for instance.

## **5.2 Pitfalls in policy responses**

From the brief description of Africa's past experiences given in the previous subsection, it is clear that external shocks can jeopardize long-term growth and development if the government makes wrong policy choices and ends up promoting anti-growth policy syndromes. In particular, the following situations need to be avoided:

### *Boom-and-bust cycles*

Another boom-bust cycle and enflaming the historically high volatility of African growth should be avoided. Boom-and-bust cycles, a feature of Africa's growth experience since 1961 (Figure 1), have a very negative impact on investment and productivity growth over the long term. The effects on poverty and other development indicators are also asymmetric between boom and bust episodes. Thus, while efforts should focus on the prevention of a downturn as much as possible, care should be taken so as not to generate boom-bust cycle. According to Arbache and Page (2008: 9):



While growth accelerations result in relatively small improvements in human development, decelerations have important negative impacts on education and health outcomes. Under 5 mortality and infant mortality, for example, are substantially higher during growth decelerations than in normal times, but they do not improve during growth accelerations.

As Sachs (2009) recently pointed out;

We should stop panicking ... Panics end badly, even panics of policy; more moderate policies will be safer in the medium term ... there is little reason to fear a decade of stagflation, much less a depression.

As shown above, Africa, despite the downturn, will not be in recession, and may have increased resilience for recovery without inducing an unsustainable boom.

### *Unsustainable debt*

Generating another debt crisis can be a grave danger. The continent's boom-and-bust cycles of the past have often been accompanied by episodes of sovereign indebtedness, snaring many African and LDCs in a debt trap in the 1990s. While many of these nations have benefitted<sup>9</sup> from the highly-indebted poor countries (HIPC) initiative and the multilateral debt relief initiative (MDRI), the current crisis is likely to put pressure on both developing-country expenditures (given the global calls for fiscal expansion) and revenue (as tax income declines due to a reduction in trade and economic activity), with the likelihood of increased debts. As sovereign bond issues become more difficult and expensive in light of the global credit crunch, many countries may be tempted to increase lending from regional banks and the Bretton Woods institutions (Ladd 2009). Unsustainable debts and irresponsible lending are hazards to be avoided (Jubilee Debt Campaign 2009). Preventing another debt crisis may require deeper debt cancellation, greater efforts to improve domestic resource mobilization in African countries (Aryeetey 2009) and implementation of a more appropriate 'international mechanism for sovereign debt restructuring, which includes provisions for temporary moratoria on debt servicing' (Ladd 2009: 1).

### *Adverse coping*

A considerable challenge in the face of this crisis is preventing households from engaging in adverse coping strategies that have lasting impact. There is risk that the most vulnerable will be left to fend for themselves, and that inequality and polarization will increase, threatening stability. Therefore, what is required for the countries of Africa is not fiscal stimulus as such, but government expenditures that are of the right type and specifically targeted. Indeed, it may be argued that now is the opportunity for many countries to implement and/or strengthen their social safety nets. Safety net programmes should include unconditional as well as conditional cash transfers to poor households, and public works programmes (see Ravallion 2008).

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<sup>9</sup> Total indebtedness of African countries, and of the developing countries in general, remains high. As pointed out by the Jubilee Debt Campaign (2009), developing-country debt stocks total US\$2.9 trillion and daily debt repayments from developing to advanced countries amount to almost US\$100 million.

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

### *Reversing liberalization*

A third hazard that needs to be avoided by African countries in responding to the crisis is reversal of the gains made in recent years by opening up the economies. Many countries may contemplate re-introduction of crippling state controls such as higher tariffs, price controls, and sectoral subsidies.

We are not cautioning against this in order to limit the policy space of countries to confront the crisis, but rather to stress the fact that although these measures may seem to bring short-term advantages, such as rising government revenue through increased tariffs perhaps or limiting state expenditure through price controls, these will have to be seen against long-term impacts which may, as it has often happened in the past, damage the ability and competitiveness of the private sector to react and adjust, and can thus lead to retaliatory actions. SSA countries, however, do have scope within the WTO to apply safeguard mechanisms to provide, amongst others, credit to domestic firms and to engage in government procurement programmes to stimulate the domestic economy. But we also recognize that the WTO itself needs reform (see also Gallagher and Wise 2009), and that this change should be an important aspect of the longer-term responses to reduce the risks of Africa's nations.

### **5.3 Entrenching global inequities**

It is not only up to the African countries themselves to avoid pitfalls in policy responses to the crisis. In particular, there is a responsibility on advanced countries not to entrench inequities and inefficiencies in the global financial and aid architecture. The latter constitutes a risk inherent in the reaction to the crisis by the G-20 nations and requires a more inclusive response on the part of the UN. As Naudé (2009c) recently points out:

the G-20 largely ignored any substantial agreements on long-term changes to the global financial system. Their recognition of the need to reform the IMF and World Bank has been noted, and in this regard perhaps the most significant gesture has been the added US\$500 billion earmarked for the IMF. But herein may lie a problem, in that the short-term desire to get funding to developing countries as quickly as possible may perpetuate the very financial system developing countries have been objecting to. Indeed, one of the other 'winners' of the current financial crisis has been the IMF, which will see its resources trebled and its influence over developing and other countries potentially expand.

Will African governments and the international community be able to sidestep these pitfalls? We are optimistic, based on the fact that governance and political contestability, unlike in the 1970s, have improved significantly across the continent. Also, there is an urgency in the world economy—perhaps unlike any in the past—for

reforming global institutions. Therefore, in our view, there is opportunity to align Africa's development needs even closer with those of the global economy.

## 6 Concluding remarks

Africa is the developing region most at risk from the global economic crisis. Its growth forecast for 2009 has been slashed from 5 to 1.7 per cent. Its exports, as a percentage of GDP, are expected to shrink by 8 per cent. Revenues, totalling as much as US\$100 billion, could be lost in 2009 alone. The consequences can be dire: three million more unemployed and up to 36 million more thrown into 'working poverty', with numerous consequences likely to leave permanent scars: higher infant mortality, greater school dropout rates, more widespread malnutrition, rising crime and conflict, and accelerated emigration, to name but a few.

These impacts come on the heels of the food and fuel price shocks of 2007/08. This may put development on the poorest continent of the world back by years. In the past, declining incomes have been associated with the outbreak of conflict, and the present crisis may well trigger an escalation of tension across the continent. In fact, since the crisis erupted in October 2008, there have been a number of new disturbances.

We believe that Africa can—and will—recover. In this paper we have called for a 'syndrome-free' (SF) recovery, which is improvement that does not contain seeds of its own destruction. We are optimistic that Africa will heed the lessons of the past, and will be able to steer clear of the pitfalls through improved governance.

However, it is not only the pitfalls of its own making that African governments should attempt to sidestep, but also inadvertent consequences of the way in which the advanced economies of the world choose to address their own recession. Here, there are three requirements. First is their role in ensuring that trade channels to Africa are kept open, that promised aid is distributed, and at accelerated pace; and that irresponsible lending which could lead to a debt crisis in a few years is avoided. Second, advanced countries should ensure that fiscal stimuli and bank bailouts in the west should not entrench the *status quo* of the global financial architecture by providing 'financial protectionism' to banks in advanced countries, supporting the US dollar, and re-energizing the Bretton Woods institutions. And finally, work has to undertaken to reform the global financial architecture. In this respect, the United Nations (UN) Conference on the *World Financial and Economic Crisis and its impact on Development* taking place in New York on 24 to 26 June 2009 may be of historical importance. It offers a unique opportunity for African countries to put their case forward and to push for appropriate short-term assistance and the coordination of recovery plans—not least to limit the potential negative consequences as the advanced economies strive to get back on their feet. It also offers an opportunity to work for better global financial and economic governance and for mechanisms to coordinate responses for resolving the growing number of global challenges Africa is increasingly exposed to, not the least of which are the food and energy crises. Finally, if the conference succeeds in putting Africa's plight—as the poorest and most-at risk-region—on centre stage in the response to the crisis, it may facilitate an encompassing approach to deal with Africa's challenges in a much more collective fashion than has been the case.

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