Policy Briefs on the Financial Crisis

N° 10 / 2009

The Financial Crisis, Trade and Regional Integration in Africa

African Development Bank

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AFRICAN DEVELOPMENT BANK GROUP

PANEL 2

The Financial Crisis, Trade and Regional Integration in Africa

Ministerial Round Table Discussions and High Level Seminars

The 2009 African Development Bank Annual Meetings

This Policy Brief was produced by **Albert Mafusire**, Research Economist; **Tonia Kandiero**, Principal, Research Economist and **Abdul B. Kamara**, Manager Research Division, with input from NEPAD, Regional Integration and Trade Department, African Development Bank

Dakar, Senegal, May 2009

EXECUTIVE SUMMARY

Trade has been a key driver of Africa's growth surge in the last ten years. The sustainability of this trade-led growth is now threatened at a time when progress in the Doha Development Round has stalled and fears of incresaed trade protection are growing.

Africa's share of global trade is still low, amounting to only 3 percent in 2008. In addition, intra-African trade remains modest, representing just 8.3 percent of exports and 9.3 percent of imports. The continent's poor performance is a result of both infrastructural constraints and poor trade facilitation such as customs and standards that make the movement of goods on the continent costly, thereby reducing its competitiveness in global trade.

Efforts to address existing constraints are already underway and the crisis presents an opportunity for Africa to accelerate the pace towards deeper regional integration. Issues of multiple memberships in economic communities, harmonisation and coordination of regional trade policies, and improvements in trade facilitation have recently attracted renewed donor interests. The Bank can play a critical role in supporting deeper regional integration, riding on the current wave of political support being expressed by its Regional Member Countries (RMCs).

As the impact of the financial crisis continues to unfold, Africa remains challenged to think out of the box, as it seeks appropriate responses to the crisis. In particular, the efficacy of some of the suggested solutions needs further interrogation.

1. INTRODUCTION

Trade has been one of the major drivers of Africa's growth surge in the last ten years. The sustainability of this trade-led growth is now threatened due to the global financial crisis. While trade had been correctly identified as one of the channels through which the financial crisis would impact the continent, its magnitude had been underestimated. The real sector effects, emerging largely through the trade and investment channels, are proving to be more damaging than had previously been expected. Weakening global demand for Africa's exports and the resulting decline in commodity prices, projected to reach about 45 percent in 2009, will have far-reaching implications for the continent's growth prospects.

Furthermore, many African countries are heavily dependent on mineral and oil exports, which contribute up to 90 percent of total export earnings and over 50 percent of government revenue in some countries. Consequently, both social and infrastructure expenditures face possible drastic cuts unless alternative financing resources are found.

Given the limited linkages of export-oriented sectors with the rest of the economy, substantial job losses in these sectors affect other sectors through the income channel. As a result, reduced demand for exports and a slowdown in private sector activity, the continent's growth prospects are bleak: a meagre 2.8 percent real GDP growth rate is expected for 2009, down from 6 percent in 2007 and 5.7 percent in 2008.

Africa's low share of global trade (only 3 percent in 2008), up to 50 percent of which is accounted for by South Africa, makes the situation even more dire. Intra-African trade remains modest, representing just 8.3 percent of exports and 9.3 percent of imports. Low intra-African trade is a result of both the lack of production diversity and infrastructural constraints that limit the movement of goods on the continent. Notwithstanding improvements in the business environments on the continent, increased inflows of foreign capital and participation by local investors may not be realized now, especially as increasing protectionist measures as a response to the financial crisis limits access to international markets. Support to continental growth drivers will, therefore, be critical in building the resilience of African economies.

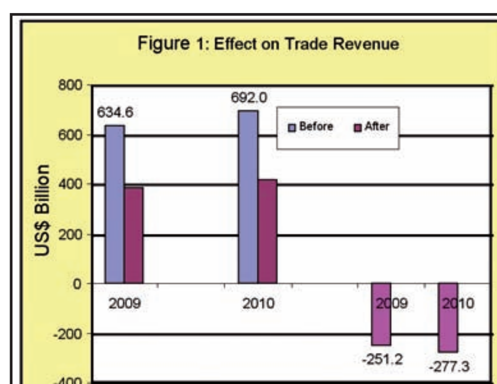
The African Development Bank has already been engaged in efforts that can promote intra-African and South-South trade. In particular, accelerating processes towards deeper regional integration, including addressing constraints such as overlapping membership, infrastructure development and the harmonization of economic, trade and financial policies, is now imperative. The Bank continues to support efforts to break the impasse in the Doha Development Round and scaling up resources for Aid-for-Trade initiatives.

There are also opportunities for the African Development Bank, mainly in its role as the premier development institution and the continent's voice. The Bank's experience and capacity will be critical assets in addressing some of the challenges, as the continent responds to the financial crisis.

2. IMPACT ON AFRICA'S TRADE PROSPECTS

As the developed world goes through the worst recession since the 1930s, African exports face a contracting market. Trade revenue in Africa is projected to decline by USD 251 billion in 2009 from an expected level of USD 634 billion and another USD 277 billion in 2010 (Figure 1). The loss in export revenue will have serious implications for Africa's current account position. These projections may turn out to be underestimations of the impact of the crisis, as some countries resort to protectionist responses. Already, developed countries are providing subsidies (industry support schemes) while some developing countries are increasing tariffs (India and South Korea) and restricting import (Indonesia and Argentina). These measures will have an effect on the direction of trade flows.

African trade will be further squeezed through a lack of trade credit. The World Bank estimates a financing gap of up to USD 700 billion for all developing countries. The impact of tightening credit markets will have dire consequences on trade performance, further exacerbating the effects of the crisis. Small-to-medium enterprises (SMEs) that are key agents in the diversification of African production and job creation are particularly at risk. Export-oriented SMEs have difficulties accessing low-cost foreign currency



Source: AfDB, March 2009

denominated working capital, leading to low capacity utilization. The financial crisis reinforces existing market failures that result in sub-optimal allocation of credit to SMEs, while the current regulatory frameworks also contribute to these difficulties as banks respond in a pro-cyclical manner.

At the regional level, the crisis has dampened prospects for increased intra-African trade by worsening financing constraints for the RECs. African governments have not been able to fully provide for the financial requirements of Regional Economic Communities (RECs) during the growth period. The financial crisis will compound the inability of these countries to meet their financial obligations to RECs, undermining their ability to effectively carry out their mandates. The rationalization of the RECs, notably to reduce multiple memberships by African countries, may partly reduce the burden that countries face in meeting their obligations to different regional bodies.

The poor state of infrastructure and inadequate trade facilitation in Africa are among the major factors contributing to lower intra-African trade. The rolling out of regional infrastructure projects and trade facilitation programs, especially within the context of the Enhanced Integrated Framework and Aid-for-Trade, is critically dependent on effective delivery of aid commitments. It is especially critical to prevent a retreat from infrastructure development and trade facilitation which would further weaken the continent's ability to absorb the impact of the crisis and further increase its marginalization in the global economy. Furthermore, deepening regional integration requires adequate infrastructure and trade facilitation, both of which will need to be funded through scaled-up external assistance.

3. OPPORTUNITIES FOR AFRICAN COUNTRIES

South-South trade – Trade barriers in Africa remain, with an average tariff rate of about 19 percent compared to global tariff peaks at 15 percent. Currently, only 40 percent of exports from developing countries go to other developing countries. Thus, concerted efforts are required to reduce trade barriers in developing countries to promote South-South trade.

Fostering regional integration – The Bank's medium-term strategy underlines the growing importance of regional economic integration and infrastructure development, under NEPAD's development agenda. The Bank is ready to join forces with other partners whose resources can be leveraged. Deeper political support, as indicated by the adoption of the *Plan of Action for Acceleration of Industrialization* by African Ministers of Trade, Mining and Industry in 2008 must be followed by concrete actions. The continent can take advantage of current donor interests in the Spatial Development Initiatives

(SDIs[1]. SDI encourages integrated development within a given space, defined by its economic potential rather than by political exigencies.

Regional infrastructure development – Financing for infrastructure has declined significantly, particularly from bilateral donors. The Bank is willing to contribute to efforts to fill this gap through a careful selection criterion that maximizes the economic value of projects by stimulating a diverse range of economic activities in a regional context. But Bank resources alone will not close the financing gap. Other donors and multilateral institutions will have to complement Bank efforts. In this regard, the bank will continue supporting efforts by the Infrastructure Consortium for Africa (ICA) in implementing the NEPAD action plan. RECs should move quickly with programs that enable the Bank to use its integrated structure as a source of advantage by building synergies across public/private sectors and foster Public-Private Partnerships (PPPs). For instance, development corridors under the SDI could generate significant economic value through the configuration, prioritization and promotion of inter-related infrastructure and large-scale economic sectoral investments in defined geographic areas. This will optimize the use of infrastructure, encourage value-added processing, enhance the competitiveness of African economies and stimulate investment-led growth.

Implementing comprehensive policy reforms – There is evidence that the global economic landscape has its own challenges, but it offers opportunities as well. The Bank continues to strengthen its support to its RMCs for comprehensive policy reforms, including strategies for deepening regional integration efforts. This support is critical, especially in this period of economic crisis where countries face a real risk of policy reversal.

4. THE ROLE OF THE AFRICAN DEVELOPMENT BANK

Counter-cyclical role – There is a need for prompt action to mitigate the impact of the financial crisis and avoid a *"reverse development"* in the Bank's RMCs. The Bank has quickly moved to implement short-term targeted interventions to mitigate procyclicality in the current financial environment. Two important objectives in this regard are: offsetting the decline in government revenues linked to falling

[1] The term SDI refers to a multi-national development in infrastructure that links more than one country and it also includes all the necessary government policies (tax breaks, investments incentives, government support, etc.). An SDI can include a development corridor but it can also be a development such as trans-frontier Game Park of which there are several examples in Southern Africa.

trade volume, and compensating the decline in credit availability. On the trade front, the Bank will address the short-term trade credit shortage through the *Trade Finance Initiative* that seeks to make available trade financing through existing regional and private banking institutions. Furthermore, the *Emergency Lending Facility*, a multi-faceted revolving credit facility that is disbursed in Euro or US dollar, has flexible utilization requirements and quick disbursing. These two measures compliment exisiting instruments, namely *budget support* to governments and *credit lines* to commercial and development banks. Efforts are also underway to scale up the Bank's financing from about USD 5.2 billion per annum projected before the crisis to between USD 8.8 billion and USD 10.5 billion per annum.

Bank support to regional integration – Deeper regional integration within Africa is imperative to build markets and new opportunities for growth, job creation and improved living standards; to create more robust, competitive and diversified economies; and, to attract and reward new sources of investment finance. With the Bank's RMCs having identified regional integration as a key strategic objective for the institution, an increasing amount of resources allocated in support of regional integration is required. However, the Bank faces resource constraints, and an increase in its resource envelop will be required to enable it to effectively support the regional integration agenda.

Strengthening financial integration – Deeper regional trade integration will require strengthening financial integration. This will, in turn, require a comprehensive program aimed at strengthening and streamlining *financial sector policies* and *financial infrastructure* (regulatory framework, payments systems). This will help in the development of strong *financial institutions* (banks, non-bank financial institutions bond and capital markets) and enhance the financial system's ability to mobilize and allocate resources, especially medium and long-term resources for development financing. This is critical for supporting private sector development, regional and international trade and, ultimately, growth and poverty reduction. While some actions have been taken in this area, both financial and human resources limit the Bank's reach and impact. Coordination and collaboration with other players should be pursued.

Voice for and within Africa – The Bank has committed itself to be an effective and credible voice for and within Africa. While there is substantial knowledge of the impact of the financial crisis, the impact is differential and is continuing to unfold. To effectively project Africa's voice as well as meaningfully influence RMCs' policy directions, the Bank has to possess superior information and demonstrate a deeper understanding of the continent and the challenges it is facing. This is possible through:

- An intensive information gathering process that allows for the conduct of critical analysis and the drawing of conclusions to inform country responses. The establishment of a network of information sources in selected parts of the continent, as recently implemented by the Financial Crisis Monitoring Group, need to be strengthened and expanded.

- Using its convening power, the Bank continues to facilitate the process of developing a common African position, especially at the G-20 level and Bretton Woods Institutions. In addition, through its participation at various international forums, the Bank continues to project Africa's voice to ensure its effective participation and representation at the international level.

- In the same vein, the Bank has added its voice to efforts calling for a speedy conclusion of the Doha Development Agenda, which remains critical to stimulating the global economy. A successful conclusion of the Doha Round would help to better integrate developing countries, including those in sub-Saharan Africa, into the global trading system, which would spur global and regional growth and facilitate Africa's attainment of the MDGs. Recent developments have shown that, instead of forging ahead with greater trade liberalization, developed and emerging economies are sliding back into a protectionist mode. Africa and other developing countries may emerge as the worst victims of a rise in protectionism.

Attendant risks can be avoided if Africa can realize its full potential in regional trade. Yet it has become very clear that though the Bank has a strategy to address major trade constraints on the continent, its implementation will be limited by the inadequacy of resources, thereby requiring a longer time span to unlock existing potential. Securing a General Capital Increase (GCI) may help the Bank to mobilize more resources to help move the development agenda forward in a quicker and more effective manner.

DISCUSSION ISSUES

1. What preferential arrangements should be put in place to help the integration of Africa into the global trading environment?

2. How best should national governments respond to the crisis without jeopardizing progress on the regional integration agenda in Africa?

3. What additional arrangements are needed to boost south-south trade?

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African Development Bank

Angle de l'avenue du Ghana et des rues Pierre
de Coubertin et Hédi Nouira
BP 323 - 1002 Tunis Belvédère (Tunisia)
Tel.: + 216 71 333 511 - Fax: +216 71 351 933
E-mail: afdb.org - Internet: www.afdb.org