



**UNITED NATIONS
ECONOMIC AND SOCIAL COUNCIL
ECONOMIC COMMISSION FOR AFRICA**

Forty-fifth session of the Economic Commission for Africa



**AFRICAN UNION
COMMISSION**

Seventh session of CAMEF

5th Joint Annual Meetings of the AU Conference of Ministers of Economy and Finance and ECA Conference of African Ministers of Finance, Planning and Economic Development

Addis Ababa, Ethiopia
26–27 March 2012



Distr.: GENERAL

E/ECA/CM/45/3
AU/CAMEF/MIN/3(VII)
7 March 2012

Original: ENGLISH

The Impact of the European Debt Crisis on Africa's Economy

A Background Paper

Acronyms and abbreviations

AfDB	African Development Bank
AIB	African Investment Bank
AMF	African Monetary Fund
AU	African Union
AUC	African Union Commission
BBC	British Broadcasting Corporation
CFA	African Financial Community
DAC	Development Assistance Committee
ECA	Economic Commission for Africa
EMU	Economic and Monetary Union
EFSF	European Financial Stability Facility
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FDI	Foreign direct investment
G-20	Group of Twenty Finance Ministers and Central Bank Governors
GDP	Gross domestic product
ILO	International Labour Organization
IMF	International Monetary Fund
MDGs	Millennium Development Goals
ODA	Official development assistance
OECD	Organization for Economic Cooperation and Development
UNCTAD	United Nations Conference on Trade and Development
UNECA	United Nations Economic Commission for Africa
US	United States

I. INTRODUCTION

1. Africa has experienced positive growth momentum in recent decades, registering previously unseen levels of economic performance, and weathering the negative effects of the ongoing global financial and economic crisis better than many other regions. Consequently, many analysts and policymakers project that the continent will become one of the fastest-growing regions in the world over the next decade.
2. However, the ongoing sovereign debt crisis in some countries of the euro area poses a serious risk for Africa's economic prospects. While only a few countries are affected, there is now an increased risk that the crisis could spread rapidly to other countries in Europe and have spillover effects in other parts of the world. The escalation of the euro area crisis has sharply depressed business confidence in developed economies, while the negative shock is straining emerging markets and developing economies. The global economy is therefore expected to slow in 2012 and in the medium term, with an increased risk of another recession, if the euro zone crisis is not resolved urgently.
3. Since these developments will inevitably have an impact on Africa on several fronts, an assessment of their likely impacts is warranted. The main potential transmission channels include trade exposure through falling demand for Africa's exports to Europe, sovereign risks (including reductions in official development assistance (ODA)), and liquidity risks that could affect other financial inflows such as foreign direct investment (FDI) and remittances.
4. Moreover, it has been suggested that the structure and governance system of the European Economic and Monetary Union is itself a root cause of the current crisis. The euro is viewed as an incomplete currency, because the 1992 Maastricht Treaty established a monetary union without a political union, as a result of which the common European Central Bank lacks a common treasury. Furthermore, while members share a common currency, they issue and manage sovereign debt individually. It is precisely the missing elements in this structure that financial markets are now questioning, and that is arguably the reason why the euro is the focal point of the current crisis. This can offer important lessons for Africa on how to manage its own agenda for achieving monetary union, as is envisaged in the 1991 Abuja Treaty. This is an important policy issue that requires consideration.
5. This background paper reviews the potential impact of the European debt crisis on Africa and offers policy advice on the actions that African leaders need to take to mitigate those negative effects. To that end, it overviews the characteristics of the euro area debt crisis, before discussing the risks it poses to Africa and the possible channels through which its effects may be transmitted. It concludes by drawing lessons from the experience of the European debt crisis for African leaders to consider in taking forward Africa's own monetary union agenda.

II. OVERVIEW OF THE EUROPEAN DEBT CRISIS

6. One of the major factors contributing to the ongoing eurozone debt crisis was the 2007-2008 global financial and economic crisis, which in itself was one of the worst crises to hit the global economy. The global financial crisis and economic downturn emanated from the subprime

mortgage crisis in the United States of America and spread to European markets as well as the rest of the world. The problem has since culminated in a debt crisis as the sovereign debt levels of some of the world's largest economies have increased sharply, placing them at risk of default.

7. In Europe, the crisis started with the collapse of the banking system in Iceland in 2008 and spread to other European countries including Greece, Ireland and Portugal in 2009. The crisis reached its first apex in early 2010, as a result of Greece's large structural deficits and the increasing cost of financing government debt. The authorities spent beyond their means and continuously misreported figures in order to satisfy the guidelines set by the European Economic and Monetary Union (EMU). The Greek Government used deficit spending to increase the living standards of its population as the deficit financed unemployment benefits, higher public sector salaries and pensions, and hence served to sustain an uncompetitive labour market.

8. Although the European Union (EU) was initially reluctant to intervene during the early stages of the crisis in Greece, its member States subsequently scheduled a number of interventions in order to ease the undue pressure on the euro and combat the risk of contagion to the rest of the euro area. Some of the interventions worth noting include the €110 billion bailout package extended to Greece in May 2010; the creation of the European Financial Stability Facility (EFSF) worth €750 billion to assist member States under extreme financial strain; and the proposal to set up a European Economic Recovery Plan aimed at stimulating demand, boosting consumer confidence and minimizing the impact on the most vulnerable. The Group of Twenty (G-20) also agreed to boost the resources of the International Monetary Fund (IMF) in an effort to assist euro area countries that are on the verge of defaulting on their debt.

9. Following the Greek crisis, European leaders met in December 2011 and called for a treaty change in all 17 euro area countries. The proposed changes include a balanced budget "golden rule"; automatic sanctions to be imposed if deficits exceed 3 per cent of gross domestic product (GDP); harmonization of euro area corporate taxes; and a tax on financial transactions. Most of these proposals have been criticized by the Greek Government and independent economists alike, raising issues regarding the feasibility of implementing them as proposed.

10. Most importantly, euro area members decided on 21 February 2012 to approve a €130 billion bailout package to Greece with the aim of restoring the country's debt level to 120.5 per cent of GDP by 2020. The amount is to be utilized to clear debt and arrears. However, there are doubts as to whether the Greek economy will recover under the painful fiscal austerity measures imposed. The gross debt levels of the eurozone countries mired in the debt crisis are expected to continue rising until at least 2013, despite stringent fiscal austerity measures. In Greece and Italy, gross debt is projected to reach 189.1 and 121.4 per cent of GDP, respectively. Italy's gross debt was estimated to be about \$ 2.72 trillion in 2011. With the exception of Germany, most other eurozone countries are expected to continue running a deficit for at least the next five years.

III. POTENTIAL TRANSMISSION CHANNELS OF THE CRISIS TO AFRICAN ECONOMIES

11. Many African countries responded quite well to the financial crisis relative to other economies. The recently published *African Economic Outlook 2011* estimates that African

economies rebounded from the slump caused by the global recession, with growth rates reaching 4.9 per cent in 2010, up from 3.1 per cent in 2009.

12. However, the sovereign credit risks ensuing in Europe are now heightening fears of substantially slower global recovery. There is compelling evidence from African economists that the impact of the crisis will vary by region depending on the degree of dependency on European markets. The most relevant channels of transmission are trade, FDI flows, ODA, remittances, and other forms of capital flows.

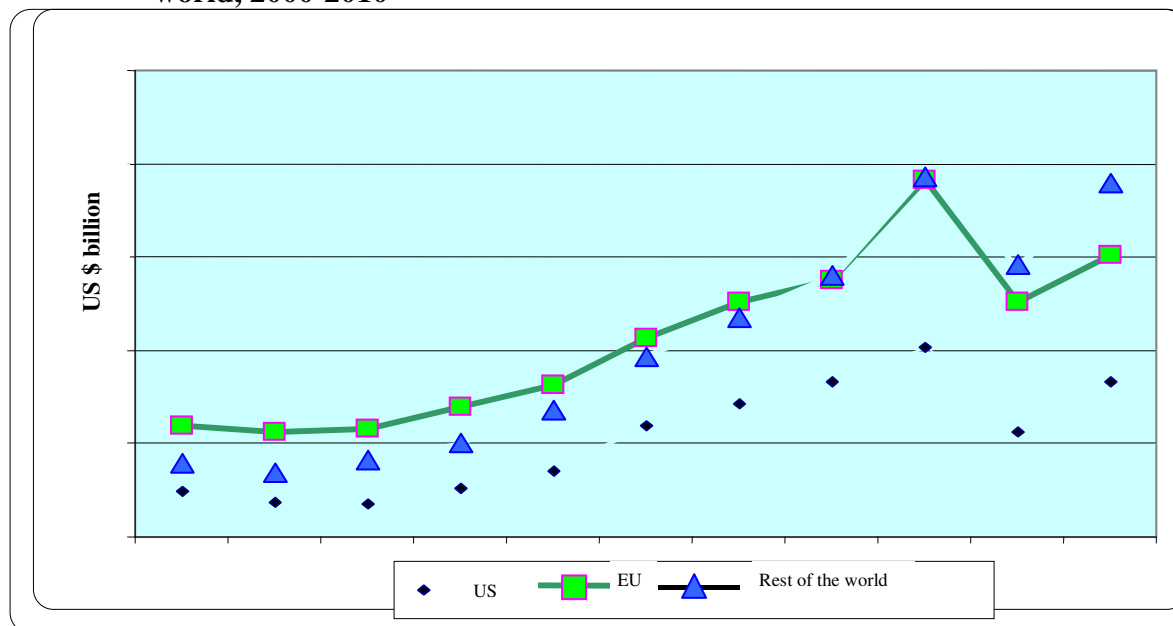
3.1 Main Channels of Transmission

(a) Impact on trade

13. The European Union remains Africa's largest trading partner, and the extent to which Africa will be affected by the euro area crisis will depend largely on the strength of trade linkages between Europe and the continent's various regions. North, Central and Francophone West Africa are likely to feel the effects more than other regions as a result of their close ties with Europe. Countries in those regions face substantial trade risk associated with any fall in demand that may occur as a result of the crisis.

14. Figure 1 shows the trend in African exports to the European Union, United States and the rest of the world since 2001. From the graph, it is clear that exports to the area have been consistently rising; they peaked in 2008 and the sharp fall in 2009 as a result of the global economic crisis was followed by a slight rebound in 2010 owing to higher prices for fuel and minerals. Nevertheless, many African economies are still at risk of a fall in export demand from Europe arising from weak aggregate demand as a result of subdued growth, fiscal consolidation measures to curtail the debt crisis and increased protectionist measures. In addition, the tightening of international credit markets means that access to trade finance is equally threatened. In fact, the latest United Nations Conference on Trade and Development (UNCTAD) figures (UNCTADStat) show that Africa's overall export volume has been shrinking over the four quarters from October 2010 to September 2011. As of 2010, exports to Europe represented over one third of Africa's total exports (see table 1).

Figure 1: Trend in African exports to the European Union, United States and the rest of the world, 2000-2010



Source: UNCTADStat.

Table 1: Africa's exports to Europe (share of total exports)

	2000	2004	2005	2006	2007	2008	2009	2010
East Africa	0.46	0.45	0.41	0.41	0.40	0.40	0.37	0.34
Southern Africa	0.42	0.41	0.42	0.40	0.38	0.35	0.33	0.31
West Africa	0.32	0.27	0.21	0.28	0.25	0.28	0.31	0.27
Central Africa	0.29	0.21	0.21	0.17	0.20	0.20	0.20	0.15
North Africa	0.69	0.64	0.63	0.60	0.56	0.58	0.56	0.55
Africa	0.49	0.44	0.41	0.41	0.39	0.40	0.39	0.36

Source: UNCTADStat.

15. However, within Africa, the impact on trade varies by sector. In 2010, oil and mining products accounted for over 65 per cent of Africa's global exports and a similar proportion of its exports to Europe. Demand for these commodities is unlikely to be hugely affected by the debt crisis in terms of volume, though global commodity price volatility could significantly impact total earnings in either direction. Other commodity exporters such as Ethiopia and Kenya, which have a large component of horticultural exports, could be negatively affected by Europe's weak economic performance.

16. There are also regional and country variations across the continent with regard to the impact of the crisis on trade, depending on trade linkages with Europe. As table 1 shows, while the proportion of Africa's exports to Europe has declined from nearly 50 per cent of total exports in 2000 to 36 per cent by 2010, they still constitute at least one third of total exports in the case of North Africa (55 per cent), East Africa (34 per cent) and Southern Africa (31 per cent). Any sharp decline in export demand from Europe could therefore have a differential impact by region.

17. More broadly, the trade impact on countries in the CFA¹ zone could be affected by the euro's movements against other hard currencies used by its trading partners, owing to the CFA franc's peg to the euro. This peg had initially provided the benefit of macroeconomic stability, and even in the initial wake of the crisis, a depreciating euro made CFA exports more competitive, especially for trade with the United States. However, the long-term impact of the peg to a depreciated euro is a loss in the value of reserves held by CFA countries, as well as continuing constraint on monetary policy.

18. The crisis presents Africa with three crucial policy lessons in its promotion of trade as a key driver of sustainable growth. First, it highlights the importance of strengthening intra-African trade which, at its current levels, is not sufficient to counter the pro-cyclical effects of weak export demand, making the continent vulnerable to external shocks. Given Africa's growing population and the corresponding expansion of its middle class, a huge market exists for intra-regional trade to service the existing domestic demand. Second, African governments should aim to build on the recent improvements in trade with their Southern partners. As table 2 shows, Africa's trade share with key Southern partners more than doubled in the last decade, from about 10 per cent in 2000 to over 20 per cent in 2009, largely reflected in the reduction in its trade share with Europe. Hence, further export destination diversification to its Southern partners will help the continent to manage the idiosyncratic risks that arise from specific regional rather than global economic shocks. Lastly, and related to the first point, the crisis highlights the importance of African countries diversifying their export bases. A narrow export base largely composed of primary commodities limits opportunities for intra-African trade as countries are unable to provide the goods that African consumers are looking for. It also exposes the continent to commodity price shocks, whose impact on growth can be debilitating, as was witnessed in 2009. Trade diversification will therefore help both to boost intra-regional trade and to mitigate the impact of external price shocks.

Table 2: Shares of traditional and emerging partners in Africa's imports, exports and total trade, 2000 and 2009 (in percentage terms)

	2009			2000		
	Trade	Exports	Imports	Trade	Exports	Imports
Total traditional partners	63.5	67.6	59	77	78.3	75.4
EU-25	44.3	43.1	45.6	53.5	51.3	56.4
Other trading partners	6.1	6.1	6.1	7.5	6.6	8.8
United States	13.1	18.4	7.3	16.1	20.4	10.1
Total four Southern partners	23.9	23.1	24.5	10.3	10.9	9.6
China	13.9	13.1	14.7	4.7	4.6	4.9
India	5.1	6	4	2.3	2.4	2.1
Brazil	2.5	2.4	2.7	1.7	2	1.3
Turkey	2.4	1.6	3.1	1.6	1.9	1.3
Other countries (68)	12.6	9.3	16.5	12.7	10.8	15.0
Total (%)	100	100	100	100	100	100
Total value (US\$ billion)	673.4	350.8	322.5	246.4	142.4	104

Source: *African Economic Outlook 2011*.

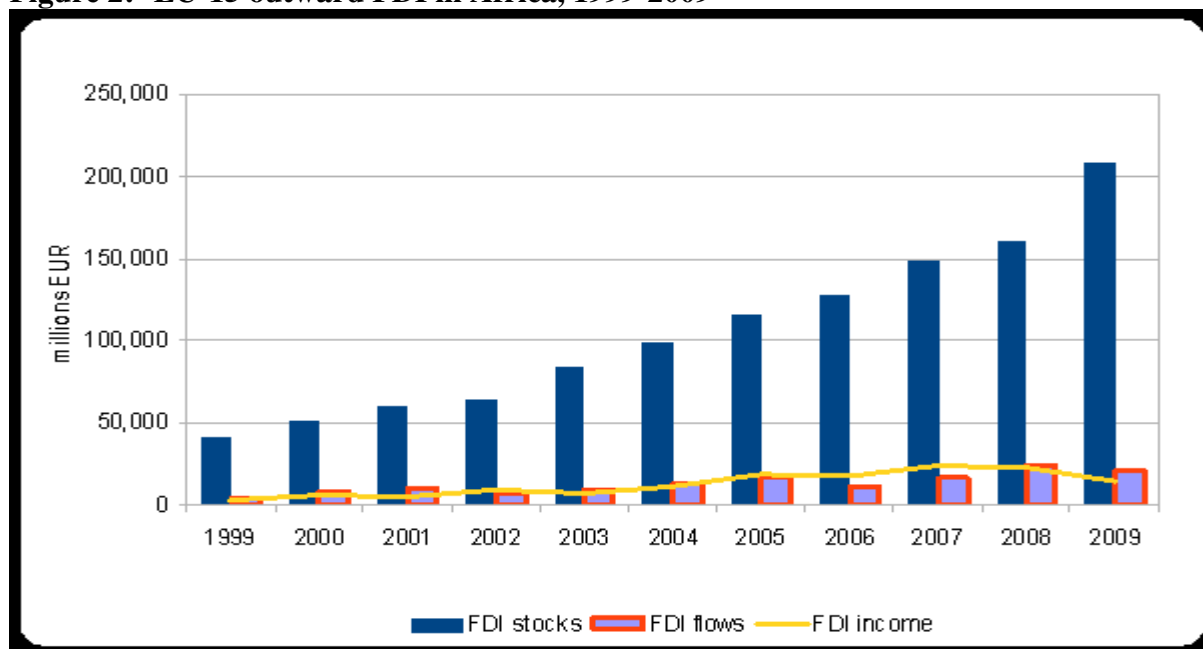
¹ African Financial Community.

(b) Impact on foreign direct investment²

19. FDI flows from the European Union to African economies increased considerably from 2007 to 2009, from €17 billion to €21 billion. In particular, the EU-15 countries have quadrupled their FDI stocks in Africa, from €51 billion in 2000 to €208 billion in 2009 (see figure 2). The European Union countries have continued to receive income from their investments in Africa, in amounts that are roughly equal to the level of FDI flows to Africa. The EU-15 group has seen its investment income from Africa almost double.

20. The trend shown in figure 2 suggests that, unless the European Union crisis becomes considerably worse and differs from the global financial crisis of 2008, African economies should not expect a significant deterioration of European Union FDI stocks. FDI flows to Africa could also potentially intensify owing to the decreased attractiveness of the European Union and United States markets. Data show that consumption and business confidence levels for these markets are as low as in 2009, when the European Union was in recession. However, the composition of FDI stocks may change, from projects that are associated with high risks to ones with relatively lower perceived risk.

Figure 2: EU-15 outward FDI in Africa, 1999-2009



Source: Eurostat, 2011.

21. On the other hand, if the European Union experiences a serious economic meltdown, there might be significant chain reactions through the global economy that could dampen FDI flows and stocks both globally and in Africa, especially over the medium term (as it takes time for investors to dismantle their direct investments). African (and other global South) investors might also have the opportunity to acquire State-owned companies in Europe, as troubled European Union States seek

² All data in this section are from Eurostat, except the figures for global FDI flows to Africa, which are from UNCTADStat.

liquidity. This is a distinct possibility, given that in 2008 African FDI in the European Union amounted to €25 billion, primarily proceeding from the three largest African economies: South Africa (24 per cent), Nigeria (19 per cent) and Egypt (16 per cent) (Eurostat).

22. Of course, it is advisable for each individual African economy to revise its investment policies and procedures and intensify efforts to continue improving the business climate, as the competition for reliable investment destinations might intensify. In the current climate, economies that are perceived as more risky may experience a deterioration in their FDI flows.

(c) Impact on ODA

23. The latest figures from the Organization for Economic Cooperation and Development (OECD) report *Development Aid at a Glance 2011* show that over 45 per cent of total aid allocation from European Union institutions goes to African countries. Moreover, data suggest that the volume of aid has actually increased despite the global financial crisis, which is in line with the commitments made by countries and institutions. In fact, the absolute figures have increased, even over 2010, as shown by preliminary data. This is, of course, because of lag effects: it takes time to make political decisions in response to economic turns of events.

24. However, if the current debt crisis in Europe turns into a serious economic crisis, African economies should expect significant reductions in ODA over the coming years. This is particularly important considering the country breakdowns of ODA. For instance, 80 per cent of the aid provided by Ireland, now severely troubled, goes to African economies, while Belgium, France, Portugal and the United Kingdom are among the top 10 donor countries for aid to Africa. Currently, a handful of countries – Italy, France³ and Iceland – have reduced their bilateral assistance to Africa owing to the debt crisis in Europe.⁴

25. In terms of sectoral allocations, the majority of aid to Africa is spent on the social sector, which includes health, education, population programmes, water and sanitation.⁵ A reduction in expenditure in these sectors could further hinder efforts to alleviate poverty. In addition, revenues from domestic resources remain minimal, adding to the pressures that many African governments will face in meeting fiscal demands that arise from reductions in ODA. The debt crisis in the euro area may also make it even more difficult to prioritize and allocate resources to tackle climate change and other environmental challenges faced by Africa.

26. It is important to note that, whilst reliance on aid is high across the continent, the impact of reductions in aid volumes will vary depending on the attributes of recipient countries. African countries vary in terms of their ODA/GDP ratios (figure 3) and net ODA received as a percentage of central government revenue (table 3). Research evidence indicates that non-natural-resource-exporting countries and fragile States will be more affected by any reduction in aid than resource-exporting countries. Allen and Giovannetti (2011) argue that fragile States⁶ that are more aid-

³ France has reduced its bilateral aid owing to its aid commitments linked to GDP.

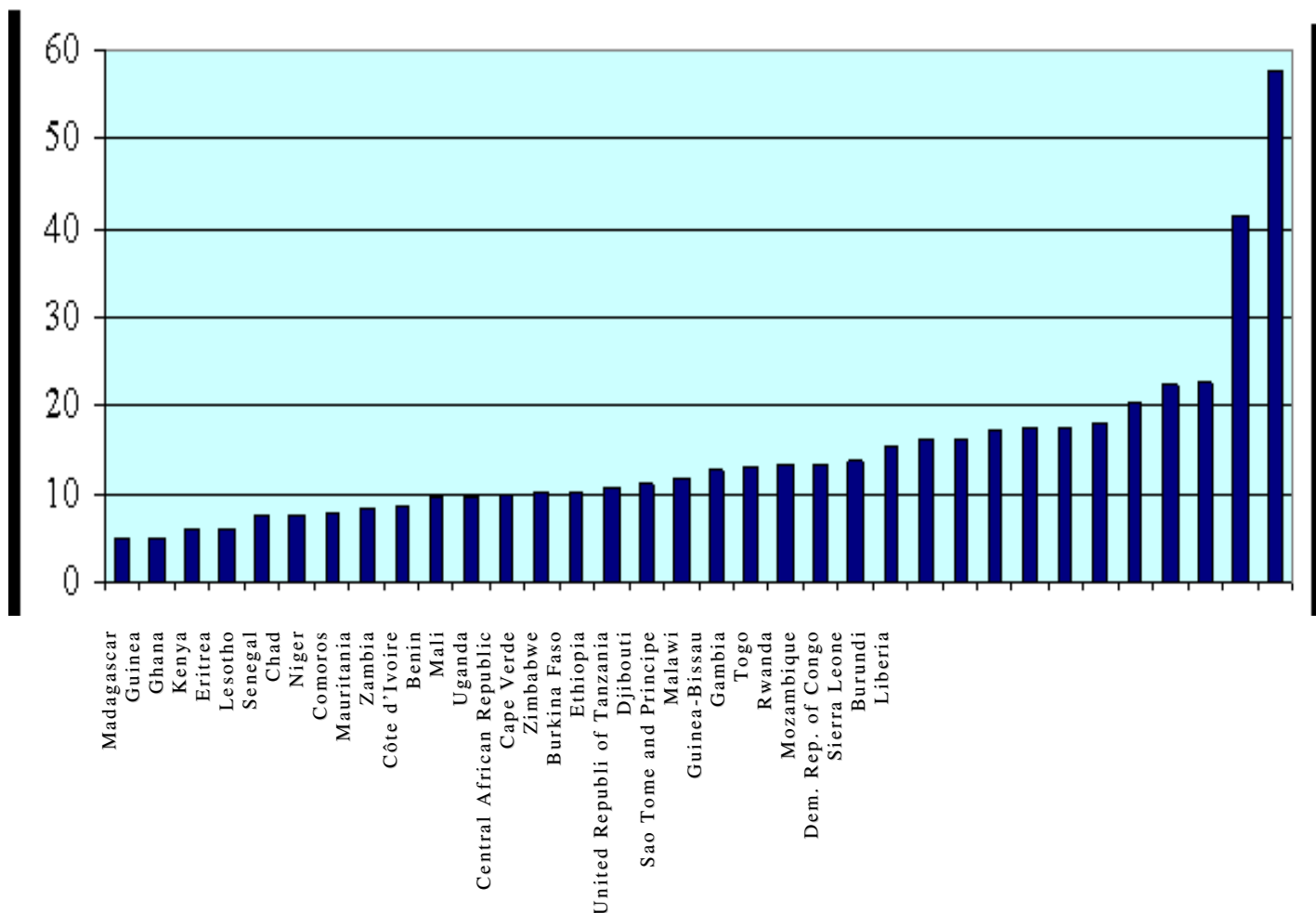
⁴ Ireland has already seen its total aid budget cut by over 22 per cent.

⁵ OECD-DAC online database.

⁶ According to the studies, the following are fragile States: Angola, Burundi, Cameroon, Central African Republic, Chad, Comoros, Democratic Republic of the Congo, Equatorial Guinea, Eritrea, Ethiopia, Gambia, Guinea, Guinea-

dependent are more vulnerable to experiencing severe macroeconomic shocks as a result of reductions of about 15-20 per cent in the volume of aid.⁷ For these reasons, African governments and the donor community should ensure that if ODA is downscaled, ODA priorities to aid-dependent countries and sectors such as education, health, and food security are maintained, or even strengthened.

Figure 3: African countries with ODA/GDP ratio over 5 per cent (2009)



Source: World Development Indicators online statistics.

Bissau, Kenya, Liberia, Mauritania, Niger, Nigeria, Rwanda, Sao Tome and Principe, Sierra Leone, Somalia, Togo, Uganda and Zimbabwe.

⁷ There are predictions that continued fiscal pressures could mean 230,000 newly poor individuals in Uganda and Ghana, 38,000 in Zambia, 57,000 in Kenya and 52,000 in Benin.

Table 3: Net ODA received (percentage of central government expenditure) (a)

Countries/Regions	2007	2008
Algeria	1	1
Benin	64	68
Burkina Faso	98	103
Cape Verde	54	45
Côte d'Ivoire	15	58
Egypt	3	2
Ghana	22	34
Kenya	21	28
Lesotho	17	
Liberia	44	
Madagascar	76	
Mali	82	75
Mauritius		8
Morocco	4	4
Nigeria	9	
Seychelles	5	9
Sierra Leone	92	102
South Africa	1	1
Togo	75	101
Tunisia	3	4
Uganda	75	87
Africa	19	
North Africa	7	
Africa excluding North Africa	25	
Africa excluding North Africa and South Africa	56	
Africa excluding North Africa, South Africa and Nigeria	56	

(a) Countries and years are presented according to availability of data for this indicator.

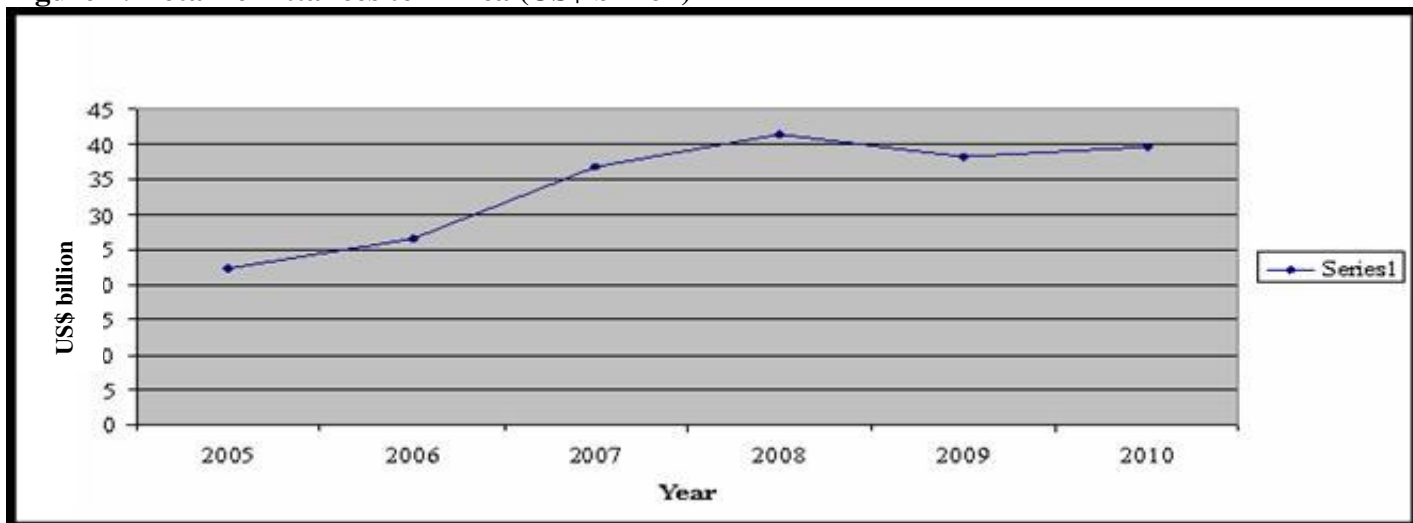
Source: African Development Indicators 2011, World Bank.

27. One positive aspect is that the likely reductions in ODA flows to Africa may spur and fast-track domestic and alternative resource mobilization. Decreasing donor dependence is also likely to reduce donor influence in African economies, making it easier for Africans to take their “destinies into their own hands”. African policymakers therefore need to increase and deepen measures to protect people already in vulnerable situations, particularly through implementing and enhancing social protection programmes.

(d) Impact on remittances

28. Transfers of money from abroad represent a significant share of many household incomes in developing countries. If more people become unemployed and face lower incomes as a result of the economic downturn, remittances are likely to decrease. Yet while remittances to Africa did fall slightly in the aftermath of the global economic crisis, from \$ 41.1 billion in 2008 to \$ 38.3 billion in 2009, they increased again to \$ 39.7 billion in 2010 (see figure 4).

Figure 4: Total remittances to Africa (US\$ billion)



Source: UNCTADStat 2011

29. Remittances from the West do not dominate the flows, however, and actually remittances from other developing countries account for a higher proportion of the total. Of course, the European Union's economic troubles are expected to have net negative effects on employment and income all over the world, meaning that remittance levels from other regions may also decrease.

30. World Bank projections indicate that remittances to Africa could increase over the next few years. However, this projection is subject to the downside risks emanating from the euro area crisis. Thus, if the crisis in Europe ends up creating persistent unemployment, it may affect the employment prospects of existing migrants and contribute to the hardening of political attitudes toward new immigration. This would lead to a dampening of remittance flows.

(e) Impact on other capital flows

31. Other capital flows such as portfolio investments and government bond purchases may be similarly affected by the euro area crisis. Indeed, liquidity might end up being channelled back to these debt-ridden countries (recapitalization). In other words, there might be an outflow of the capital investments made in African economies, with a particular impact on Egypt, Nigeria and South Africa. It is important to pay attention to these potential outflows as they might lead to liquidity constraints, especially in certain sectors relying on extractive resources.

32. However, in a reverse scenario, it is possible that investors seeking greener pastures for their capital away from debt-ridden countries could find some African economies and sectors relatively more attractive. If these additional capital inflows are in the form of short-term "hot money", the risks and consequences could be similar to those seen in the United States in 2008, when the global financial crisis was sparked.

33. If risk-averse investors take out their capital, economies could face liquidity constraints, which would have severe consequences for economic activity on the ground. Liquidity shortages

could dampen investments considerably and force firms to cancel payments, which could have serious economic consequences throughout the economy, leading to bankruptcies with associated higher unemployment and poverty. It is therefore important for African economies to consider appropriate regulatory schemes, including moderate and temporary capital controls, in order to minimize the potential negative consequences of hot money inflows.

3.2 Expected Consequences

34. Depending on the magnitude and the form of the transmission mechanisms discussed above, African economies and peoples may face various negative social and economic effects.

(a) Reduced economic growth

35. Based on OECD projections of the impact of the euro area crisis on Africa, ECA has estimated that Africa's GDP growth rate is likely to reduce by 0.7 and 1.2 percentage points in 2012 and 2013 respectively, under the OECD downside scenario. Under a scenario involving an optimal political outcome in Europe, Africa's growth rate will increase by 0.3 and 0.6 percentage points, respectively. Indeed, economic performance will clearly be affected under any of the OECD projected scenarios, owing to reduced export demand and lower commodity prices.

36. As economic growth is impacted, so too is the ability of African governments to mitigate social and economic effects via fiscal policy. Decreased tax revenue will put pressure on governments just when increased spending will be needed to combat the effects of higher unemployment and food prices. The social implications of decreased economic activity and increased unemployment must also be taken into account, as these have the potential to affect Africa in the wake of continuing turmoil in the euro area.

(b) Reduced spending on social sectors and slower progress on MDGs

37. External assistance accounts for a large proportion of the funding of social sectors in African countries. Many countries are already experiencing difficulties in providing social goods and services, resulting in heavy reliance on aid for budgetary planning. For that reason, declines in aid flows as a result of budgetary restrictions in donor countries affected by the crisis are likely to lead to cuts in the funding of social programmes, since health, education and other social programmes targeting the most vulnerable are the most liable to suffer budget cuts.

38. Depending on the changes in ODA flows over coming years, the living conditions for people in poverty may worsen. Over the short term, this will be especially true in the event of any sudden cuts in ODA resources to social sectors, such as health and education. To date, there is no sign of a negative change of ODA flows to social sectors in the aftermath of the global financial crisis and, in fact, donors are increasingly prioritizing such sectors. However, if the euro area perceives the current crisis to be more serious than previous downturns, ODA flows may come to a rather abrupt halt.

39. Reduced inflows into Africa are likely to increase poverty levels by reducing the resources directed to the agricultural sector in Africa. A look at World Bank statistics⁸ reveals that in Africa, the agricultural sector employs nearly two thirds of the population and contributes on average one third of GDP. In addition, the World Bank estimates that economic growth in the agricultural sector is twice as effective in reducing poverty as economic growth in other sectors (2008 World Development Report: Agriculture for Development. Policy Brief).

(c) Increased unemployment, vulnerability and poverty

40. Although not likely in the short run, any reduction in trade and inflows owing to the economic downturn in Europe is likely to translate into higher unemployment, vulnerability and poverty in Africa. Employment and income reductions originating in the export sector are likely to spread to other sectors. A fall in income in one sector will, via economic interdependence and negative multiplier effects, lead to a reduction in demand in other sectors, especially basic consumer goods sectors. As they experience these multiplier effects, States must also be aware of the challenges of structural changes, such as labour force growth, as well as increased demand in export sectors such as petroleum, gold and other minerals, set against reduced demand in other sectors such as tourism, horticulture and diamonds.

41. ILO estimates show that the unemployment rate in Africa declined between 2000 and 2011, although in North Africa it rose significantly between 2010 and 2011. ILO projections for 2012 indicate that the rate is likely to further increase slightly in North Africa to 11.0 per cent – probably reflecting both the impact of dampened recovery as a result of the social and political instability and that of the European debt crisis on migrant workers. For the rest of Africa, unemployment is expected to stay virtually unchanged at around 8.2 per cent. Deliberate pre-emptive measures to tackle unemployment and poverty levels – especially among the youth and women – will help to put the continent on a more sustainable and inclusive growth path.

42. In light of a drop in agricultural output owing to reduced resources and climate change, African economies may experience a repetition of the food price crisis of 2008. Such food price increases, of course, put people already in vulnerable situations at a heightened risk of undernutrition. According to FAO projections, global food prices were expected to further increase by 30 per cent by the end of 2011, posing severe challenges for people in poverty.

43. If European FDI stocks and inflows have a net negative effect in African economies, those economies are likely to experience higher unemployment and poverty levels, in the absence of counterbalancing effects with corrective policies implemented and additional FDI inflows from the rest of the world. In addition to these effects, if African economies and households experience a net deterioration of remittance inflows, they will be exposed to higher vulnerability and poverty, owing to reduced income levels and reduced access to social services.

⁸ World Development Indicators 2010, online statistics.

IV. LESSONS LEARNED AND POLICY IMPLICATIONS

(a) Lessons learned

- *Country-level lessons*

44. There are several lessons to learn from the occurrence of recent financial crises, particularly the sovereign debt crisis in Europe. One critical lesson is that the current international financial architecture cannot be left unchanged. However, there is a need to adopt prudent macroeconomic policies at the national level, as well as a conducive political environment to support the new financial architecture. Central bankers, financial regulators and credit agencies should play a key role in establishing the new architecture, supported by governments passing the relevant legislation. African countries should continue implementing the macroeconomic and fiscal reforms that saw the continent achieving high growth rates prior to the financial and economic crisis. That sustained growth is part of the reason for the resilience shown by most African countries in the face of the crisis.

45. Country risk monitoring and analysis should be strengthened in an effort to identify problems earlier and to adjust exposure in a prompt and more systematic way. Specifically, financial sector supervision/regulation should now focus more strongly on macroprudential supervision, including the need to systematically link overall financial sector balance sheets to fiscal and external sector accounts. This type of monitoring should also be done regionally to complement what is being done on an individual country basis.

46. African central banks' supervisory and regulatory functions should be strengthened and there should be minimal government intervention in the decisions taken by the regulatory agencies. This will assist in the enforcement of the rules and regulations of prudent financial management among financial institutions and will also ensure consistency of monetary aggregates with a sustainable balance of payments. It should be accompanied by the strengthening of financial institutions and enforcement of strict transparency standards in financial transactions.

47. Another lesson to be drawn from the crisis relates to the need for monitoring of countries with a high proportion of short-term debt as well as private capital flows in their external liabilities, since that might pose problems even if their overall indebtedness is modest. Countries should be required to provide data on their economy's overall level of external indebtedness, with an emphasis on the private component of debt, and give a breakdown of the debt by maturity, debtor and creditor. If short-term debt is owed by banks, then the banking system's soundness and the quality and liquidity of its external assets must be taken into account in assessing the country's external creditworthiness. The current second wave of the global financial and economic crisis in the form of the sovereign debt default looming in Greece makes this lesson all the more important.

- *Regional lessons*

48. The global financial crisis had a major impact on many African countries as a result, inter alia, of reduced commodity exports, the shrinking of domestic tax bases owing to a contraction of

domestic output, and reduced remittances, leading to a deterioration of balance of payments positions. Greater intra-African trade and regional integration are therefore required.

49. This builds a strong case for the establishment of an African Monetary Fund (AMF) to play an oversight role and to curb financial instability where it is detected. Some would argue that IMF exists to perform such a role. However, AMF would have the mandate to penalize defaulting members subject to the rules governing the African Union, whereas IMF would be inhibited in its response. In addition to AMF, the African Investment Bank (AIB) would play a critical role in mobilizing savings for investment within the continent at times of global crisis such as the present.

50. Africa is underrepresented in the G-20, which has been identified as the “premier forum” for international economic and financial cooperation. There is an urgent need for the continent to be better represented in the expanded G-20 given the extent of the impact of the recent crisis on African economies, which had nothing to do with its origins. This will ensure that Africa has a say in how the international financial system is crafted to maximize benefits.

51. Ultimately, Africa is responsible for development across the continent, and the current global and European debt crises highlight the importance of turning development financing into a process driven at the regional and national levels within the continent. Africa should therefore strengthen its efforts to enhance domestic resource mobilization to finance its development agenda, which will facilitate greater ownership and accountability in the development process.

52. The current European economic crisis can also be seen as an opportunity for the African Union to learn from the structural weaknesses of the European Economic and Monetary Union. The African Union has a vision of establishing its own monetary union and creating its own currency. The European Union is a pioneer in this respect as a continent that has managed to achieve monetary integration. Yet, despite those accomplishments, the European Union member States are suffering from a debt crisis that was brought about by various discrepancies in the structure of the monetary union established. One of them is the lack of a fiscal policy framework consistent with a monetary union. The current European crisis has proved that it is necessary to establish a single fiscal policy in order to use government spending and taxation to regulate the region’s economy. In the absence of such a measure, governments have been able to run deficits that debilitate their own economies as well as that of the European Union as a whole. African countries will therefore need to establish a single fiscal policy as well as a single monetary policy in order to avoid such consequences. As a continent that encompasses countries with diverse political, economic and social backgrounds, establishing such a policy requires greater political will and policy coordination among individual countries. Just like most European member States, the leaders of African countries will want to maintain their sovereignty.

(b) Policy implications

53. Given the immediate impact and ensuing consequences of the European debt crisis for Africa, it is vital that countries adopt a set of strong policy responses.

54. *Fiscal and monetary policy* – African countries that have fiscal space may choose to embark on discretionary fiscal easing to sustain aggregate demand, depending on the availability of

domestic and external financing. However, such policies should be embarked on carefully so as not to crowd out the private sector and to avoid a negative impact on Africa's progress towards debt sustainability. Monetary authorities should continue to foster a climate of high growth, whilst intervening when inflationary pressures prove excessive.

55. *Financial resource mobilization* – Given the potential fall in financial flows to Africa, measures must be taken to broaden the tax base as well as increase the efficiency of tax collection. Mechanisms must be found to ensure that the private and informal sectors are taxed appropriately. Issuing bonds should also be part of the fiscal framework. Africa can, for instance, mobilize financial resources by targeting its diaspora with tailored financial instruments.

56. *Transfers to mitigate social impact* – It is people in poverty who are most likely to suffer from the consequences of decreased economic activity and the reduction in the financial resources available to the African private and public sectors. Governments must therefore use whatever fiscal tools are available to facilitate transfers to those most affected, for example, by increasing support to the unemployed and temporarily providing subsidies to bring down the cost of food. Revenues from the extractive sectors can be utilized in this regard.

References

AfDB (2010). *The European Debt Crisis: Risks for Africa? Market Brief*, vol. 1, Issue 2, 14 July.

AfDB and others (2011). *African Economic Outlook 2011*. Paris: OECD Publishing.

Al Jazeera (2011). EU leaders strike deal on eurozone debts. Available from <http://www.aljazeera.com/video/europe/2011/10/2011102721452285198.html>

Allen, Franklin and Giorgia Giovannetti (2011). The effects of the financial crisis on Sub-Saharan Africa. *Review of Development Finance*, vol. 1, Issue 1.

Atta-Mensah, Joe (2011). Would recent turmoil of global market impact on Africa? UNECA draft paper.

BBC News (2011a). Eurozone emergency deal: Key elements. Available from <http://www.bbc.co.uk/news/world-europe-15472679>.

BBC News (2011b). Leaders agree eurozone debt deal after late-night talks. Available from <http://www.bbc.co.uk/news/world-europe-15472547>.

Burki, Shahid Javed (2000). *Changing Perceptions and Altered Reality: Emerging Economies in the 1990s*. Washington D.C.: World Bank.

ECA (2010). Reform of the International Financial Architecture and the Policy Implications for Africa. Background paper. Addis Ababa.

ECA (2011). *Assessing Progress in Africa toward the Millennium Development Goals*. Addis Ababa.

ECA and AUC (2011). *Economic Report on Africa: Governing development in Africa – the role of the State in economic transformation*. Addis Ababa: ECA.

European Commission (2011). Eurostat. Available from <http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home/>.

FAO (2011). FAOSTAT. Available from <http://faostat.fao.org/default.aspx>.

Federal Reserve Bank of Dallas (2010). Africa – Missing Globalization's Rewards? *Globalization and Monetary Policy Institute 2010 Annual Report*. Available from <http://dallasfed.org/institute/annual/2010/annual10d.pdf>.

Friedman, George (2011). *Global Economic Downturn: A Crisis of Political Economy*. Available from <http://finance.townhall.com>.

Kamara, Abdul B. and Gil Seong Kang (2010). How Africa could suffer from the EU's economic slowdown. *Trade Negotiations Insights*, vol. 9, No. 8 (October). Geneva: International Centre for Trade and Sustainable Development. Available from <http://ictsd.org/i/news/tni/87751>.

ILO (2011). *Global Employment Trends 2011: The challenge of a jobs recovery*. Geneva: International Labour Office.

IMF (2011). Central African Economic and Monetary Community: Staff Report on Common Policies of Member Countries. Country Report No. 11/329. Washington, D.C.: International Monetary Fund. Available from <http://www.imf.org/external/pubs/cat/longres.aspx?sk=25373.0>.

Kawai, Masahiro (2009). Reform of the International Financial Architecture: An Asian Perspective. Working Paper, No. 167. Tokyo: Asian Development Bank Institute. Available from <http://www.adbi.org/working-paper/2009/11/24/3370.reform.international.financial.architecture/>.

OECD (2005). Paris Declaration on Aid Effectiveness. Adopted by the High Level Forum on Joint Progress toward Enhanced Aid Effectiveness. Paris, 2 March. Available from www.oecd.org.

OECD (2008). Accra Agenda for Action. Adopted by the Third High Level Forum on Aid Effectiveness. Accra, 4 September. Available from www.oecd.org.

OECD (2011a). *Development Aid at a Glance, Statistics by Region, Africa*. Available from www.oecd.org/dataoecd/40/27/42139250.pdf.

OECD (2011b). *OECD Economic Outlook*, preliminary version, November. Paris.

Reuters (2010). Timeline: Greece's debt crisis. Available from <http://www.reuters.com/article/2010/05/02/us-greece-economy-timeline-idUSTRE6412E820100502>.

Stiglitz, Joseph (2011). The global economic situation and sovereign debt crisis. Presentation to the Second Committee and the Economic and Social Council, United Nations. New York, 24 October.

UNCTAD (2009). *The Global Economic Crisis: Systemic Failures and Multilateral Remedies*. New York and Geneva: United Nations.

UNCTAD (2011). UNCTADStat. Available from <http://unctadstat.unctad.org>.

World Bank (2008). World Development Report: Agriculture for Development. Policy Brief.

World Bank (2011). World dataBank, World Development Indicators (WDI) and Global Development Finance (GDF). Available from <http://databank.worldbank.org/ddp/home.do>.

World Bank (2011). African Development Indicators Database. Available from <http://data.worldbank.org/data-catalog/africa-development-indicators>.