



EUROPEAN REPORT ON DEVELOPMENT

MOVING AWAY FROM FRAGILITY

Accra (Ghana), 21-23 May 2009

CONFERENCE: " FINANCIAL MARKETS, ADVERSE SHOCKS AND POLICY RESPONSES IN FRAGILE COUNTRIES "

This conference was the fifth in a series of seven events organised by the European University Institute (EUI) and the European Commission to prepare the European Report on Development 2009 (ERD 2009). Around 80 researchers and experts, mostly from Africa and Europe, attended the event.

AFRICA BADLY HIT

Introducing the conference, Giorgia Giovannetti from the EUI explained that, contrary to initial expectations based on the presumed independence of African financial markets, Africa has not been spared by the current global economic and financial crisis. Recent economic forecasts from the IMF expect a drop in economic growth for the Sub-Saharan region from an averaged 6% since 2000 to a mere 1.5% in 2009. As observed by Joe Masawe of the Bank of Tanzania: "In Africa, although we were spared the first-round effects [of the financial crisis], we are suffering in the second round..." and the "shock to the financial system is likely to come from the real sector".

This has serious socio-economic implications. According to figures from the African Development Bank, 27 million extra people could fall into extreme poverty, while the International Labour Organisation expects a rise in unemployment by 8.5% (3 million new unemployed). This could severely jeopardise progress towards the Millennium Development Goals (MDGs).

However, there was a general consensus among the participants on the fact that the degree of vulnerability and resilience to external shocks strongly varies among African countries. The effects, as well as the transmission channels, are highly heterogeneous, hence the need for sound impact assessments and analysis at country level.

WHAT ARE THE TRANSMISSION CHANNELS?

Most African financial markets are small and characterised by a relatively low level of integration into the global financial system, although the situation varies among countries and some with more developed and integrated financial sectors (such as Nigeria and South Africa) have suffered from direct "contagion effects".

Analysing the significant gap between Africa and other developing regions regarding financial sector development, Franklin Allen of the University of Pennsylvania emphasised the low level of population density as well as the rich endowment in natural resources as key factors behind the phenomenon. Looking at the specific case of Burundi, Janvier Nkurunziza of the UN's Conference on Trade and Development (UNCTAD) explained that the financial sector there is not development-oriented essentially because of the excessive influence of the state ('predatory state'), the high risks associated with macro-economic and political instability, as well as the lack of long-term financing. During the debate, the key role of non-banking and non-formal financial institutions, including microcredit facilities, to reduce financial exclusion and boost local economic activities in Africa was highlighted by many participants.



MOBILISING EUROPEAN RESEARCH
FOR DEVELOPMENT POLICIES

It is mainly indirectly, through its impact on the real economy, that the current crisis is affecting African countries. These indirect transmission channels include declining commodity prices and exports, a drop in remittances, lower levels of foreign direct investments, as well as potential reductions in future aid flows. Analysing the specific case of trade, Philippe Martin from Sciences-Po, the Paris school of political science, highlighted the strong dependence of African exporters on short-term external trade finance as a potential vulnerability factor. On ODA, Simone Bertoli (EUI) and Marco Sanfilippo (University of Florence) predicted a substantial reduction in aid budgets of OECD DAC countries in 2009, while Chinese economic co-operation to Africa is, in contrast, likely to increase. This could have important implications from a fragility perspective, since many of China's major African partners are countries which perform badly in terms of political freedom and governance.

Are African countries in situations of fragility particularly exposed to the current turmoil? Giorgia Giovannetti explained that, although the size of the shocks might be limited, the ensuing effects could be substantial because of their limited resilience to external shocks. Besides, fragile countries could also be subject to negative spillover effects from emerging African economies, including a potential decrease in intra-regional migration flows. Moreover, the drying up of foreign resources could even push some previously stable countries towards fragility, the assembled experts agreed. In that respect, Antonio Ciccone from the Pompeu Fabra University showed a positive correlation between, on the one hand, commodity price downturns and growth slowdown in rich countries and, on the other hand, the outbreak of violent conflicts in Africa.

In addition to its macroeconomic effects, the current crisis also has negative implications at the micro level. To establish what it means concretely for the poor, Abena Oduro of the University of Ghana explored what effects and risks shocks may imply for African households, as well as the coping strategies they employ to deal with them, including the role of formal and informal financial institutions. In that regard, she emphasised the need for well targeted public social protection programmes for very poor households, as they do not have access to formal credit institutions and informal insurance mechanisms have limitations

POLICY RESPONSES

Since foreign sources are expected to dry up, the point was made that the crisis could be an opportunity for African countries to mobilise more their domestic resources and reduce their dependence on external income streams. As stressed by Ernest Aryeetey of the University of Ghana, this would require strong institutional and structural reforms, in view notably of strengthening financial institutions, including microfinance, as well as expanding the tax base. The potentially positive interaction between domestic resource mobilisation and state building efforts (through enhanced accountability) was also mentioned.

Looking at possible domestic fiscal policy responses, Sanjeev Gupta from the IMF stressed that not all African countries have scope for fiscal expansion, including through fiscal stimulus, hence the importance of additional donor support. He added that priority should be given to expanding social safety nets and other expenditures (such as infrastructure), as tax reductions tend generally to benefit the rich and are difficult to reverse.

Representing the European Commission, Nicolas Gérard outlined the main features of the recently adopted EU response to help developing countries cope with the current crisis, as well as the vulnerability assessment exercise currently being carried out by the Commission in close consultation with the Bretton Woods Institutions.

Several policy options were proposed to tackle a potential decrease in ODA flows, such as a reallocation of available funds to the countries most in need, a better division of labour between traditional and emerging donors, as well as the need to improve aid predictability and to look for innovative sources of financing. Ramon Marimon (EUI) proposed the basic features of an innovative approach to aid provision, which could improve the current record of aid effectiveness. During the debate, many African participants also stressed the importance of investing in agriculture as a key provider of jobs and revenues, as well as the need for a more inclusive global governance architecture.

“NEW FACES FOR AFRICAN DEVELOPMENT”

In a bid to support young African academics and highlight their research work, 15 young researchers from across Africa – out of an original pool of 158 submissions from 38 countries – were invited to present their research on fragility-related issues at the conference, as part of the ‘New Faces for African Development’ initiative launched by the EUI in the context of the ERD process.

The researchers provided valuable snapshots from the field. The issues they covered included the use of traditional African governance mechanisms to decentralise power, Zimbabwe's descent into fragility, food insecurity in Nigeria, as well as the link between aid and growth.

A podcast featuring some of these ‘New Faces’ will soon be available on the ERD website.

For further information on the ERD 2009,
please go to the ERD website:
<http://erd.eui.eu>

or contact the ERD Research Team at:
ERD.secretariat@eui.eu



**MOBILISING EUROPEAN RESEARCH
FOR DEVELOPMENT POLICIES**