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FRAGILE COUNTRIES AND
THE 2008-2009 CRISIS

Franklin Allen and Giorgia Giovannetti

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Abstract

This paper analyses the channels through which the economic and financial crisis of 2008-2009 is transmitted to fragile countries in Sub-Saharan Africa. Trade stands out as the main direct channel, even though intra-Africa remittances play a relevant role, given that most migrants in Sub-Saharan Africa fragile countries cannot afford the cost of migrating to Europe or to the United States and stay close, remaining in the continent. Whether reduced aid flows also act as a crisis transmission channel remains an open question, even though preliminary estimates suggest that, at least in the medium run, OECD countries are likely to lower aid, with potentially very damaging effects on fragile countries. The paper also shows that fragile countries are characterised by very low resilience and capacity to cope with shocks. It concludes, by highlighting how Sub-Saharan Africa fragile countries' policymakers' room for manoeuvre is limited in periods of crisis because of low fiscal space and limited institutional capacity. It advocates that the right response to the crisis would be to mobilise domestic resources, although this will require functional institutions able to offset the potential trade-offs between adverse short-term shocks and a long-term perspective.

Keywords

Financial crisis, Sub Saharan Africa, real transmission channels. JEL Classification F0 O1

1. Introduction^{*1}

When the current crisis broke out in the summer of 2007, there was a widespread perception that Sub-Saharan Africa was going to be affected only to a limited extent, with fragile countries making no exception in this respect.² The limited depth and low integration of their financial systems with the US and European capital markets appeared to be sheltering them – so the reasoning went - from a direct transmission of the crisis. According to the African Development Bank, “few banks and investment firms in Africa had derivatives backed by sub-prime mortgages. No difficulties have been reported on African sovereign wealth funds” (AfDB, 2009; web site). *The Economist* went even further suggesting that investors looking for alternative sources of returns should “buy Africa”.³ But, as the events continued to unfold, this perception proved to be wrong; even though the wealth effects of the crisis are, indeed, less pronounced than in other developing countries, Sub-Saharan Africa, and especially fragile countries, proved to be vulnerable to trade linkages, and to the disruption of the trade finance accompanying the financial crisis.⁴ Furthermore, contrary to the standard views of remittances being counter-cyclical, and according to preliminary evidence, remittance flows contracted, unemployed migrants started going back to their countries of origin, foreign direct investment fell,⁵ and private sector financing was restricted. Moreover, as the funds devoted to official development assistance tend to follow donor countries’ economic cycle,⁶ a bad scenario could materialise with a fall in aid from OECD countries. Even if donor countries were to live up to their earlier commitments, keeping the share of aid over GDP constant could still lead to a reduction in actual flows, because of the recession and because of unfavourable exchange rate movements.⁷

In what follows, after a brief overview of the crisis, we explore the channels through which the current financial crisis is transmitted to SSA, emphasising the impact on fragile countries, and with an eye on the possible policy prescriptions. The crisis has, indeed, underscored Africa’s vulnerability to external shocks and its low resilience. Countries in situations of fragility, despite their limited integration into the world economy, have also proved vulnerable to the current crisis. More importantly, they are the least able to cope with it, given a low fiscal capacity and lack of formal (and often informal) safety-nets. This entails that - unless they prove able to guarantee jobs, food security, life-saving programmes (AIDS/health) - fragile countries could be pushed back to much lower levels of development, rolling back their recent progress. Furthermore, a possible interruption in the investments for capacity for growth (both in terms of infrastructures and human capital/education) may produce even worse effects in the long run. As African countries have a limited formal and informal financial system (Allen *et al.*, 2008), and, thus, a limited ability to borrow and smooth shocks (Naudé, 2009; Oduro, 2009), the real effects of the crisis (on firms and individuals) can be not only disruptive but also very persistent. EU policy should aim at helping to smooth the effects in the short-

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¹ We thank François Bourguignon for comments on a previous version of this paper. Special thanks go to Simone Bertoli, Stefania Innocenti, Marco Sanfilippo and Elisa Ticci for discussions and joint work on some of the issues dealt with. We also thank for useful comments the participants to the ERD 2009 Conference in Accra (21-23 May) and Florence (22-23 June) where part of this paper were presented. None of the above is responsible for mistakes or imperfections.

² See, for instance, IDS, 2008 on Ethiopia

³ *The Economist*, 19 February 2008.

⁴ See Bergman and Martin, 2009.

⁵ See Unctad, 2009.

⁶ See Bertoli *et al.*, 2007.

⁷ For instance, the UK pound has been devaluating versus the dollar and the euro in the last year, so that, despite an increase in the pound amount, aid to some countries such as Sierra Leone, which receives substantial UK funding, fell.

run in order to avoid the longer-term impact. Furthermore, it should help fragile countries to lengthen their time horizon. Only if they respond to the crisis while solving long-term structural weaknesses, can fragile countries move “out of fragility”.

2. An Overview of a Crisis that Originated Elsewhere

Financial crises have been pervasive for many years. Bordo *et al.*, (2001) find that their frequency in recent decades has been double that of the Bretton Woods Period (1945-1971) and the Gold Standard Era (1880-1993), comparable only to the period during the Great Depression. Nevertheless, the financial crisis that started in the summer of 2007 came as a great surprise to most people. What initially was seen as difficulties in the U.S. sub-prime mortgage market, rapidly spilled over, first to financial markets, and then to the real economy. The crisis has changed the financial landscape worldwide and its full costs are yet to be evaluated.

Despite its severity, the current crisis is similar to past crises in many dimensions. Reinhart and Rogoff (2009) document the effects of banking crises using an extensive data-set of high and middle-to-low income countries. They find that systemic banking crises are typically preceded by credit booms and asset price-bubbles, and result in substantial drops in housing prices (on average 35% spread over a period of 6 years), equity prices (55% over 3 ½ years), output (9% over two years) and an increase of unemployment (7% over a period of 4 years) and central government debt (86% compared to its pre-crisis level). While Reinhart and Rogoff stress that the major episodes are sufficiently far apart that policy-makers and investors typically believe that “this time is different”, they warn that the global nature of this crisis will make it far more difficult for many countries to grow their way out.

The seeds of the crisis can be traced to the low interest-rate policies adopted by the Federal Reserve and other central banks after the collapse of the technology stock bubble. In addition, the appetite of Asian central banks for (debt) securities contributed to lax credit. These factors helped fuel a dramatic increase in house prices in the U.S. and several other countries such as Spain, Ireland and the U.K. In 2006, this bubble reached its peak in the U.S. and house prices there and elsewhere started to fall.⁸

Although the financial system, and, in particular, banks, came under tremendous pressure during this period, the real economy was not much affected. All this changed in September 2008 when the demise of Lehman Brothers forced markets to re-assess risk. While the bankruptcy of Lehman Brothers induced substantial losses to several counter-parties, its more disruptive consequence was the signal it sent to the international markets. Re-assessing risks previously overlooked, investors withdrew from the markets and liquidity dried up.

In the months that followed and in the first quarter of 2009, economic activity in the U.S. and many other countries declined significantly. Unemployment rose dramatically as a result. The general consensus is that the crisis is the worst since the Great Depression.

What caused the crisis? From August 2007 until September 2008, there was fairly wide agreement that poor incentives in the U.S. mortgage industry had caused the problem. According to this explanation what had happened was that the way the mortgage industry worked had changed significantly over the years. Traditionally, banks would raise funds, screen borrowers, and then lend out the money to those who had been approved. If the borrowers defaulted, the banks would bear the losses. This system provided good incentives for banks to assess the creditworthiness of borrowers carefully. Under the new system, brokers and banks screened borrowers. The mortgages were then securitised and sold off. The people originating the mortgages and securitising them do not bear any

⁸ Mayer *et al.*, (2009) and Nadauld and Sherlund (2008) provide excellent accounts of the developments in the housing market preceding the crisis.

losses that might occur and so incentives were eroded. Another important incentive issue concerned the ratings agencies. Their incentives were eroded because the agencies began to receive a large proportion of their income from undertaking ratings of the securitised products.

As the crisis continued and then after the default of Lehman Brothers in September of 2008, the dramatic collapse in the global real economy made this view that sub-prime mortgages were to blame less and less plausible. The economies in many countries in Asia and in Europe were drastically affected, even though their banks had very little exposure to U.S. securitisations and remained strong. As this happened, it became much more difficult to believe that what caused all of this was an incentive problem in the U.S. mortgage industry.

The main problem was that there was a large and global bubble in real estate in the U.S. as well as in Spain, Ireland and the U.K. The bubble burst causing huge problems in the securitised mortgage market and in the real economy.

It can be argued that one of the main causes for the bubble were the policies of the Federal Reserve back in 2003, when interest rates were as low as one per cent. This was at a time when housing prices were still growing quite strongly at a rate above one per cent. Even if they had only been growing at the rate of inflation, which was around three per cent, the Fed suddenly created an incentive to go out and borrow at one per cent and buy houses going up at three per cent. In addition, there were various other aspects that made it advantageous to buy. These included the tax advantages of being able to deduct interest on mortgages compared to no deductibility of rent payments, plus some other policies to encourage poor people to buy houses. All these factors created a huge demand for buying houses. This led to an increase in house prices and the process then fed on itself. When house prices started to go up by five or ten per cent a year, then it became worth borrowing even after the Fed raised interest rates. However, the Fed low interest rate policy was not the only factor. In some European countries, there were also large property bubbles even though the ECB was controlling interest rates and they did not go nearly as low. The second important element was global imbalances. This problem started with the Asian Crisis of 1997. Many Asian economies, which had done very well, such as South Korea, fell into serious difficulties. In the case of South Korea, it was because its firms and banks had borrowed too much in foreign currency. They turned to the International Monetary Fund (IMF) for help to see them through these difficult times. However, in exchange for help the IMF required countries to raise interest rates and cut government spending. This is the exact opposite of what the U.S. and Europe have done when faced with a very difficult crisis. What the Asian countries deduced from the 1997 crisis was that what they had to do was to make sure that they would never again have to go to the IMF to obtain relief from a crisis. Instead, they accumulated literally trillions of dollars of assets in reserves.

For political reasons, it became difficult for the Chinese, in particular, to buy companies and what they ended up doing was to invest mainly in debt instruments. They bought a large amount of Treasuries, Fannie Mae and Freddie Mac mortgage-backed securities. This wave of debt happened not only in the U.S., but also in Europe. This huge supply of debt helped to drive down lending standards to ensure that it was all taken up. The large amount of debt resulting from global imbalances was the second major factor contributing to the bubble.

Why did the collapse of the bubble create so many problems? The whole global economy went into a downward trend. It can be argued that what went wrong was that people had made the wrong decisions for about a decade, based upon the assumption that asset prices would keep on going up. In the U.S., the aggregate saving rate fell to zero. What was the point of saving? If you owned a house, its price was going to keep on going up. If you owned stocks, their value was going to keep on going up. So people stopped saving and many borrowed to finance consumption. The leverage ratios of households, of firms, and of institutions, all went up. When there was the big fall in asset values, people found they were over-leveraged and they had saved too little. This meant that they stopped doing what they were doing before and started saving to pay off debt and build up their assets.

Another example of price volatility is commodities.⁹ For firms making investments, to know what to do is a significant problem. In addition, to the uncertainty about commodity prices, exchange rates have also been volatile. In the summer of 2008, the pound sterling was over \$2. Then, it went down to \$1.40. The Euro was at \$1.60 then. It went down to about \$1.25 before rising back to about \$1.40.

To summarise, it is very difficult for anybody trying to make decisions because they do not know where prices are going to be a month from now, let alone a year from now. This is what is chilling the global economy. Consumers and firms are unwilling to make decisions because they do not know what prices are likely to be going forward. This is why the sales of consumer durables such as cars and investment goods such as machine tools have stalled. Since these represent a large proportion of exports and imports, world trade has collapsed.

The volatility in commodity prices and the collapse in world trade are two aspects of the crisis that are likely to be particularly problematical for African countries. We turn next to consider their position at the start of the crisis and the likely effects of the crisis on them. The 2008–09 crisis ends a prolonged period of world economic growth and globalisation, in which world trade grew twice as fast as world GDP. And, more importantly, it undermines the drivers of the recent globalisation phase: open markets, globally-integrated production chains and many more footloose international companies.

The slowdown of world trade was much sharper than that of GDP,¹⁰ possibly due to the general synchronisation of cycles among countries or to the larger weight of intermediate goods in trade, in turn, due to the fragmentation of production - which, after stimulating rapid growth over the last 10 years, magnified the decline.

3. How the Crisis Hit Sub-Saharan Africa

The economic and financial crisis came on top of a period of highly-volatile commodity prices and exchange rates, which increased uncertainty and strengthened a vicious circle of falling trade flows and investments. Food and fuel price spikes through mid-2008 put food-importing and oil-importing Sub-Saharan African fragile countries under severe stress, pushing down their foreign exchange reserves and making it difficult for them to pay for imports and to sustain growth. Conversely, oil-exporting countries have benefited from increased revenues and several have been able to strengthen their foreign reserve position. However, the boom and slump contributed to output volatility, discouraging investments in long-term productive capacity.

As emphasised by the IMF (2009a), most Sub-Saharan African countries have almost consecutively suffered fuel, food and financial (3F) shocks. The average rate of growth, low in the 1980s and 1990s, the so-called “lost decades”, has increased since 2000 (see Table 1), inducing an improvement in Millennium Development Goals (MDGs) even in some fragile countries.¹¹ Most recent estimates put real Sub-Saharan Africa GDP growth for 2009 at around 1.5%, down from an estimated 5.5% in October 2008. These figures would make 2009 the first year in a decade in which most fragile Sub-Saharan African countries recorded negative growth in real GDP *per capita*, threatening the

⁹ In the summer of 2008, oil was trading at \$147 dollars a barrel, then the price went down to around \$40 in a short space of time. If you are going to buy a car, should you buy one that is going to be fuel efficient, but costs significantly more, or should you buy something less efficient but cheaper on the assumption that oil prices are going to be low in the long-run?

¹⁰ According to Eichengreen and O’Rourke, 2009, the fall in world trade was even sharper than in the Great Depression. The estimated elasticity of world trade to world GDP is around 2 per cent. This has supported globalisation and is now likely to backfire.

¹¹ See Global Monitoring Report, 2009, and Harttgen and Klasen, 2009, for an assessment of MDG progress by country.

progress towards the MDGs and undermining political stability.¹² Slower growth does not always threaten to reverse human development, but it does produce setbacks, especially through cuts in education and health expenditure, which have serious long-term consequences.

Table 1: Real GDP Growth over different time periods

Country Name	1980-89	1990-99	2000-07	2008	2009	2010
Angola	1.6	-1.8	20.3	13.2	0.2	9.3
Benin	-0.2	1.1	4.6	5	3.8	3
Botswana	7.9	3.5	4.4	2.9	-10.3	4.1
Burkina Faso	1.1	2.1	3.6	5	3.5	4.1
Burundi	1.0	-3.1	3.6	4.5	3.2	3.6
Cameroon	0.9	-2.2	3.5	2.9	1.6	2.7
Cape Verde	2.6	2.8	7.8	5.9	3.5	4
Central African Republic	-1.6	-1.3	3.7	2.2	2.4	3.1
Chad	2.5	-1.0	4.6	-0.2	1.6	4.6
Comoros	0.1	-0.6	0.5	1	1	1,5
Congo, Dem. Rep. of	-1.2	-8.2	6.3	6.2	2.7	5.4
Congo, Rep. of	3.7	-2.0	-1.6	5.6	7.4	12.2
Côte d'Ivoire/The Ivory Coast	-4.5	-0.4	1.6	2.3	3.7	4
Equatorial Guinea	-1.4	17.5	21.4	11.3	-5.4	-2.8
Eritrea	..	6.5	1.3	1	0.3	1.4
Ethiopia	-0.9	-0.5	11.5	11.6	7.5	7
Gabon	-11.0	-0.2	5.6	2.3	-1	2.6
Gambia, The	0.3	-0.6	6.3	6.1	3.6	4.3
Ghana	3.7	-1.1	1.6	7.3	4.5	5
Guinea	0.3	1.0	1.8	4.9	0	2.7
Guinea-Bissau	0.3	-1.0	2.7	3.3	1.9	2.5
Kenya	0.5	-0.8	7.0	1.7	2.5	4
Lesotho	1.3	2.3	5.1	3.5	-1	3.1
Liberia	-6.2	-3.1	9.5	7.1	4.9	6.3
Madagascar	-2.4	-1.3	6.2	7.1	-0.4	0.9
Malawi	-2.4	1.9	8.6	9.7	5.9	4.6
Mali	-1.7	0.9	4.3	5.1	4.1	4.5
Mauritania	-0.4	-0.2	1.0	..	..	..
Mauritius	4.9	4.2	4.2	6.6	2.1	2
Mozambique	-0.6	2.2	7.0	6.8	4.3	5.2
Namibia	-2.4	1.0	4.1	2.9	-0.7	1.7
Niger	-2.9	-1.6	3.3	9.5	1	5.2
Nigeria	-1.9	0.2	6.4	6	2.9	5
Rwanda	-0.5	1.2	7.9	11.2	5.3	5.2
São Tomé and Príncipe	..	..	6.0	5.8	4	4.5
Senegal	-0.6	0.0	4.7	2.5	1.5	3.4
Seychelles	1.2	3.3	7.3	-1.9	-8.7	4
Sierra Leone	-1.2	-5.2	6.4	5.5	4	4
Somalia	..	..	..	..	..	..
South Africa	-0.3	-0.8	5.1	3.1	-2.2	1.7
Sudan, The	0.5	1.8	10.2	..	..	..

¹² Sub-Saharan Africa has, on average, a negative rate of growth of real GDP *per capita* (-0.6%). Fragile Sub-Saharan African countries record a positive 0.2% rate of growth, but this figure masks a high degree of heterogeneity.

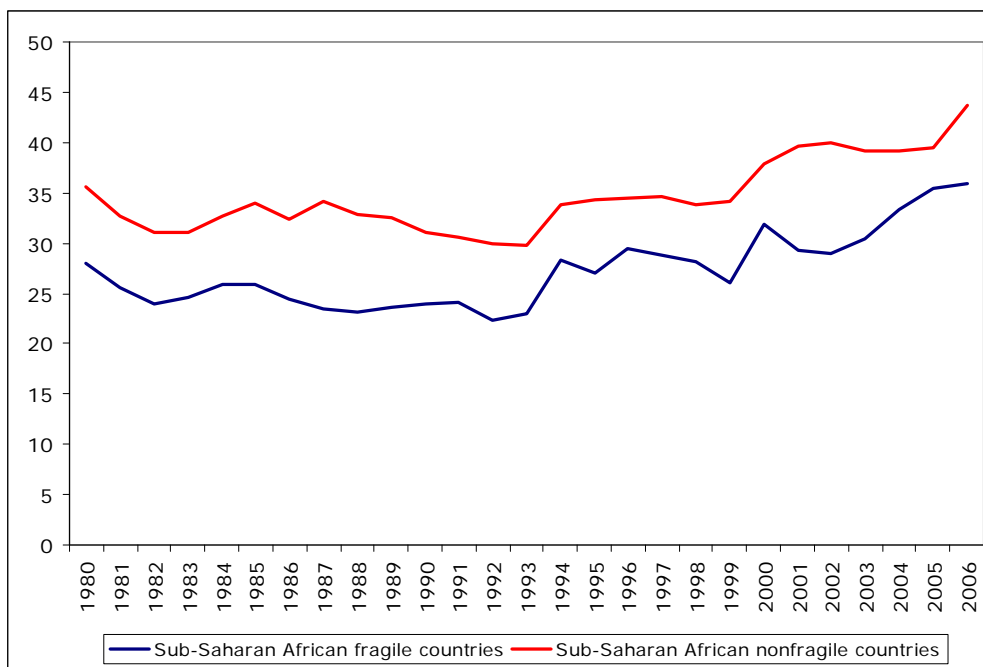
Country Name	1980-89	1990-99	2000-07	2008	2009	2010
Swaziland	4.9	0.4	3.5	2.4	0.4	2.6
Tanzania	0.6	0.2	7.1	7.4	5	5.6
Togo	-0.9	-0.5	1.9	1.1	2.4	2.6
Uganda	-0.5	3.4	8.6	9	7	6
Zambia	-1.7	-2.2	6.3	5.8	4.5	5
Zimbabwe	1.4	0.5	-6.1	-14.1	3.7	6

Note: countries belonging to the operational definition of fragile countries are in bold

Source: World Bank, Africa Development Indicators 2008/09; IMF, World Economic Outlook (April 2009); IMF, Regional Economic Outlook Sub-Saharan Africa (October 2009)

During the recent period of growth prior to the present crises, Sub-Saharan Africa had become more integrated with the rest of world, as reflected in its rising (albeit still low) share in global exports and in GDP (Figure 1).¹³ Fragile countries, on average less integrated than other Sub-Saharan African countries, followed the same trend. This increasing international integration has exposed Sub-Saharan African countries much more to disruptions in trade and to other shocks. It has also had a marked effect on tax revenues (and, in some countries, on tax policy), with reduced receipts from trade taxes. These challenges of globalisation for resource mobilisation are exacerbated by the recent crisis, which also lowers the tax base.

Figure 1: Exports rising as a share of GDP



Source: World Bank, World Development Indicators 2009.

Fragile countries in Sub-Saharan Africa are characterised by very different resource endowments, but because of the high volatility of raw material prices (see Figure 2), the negative spill-over of the crisis are felt both on oil exporters and producers of non-energy commodities (minerals and agricultural

¹³ The ratio of exports to GDP for some countries, particularly for the oil exporters in Central Africa, is probably inflated by the high prices for raw materials.

products) and the reversal in price trends implies a toll on countries which are highly dependent on natural resources.¹⁴

Table 2: List of Sub-Saharan African food importer and exporter countries

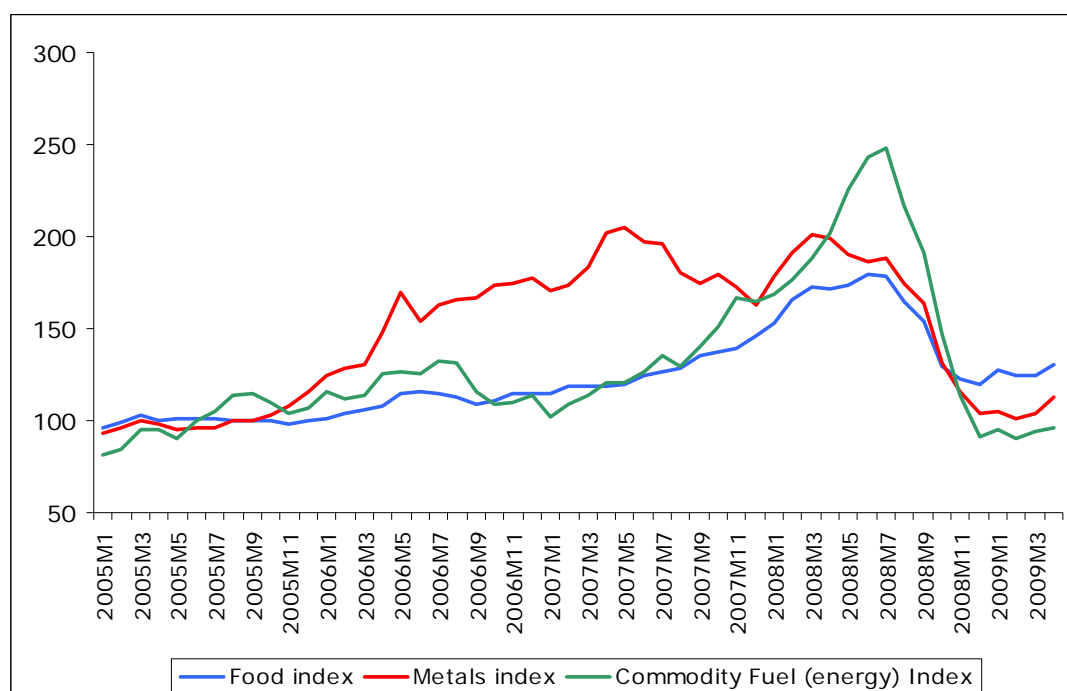
Food Importers⁽¹⁾	
Angola	Liberia
Benin	Malawi
Burundi	Mali
Cape Verde	Mauritania
Central African Rep.	Mauritius
Chad	Mozambique
Comoros	Niger
Congo, Dem. Rep. of	Nigeria
Congo, Rep. of	Rwanda
Equatorial Guinea	São Tomé and Príncipe
Eritrea	Senegal
Ethiopia	Seychelles
Gabon	Sierra Leone
Gambia, the	Tanzania
Ghana	Togo
Guinea	Uganda
Guinea-Bissau	Zimbabwe
Lesotho	
Food Exporters	
Botswana	Namibia
Burkina Faso	Somalia
Cameroon	South Africa
Côte d'Ivoire/The Ivory Coast	Sudan, The
Kenya	Swaziland
Madagascar	Zambia

Notes: countries belonging to the operational definition of fragile countries are in bold; (1) Food is defined as raw food in SITC Rev. 2, excluding all cash crops, processed food and seafood; a country is considered food importer if the difference between exports and imports is negative on the 2004/05 average.

Source: ERD elaboration on Ng and Aksoy (2008).

¹⁴ For example, exporters of copper, oil, timber and diamonds; for example, the fall in copper prices, according to the African Development Bank, resulted in a drop in Zambia's foreign exchange reserves from USD 649 million during the first half of 2008 to USD 454.5 million in the second part of the year.

Figure 2: Recent Developments in prices of Food, Metals and Fuels



Source: IMF Primary Commodity Prices

Table 3 assesses the vulnerability of different countries to different type of shocks, demand for food and raw material importers and supply for food and raw material exporters. Most fragile countries stand out as highly vulnerable to either a supply or a demand shock.

Table 3: Vulnerability to food, fuel and financial shocks in fragile countries

Country Name	Vulnerability to food shock		Vulnerability to fuel shock	
	Demand	Supply	Demand	Supply
Angola	...	...	...	High
Benin	High	High	High	Low
Botswana	Medium	Low	Low	Low
Burkina Faso	Medium	Medium	High	Low
Burundi	Low	High	Low	Low
Cameroon	Medium	Medium	High	High
Cape Verde	High	High	Medium	...
Central African Republic	Medium	Low	Medium	Low
Chad	...	...	...	...
Comoros	Medium	High	Low	...
Congo, Dem. Rep. of.	...	...	...	...
Congo, Rep. of	...	...	...	...
Côte d'Ivoire/Ivory Coast, The	Medium	High	High	High
Equatorial Guinea	...	...	...	...
Eritrea	High	High	Low	Low
Ethiopia	Medium	High	Medium	Low

Gabon	Medium	Low	Low	High
Gambia, The	High	High	Medium	Low
Ghana	Medium	High	Medium	Low
Guinea	High	Low	High	Low
Guinea-Bissau	...	...	...	...
Kenya	Medium	High	High	Low
Lesotho	High	Low	Low	Low
Liberia	...	...	...	...
Madagascar	Medium	High	Medium	Low
Malawi	Medium	High	Medium	Low
Mali	Medium	Medium	High	Low
Mauritania	High	High	High	...
Mauritius	Medium	High	Medium	Low
Mozambique	Medium	Medium	Medium	Medium
Namibia	Medium	High	Low	Low
Niger	High	High	Medium	Low
Nigeria	Medium	Low	Medium	High
Rwanda	Medium	High	Medium	Medium
São Tomé and Príncipe	High	High	High	Low
Senegal	High	High	High	Low
Seychelles	High	High	High	...
Sierra Leone	High	High	High	...
Somalia	...	...	...	...
South Africa	Low	Low	Medium	Low
Sudan	Medium	Low	Low	High
Swaziland	Medium	Medium	Medium	Low
Tanzania	Medium	High	High	Low
Togo	Medium	High	High	Low
Uganda	Medium	High	High	Low
Zambia	Low	Low	Low	Medium
Zimbabwe	Low	High	Medium	Low

Source: Institute of Foreign Studies, UK and authors' calculation on IMF, World Bank, UNCTAD

4. Channels of transmission of the financial and economic crisis: Is there a Fragile Countries Specificity?

The literature on the transmission of the crisis distinguishes between direct effects, *i.e.*, the financial channels and indirect effects (real channels). As far as Sub-Saharan Africa is concerned, we maintain that, given the low level of formal financial development, the indirect real channels prevail. These include effects through trade (both reduction in export earnings and terms of trade effect), remittances, foreign direct investment and foreign aid. We briefly detail these first, and look at the (lower) direct transmission of the crisis later.

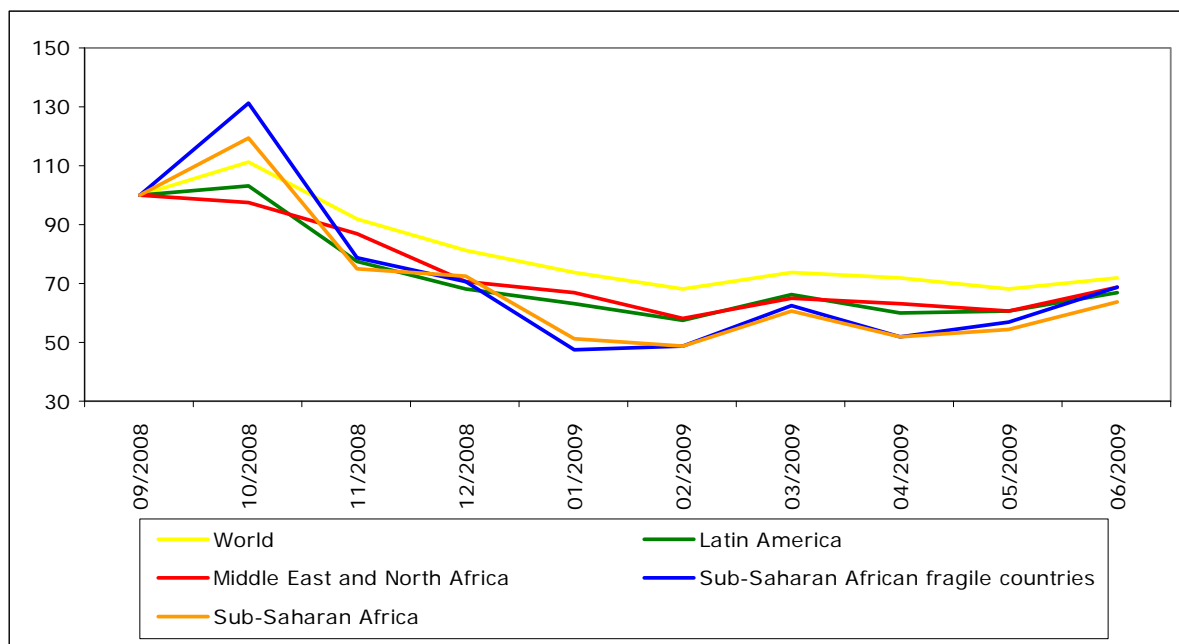
4.1 Trade

Many Sub-Saharan African countries, including fragile raw material exporters, have relied heavily on export markets to grow. The crisis has been transmitted to them mainly through declining demand for exports and declining export prices.

It takes time to assess the effects of the crisis on trade flows, but early signals are not reassuring: the demand from Europe, the United States and China for Sub-Saharan African products and even more for the products of fragile countries has fallen sharply, more than for products from other

developing areas (Figure 3a, b and c). This is partly due to the fact that their exports are mainly raw materials. But even for manufacturers who concentrate on low-technology products, this group suffers more than other developing areas.¹⁵ Moreover, many Sub-Saharan African fragile countries have suffered from increased exchange-rate volatility, which has induced high uncertainty and high costs for international trade. The countries in the CFA¹⁶ zone have an exchange rate pegged to the Euro and have experienced a real exchange rate depreciation. This, to a certain extent, makes imports from these countries cheaper, but because fragile states have little capacity to increase exports, they cannot fully exploit this opportunity.¹⁷

Fig 3a: U.S. Imports



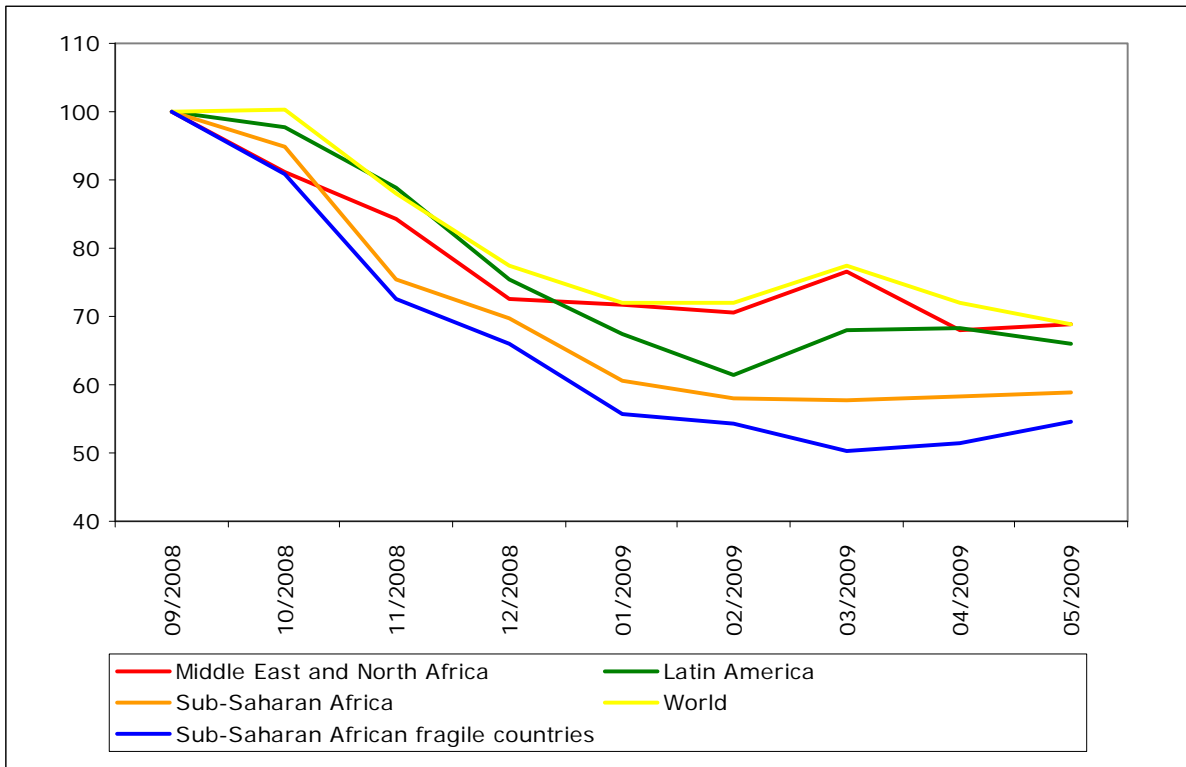
Source: Global Trade Atlas

¹⁵ See UNCTAD 2009.

¹⁶ CFA stands for Communauté Financière Africaine or African Financial Community. West African CFA countries are Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Sénégal and Togo. Central African CFA countries are Cameroon, Central African Republic, Chad, Republic of the Congo, Equatorial Guinea and Gabon.

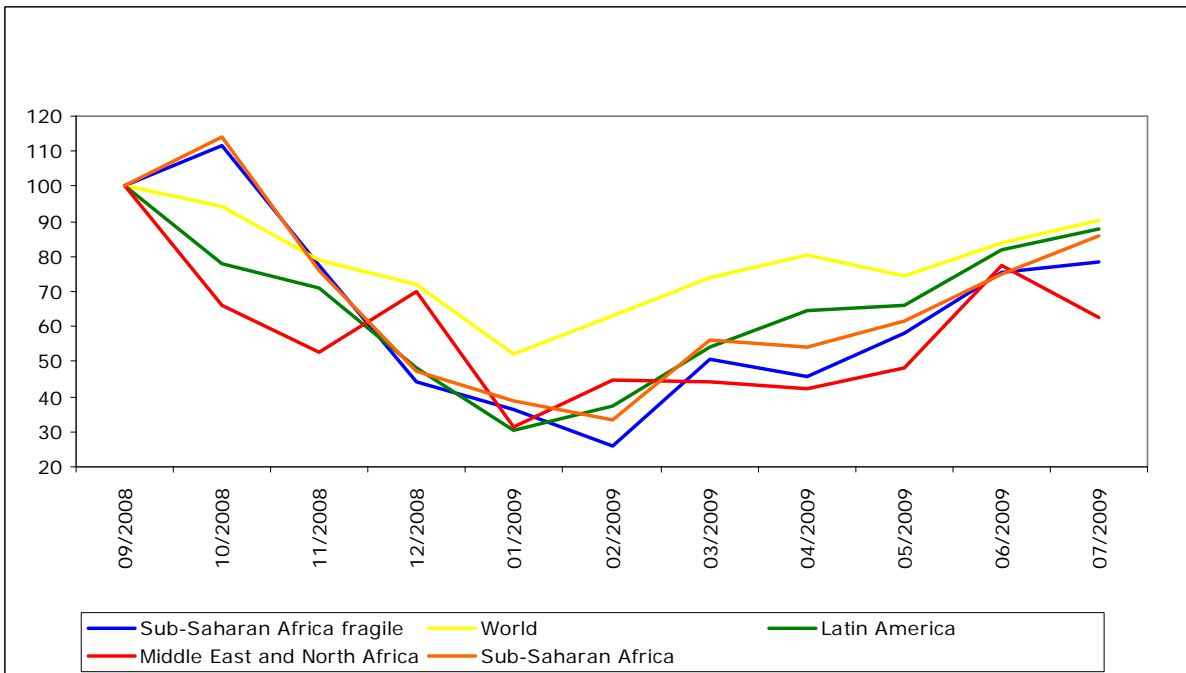
¹⁷ AfDB 2009b.

Fig 3b: EU27 imports



Source: Global Trade Atlas

Fig 3c: Chinese imports



Source: Global Trade Atlas

Trade developments affect different countries differently, depending not only on how much the country had relied upon trade in order to grow, but also on their specialisation, main export and import markets, dependence on forms of financing, degree of internationalisation of domestic firms,¹⁸ place in the global value chain, and so on.

For primarily exporting countries, the financial crisis is likely to have affected the capacity to finance world trade (see IDS, 2009, Berman and Martin, 2009, and Humphrey, 2009). International trade depends heavily on trade credit being extended; around 90 per cent of trade is traditionally financed by short-term credit. With the credit crunch starting to bite, trade finance has also been reduced, concurring with an estimated fall in world trade around 10-15 per cent (Auboin 2009), as banks have limited their risk exposure. As a consequence, there is a dual pressure on fragile countries: few earnings, no credit.

The international trade literature has recently provided evidence on the positive role of financial development on exports at a macro-economic level (see, for all, Manova, 2008 and Beck, 2008). This positive effect may partly come from the existence of fixed costs that have to be paid by firms to enter foreign markets, and which make financial constraints more stringent. This suggests a hypothesis of why African countries could be affected in a different way: exporters may finance themselves differently from exporters in other developing countries (and in developed countries). Mainly, due to the fact that the financial system is under-developed and highly risky and to the fact that firms do not have sufficient self-finance, exporting firms rely on letters of credit provided by credit institutions in destination countries. However, letters of credit require confidence – which is low in recessions – as well as availability of liquidity to provide finance and insurance for payment to the exporters (again low, given the credit crunch in developed countries). The limited availability of comprehensive and reliable data on trade financing makes it difficult to assess this impact; furthermore, the availability of, and the facility of, access credit is likely to vary substantially between sectors and countries.

Interestingly enough, Humphrey (2009),¹⁹ in a detailed study on the horticulture sector in Africa, suggests that finance, so far, has not been an issue for exporters:

“very few firms faced any problems with respect to availability of trade finance. [...] Sub Saharan countries appear to be less affected, so far, by trade finance problems than other regions [...] restriction on credit are hitting small traders and cooperatives that do not have the business linkages needed to access. To the extent that there is some credit rationing, the marginal firms are hit first” (p. 2).

Berman and Martin (2009), on the other hand, maintain that low financing opportunities have dampened African exports. They object to the finding by Humphrey (2009), and emphasise that:

“during a financial crisis when uncertainty is high, trust and liquidity are low, banks and firms in the importer country first cut exposure and credit to countries which are seen as more at risk. This would in particular affect trade financing through letters of credit where the importer pays the exporting firm in advance.”

Their view is in line with the *Global Monitoring Report 2009*:

“with up to 20% of the \$15.8 trillion world merchandise trade in 2008 involving secured documentary transactions, such as letter of credit (LCs), trade finance is critical to sustaining the Multilateral trading system. As the financial crisis spread, the demand for LCs, insurance, and guaranteed increased, because exporters wanted to be certain that importers would pay on schedule” (p. 143).

¹⁸ A large amount of the recent literature has pointed out that globalisation was fuelled by the “second unbundling” (Baldwin, 2006). If this process now rebundles itself, the effect on trade integration (or rather disintegration) could be more than a proportional fall.

¹⁹ The argument in Humphrey, 2009, is based upon an original survey on two specific sectors and may be difficult to generalise.

One related issue is the cost of trade finance: the high volatility and the need for serious risk assessments are likely to result in higher cost of finance for importers, exporters and financial intermediaries.²⁰ Furthermore exporters may find themselves in a situation of not being able to repay their debts, and this could induce a vicious circle. Moreover, Berman and Martin (2009) claim that, in the past, SSA countries were hit harder and longer - than other groups of countries - by recessions and financial crises in the countries to which they were exporting. They test the hypothesis that this was just a composition effect, under the assumption that the raw material cycle is closely connected to the cycle in industrial countries, but they reject it: both the manufacturing and the raw material exports of SSA have been hit harder than those of other regions. They also find that African countries are hit harder when the importer country is an industrialised country.²¹ This raises the issue of the competitiveness of SSA exports, which is closely related to the poor infrastructure conditions in most SSA countries. The poorly maintained roads (often unpaved), the few ports, the limited railway networks, the high shipping costs and especially the excessive check points, red tape and inefficient border procedures, all increase production costs, economic distance and uncertainty (for both domestic and foreign firms), thereby undermining competitiveness.²²

4.2 Terms of Trade

After having historically worsened, over the last decade, the terms of trade of developing countries had started to improve substantially (Kaplinsky, 2006). The historically-long commodity-price boom (2002-2008), heaven for raw material exporters and hell for importers, came to a halt in the second half of 2008 and future developments are uncertain.²³ African countries which are net importers of natural resources and - more recently - food, had been severely affected by high prices, and their balance of payments have been under severe stress. The decline in the world price of food items and oil between June 2008 and March 2009²⁴ represented a significant indirect channel through which the financial crisis could give some relief to fragile countries, mitigating the pressure of the adverse terms of the trade shock, reducing inflation and improving their Balance of Payments. The level of stress of these countries at the start of the crisis, however, makes the recovery of fragile countries difficult.

The fall in prices has, on the other hand, had a serious negative impact on many fragile countries, given the high level of concentration of their exports: exports of mining and related activities represent over 80 per cent of the total for Mozambique, Zambia, Botswana, exports of oil over 90 per cent for Angola and Chad. Key consequences of the decrease in raw material prices for resource rich countries are: declining reserves, non-profitability of some oil fields that have high extraction costs, reduction in government funding capacity, and the cancellation or postponement of a number of investments in extractive industries which are highly dependent on foreign direct investment.²⁵ In addition, agricultural exporters tend to rely on one (or two) products, the typical case being Guinea Bissau, where 91.3 per cent of exports is in cashew nuts, which is, therefore, strongly affected by (large) price changes.

²⁰ According to Global Monitoring report, 2009, "by the end of 2008, trade finance deals were offered at 300-400 basis points over interbank refinance rates-two or three times more than the rate a year earlier [...] The cost of LCs was reported to have doubled or tripled for buyers in emerging countries" (p. 144).

²¹ This result could mean that the current crisis would have a very large impact on SSA, since it originated in US and spread rapidly to developed countries.

²² See Unctad, 2009.

²³ While global demand has a negative impact because of the economic crisis, that of China is picking up and could reverse the declining trend. Furthermore, there are several supply constraints.

²⁴ The FAO Food Price Index was down to 148 in December, from 219 in June 2008, while the oil basket price of the OPEC was down from \$131.2 to \$38.6 over the same period.

²⁵ A Further effect, which could re-inforce the previously indicated effects, could be currency depreciation.

Table 4: SSA - Import and export concentration and three main exports with their share in total exports

Country Name	Export concentration 2006	Import concentration 2006	1st exported product* with its share in total exports**	2nd exported product* with its share in total exports**	3rd exported product* with its share in total exports**
Angola	1.0	0.1	Petroleum oils and oils obtained from bituminous minerals, crude (96.7%)		
Benin	0.6	0.2	Cotton, not carded or combed (29.8%)	Petroleum oils and oils obtained from bituminous minerals, other than crude (20.8%)	Copper waste and scrap. (10.9%)
Botswana	0.7	0.1	Diamonds, whether or not worked, but not mounted or set. Unworked or simply sawn, cleaved or bruted (56.0%)	Nickel mattes (21.2%)	Copper mattes (3.7%)
Burkina Faso	0.6	0.2	Cotton, not carded or combed (71.6%)	Sesamum seeds (4.3%)	Guavas, mangoes and mangosteens (2.6%)
Burundi	0.6	0.1	Coffee, not roasted:-- Not decaffeinated (62.1%)	Black tea (fermented) & partly fermented tea in packages exceedg 3 kg (4.3%)	Other black tea (fermented) and other partly fermented tea (3.4%)
Cameroon	0.5	0.3	Petroleum oils and oils obtained from bituminous minerals, crude (52.7%)	Wood sawn or chipped lengthwise, sliced or peeled, whether or not planed, sanded or end-jointed, of a thickness exceeding 6 mm (9.1%)	Cocoa beans, whole or broken, raw or roasted (6.1%)
Cape Verde	0.5	0.1	Fish, frozen, excluding fish fillets and other fish meat of heading 03.04. (25.4%)	Cotton, not carded or combed. (12.9%)	Cocoa paste, not defatted (10.2%)
Central African Republic	0.5	0.2	Wood in the rough, whether or not stripped of bark or sapwood, or roughly squared (30.3%)	Diamonds, whether or not worked, but not mounted or set. Unsorted (21.4%)	Cotton, not carded or combed. (16.8%)
Chad	0.9	0.1	Petroleum oils and oils obtained from bituminous minerals, crude (95.3%)	Cotton, not carded or combed. (2.3%)	
Comoros	0.5	0.1	Vessels and other floating structures for breaking up (31.0%)	Cloves (whole fruit, cloves and stems) (19.8%)	Essential oils (terpeneless or not), including concretes and absolutes; resinoids; extracted oleoresins (19.0%)

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Country Name	Export concentration 2006	Import concentration 2006	1st exported product* with its share in total exports**	2nd exported product* with its share in total exports**	3rd exported product* with its share in total exports**
Congo, Dem. Rep. of	0.4	0.1	Petroleum oils and oils obtained from bituminous minerals, crude (83.2%)		
Congo, Rep.of	0.9	0.1	Diamonds, whether or not worked, but not mounted or set. Unworked or simply sawn, cleaved or bruted (24.6%)	Petroleum oils and oils obtained from bituminous minerals, crude (14.9%)	Cobalt ores and concentrates (14.7%)
Côte d'Ivoire/Ivory Coast, The	0.3	0.3	Cocoa beans, whole or broken, raw or roasted (29.4%)	Petroleum oils and oils obtained from bituminous minerals, crude (17.0%)	Cocoa paste, not defatted (6.3%)
Equatorial Guinea	0.9	0.3	Petroleum oils and oils obtained from bituminous minerals, crude (87.9%)	Methanol (methyl alcohol) (3.9%)	Liquefied:-- Natural gas (3.2%)
Eritrea	0.2	0.1	Natural uranium and its compounds (69.1%)	Nuclear reactors, boilers, mchy & mech appliance (6.4%)	Sesamum seeds (3.3%)
Ethiopia	0.4	0.2	Coffee, not roasted, not decaffeinated (42.1%)	Sesamum seeds (16.3%)	Fresh (6.5%)
Gabon	0.8	0.1	Petroleum oils and oils obtained from bituminous minerals, crude (71.8%)	Manganese ores and concentrates (9.6%)	Wood in the rough, whether or not stripped of bark or sapwood, or roughly squared (0.0%)
Gambia, The	0.5	0.2	Cashew nuts:-- in shell (36.0%)	Titanium ores and concentrates (8.5%)	Ground-nut oil and its fractions, crude (8.5%)
Ghana	0.4	0.1	Cocoa beans, whole or broken, raw or roasted (45.6%)	Manganese ores and concentrates (8.4%)	Petroleum oils and oils obtained from bituminous minerals, other than crude (4.1%)
Guinea	0.7	0.1	Aluminium ores and concentrates. (52.4%)	Aluminium oxide; other than artificial (15.3%)	Copper ores and concentrates. (7.9%)
Guinea-Bissau	0.7	0.2	Cashew nuts: in shell (91.3%)		
Kenya	0.2	0.2	Cut flowers and flower buds of a kind suitable for bouquets or for ornamental purposes, fresh (13.7%)	Other black tea (fermented) and other partly fermented tea (11.8%)	Petroleum oils and oils obtained from bituminous minerals, other than crude (5.9%)
Lesotho	0.4	0.1	Diamonds, whether or not worked, but not mounted or set.	Jerseys, pullovers, cardigans, waist-coats and similar articles,	Men's or boys' suits, ensembles, jackets, blazers, trousers, bib and

Country Name	Export concentration 2006	Import concentration 2006	1st exported product* with its share in total exports**	2nd exported product* with its share in total exports**	3rd exported product* with its share in total exports**
			Unworked or simply sawn, cleaved or bruted (28.9%)	knitted or crocheted, of cotton (18.5%)	brace overalls, breeches and shorts (other than swimwear), of cotton (14.5%)
Liberia	0.7	0.8	Tankers (46.1%)	Other vessels for the transport of goods and/or persons (21.9%)	Natural rubber latex, whether or not prevulcanised (11.6%)
Madagascar	0.2	0.2	Jerseys, pullovers, cardigans, waist-coats and similar articles, knitted or crocheted, of wool or fine animal hair (12.4%)	Shrimps and prawns (10.1%)	Women's or girls' suits, ensembles, jackets, blazers, dresses, skirts, divided skirts, trousers, bib and brace overalls, breeches and shorts (other than swimwear) (8.0%)
Malawi	0.6	0.1	Tobacco, partly or wholly stemmes (49.5%)	Raw sugar not containing added flav (8.8%)	Other black tea (fermented) and other partly fermented tea (5.7%)
Mali	0.7	0.2	Cotton, not carded or combed. (70.8%)	Guavas, mangoes and mangosteens (4.4%)	Sesamum seeds (2.0%)
Mauritania	--	0.2	Iron ores and concentrates, including roasted iron pyrites. Non-agglomerated (45.3%)	Petroleum oils and oils obtained from bituminous minerals, other than crude (19.0%)	Molluscs or aquatic invertebrates other than crustaceans, other than live, fresh or chilled (9.7%)
Mauritius	0.3	0.1	T-shirts, singlets and other vests, knitted or crocheted; of cotton (17.5%)	Cane sugar and chemically pure sucrose, in solid form. (15.9%)	Prepared or Preserved Fish - Tunas, skipjack and bonito (Sarda spp.) (9.5%)
Mozambique	0.6	0.1	Aluminium, not alloyed (51.3%)	Petroleum oils and oils obtained from bituminous minerals, other than crude (9.9%)	Electrical energy. (optional heading) (5.1%)
Namibia	0.3	0.1	Diamonds, whether or not worked, but not mounted or set : Unworked or simply sawn, cleaved or bruted (20.2%)	Unwrought zinc, containing by weight 99.99 % or more of zinc (18.7%)	Natural uranium and its compounds; alloys, dispersions (including cermets), ceramic products and mixtures containing natural uranium (12.1%)
Niger	0.5	0.1	Natural uranium and its compounds (83.7%)	Paintings, drawings and pastels (2.2%)	
Nigeria	0.9	0.1	Petroleum oils and oils obtained from bituminous minerals, crude (87.5%)	Liquefied:-- Natural gas (6.6%)	Petroleum oils and oils obtained from bituminous minerals, other than crude (2.0%)
Rwanda	0.5	0.1	Coffee, not roasted, not decaffeinated (43.2%)	Tin ores and concentrates. (15.6%)	Other black tea (fermented) and other partly fermented tea (13.7%)

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Country Name	Export concentration 2006	Import concentration 2006	1st exported product* with its share in total exports**	2nd exported product* with its share in total exports**	3rd exported product* with its share in total exports**
São Tomé and Príncipe	0.9	0.2	Cocoa beans, whole or broken, raw (49.5%)	Prefabricated buildings. (4.6%)	Parts and accessories (other than covers, carrying cases and the like) suitable for use solely or principally with machines of headings 84.69 to 84.72 (4.6%)
Senegal	0.2	0.2	Petroleum oils and oils obtained from bituminous minerals, other than crude (14.3%)	Phosphoric acid and polyphosphoric acids (9.5%)	Ground-nut oil and its fractions, crude. (7.1%)
Seychelles, The	0.6	0.3	Tunas, skipjack and bonito (Sarda spp.) (47.8%)	Yellowfin tunas (Thunnus albacares) (11.0%)	Skipjack or stripbellied bonito (7.9%)
Sierra Leone	0.5	0.1	Diamonds, whether or not worked, but not mounted or set : Unworked or simply sawn, cleaved or bruted (31.1%)	Aluminium ores and concentrates (11.7%)	Titanium ores and concentrates (11.2%)
Somalia	0.4	0.3	Goats (33.7%)	Live bovine animals : Other than pure-bred breeding animals (10.5%)	Pure-bred breeding animals (10.4%)
South Africa	0.2	0.1	Platinum: - Unwrought or in powder form (7.6%)	Diamonds, whether or not worked, but not mounted or set: - Unworked or simply sawn, cleaved or bruted (6.1%)	Gold (including gold plated with platinum) unwrought form. (5.1%)
Sudan, The	0.9	0.1	Petroleum oils and oils obtained from bituminous minerals, crude (92.3%)		
Swaziland	0.4	0.1	Raw sugar not containing added flav (12.7%)	Food preparations not elsewhere specified or included. (10.2%)	Mixtures of odoriferous substances of a kind used in the food or drink (9.9%)
Tanzania	0.4	0.2	Tobacco, partly or wholly stemmed/s (8.5%)	Coffee, not roasted: Not decaffe (7.5%)	Fish fillets and other fish meat (whether or not minced), fresh or chilled. (7.4%)
Togo	0.3	0.2	Cocoa beans, whole or broken, raw or roasted (25.3%)	Petroleum oils and oils obtained from bituminous minerals, other than crude (13.0%)	Cement clinkers (8.3%)
Uganda	0.3	0.2	Coffee, not roasted :-- Not decaffe (25.6%)	Fish fillets and other fish meat (whether or not minced), fresh or chilled (12.8%)	Tobacco, partly or wholly stemmed (7.3%)

Country Name	Export concentration 2006	Import concentration 2006	1st exported product* with its share in total exports**	2nd exported product* with its share in total exports**	3rd exported product* with its share in total exports**
Zambia	0.7	0.1	Refined copper: -- Cathodes and sections of cathodes (62.1%)	Copper ores and concentrates. (6.3%)	Cobalt mattes and other intermediate products of cobalt (5.3%)
Zimbabwe	0.2	0.1	Nickel, not alloyed (22.7%)	Tobacco, partly or wholly stemmed (11.1%)	Nickel ores and concentrates. (9.4%)

Notes: Countries belonging to the operational definition of fragile countries are in bold.

* Products are reported when accounting for more than 2 per cent of total exports. ** Figures in [] represent the share of Africa in the World export for each product.

Source: UNCTAD Handbook of Statistics, 2008 (data of 2006: import and export concentration): AEO 2009 (data of 2007, tree main product exported).

The transmission of the crisis through terms of trade depends on the degree of the concentration of exports. As Table 4 indicates, many African countries in situations of fragility depend on the export of few commodities for over three quarters of their export revenue. However, to assess the likely impact of the crisis, the crucial element is the elasticity of the commodity demand in importing countries (see Mayn and Kennan, 2009). Demand for fuel is typically quite rigid, so is the demand for agricultural products, while the elasticity of demand for manufacturing tends to be higher. Furthermore, the elasticity crucially depends on the characteristics of the destination markets.²⁶ What can be seen is that the export diversification index for Sub-Saharan African fragile countries is less than half that of non-fragile countries. The concentration of destination markets is also high: 15 Sub-Saharan African countries earn more than half of their export revenues from exports to a single geographical area. Specifically, nine countries derive more than 50% of their revenues from exports to Europe. For three countries, Djibouti, Togo and Zimbabwe, intra-Africa trade is predominant, accounting for over 50% of total trade. The products that fragile countries export outside Africa - mainly fuels²⁷ - differ from what they export within the region, which also include manufacturing products. Hence, their exports within Africa are more diversified than their exports to the rest of the world. So, an expansion of intra-African trade could reduce the impact of commodity price volatility, and thus the vulnerability of fragile countries to trade-related shocks.

The relationship between state fragility and export concentrations can be traced back to the resource endowments: their abundance can reshape the interests and behaviour of an incumbent government, inducing excessive reliance on natural resources, limiting the expansion of the manufacturing sector and deteriorating governance.²⁸ Chauvet and Collier (2008) find that resource rents significantly reduce the chances of achieving a sustained turnaround out of a situation of state fragility. A doubling of resource rents as a share of GDP roughly doubles the time taken. Furthermore, because of low export diversification, fragile states may be more prone to the “Dutch disease”, which occurs when the exchange rate appreciates as a result of capital inflows, making exports less competitive. However, the resource endowments provide a means of reacting to the crisis (for instance, providing enough reserves).

4.3 Tourism

Recently, in the years of high world growth and trade expansion, tourism has become an important source of foreign currency earnings even in some fragile countries (see Table 5).

²⁶ See ODI country studies, 2009, reported in ODI web page (financial crisis programme).

²⁷ Because oil is mainly exported outside the region, intra-African trade for fragile oil exporters is, on average, lower than for non-oil exporters.

²⁸ See Chapter 4, and Collier, 2009, for further analysis of these mechanisms.

Table 5: International tourism, receipts (% of total exports)

	2000	2001	2002	2003	2004	2005	2006
Angola	0.4	0.5	0.6	0.6	0.6	0.4	0.3
Benin	14.6	16.4	15.7	15.1	15.4	14.0	-
Botswana	7.6	8.9	11.5	12.5	13.0	10.6	10.2
Burkina Faso	9,7	9,6	-	-	-	-	-
Burundi	2.6	2.0	4.2	2.7	2.8	2.1	1.7
Cameroon	5.1	6.6	4.3	8.5	5.8	-	-
Cape Verde	43.9	46.1	51.4	52.9	51.6	48.4	55.1
Central African Republic	-	-	-	-	-	-	-
Chad	-	-	-	-	-	-	-
Comoros	-	-	-	-	-	-	-
Congo, Dem. Rep.	-	-	-	-	-	-	-
Congo, Rep.	0.5	1.0	1.0	1.1	0.6	0.7	
Côte d'Ivoire/Ivory Coast, The	1.2	1.3	1.0	1.2	1.2	1.1	0.9
Equatorial Guinea	-	-	-	-	-	-	-
Eritrea	36.8	-	-	-	-	-	-
Ethiopia	20.7	22.3	24.5	26.7	27.2	27.6	29.1
Gabon	2.8	1.7	2.9	2.5	1.8	-	-
Gambia, The	-	-	-	35.9	28.0	31.6	34.4
Ghana	14.6	15.6	14.9	13.8	14.5	22.2	17.8
Guinea	2.5	2.6	5.4	4.3	3.7	-	-
Guinea-Bissau	-	4.5	3.6	3.4	2.6	-	-
Kenya	18.0	17.8	16.0	17.1	18.7	18.2	19.8
Lesotho	9.5	7.2	5.1	5.3	4.4	4.2	3.7
Liberia	-	-	-	-	-	-	-
Madagascar	12.8	11.7	8.7	10.1	16.9	21.8	-
Malawi	6.9	8.5	9.5	-	-	-	-
Mali	7.3	10.4	10.1	11.8	11.7	10.8	-
Mauritania	-	-	-	-	-	-	-
Mauritius	27.9	28.8	28.1	30.2	33.5	31.7	32.5
Mayotte	-	-	-	-	-	-	-
Mozambique	10.7	6.6	5.7	7.9	5.5	6.6	5.2
Namibia	10.4	18.3	18.7	22.8	18.5	14.6	14.9
Niger	7.2	9.1	6.1	6.6	6.1	7,8	-
Nigeria	0.9	0.9	1.4	0.2	0.1	0,1	-
Rwanda	21.1	18.2	23,4	21.5	21.9	19,1	11,2
São Tomé and Príncipe	61.5	90.4	67.7	69.7	-	-	-
Senegal	11.6	12.5	13.8	14.7	13.2	-	-
Seychelles	46.7	43.3	44.9	41.8	40.8	37.4	37.8
Sierra Leone	18.2	17.3	38.7	33.9	26.9	24.5	7.4
Somalia	-	-	-	-	-	-	-
South Africa	9.0	9.1	10.1	13.9	12.7	12.7	11.8
Sudan, The	0.3	0.2	5.2	0.7	0.5	1.8	2.1
Swaziland	1.9	2.0	3.8	0.4	3.7	3.5	3.3
Tanzania	29.5	35.4	33.6	30.2	29.2	28.4	29.6
Togo	2.6	3.3	3.1	3.8	3.3	3.2	-
Uganda	24.9	27.0	27.5	22.3	24.1	27,9	23.8
Zambia	15.2	7.6	6.1	7.1	4.4	3.9	2,7
Zimbabwe	-	-	-	-	-	-	-

Note: countries belonging to the operational definition of fragile countries are in bold.
Source: WDI 2008

Since September 2008, the number of air passengers has dropped sharply. Although a good part of this drop is due to reduced travel for business purposes, it would also include less tourist travel, as households generally reduce consumption on luxury goods. As a consequence, Massa and te Velde (2008) also include African countries exporting high income elastic services such as tourism in the list of possible “losers” from the 2008-2009 crisis. Moreover, a fall in tourism flows is likely to spread fast to other services (hotel, restaurants and so on) amplifying the impact of the shock.

Maritime transports, shipping and related services have also suffered from the downturn in demand.²⁹

4.4 Foreign Direct Investments

FDI has been an important source of resources for some (few) Sub-Saharan African fragile countries and a powerful engine of growth, depending on which sectors they were targeted at. Investments into the oil industry generate little domestic employment, given the small number of the employees and high skills required, while those for tourism or some traditional manufacturing stimulate domestic employment, consumption and growth.³⁰

FDI as a share of GDP has been lower in Sub-Saharan Africa than in other developing countries, unevenly distributed across countries and often related to natural resource endowment. FDI had been increasing in absolute terms and as a share of GDP since 2000, but the economic crisis has reduced the total amount of funds or delayed some projects. OECD (2008) signals that FDI to non-fragile African countries amounted to \$24.5 billion in 2005, compared to \$6.4 billion to fragile countries in the same year. Though this figure is higher than the \$4.2 billion recorded in 2000, FDI to fragile African countries has been declining since 2003, and highly concentrated: four resource-rich countries, namely, Angola, Chad, Nigeria and the Sudan, received 70 per cent of the total FDI over the period 2000-2005 (OECD, 2008).

The crisis tightened credit and lowered profits for firms in developed and emerging economies, leading them to revise their investment plans downwards and assume a wait-and-see attitude.³¹ The high and increasing uncertainty linked to the concurrent fuel, food and financial crises explains the general decline in FDI, which has been particularly damaging because of its persistent effects,³² perhaps even beyond those warranted by a country’s fundamentals.

In the first half of 2008, Angola and Nigeria, as well as the Democratic Republic of Congo and Guinea, each received more than \$1 billion in FDI inflows.³³ But in the second half of 2008 and the first half of 2009, a number of investments in natural resources and manufacturing were put on hold or cancelled. The Democratic Republic of Congo and Zambia have had mining projects cancelled, the Sudan has had a refinery postponed, and Botswana and Tanzania have had mining projects postponed.

As countries become more open to capital flows, crises are more easily transmitted across borders (see Reinhart and Rogoff, 2008) and the traditional positive long-term relationship between financial

²⁹ In Tanzania, the fleet deployment in February 2009 compared to mid-2008 was minus 8%; see UNCTAD, 2009, p. 23, and Global Monitoring Report, 2009.

³⁰ See Bonassi *et al.*, 2006.

³¹ Theoretical models of investment under uncertainty (Dixit, 1989) have in the past used the option theory to explain this investors’ attitude when the environment is perceived as risky. For the same values of the fundamentals, the behaviour of firms is different, depending on the history of the firms: if a firm is already investing in a country, it goes on, but new investments are postponed. The behaviour of firms could explain the current situation: what is a discontinuity in individual behaviour (firms may decide to invest or not to invest in the same situation, depending on their history, and multiple equilibria are possible) makes the aggregate investment function highly non-linear.

³² It takes time for investments to be realised, and a decline in a year produces a long-lasting impact over the years to come.

³³ See UNCTAD, 2009b, p. 42.

development and growth seems to co-exist with a negative short-term relationship through financial fragility. Against this background, there is evidence that the current crisis is having a negative impact on international investments, even though Africa has so far been less affected than other regions.³⁴

Table 6: Some example of Investments postponed/cancelled in the last few months

Country	Type of project	Postponed	Cancelled
Botswana	Mining Project	■	
Congo	Mining Project		■
Sudan	Refinery Project	■	
Tanzania	Mining Project	■	
Zambia	Mining Project		■

Source: authors' elaborations

The actual high number of cancellation and postponements in investment in Africa is, indeed, aggravated by the fact that fragile countries are perceived as “high risk”. Political risk, together with low returns on investment, macro-economic instability, low productivity, exchange rate performance, wages and infrastructure are among the key variables that have been identified in some of the empirical works as the main deterrent of investments in African countries compared to other developing countries.³⁵ Naudé and Krugell (2007) also add that the existence of good institutions is equally important in attracting FDI. In a situation of uncertainty, another relevant issue is that of contract enforcement. Recent research has pointed to the importance of a sound legal framework and stable political environment to attract foreign capital, as well as to the influence of a country’s history of default. It is, however, difficult to enforce a contract if the players are not well-identified, and have little – or a bad – reputation. This, of course, means that some commitment devices have to be imposed, but this is very difficult in countries with dysfunctional institutions, unless deals are made through the informal institutions, under the assumption that these are easily recognised by people and, at least to a certain extent, accountable. One related issue concerns the absence of capacity to manage public resources, which can lead to substantial problems of corruption. One solution is the implementation of a mechanism that creates external controls on revenue generating entities.³⁶

High uncertainty, reduced access to finance, grim growth prospects and a higher degree of risk aversion are the main channels of transmission of the crisis that dampen FDI flows. Some positive forces do, however, exist. According to UNCTAD (2009b) “financial crises and tough economic periods also offer opportunities to buy assets at ‘bargain prices’ and take advantage of large scale consolidations in some industries” (p. 30), and a number of firms have taken advantages of such opportunities in “oil and gas, metal mining, automotive and financial services industries”. Furthermore, Sovereign Wealth Funds (SWFs) – especially those of oil rich Gulf states and East Asian emerging countries - have been increasingly involved in FDI both in advanced and in developing countries (South-South FDI) and might play a role both in manufacturing and in land acquisition in Sub-Saharan Africa.

³⁴ UNCTAD, 2009b predicts that global FDI inflows declined by 15% in 2008 to about \$1.6 trillions and that further decline is expected for 2009. AfDB (2009) says that FDI to Africa in 2008 were \$61.9 billion (up to 17% compared to 2007) and emphasises the differences between countries.

³⁵ See Asiedu, 2001; Razafimahefa and Hamori, 2005; Khadaroo and Seetanah, 2007.

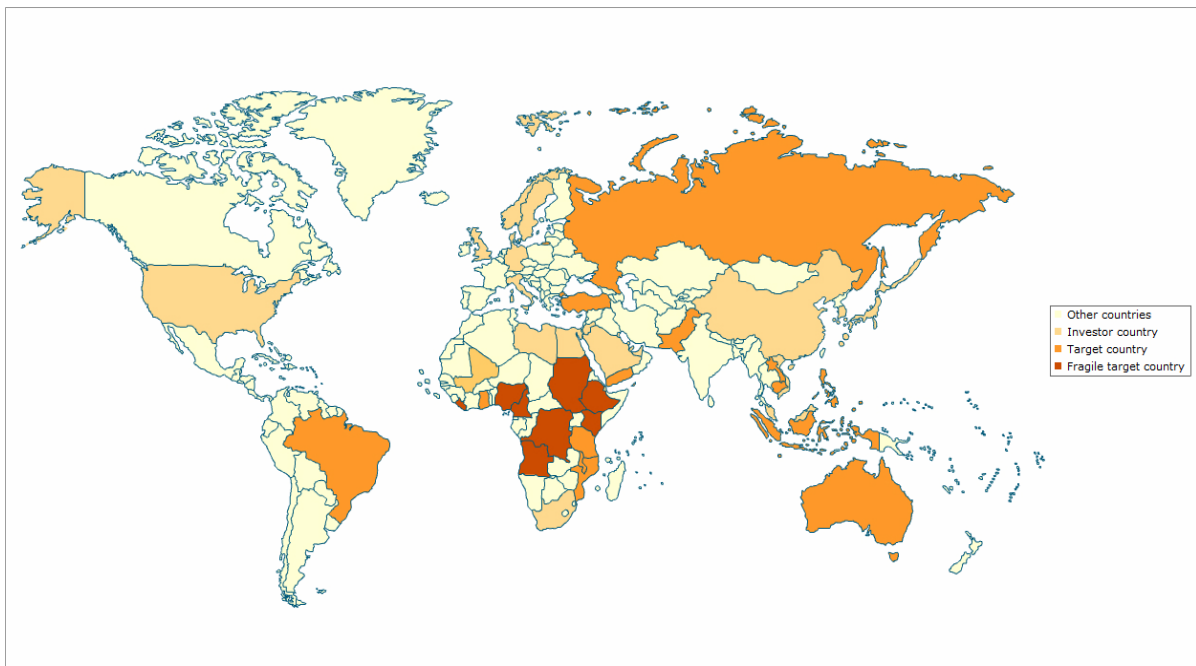
³⁶ An example of control mechanism implemented in Liberia has been, for instance, GEMAP, the Governance and Economic Management Assistance Programme, which is described by Dwan and Bailey (2006) and UNDP (2006).

4.5 A Peculiar Direct Investment: Land acquisition

One probably unexpected consequence of the financial crisis is an increasing trend to buy farmland in developing countries (mainly in SSA) by other countries seeking food security (namely, China and Arab countries, see Cotula *et al.*, 2009, and von Braun and Meinzen-Dick, 2009). It is an alternative way to invest capital in a moment of low and risky returns on financial assets. Higher agricultural prices such as those prevailing in 2008 may have pushed the trend, since they may result in higher land prices, because “the expected return to land increases when profit per unit of land increases” (von Braun and Meinzen-Dick, 2009). Furthermore, there is a problem of lack of water in some countries (including China and the Emirates), which makes foreign production attractive, because it allows countries not to deplete their domestic water resources.

Information by the international press and some national inventories suggests that land investments in Africa have been mushrooming. The scale and consequences of this trend are still largely unknown since qualitative and quantitative information are limited,³⁷ not fully reliable and not transparent. Data collected from media reports reveal that an estimated 15-20 million hectares might have been subject to bargaining in developing countries (*The Economist* 2009) and the phenomenon mainly involves the Sub-Saharan region (see Figure 4).

Figure 4: Foreign Direct Investments in land



Source: Unctad, World Investment Report 2009

Several factors interact to explain foreign land acquisitions in Africa, both from the demand and the supply side. On the demand side, the perception of a great availability and accessibility of farmland and of under-exploited water sources in Africa has represented a preliminary condition, but a triggering role has been played by the recent trends in food and oil prices and the consequent protectionist reactions of some major food exporters. These events have revealed the ongoing transformation in food and energy markets which does not exclude price spikes in the future. Increased

³⁷ More information is needed on the type of contract: lease, or property? For how long? Guaranteed? How? Issues of security related to it. In SSA, de jure the state owns most rural land, but ownership is de facto different. This has consequences on the type of contracts being signed and therefore on the costs and benefits for the contractors.

demand of food (such as meat and dairy produce) requiring land-demanding production techniques, growing demand of energy sources which offer an alternative to fossil fuels, increasing scarcity of water for productive use and slow rate of growth in farm productivity, and, in some areas, reduction in farm production, all tend to exert pressures to farmland frontier expansion. The margin for higher rates of return on agricultural commodity investment has increased, and food importers might be less willing to entrust their food security completely to international markets, which are out of their control. Outsourcing food production has become a more feasible national strategy in a period in which the link between FDI and foreign policies (or national interests) has been re-inforced by the increasing involvement of state-owned enterprises and of Sovereign Wealth Funds (SWFs) in international markets.

On the other hand, the neglected role of the agricultural sector long suffered by many African countries has stimulated the supply of land to the market. The countries towards which land investments are directed are now attempting to take the opportunity represented by the rising trend of land and water value. The underlying idea is to promote the economic development of the country and to reduce poverty by exchanging abundant resources (land) with scarce ones (capital, infrastructures, skills, technology).

If this wave of land acquisitions continues to expand according to the current pattern, the consequences at stake for African agriculture and African populations could be profound, persistent and not easily reversible. The direction of this process is heading towards land concentration, the development of agricultural production and distribution systems, and labour relations oriented to the agri-business model, greater integration with urban and international markets, and restrictions of no formally recognised-resource uses. A further potential problem is that there are no incentives for countries acquiring land, especially if they obtain the lease and not the property,³⁸ to pursue a sustainable use of resources.

In many African countries, and especially in fragile ones, the majority of the population live in rural areas and agriculture development can have a leading role in poverty reduction and economic growth, while investment in infrastructural development, know-how and technology can have significant positive spill-overs. Thus, the social and economic transformation that could emerge from this process could open great opportunities for poverty reduction and the economic development of African recipient countries. However, the risks are substantial, the main risk being a possible loss of long-term control over land for countries or local communities. Recipient countries may become more food insecure, suffer from displacement of workers, and have a higher probability of riots and even conflicts. Changes in access to land and water resources, in resource management and in production techniques, can have implications also for environmental sustainability. International development agencies and the research community are working to provide recommendations and assistance to stakeholders (investors, governments, local populations and civil society) in order to facilitate materialisation of the potential benefits of the renewed interest in agricultural investment, but these efforts are likely to be costly and with highly uncertain results.

As shown in the following table, the conditions that should be met to ensure the poverty-reducing effects of domestic and foreign investment in Africa's farmland are very challenging, especially in countries with weak negotiating capacity or position with incoming investors, with low capacity to reconcile conflicts over resources, or where citizen claims are less likely to receive the attention of state institutions, in other words, in fragile states.

³⁸ Indeed, even with property, if property rights are not ensured, as in most fragile countries.

Table 7: Pros and Cons of foreign direct investment in land

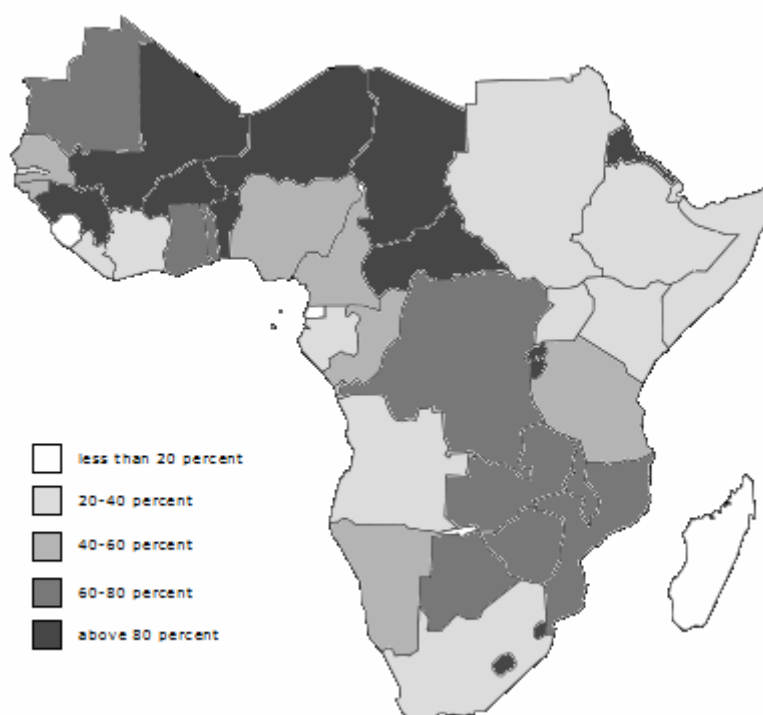
Conditions for sustainable poverty-reducing effects of large-scale land investments	Actions that can help to meet the conditions	Observations
Clear definition and recognition of pre-existing resource-use rights.	Land titling of resources; mapping of community resources and informal use of resources; involvement of local populations in decision-making process.	Most of Africa's people do not hold formal use or property rights to the natural resources to which they access. Land titling requires time and resource-costly processes. International experiences show that the badly-designed land tenure reform and titling programmes can exclude more vulnerable groups and can create destabilising forces. Transparent and informed engagement of local stakeholders is particularly difficult in countries with a low level of education and weak social contract between citizens and state institutions.
The design of contracts able to represent a sustainable balance between priority, perspectives and incentives of the stakeholders (investors, governments and local populations).	The implementation of transparent and participatory decision-making process. Technical assistance to capacity building for contract design, supervision, management.	See observations above. One of the main obstacles to this condition is the imbalance in bargaining power and negotiating capacity between investors, governments, and local communities and farmers.
Credibility and enforceability of commitments by investors and host governments. Identification and compensation of the rights of negatively affected people.	Baseline assessment studies on ex-ante environmental, social and economic conditions. Monitoring of contract accomplishment by state institutions or international stakeholders. Actions to ensure transparency and dissemination of information.	Local populations usually lack financial and human resources to meet these conditions. Recipient governments are likely to lack necessary capacity and fiscal resources or willingness to maintain effective structures and impose credible threats of punishment of non compliances. Problems of asymmetric information can hinder the definition, evaluation and monitoring of compliances.
Creation of better and more labour opportunities.	See actions above on contract enforcement and design. Strengthening and involvement of trade unions and labour/worker representatives.	Economic and financial sustainability of the projects might provide new investors with motivations to implicitly or explicitly retract their commitments for implementation of labor standards and labour-intensive techniques. Trade unionisation of workers might be against interests of national élite.
Agricultural projects should lead to an increase in productivity by at same time being environmental sustainable.	See actions above. Setting up and strengthening of institutions (rules, agencies and structures) for environmental regulation and supervision. Technical assistance to new investors and mechanisms to adopt local knowledge of agricultural techniques.	See observations above. In many Africa's areas, land has a low resilience to agricultural intensification. External investors might lack an appropriate knowledge of local ecosystems and sustainable production practices. Contract farming arrangements, joint ventures, and systems of contract-growing can improve the absorption of local knowledge and benefit sharing among investors and local populations. However these results are likely to be jeopardised by asymmetric economic and power positions of the counterparts.

4.6 Remittances

Migrants' remittances to Africa reach countries where other private flows, such as foreign direct investments, are limited or non-existent, sometimes even exceeding the size of official development assistance (OECD, 2008). The social and economic relevance of migrants' remittances for fragile African countries can be hardly over-stated,³⁹ as the usual concerns about the ability of Balance of Payments statistics to capture these transfers apply *a fortiori* in this context. This is so because "Sub-Saharan African migrants have tended to stay on the continent", as Sander and Maimbo (2005) observe, and formal remittance corridors among African countries tend to be characterised by extremely high transaction costs.⁴⁰ This is a factor that drives transfers towards informal channels (Freund and Spatafora, 2008), which are hardly captured by official figures.

This argument applies to an even larger extent to fragile countries, as they are, on average, poorer than non-fragile ones, and the low level of incomes makes it harder for their would-be economic migrants – not to mention the refugees - to afford the high migration costs that are associated with migration to a high-income country. Figure 5 reports the share of emigrants from each country, which reside in another African country.⁴¹

Figure 5: Share of emigrants residing within Africa



Source: ERD elaboration based upon data from the University of Sussex and the World Bank reported in Ratha and Shaw (2007).

³⁹ See Maimbo (2006) for a description of how remittances contribute to the survival of key economic activities in Somalia, where remittances are estimated to represent 40 per cent of the incomes of urban households.

⁴⁰ For instance, a \$200 transfer from South Africa to Mozambique had a cost that ranged between \$22.66 and \$52.56 in the first quarter of 2009 (see <http://remittanceprices.worldbank.org>).

⁴¹ Note that, for some countries, such as Ghana and Egypt, a break-down of the estimated number of immigrants by countries of origin is not available, so that the data reported in Figure 1 are an under-estimate of the extent of intra-regional migration in Africa.

The share is as high as 89 per cent for Niger and 83 per cent for the Central African Republic, and many other countries are characterised by a mainly intra-regional pattern of migration. Figure 5 has two relevant implications: first, Balance of Payments figures on remittances are most likely to underestimate severely the actual flows of migrants' remittances to fragile countries; second, the impact of the current crisis on fragile countries depends also on how some emerging African countries, such as South Africa, will be affected, as they represent important destination countries for African migrants.

The relevance of remittances for recipient countries is not connected exclusively to their sheer size, but it also relates to a key distinctive feature of this flow, namely, the fact that remittances tend to be stable – or even move counter-cyclically (Ratha, 2006) – along the business cycle of recipient countries, thus reducing the likelihood of a Balance of Payments crisis (Bugamelli and Paternò, 2006). However, a crucial question as to how remittances to fragile African countries will react to the large downward fluctuation that has characterised the business cycle of most recipient countries throughout 2009.

An early assessment provided by Ratha *et al.*, (2008) suggested that remittances were likely to remain resilient even in the face of the global financial and economic crisis, albeit with a reduction in the strong rate of growth observed over the past few years. A recent contribution by Ratha and Mohapatra (2009) moderated this initial optimism, suggesting that remittances to developing countries will fall between 5 and 8 per cent in 2009, with a similar fall predicted for Sub-Saharan Africa alone, where remittances are estimated to \$18-19 billion, down from the \$20 billion that were officially recorded in 2008. Ratha and Mohapatra (2009) argue that, this reduction notwithstanding, migrants' remittances is the flow to developing countries which will be less sensitive to the negative effects of the crisis.⁴²

A recently released economic outlook for Sub-Saharan Africa presents less optimistic figures with regard to the reaction of remittances to the recession which is hitting the countries of destination of the migrants, as the IMF (2009) suggests that the econometric analysis of the data reveals that “a 1 percentage point decline in growth in host countries would lead to a 4 percent decline in remittances”. The IMF (2009) argues that this figure could actually represent an upper bound for the actual decline in remittances due to the crisis, as the widespread nature of the current crisis is unprecedented in the historical data.⁴³

A more detailed, country-specific assessment, is unfeasible, as it would require us to have reasonable forecasts about the evolution of the bilateral exchange rates of the destination countries of the migrants against the dollar, as this is the single most relevant factor in shaping the dollar value of the incoming migrants' remittances. Nevertheless, it is fair to say that the remittances are unlikely to represent the single most relevant channels through which fragile African countries are going to be affected by the crisis, although the reduction in migrants' remittances could be larger than that which early forecasts suggested.

Furthermore, the decline in remittances can have an impact on the composition of expenditure, if, as suggested, for instance, by Maimbo and Ratha (2005), remittances are more likely to be invested in education and housing than income from domestic sources is. A lower expenditure in schooling could, however, have very persistent effects, and it could also affect the prospects for future recovery.

⁴² The possible reduction in the tightening of immigration controls in destination countries would produce only a delayed and limited impact on remittance flows, whose size is determined by the existing number of migrants and not by the size of recent arrivals, and the fiscal stimulus packages that are currently being deployed contain substantial provisions for infrastructural investments, which are realised by migrant-intensive firms (Ratha and Mohapatra, 2009).

⁴³ A recent study by Cali' and dell'Erba, 2009, estimating remittances for SSA in 2009 and 2010, suggests a reduction of 6 per cent and 7 per cent, respectively.

4.7 Fading Aid: a scenario to be avoided

The OECD Development Assistance Committee (DAC) recently celebrated 2008 as a record year for aid, as the total resources allocated by its member countries to development aid reached an unprecedented level.⁴⁴ Chinese flows also increased to a new peak in 2008. However, such an achievement could be short-lived, if the current economic and financial crisis induces donor countries to reduce the fiscal resources that are currently allocated to official development assistance. A failure on the part of donor countries to live up to these commitments would seriously endanger the ability of the recipient countries to cope with the effects of the crisis through adequate fiscal policies, and it would thus jeopardise the progress towards the achievement of the Millennium Development Goals.

Aid budgets may be *innocent bystanders* of the current crisis, and may be reduced to raise the resources that donor countries currently need to finance huge rescue interventions and their fiscal stimulus packages in order to sustain internal demand. Robert Zoellick, the president of the World Bank, has recently issued a *Call to Action*, suggesting that “developed countries [should] pledge an amount equivalent to 0.7 per cent of their stimulus packages as additional aid, over and above existing ODA commitments”.⁴⁵ Similarly, the International Monetary Fund has recently argued that donor countries should not renege on their prior commitments to scale up aid to Africa, as honouring the Gleneagles commitments could help sustain Sub-Saharan African growth and mitigate the impact of the global financial crisis” (IMF, 2009). Needless to say, the resources that developed countries are currently devoting to sustain their economies are such that they “made the efforts to enhance flows of international development aid, which had peaked at around \$120 billion in 2006, pale in comparison” (North-South Institute, 2009). This entails that a reduction in the aid budget would have a limited to non-existent effect on the financing needs of donor countries,⁴⁶ but such an observation is not sufficient to dismiss the concerns about the evolution of aid flows in 2009, and over the next few years since, in the medium- to long-term, the large budget deficit due to fiscal stimulus in developed countries will have to be financed.

The experience with past crisis episodes – which were not global in scope like the current one – reveals that donor countries tend to reduce their aid budgets significantly when facing a major recession. The figures provided by David Roodman show that Norway, Sweden and Finland reduced their aid budgets in real terms by 10, 17 and 62 per cent respectively after the Nordic banking crisis in 1991.⁴⁷ Even recent signals are not reassuring: as Cindy Prieto points out,⁴⁸ the Irish Government released an official statement on 3 February 2009, which reveals that Ireland will reduce its aid budget from €91 million to €796 million,⁴⁹ which was then followed by a further cut in April, the fourth in

⁴⁴ OECD DAC, “Development aid at its highest level ever in 2008”, document released on 30 March 2009, and available at: http://www.oecd.org/document/35/0,3343,en_2649_34487_42458595_1_1_1_1,00.html.

⁴⁵ See the document “World Bank Group Response to the Financial Crisis”, presented on March 24, 2009, and available at: <http://www.worldbank.org/html/extdr/financialcrisis/pdf/WBGResponse-VFF.pdf>.

⁴⁶ Robert Zoellick, quoted in Mold *et al.*, (2009) recently affirmed that “at \$100 billion a year, the amount spent on overseas aid is a drop in the ocean compared to the trillions of dollars that are now being spent on financial rescues in the developed world”.

⁴⁷ David Roodman, “History Says Financial Crisis Will Suppress Aid”, 13 October 2008, Centre for Global Development, available at: <http://blogs.cgdev.org/globaldevelopment/2008/10/history-says-financial-crisis.php>.

⁴⁸ Cindy Prieto, “Ireland Becomes First Major European Donor to Cut Aid”, 5 February 2009, Centre for Global Development, available at: <http://blogs.cgdev.org/globaldevelopment/2009/02/ireland-becomes-first-major-eu.php>.

⁴⁹ “In this context, the Government has taken the difficult decision to reduce the total budget provided for Ireland’s Overseas Development Assistance in 2009 from €91million to €796 million. The size of our aid programme is linked to our own economy, and specifically to GNP growth. Our intention is that, by taking action to curb public expenditure at this time, we will establish a platform for the resumption of strong economic growth, and further significant expansion of the Government’s development programme in years to come”; from the Statement on ODA levels by the Minister for

less than 10 months, which reduced commitments for 2009 by 22 per cent with regard to what was initially planned. By the same token, analysis of the Italian budget reveals that Italy could halve its aid budget in 2009, thus hitting a historical low, with aid falling close to – if not, even below – 0.10 percent of gross domestic product.⁵⁰ As the concerns about the future evolution of aid flows could be solid-grounded, we provide an assessment of the exposure of fragile African countries to the effect of the possible cuts in aid budgets on the part of donor countries.

Extending the work of Bertoli *et al.*, (2007), who analyse the determinants of the aid allocations by the member countries of the OECD Development Assistance Committee over the 1970-2004 period, we predict the level of aid budget in 2009 for each of the 22 member countries; then, we will move from the part of the donors' to that of the recipients, assuming that each donor allocates its budget across recipient countries keeping the allocations that had prevailed over the 2003-2007 period unchanged.⁵¹ This suggests a picture of the magnitude of such an effect, and of its repercussions across African countries.

Surprisingly enough, in the otherwise extensive literature on official development assistance, little attention has been paid to the factors that influence donor choice to allocate fiscal resources to aid.⁵² The few exceptions are represented by Round and Odedokun (2004), Faini (2006), Bertoli *et al.*, (2007), and Chong and Gradstein (2008). These papers consider a set of structural, economic, political and institutional variables as possible determinants of the aid to GDP ratio for each OECD DAC member country, and the limited number of existing analyses entail that a shared consensus on the determinants of aid allocations has not yet been reached, and the relationship between the evolution of fiscal budget and the aid allocations makes no exception. While Faini (2006) concludes that a lower budget deficit is associated with a higher aid to GDP ratio, both Round and Odedokun (2004) and Bertoli *et al.*, (2007) draw the opposite conclusion, suggesting that the fiscal deficit is *per se* a poor measure of the fiscal stance of a government. However, this is not sufficient to conclude, as Mold *et al.*, (2009) do, that “the existing evidence lends support to a rather agnostic interpretation of trends for aid budgets during the course of the current crisis”, as the budget deficit represents just one of the channels through which the crisis might affect donors' aid efforts. Existing studies consistently find that aid allocations increase with a stronger rate of growth of GDP,⁵³ and with a higher level of fiscal revenues, and this suggests that the impact of the crisis on aid flows might be severe, because - as Mold *et al.*, (2009) themselves suggest - we are currently moving in “unchartered waters”.

4.8 Predicting aid budgets for 2009

We extend to 2008 the dataset of Bertoli *et al.*, (2007), and we model the aid to GDP ratio on an unbalanced panel of observations for the 22 OECD DAC member countries over the 1970-2008

(Contd.) _____

Foreign Affairs, Mr Micheál Martin, T.D., and the Minister of State for Overseas Development, Mr Peter Power, T.D. available at: <http://www.dfa.ie/home/index.aspx?id=81054>.

⁵⁰ Action aid Europe, “False sheen on European Aid Money”, statement released on March 30, 2009, and available at: <http://www.actionaid.org/eu/index.aspx?PageID=4485>.

⁵¹ OECD DAC data on total aid budgets are available – on a preliminary basis – also for 2008, but bilateral allocations are not, and this is why we will look at allocations across recipient countries over the 2003-2007 period.

⁵² Alesina and Dollar (2002) and Boschini and Olofsgård (2007) analyse how OECD DAC countries allocate across recipient countries a given aid budget, while here we are interested in analysing how such a budget is determined, while Biggeri and Sanfilippo (2009) perform a similar analysis for a non-DAC donor, namely, China.

⁵³ Bertoli *et al.*, (2007) find that the aid to GDP ratio moves procyclically, but the existence of an independent development agency smoothes the pattern of aid allocations along the business cycle, as it represents an internal lobby which is better able to defend its budget share against competing claims.

period. The definition of aid that we adopt is total disbursements, thus including both debt cancellations and emergency aid.⁵⁴

Table 8: Determinants of aid effort in OECD DAC member countries

	Aid to GDP ratio
Trade balance	0.619 [0.364]
Public debt	-0.00138 [0.000360]***
Primary fiscal balance	-0.0135 [0.00226]***
Government revenues	0.0133 [0.00286]***
Independent aid agency	0.0149 [0.0341]
Output gap	-0.00124 [0.00380]
Output gap, cube	0.000264 [6.60e-05]***
Constant	-0.116 [0.0911]
Observations	626
Number of country	22
Period	1970-2008
Country-fixed effects	yes
Year-fixed effects	yes
R ²	0.358

Note: robust standard errors in brackets; *** p<0.01, ** p<0.05, * p<0.1

The set of determinants on which the evolution of the aid to GDP ratio is modelled includes the trade balance, the public debt, the primary fiscal deficit, government revenues, the output gap – with all these variables taken as ratios to the GDP – and the existence of an autonomous aid agency.⁵⁵ The estimation strategy allows for both country- and year-specific fixed effects. The measure of the output gap – which captures the phase of the business cycle as it reflects the difference from the potential level of the GDP and its actual level – is included also in a higher-order term, to capture possible relevant non-linearities in the relationship between the business cycle and the aid budget. Specifically, this allows us to test whether major slowdowns and recessions lead to a more than proportional reduction in the size of the budget item that is allocated to development aid.

Table 8 reports the outcome of the panel estimation that represents the basis for the prediction of aid budget in 2009. The estimated co-efficients are in line with those obtained in Bertoli *et al.*, (2007), with just one single, but relevant, departure: while the co-efficient of the output gap is statistically insignificant, the cube of this variable is highly significant statistically, suggesting that major fluctuations in the business cycle – like the current one – can have a more than proportional impact on budget allocations to development aid. The estimates reported in Table 8 allow us to predict the level of the resources that each donor country could devote to aid in 2009. Clearly, such a prediction is

⁵⁴ This choice is constrained by the fact that this is the only measure of aid that – albeit on a provisional basis – the OECD DAC has already released for 2008.

⁵⁵ The sources of the data are represented by the OECD QWIDS and Economic Outlook databases, while the institutional variable on the existence of an independent development agency was originally collected by Bertoli *et al.*, (2007).

exposed to two sources of uncertainty: the first relating to the estimation of the co-efficients of the relevant variables, and the second relating to the forecasts of the variables themselves, which are drawn from the OECD Economic Outlook. This entails that these predictions need not to be taken at face value, although they can reveal the size of the possible effects of the crisis on aid flows. Table 9 reports the size of the aid budget for each OECD DAC member country in 2008, and the levels that we predict for 2009.

Table 9: Actual aid budgets in 2008 and predicted aid budgets for 2009, \$ million

Donor country	2008	2009	variation
Australia	3,166	2,680	-486
Austria	1,681	1,477	-204
Belgium	2,381	2,123	-258
Canada	4,725	3,672	-1,053
Denmark	2,800	2,711	-89
Finland	1,139	1,027	-112
France	10,957	9,460	-1,497
Germany	13,910	11,757	-2,153
Greece	693	536	-157
Ireland	1,325	860	-465
Italy	4,444	2,936	-1,508
Japan	9,362	6,893	-2,469
Luxembourg	409	375	-34
Netherlands	6,993	6,598	-395
New Zealand	346	309	-37
Norway	3,967	3,502	-465
Portugal	614	533	-81
Spain	6,686	5,676	-1,010
Sweden	4,730	4,561	-169
Switzerland	2,016	1,804	-212
United Kingdom	11,409	10,438	-971
United States	26,008	17,615	-8,393
DAC total	119,761	97,544	-22,217

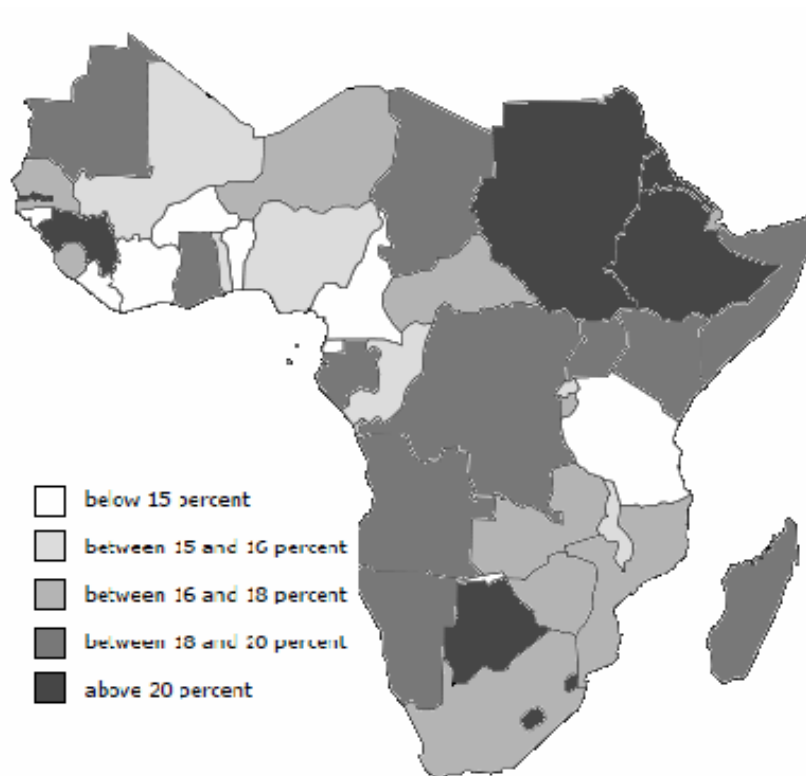
Source: ERD elaborations on OECD DAC.

Table 9 suggests that total aid flows from OECD DAC countries could fall by \$22 billion in 2009, and the fall is unevenly distributed – both in absolute and in relative terms – across donor countries. Such a predicted impact of the current financial and economic crisis on total aid budgets casts doubts on the possibility of the member countries living up to their commitments to scale up aid flows to Africa.

4.9 The impact on Sub-Saharan African countries

To see now how different recipients are affected, we assume that OECD DAC countries allocate the same predicted budget for 2009 across countries as they did on average over the period 2003-2007. The picture that we get is not optimistic, as the predicted reductions in aid flows for African countries between 2008 and 2009 range between 12 and 36 per cent. As Figure 6 shows, most Sub-Saharan African countries can be expected to be exposed to a reduction in aid flows of between 15 and 20 per cent, which – especially in more aid-dependent countries – could represent a severe macro-economic shock.

Figure 6: Estimated reduction of Aid flows to Africa in 2009



Source: ERD elaboration

While Figure 6 does not evidence a differential exposure to the effects of the predicted fall in aid flows, what needs to be stressed is that these countries are less able to cope with a reduction in what represents – for most of them – the single most relevant revenue item in their Balance of Payments. Fragile African countries might suffer severe social costs from such a sharp reduction in aid flows, which could be avoided – or, at least, softened – by an improvement of the focus of aid flows on the countries that pose the more severe development challenges.

Needless to say, European donors should avoid reducing aid to Sub-Saharan African countries in general, and to fragile countries in particular, as the aid channel would then add to the adverse effects that go through the channels previously described. However, the fear that donor countries, which have incurred high domestic costs in order to cope with the present economic crisis, may reduce their flows cannot be easily dismissed, given both the historical experience and some worrying early signals. The IMF (2009c) argues that “notwithstanding international commitments to scale up aid, projections do not suggest such scaling-up to be in the pipeline for 2009”,⁵⁶ and suggests that low income countries could suffer from a 25 per cent reduction with respect to the previous year.

⁵⁶ IMF 2009c, p. 30.

5. Direct Impact of the financial crisis on Sub-Saharan Africa

We mentioned before that most fragile Sub-Saharan African countries have under-developed financial systems and that this has somehow protected them from a direct transmission of the crisis. “Africa’s external financing (bonds issues, stocks and private borrowing) is low,⁵⁷ representing only 4% in 2007 of overall issue for emerging economies” (Kasekende *et al.*, 2009, p. 1). Since the financial channels include effects through the stock markets (stock market capitalisation of Africa is only 2.09% of world capitalization) and the banking sector,⁵⁸ *i.e.*, mainly borrowing from advanced economies and private investment funds, African countries, where the (small) banking system plays, in any case, a bigger role than financial markets, were at the “borders of the crisis”. Furthermore, the banking system has suffered mainly in those countries where there is a presence of foreign banks (Mozambique, Swaziland and Madagascar). Many countries, especially oil exporters, had accumulated foreign exchange reserves in the years of the raw material price boom, and this has supported the birth (expansion) of Sovereign Funds (for instance, in Nigeria or the Sudan, see box). It is not clear (due to the lack of recent data) how SWF will evolve.

Short-term portfolio flows are too limited to affect the SSA economy seriously. According to latest estimates, short-term net private capital flows to emerging countries accounted for USD 253 billion in 2007 and declined to USD 141 billion in 2008.⁵⁹ Inflows into fragile African countries are, however, negligible, and this channel could impact on fragile countries mainly through its indirect effect, via intra-Africa migration and trade flows (namely, through the influence of South Africa, Kenya and Nigeria on fragile African countries). A higher risk aversion together with the global credit-tightening, as well as the increased volatility of capital markets and exchange rates, has, however, involved a decrease of the (already low) inflows in SSA. This decline (or reversal of trend) in portfolio flows could affect government borrowing and increase debt burdens and create some debt-servicing difficulties in some countries. “In Nigeria, foreign portfolio investors withdrew \$15 billion from the capital market in January 2009” (p. 3, ODI, 2009), the stock market capitalisation fell by almost half, and the “All Share Index lost a total share of 67% from March 2008 to March 2009” (*ibidem*). But also in other SSA countries, such as Kenya, Uganda, Benin, Ghana or Zambia, the stock markets lost more than 20% in the last year. Some of these emerging African markets (South Africa, Kenya, Ghana and Nigeria), in which financial markets are more integrated, suffered a direct effect and spread the negative spill-overs also onto neighbouring countries. Furthermore, “many bond issuance plans were put on hold. Ghana has cancelled a plan for \$300 million debt... Kenya has delayed a planned debut \$500 million Eurobond. Tanzania has postponed plans to issue a debut Eurobond totaling at least \$500 million until market conditions improve. Uganda will not issue a debut Eurobond to fund infrastructure projects”. (see Macias and Massa, 2009 p. 5). Furthermore, according to the IMF (2008), there were no SSA foreign currency denominated bond issues in 2008.

⁵⁷ Bond issue stood at only USD 6 billion with respect to USD 33 billion for Asia and USD 19 billion for Latin America; Africa received only USD 3 billion of private resources in 2007, compared to USD 42 billion for Asia, AfDB, 2009.

⁵⁸ Banking assets are 0.87% of global banking assets, according to AfDB, 2009.

⁵⁹ According to Macias and Massa, 2009, in 2006 portfolio equity flows to SSA doubled “reaching a value of \$15 billion. Most of these flows went to South Africa (88%), but other countries with established and relatively more developed stock markets, like Botswana, Côte d’Ivoire/the Ivory Coast, Ghana, Mauritius and Kenya, also experienced increases in portfolio flows”. p. 3.

Table 10: Stock market losses for some countries

Region / Country	Index Name	Index Code	% change in July	% change in August	% change in September	% change in third Quarter
Côte d'Ivoire/ Ivory Coast	BRVM Composite Index	BRVM CI	-4.0	5.6	0.5	1.9
Egypt	CASE 30 Index	CASE30	8.3	8.6	1.3	19.1
Kenya	Kenya Stock Index	KSE	-0.7	-5.5	-1.8	-7.8
Mauritius	Mauritius AllShares	SEMDEX	4.6	0.8	10.7	16.7
Morocco	Casa All Share Index	MASI	-5.3	1.1	-2.5	-6.7
Nigeria	NSE All Share Index	NSE	-5.9	-7.7	-3.6	-16.2
South Africa	All Share Index	JALSH	10.0	4.1	-2.9	11.2
Tunisia	Tunis se Tnse Index STK	TUNINDEX	-1.5	3.5	9.1	11.2
USA	Dow Jones Industrial	DJ Index	8.6	4.1	-0.6	12.3
France	CAC 40 Index	CAC40	9.1	7.8	-1.2	16.2
Japan	Nikkei 225 Index	N225	4.0	1.7	-7.6	-2.3

Source: African Development Bank 2009

One financial channel of transmission which is relevant in SSA is the increase in the costs of external debt. This started to rise in July 2007, even though the spreads remained moderate until the beginning of the financial crisis. According to the AfDB (2009), the spreads for African countries in October 2008 rose by 250 basis points (on average). Furthermore, Kenya, Uganda and Tanzania were forced “to postpone tapping of international financial markets to mobilise long-term resources, turning instead to local markets” (Kasekende *et al.*, 2009 p. 5). Finally, we mentioned above that the financial crisis amplified the increase in the margin applied to loans in the international financial markets, especially for emerging and African countries. In most countries, the impact of the financial crisis manifested itself through currency fluctuations, especially against the US dollar or the Euro. The depreciation of some currencies is attributable to the impact of the financial crisis on commodity prices and the decline in foreign exchange reserves.

6. Can fragile states cope with the crisis?

Having described some “facts” related to the financial crisis and highlighted the main transmission channels to SSA and fragile countries in particular, we can assess the capacity of fragile countries to cope with the crisis. This could suggest some guidelines for intervention for the EU. We mentioned above that countries are vulnerable economically when they are particularly sensitive to external shocks. We first evaluate the exposure to shocks, and then the capacity to react. We want to check whether fragile countries - in line with expectations - are more vulnerable to shocks than other Sub-Saharan countries. Like Naudé (2009), we consider diversification, external indebtedness, the openness of the economy, cross-border liabilities, capital to risk-weighted assets, and rate of credit growth in the private sector.⁶⁰ More precisely, for each fragile country with data (hence, excluding Mauritania, Somalia, Sudan and Zimbabwe), we analyse:

⁶⁰ Guillaumont and Guillaumont Jeanneney (2009) refer to structural vulnerability using an economic vulnerability index that combines the exposure to shocks - population size, distance from world market, concentration of goods exports, and relative share of value added in agriculture, forestry, and fishing - and the “size” of the shock itself. AfDB (2009) uses structural macro-economic factors such as falling reserves, high concentration of foreign ownership in the banking system, inflationary expectations, and reductions in GDP growth, the terms of trade and the current account. The

- Openness, measured as the share of exports over GDP;
- Concentration of exports, measured as the Herfindal-Hirschman Index - the more diversified the basket of exports, the less vulnerable the country;
- External indebtedness, measured as external debt as a share of GDP;
- Regulatory capital to risk-weighted assets;
- Cross-border liabilities;
- Growth of credit to the private sector.

We compute the ranking for countries as a simple average to avoid distortions. We rank all Sub-Saharan countries - fragile and non-fragile - according to a criterion in which a low rank means low vulnerability and a high rank means high vulnerability. We then divide the countries into roughly three equal groups from low to high. Countries in situations of fragility, according to our operational definition, are spread equally among the three groups.⁶¹

(Contd.) _____

European Commission DG Development uses three sets of variables: dependence on export revenues; dependence on external financial flows and capacity to react.

⁶¹ Also the ranks by the African Development Bank and the European Commission DG Development give similar results. Fragile countries are spread across the different groups even though the variables considered to rank countries according to their vulnerability are somehow different.

Table 11: Overall vulnerability rank

Country	Rankings		
	Naudé (2009)	AfDB	European Commission DG Development
Angola	High	High	Low
Benin	Low	Moderate	Medium
Botswana	Medium	Very Low	Low
Burkina Faso	Medium	Moderate	Medium
Burundi	High	Very high	Medium
Cameroon	Medium	Low	Low
Cape Verde	High	Moderate	Medium
Central African Republic	Low	High	High
Chad	Medium	Moderate	Low
Comoros	Low	n.c.	Medium
Congo, Dem. Rep. of	High	High	High
Congo, Rep. of	Low	n.c.	Low
Côte d'Ivoire/Ivory Coast, The	High	High	Medium
Equatorial Guinea	Low	Low	Low
Eritrea	Low	Very high	Medium
Ethiopia	Low	Moderate	Medium
Gabon	High	Very Low	Low
Gambia, The	Low	High	High
Ghana	High	Moderate	High
Guinea	Medium	n.c.	Medium
Guinea-Bissau	Medium	Moderate	Medium
Kenya	Medium	High	Medium
Lesotho	Medium	High	Medium
Liberia	High	High	High
Madagascar	Low	Very high	Medium
Malawi	Low	High	Medium
Mali	High	n.c.	Medium
Mauritius	High	Moderate	Medium
Mozambique	High	n.c.	High
Namibia	Medium	Very Low	Medium
Niger	Low	Very high	Medium
Nigeria	High	High	Low
Rwanda	Low	High	Medium
São Tomé and Príncipe	Medium	High	High
Senegal	Medium	Very high	Medium
Seychelles	High	Moderate	High
Sierra Leone	Low	High	Medium
South Africa	High	n.c.	n.c.
Swaziland	Medium	Low	Low
Tanzania	Medium	Moderate	High
Togo	Medium	Very high	Medium
Uganda	Low	Low	Medium
Zambia	Medium	High	High

Notes: countries belonging to the operational definition of fragile countries are in bold; n.c. denotes not classified; vulnerability indexes combine into a synthetic measure the external and fiscal position of a country, and the degree of diversification of its export basket.

Source: Naudé (2009) and European Commission DG Development, personal communication.

Fragile countries will suffer from the steep fall in international trade. However, they will also suffer from deteriorating terms of trade and shrinking remittances because of higher unemployment in developed countries and in emerging Sub-Saharan African countries, declining FDI and disinvestments and possibly a reduction in aid flows, at least in the short- to medium-run. To understand how they can cope with the recession or other negative shocks, we propose and apply an overall resilience index.

Resilience is a multi-faceted characteristic of a socio-economic system, which is only partly understood, and whose measurement is controversial. Following Naudé (2009), we focus here just on its macro-economic dimensions, which relate to the ability of the state to implement adequate policies in reaction to a shock, such as the 2008-09 crisis. Hence, additional dimensions of resilience – at household or community level – are not considered; although their relevance should not be downplayed, it is still state institutions which represent a pillar of resilience. With this *caveat* in mind, we build an index of the resilience of each Sub-Saharan African country, by examining four separate dimensions:⁶²

- Macro-economic management, reflected in balance of payments and fiscal balances and levels of currency reserves;
- Good governance;
- Market efficiency, measured by the Doing Business in 2009 indicators;
- Social cohesion, measured by using the ethnolinguistic fractionalisation index and the political instability index.

We then aggregate these four components of the resilience index, and we rank Sub-Saharan African countries according to their capacity to cope with external shocks, in three main categories: low, medium and high resilience. The sub-group of fragile countries is mainly classified as low resilience.

Table 12: Overall Resilience Rank- from low to high

Low		Medium		High	
Congo, Dem. Rep. of	1	Ethiopia	16	Burkina Faso	31
Chad	3	Sierra Leone	17	Togo	32
Burundi	4	Zambia	18	Madagascar	33
Central African Republic	5	Malawi	19	Benin	34
Eritrea	6	São Tomé and Príncipe	20	Tanzania	35
Congo, Rep. of	7	Cameroon	21	Mozambique	36
Guinea-Bissau	8	Mali	22	Lesotho	37
Côte d'Ivoire	9	Uganda	23	Swaziland	38
Guinea	10	Nigeria	24	Seychelles, The	39
Niger	11	Ghana	25	Gabon	40
Kenya	12	Senegal	26	Namibia	41
Liberia	13	Cape Verde	27	South Africa	42
Angola	14	Rwanda	28	Mauritius	43
Comoros	15	Equatorial Guinea	29	Botswana	44
		Gambia, The	30		

Note: countries belonging to the operational definition of fragile countries are in bold
Source: Naudé (2009).

⁶² See the background paper by Naudé (2009) in Volume 1B with additional details on the index.

We note that the most fragile countries are in the group of low resilience countries. In each country, it is likely that those most affected will be the poorest, those less resilient than average (at community and household level).

The ability of fragile countries to react to the crisis was impaired not only by fragility itself, but also by the previous food and fuel crises: food- and oil-importing fragile countries suffered from the transmission of the real effects of the 2008-09 crisis when most of them were already in a highly-stressed situation, which further added to their limited ability to react to the crisis due to the fragility of their state institutions.

If we consider the vulnerability and low resilience jointly, we see that many fragile countries have high vulnerability and have low resilience: these are the countries most exposed to the effects of the crisis.

7. A Summary of the main effects of the crisis for countries in situation of fragility

We have analysed the channels of transmission of the current crisis to Sub-Saharan Africa, with an eye on countries in situations of fragility which have weak governance institutions, which, in turn, undermine their ability to provide public services to the community. Many of these countries are still in a situation of armed conflict, or have recently emerged from conflicts. Most of them are net food importers and have had to cope with increasing food prices, which are still higher than before the recent food crisis, while some are oil (raw materials) importers and have had to cope with high and highly volatile prices (which, in turn, increases uncertainty and discourages trade and investments). Most of them depend on the exports of a small basket of products, directed to a small set of markets. They heavily depend on remittances and aid flows, and on scant domestic resources, which depend largely on taxes on exports (which therefore fall with declining exports). Foreign direct investment inflows are concentrated in a few sectors (mining, oil, and, more recently, land). Financial markets are at best in an infant state. Safety-nets are limited, when they exist.

On the one hand, there are some specific features of African countries in situations of fragility, which distinguish them from other developing countries, and, on the other hand, countries in situations of fragility, even before the financial crisis started, were in precarious conditions and had very little space for manoeuvre.

What characterises SSA (and is likely to characterise fragile countries) is a persistence of the effects of shocks, potentially very damaging, especially in countries in which the capacity to cope with the shocks is very low. Exports seem to take longer to recover than in other developing countries, and not because of their composition, skewed towards raw materials (see Berman and Martin, 2009), uncertainty impacts strongly - and asymmetrically - on foreign direct investments; the withdrawal or postponement of infrastructural projects has very long-term consequences, especially in terms of lower competitiveness of exports; the fall of remittances can also have long-term consequences, because, in many cases, income from remittances is used differently from domestic income sources: remittances are often invested in education and housing (Maimbo and Ratha, 2005). Acquisition of farmland in Africa could improve agricultural productivity, but there are many risks that all the benefits are taken by the "new owners", in a situation in which recent forecasts mention that food imports in Africa will increase substantially and that food security will be a major issue in the years to come.

A number of estimates of the effect of the crisis on SSA (less on fragile countries in Africa) exist, and more will be produced in the next few months. The worrisome feature is that, so far, starting from October 2008, all estimates have been continuously revised downwards. All the existing estimates emphasise a general decline in growth, affecting most countries (see IMF, 2009, AfDB, 2009, WB, 2009), and point to negative spill-over effects. Furthermore, though it is often true that growth does not translate into improvements in development indicators (and/or in well-being), a reduction in growth is very likely to have damaging effects on many of the MDGs (and other development targets).

Asymmetries are, indeed, very common: growth may not translate into better education or health, but recession undoubtedly implies fewer resources for health and education (as well as other development indicators).

Table 13: Financial Inflows to SSA as percentage of GDP in 2007

Country	ODA net inflows, all donors	FDI inflows	Workers remittances	Exports
Angola	0.41%	-2.53%	n.a.	71.30%
Benin	8.47%	0.86%	3.12%	11.80%
Botswana	0.85%	4.01%	0.95%	47.40%
Burkina Faso	13.74%	8.86%	0.74%	10.50%
Burundi	48.07%	0.01%	0.01%	8.30%
Cameroon	934%	1.37%	0.50%	24.20%
Cape Verde	11.19%	12.14%	9.79%	43.10%
Central African Republic	10.38%	1.60%	n.a.	14.80%
Chad	5.01%	8.59%	n.a.	11.80%
Comoros	9.46%	0.17%	2.55%	14.80%
Congo	1.66%	4.59%	0.15%	80.30%
Congo Dem. Rep.	12.20%	7.22%	n.a.	46.00%
Côte d'Ivoire/ Ivory Coast, The	0.83%	2.15%	0.91%	46.60%
Equatorial Guinea	0.25%	13.72%	n.a.	81.90%
Eritrea	11.73%	-0.21%	n.a.	6.80%
Ethiopia	12.47%	1.31%	0.89%	12.80%
Gabon	0.42%	2.33%	0.06%	64.70%
Gambia, The	11.13%	9.79%	9.80%	36.00%
Ghana	7.66%	5.69%	0.70%	39.80%
Guinea	5.39%	2.67%	1.00%	29.10%
Guinea-Bissau	32.43%	1.84%	7.63%	23.50%
Kenya	4.72%	2.69%	4.81%	25.40%
Lesotho	776%	6.33%	22.22%	55.00%
Liberia	95.37%	5.75%	93.86%	38.30%
Madagascar	12.14%	13.56%	0.15%	28.60%
Malawi	20.47%	1.52%	0.03%	23.70%
Mali	14.21%	5.03%	2.96%	28.20%
Mauritania	12.90%	5.42%	0.07%	
Mauritius	1.08%	4.89%	3.10%	60.80%
Mozambique	22.02%	5.30%	0.99%	37.60%
Namibia	2.35%	8.01%	0.19%	49.00%
Niger	12.74%	0.64%	1.56%	19.90%
Nigeria	1.22%	7.44%	1.99%	40.30%
Rwanda	20.90%	1.97%	1.50%	10.00%
São Tomé and Príncipe	25.70%	25.22%	1.43%	7.60%
Senegal	7.46%	0.69%	7.73%	23.50%
Seychelles	0.31%	27.23%	539.56%	123.80%
Sierra Leone	32.06%	4.85%	2.28%	20.90%
Somalia				
South Africa	0.28%	2.01%	0.15%	31.60%
Sudan, The	4.52%	5.24%	2.49%	
Swaziland	2.17%	1.30%	3.41%	76.90%
Tanzania	16.84%	3.59%	0.09%	21.20%
Togo	4.84%	2.76%	7.70%	42.00%
Uganda	14.51%	3.09%	7.13%	17.00%

Zambia	9.16%	8.62%	0.52%	42.70%
Zimbabwe	3.88%	0.58%	n.a.	17.10%
Africa	2.97%	4.07%	2.48%	
SSA (incl. Sudan)	4.19%	3.86%	1.89%	38.20%

Note: countries belonging to the operational definition of fragile countries are in bold.

Source: ERD elaboration on OECD, African Economic Outlook 2009.

Considering FDI, aid, remittances and portfolio outflows together, the amount of financial resources at risk in Africa for 2009 could be around 12-15 per cent of African GDP (AfDB, 2009). A fall of 30-40 per cent in these inflows could mean an annual decline in financial resources of around USD 50-60 billion, which, according to the ODI (2009), means “50 million people trapped in absolute poverty, with the number expected to rise to 90 million” (p. 1). Recent estimates suggest that, as far as poverty is concerned, there could be around 230,000 new poor in 2009 in Uganda (0.8% of population) and in Ghana (1%), 38,800 for Zambia, 57,700 for Kenya, and 52,000 for Benin.⁶³ Clearly, all other MDGs could be at risk: increase in infant mortality (400,000 additional deaths, according to the AfDB, 2009), and education attainments are further examples. This could prove particularly damaging in the longer-run, since only by investing in human capital could fragile countries be fit to recover from the crisis and provide themselves with opportunities.

Another variable of concern is unemployment. This is particularly relevant, since there seems to be a positive relationship between young male unemployment and illegal activities (drug traffic, terrorism, *etc.*).⁶⁴ According to recent estimates, unemployment could increase by 8.5% in 2009. The ILO (2009) maintains that there could be 3 million newly-unemployed while there could be up to 28 million additional vulnerable jobs because of the crisis.⁶⁵ The ODI (2009) concentrates on few SSA countries and assesses some numbers for the newly-unemployed: 8,100 workers in Zambia in the mining sector, 5,000 in Ghana in foreign-owned firms, 1,200 in Kenya in the horticultural industry. According to the Minister of Mining of the DRC (quoted from Kasekende *et al.*, 2009) closures of mines have “caused a loss of up to 200,000 jobs” (p. 15), “a local textile company in the West (of Madagascar) closed, causing the job of 4,000 jobs” (p.16).

The fragility of state institutions blunts political processes for state capacity and citizen expectations to reach an equilibrium. The global financial and economic crisis further jeopardises the chances that such an equilibrium will be maintained in fragile Sub-Saharan African countries. Armed conflict is a possible outcome of the divergence between state capacity and citizens’ expectations. This concern was voiced by Dominique Strauss-Kahn, the Managing Director of the IMF, who argued that, for low-income countries:

“we don’t just care about growth for growth’s sake, we also want to safeguard peace and prevent war. Indeed, when low-income countries were doing well over the past decade or so, the incidence of war declined significantly. The great fear is that this trend could be reversed.”⁶⁶

Miguel *et al.*, (2004) analysed the determinants of civil war in 41 African countries, showing that a 5% reduction in the rate of economic growth increases the risk of a conflict by a half. Brückner and Ciccone (2007) find that a crash in the price of an export commodity increases the likelihood of an armed conflict. And Ciccone (2008) shows that a drought-induced fall in incomes produces a similar effect.

Such a tragic outcome of the crisis in Sub-Saharan African fragile countries increases the human and social costs of the global financial and economic crisis. While Sub-Saharan African countries need

⁶³ These estimates are from ODI, 2009 and rely on country case studies.

⁶⁴ See Collier, 2009.

⁶⁵ Antonopoulos, 2009, argues that job losses in developing countries are most likely to hit “female intensive” activities.

⁶⁶ Strauss-Kahn, 2009.

not suffer more from a higher macro-economic shock than other countries in the region, the consequences could be much more severe, due to their limited capacity to implement adequate policy responses to the shocks. This is why protecting fragile countries from the fallout of the crisis should rank high among the donor priorities.

8. Possible responses to the crisis

There is a need for a country-by-country assessment. The variety of indirect channels through which fragile countries could be affected suggests that it is necessary to move towards a tailored approach, in which we analyse the exposure of each single country to the effects of the crisis. Recent research⁶⁷ has shown that even some of the most successful among the SSA countries are likely to face a slowdown. The magnitude of the slowdown, in turn, depends upon a combination of factors, including the terms of trade shock, the degree of the economies' dependence upon external financial flows, the performance of macro-economic indicators,⁶⁸ and the degree of inter-relation of the financial system with the international markets. Another relevant issue has to do with the opportunity to adjust the exchange rate downwards and on the consequences for the Balance of Payments.

For all countries, it is necessary, in the long-run, to build greater resilience to shocks. This requires the diversification of their economies, and, in particular, for those countries that have heavy reliance on one or two primary commodities to develop other sources of income. Diversification of exports is an important part of this. Stabilisation funds may also have a role to play. There is a significant need for countries to reduce their aid dependency since this makes them much less vulnerable to reductions when a crisis occurs. Stability will be enhanced by the development of pro-cyclical fiscal systems. Countries can use foreign exchange reserves to allow external shocks to be smoothed so that the countries can self-insure. For countries that are heavily reliant on only a few commodities, the use of long-term contracts with fixed prices may be helpful,

In the short-term, it is important that EU policies be designed to mitigate the effects of the crisis. Provision of trade credit is one important aspect of this. If exporters are unable to obtain trade credit commercially, then the EU should help by setting up a system of guarantees for risks which would be covered in normal times. In the case of fragile countries, this could be done directly through the importers of African goods in EU countries.

Given the importance of remittances, the EU should avoid sending home migrant workers. Although the number of people who directly come from Sub-Saharan Africa to the EU may be small, the indirect effects of sending home people to North Africa and the Middle East could be significant. They may displace people in their home countries who then return home to Sub-Saharan African countries.

One way that countries can try to offset the effects of the crisis is through generating revenue from the use of land by foreigners. As discussed above, while this potentially has many benefits, there is also significant potential for abuse. The EU could help to maximise the advantages by developing guidelines for the use of land by other countries. Instead of outright sales, leases would have many advantages. They would provide a disciplining device if there were any abuses of the way in which the land were used. Also, the agreements should ensure the use of local labour so that there is no undesirable impact on unemployment. Perhaps most important of all, the agreements should be designed to maximise the transfer of technology, since this will bring long-term benefits to the country. From the point of view of the country using the land, leases have the advantage that they

⁶⁷ See, for instance, Massa and te Velde (2008), and ODI (2009).

⁶⁸ The authors find for instance that in terms of reserves hold, although SSA countries as a group are healthy, the group of fragile countries is seriously lagging behind (Massa and te Velde, 2008).

reduce the chance of expropriation. If they buy the land and these deals become unpopular, the land may simply be nationalised and the countries expropriated.

The EU should also commit itself to maintain aid to African countries, particularly to the most fragile states. The amounts involved are very small compared to the amounts spent on the bail-outs of financial institutions. Moreover, while the expenditure on aid is small, its effect on welfare is much greater.

During these difficult times, the EU should step up its efforts to help prevent corruption and the outflow of funds obtained by corrupt officials from European financial institutions. The issue of tax evasion has come to the fore within the EU. Increased enforcement efforts should also be directed to help Sub-Saharan African countries control the illegal activities of their citizens. Laws should also be passed in order to make it easier for countries to repatriate such funds obtained through illegal activities.

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