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AFRICA

FALLACIES ABOUT THE GLOBAL FINANCIAL CRISIS HARMS RECOVERY IN THE POOREST COUNTRIES

WIM NAUDÉ*

The global financial crisis, which erupted in September 2008, has had a particularly detrimental impact on the poorest countries, of which the majority is in Sub-Saharan Africa. As in other regions, the crisis has led to a drop in African countries' export revenues, and raised the costs and difficulties of accessing finance for firms, households and governments alike. But for African countries, unlike perhaps many other regions that have also been adversely affected, the shocks of the crisis may imply more long-term difficulties. This is due to a number of structural features shared by many countries of the continent, in particular (i) the high level of poverty to start out with, and the resulting lower household and government resilience to weather the shocks as in other regions, (ii) the greater dependency on aid than in other regions, (iii) the dependence on commodity-driven export growth and hence a high degree of vulnerability to declines in external demand, (iv) the large number of fragile states in the region, and (v) the relatively large number of small economies, many of which are landlocked and do not yet share the benefits of strong regional integration.¹

The challenge facing the poorest countries, such as those in Africa, is not only to ensure proper short-term economic management of the crisis (and political stability), but also to steer long-term recovery in a way that will not undermine recent gains in development, and moreover will contribute to-

wards a continent that is less vulnerable and more resilient towards external shocks. This is a tall order. Strengthening African governance, regional integration and continuing to fast-track aid disbursements and keeping to aid commitments will all make a contribution, but ultimately, little long-term progress will be made unless policymakers here and in the West arrive at the correct views as to the causes, impact and consequences of this crisis. Unfortunately, one year into the crisis, many fallacies abound. The problem is that if the world acts according to these fallacies, it will harm the recovery in Africa.

There are at least ten fallacies or misunderstandings about the global financial crisis. I will describe these briefly, note why I think they are wrong and point to their implications for the developing world, especially for the poorest countries such as many of those in Africa.

Fallacy 1: the crisis is solely a subprime mortgage crisis

The first fallacy is that the crisis is solely due to the problems in the US subprime mortgage market. The danger of holding this view is that one might be convinced that once the US financial system is cleaned up (i.e. rid of the 'toxic assets') growth will resume and it can be business as usual. And in the meantime, developing countries should only be concerned with preventing contagion from spreading to their banking systems. If, however, one realizes that the crisis has deeper causes, and act to address these, the benefits to developing country recovery and growth will be much more. Specifically, recognizing weaknesses in the world financial architecture and governance and in the structural dominance of the financial sector (the so-called Wall Street oligarchy) may lead to more relevant and appropriate steps being taken to prevent a re-occurrence of a bubble economy.

While the causes of the crisis seem complex, at its root may lie a simple reality: global imbalances in



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¹ Much has been written on the likely impact of the crisis on African countries, and on the options available to African countries and the development community. Representative papers and reports include African Development Bank (2009a and 2009b), Aryeetey (2009), IMF (2009), Fosu and Naudé (2009), Maimbo (2009) and Naudé (2009c).

consumption and saving and ‘regulatory capture’ by a dominant financial sector in the United States. The causes are intertwined: *per se* global imbalances would not have led to crisis, and without imbalances the size and scope of the damage done by inadequate regulation may not have been as large.

Global imbalances

Global imbalances refer to what has also been termed the global savings glut (Bernanke 2005). These intensified after the 1997–98 Asian crisis when these countries found the assistance of the IMF to be unsatisfactory (for various reasons) and started to accumulate foreign exchange reserves as self-insurance. But many other developing countries, and developed countries such as Japan, also started to accumulate foreign reserves. Most of the world’s foreign reserves are in fact now held by middle-income developing countries. Currently, developing countries hold approximately 6 trillion US dollars in foreign exchange reserves. China is the largest single holder of US dollars, having around 2 trillion in reserves. The costs of these reserves to China and other developing countries are substantial. In effect developing countries’ saving is funding high consumption in developed Western countries, such as the United States, which by 2007 accounted for more than 18 percent of global consumption demand.

During the 2000–2007 period, the fact that the United States was the issuer of the global reserve currency, made it possible for the US Federal Reserve to lower interest rates – by up to 27 times between 2001 and 2003 – after the dot-com crisis (Lin 2008). In effect, as it is now clear in hindsight, the Federal Reserve responded to the bursting of the dot-com bubble by inflating another bubble – this time in house prices. This further fuelled household consumption in the United States, which rose to exceed 70 percent of GDP, the highest level ever in this country. As a result, global imbalances continue to widen.

But global imbalances cannot alone bear the blame for the crisis – and neither should they be used to point the fingers for the cause of the crisis at developing countries. After all, the United States was under no obligation to expand household consumption and inflate house prices in the manner that happened. The reason why it did, and why the rise in house prices fed the growth of the subprime mort-

gage sector, is to be found in what could be described as regulatory capture in the United States (Johnson 2009a).

Regulatory capture refers to the dominance of the financial sector in the US economy and to the extent that it was able to influence the weakening of underwriting standards, regulation, supervision – all of which resulted in moral hazards, inappropriate and skewed incentives, and excessive risk taking.² Regulatory capture contributed to (a) regulatory failure, (b) the rise of ‘shadow banking’ that is of financial intermediation outside the regulated and supervised banking sector, and (c) incentive failure (Krugman 2007; Bicksler 2008). These three pathologies led to problems during the 1997–98 Asian crisis, the dot-com crisis, as well as in the current crisis and the way it is now being handled. For instance the dot-com crisis was largely caused by relaxed underwriting standards (new high-tech firms could list on the stock exchange with very little prospects or reputation) and fraudulent ‘laddering’ and ‘spinning’ practices by investment banks (Taibbi 2009). Similarly, between 2000 and 2007 regulatory failure include relaxed underwriting standards with respect to the issuing of mortgage loans (with the so-called ninja-loans, applicants were neither required to have proof of income, employment or assets), the shift by banks of poor quality assets off balance sheet, the issuing of inappropriate AAA ratings on securitized mortgage debt by credit rating agencies (CRAs) who were paid for by the very investment banks issuing the debt (see SEC 2008; Ely 2009), and the backing of credit default swaps (CDSs), which were issued as insurance against mortgage securities, by more CDSs.

Fallacy 2: the crisis is a single one-off event

Many previous financial crises had much narrower causes and erupted in a single discernable shock – albeit affecting many indicators – but essentially dissipating over time, allowing growth to resume. Many previous crises in Africa were of this nature. It is a fallacy to think that the current financial crisis is similar.

The current global economic crisis is different in that it is characterized by waves of successive ex-

² Good descriptions of the extent of this regulatory capture are contained in Johnson (2009a), Stiglitz (2009b) and Taibbi (2009).

Table 1
GDP per capita growth rates for developing country regions 1960–2007 and World Bank forecasts for output growth in 2009–2010 (%)

	1961–69	1970–79	1980–89	1990–99	2000–07	2009 (f)	2010 (f)
East Asia & Pacific	1.58	3.98	5.43	6.43	7.08	5.5	6.6
Latin America & Caribbean	2.79	2.85	– 0.68	1.40	1.93	– 2.2	2.0
Middle East & North Africa	4.39	3.00	– 0.20	1.61	2.22	3.1	3.8
South Asia	1.80	0.23	2.88	2.97	4.77	4.6	7.0
Sub-Saharan Africa	1.99	0.72	– 0.86	– 0.53	2.13	1.0	3.7
Europe & Central Asia	na	na	na	– 1.59	5.12	– 4.7	1.6

Source: Author's compilation from World Bank World Development Indicators, Online and (f) World Bank Global Economic Prospects, 22 June 2009.

ternal shocks to developing countries over the short space of three years. It started with house price and stock market declines in 2007, spikes in food and energy prices in mid-2008 further collapses in stock markets and contractions in credit markets in late 2008, and a slump in world demand in 2009. Now, at the time of writing, food and energy prices are edging upwards again, many stock markets are experiencing bull runs, and warnings are emerging that bubbles may reappear in asset prices (Ely 2009; Schiller 2009). Indeed, at the time of writing (in October 2009) the gold price reached record heights.

Each of the waves mentioned have impacted negatively on African countries over the past three years. An often bemoaned fact is that when the crisis started to unfold in March–June 2007, many African countries were enjoying a decade or so of good growth. Table 1 shows the average GDP per capita growth rates of the various developing regions since 1961, as well as forecasts for growth in 2009 and 2010. It can be seen from Table 1 that all developing country regions achieved higher average growth in the period since 2000, as compared to the previous decade. Sub-Saharan Africa, in particular, was on the path to recovery following the 'lost decade' of the 1980s and the adjustments of the 1990s. Similarly, the countries of Eastern Europe and Central Asia were gaining during the last eight years after the painful transition period of the 1990s.

One of the first casualties of the crisis was growth in developing countries, which slowed down across all regions. Lower growth leading to higher unemployment and higher poverty is widely seen to have more serious longer-term impacts on developing country prospects than similar growth disruptions in richer countries.

Fallacy 3: the crisis has been caused by too rapid financial innovation

Another fallacy is the belief that the crisis has been caused by too rapid financial innovation. Believing this could be an argument for that one may start to caution against the stronger regulation of banks and other financial institutions for the sake of not stifling 'innovation'. In this view, the innovations of the past decade in financial markets were 'good' in spreading risk and should not be discouraged, and that it is good enough merely to 'plug' the regulatory and oversight gaps which this crisis has exposed.

However, with the more accurate expectation that innovation should make a positive contribution and realizing that innovation in finance of the past decade has in fact not spread risk but covered risk up as well as full of moral hazard and conflict of interest problems, the call for real financial innovation must be made, which would include ways to extend banking to hundreds of millions of people across Africa who daily suffer from a credit crunch.

The common frauds in financial markets known as pyramid schemes (or Ponzi schemes) often (purposely) appears very complex, but cannot in any way be seen as innovations. Indeed, many of the so-called innovations in financial markets only created the pretence of spreading risk but in fact did nothing of the sort. As put by Paul Krugman (2007), the innovations of recent years – the alphabet soup of CDOs and SIVs, RMBS and ABCP – were sold on false pretences. They were promoted as ways to spread risk, making investment safer. What they did instead – aside from making their creators a lot of money, which they did not have to repay when it all went bust – was to spread confusion, luring investors into taking on more risk than they realized. Far from being innovative, the com-

plex securitization of bad mortgages was quite ill-suited for performing the basic functions of a good financial system, namely to spread and minimize risk and channel financial resources effectively. Instead they may have covered risk up or even created risk (Stiglitz 2009a).

So-called ‘financial innovations’ may also have contributed to the bubble in oil prices in 2008. Khan (2009) argues that it was the rapid ‘financialization’ of oil markets that allowed the speculation that led to inflated oil prices in 2008, when the price of oil jumped from 90 USD per barrel in January 2008 to 147 USD per barrel in July 2008, dropping after the bubble burst to below 40 USD per barrel by December 2008. The volume of oil futures (‘paper barrels’) is more than 15 times the daily production of oil (Khan 2009). With a growing demand for bio-fuels this put great upward pressure also on food prices, with both the fuel and food price crisis causing untold suffering in developing countries during 2007 and 2008. In view of this, many now would agree with Morris (2008), who argued that it is impossible to exaggerate the sheer idiocy of the financial machinery of the first decade of this century.

Africa’s development requires financial deepening, that is, a financial sector that can effectively intermediate between savers and borrowers. The global economic crisis has made it clear that proper financial innovation requires proper regulation, oversight and governance of banks holding appropriate capital buffers against unforeseen shocks.

Fallacy 4: the crisis was unforeseen

There is a widespread view that the current crisis was unforeseen. This view was widely reported when Queen Elisabeth II asked, at a London School of Economics Seminar in November 2008, why no one apparently forecasted or warned about the impending crash (Bezemer 2009). Giles (2008) maintained that the credit crisis, which has morphed into recession across advanced economies, leaves most economic forecasters with ample egg on their face. This has led many in the economics profession to engage in hand-wringing self-criticism, and for some to apologize on behalf of the entire profession (Posner 2009).

The danger of subscribing to this fallacy is that it makes it acceptable not only to ignore current pol-

icy advice from economists (and also to ignore lessons learnt from previous crises), but also to ignore the policy advice (mostly uncomfortable) which comes by implication from those who did indeed expect a crisis to take place.

There were indeed important failings in institutions central to the global financial architecture in warning about the crisis and in working towards preventing it, in particular in the IMF and the US Federal Reserve. On a number of occasions the IMF had apparently misread the developing situation (as opposed to many others, as I will show). For example in 2006 the IMF is quoted to have indicated that “there is little evidence to suggest that the expected or likely market corrections in the period ahead would lead to crises of systemic proportions” (Bezemer 2009, 5). Also in its October 2007 *World Economic Outlook*, the IMF, although concerned about the subprime crisis in the United States and its potential negative impact on slowing down growth, still assumed in its baseline forecasts that, “market liquidity is gradually restored in the coming months and that the inter-bank market reverts to more normal conditions” (IMF 2007, xv). And, according to the Federal Reserve’s Chairman Alan Greenspan in February 2005, there was no danger of the US economy running into ‘anything resembling a collapsing bubble’ and he expressed a ‘shocked disbelief’ when it did happen in September 2008 (Bezemer 2009). But this does not mean the crisis was unforeseen. Bezemer (2009) compiled a table discussing the views of a dozen analysts who did foresee a serious crisis or crash – see Table 2.

Fallacy 5: the crisis spells the end of globalization

Globalisation is the integration of the world economy due to technological advances and policy initiatives, such as financial and trade liberalisation. For many, the global economic crisis, being a crisis of ‘capitalism’, will set back the process of globalization (e.g. Truman 2009). This end of globalization or the ‘undoing of globalization’ hypothesis has many adherents. It is partly premised on the notion that globalization has either caused or made possible the current crisis. Lin (2009) argues that the crisis was made possible because the volume and patterns of international financial flows have increased considerably in recent times.

The danger of subscribing to this fallacy is that this may become a self-fulfilling prophecy, as countries

Table 2

Foreseeing the global economic crisis

Analyst /Economist	Forecast
Dean Baker (2006)	“Plunging housing investment will likely push the economy into recession”.
Wynne Godley (2006)	“The small slowdown in the rate at which US household levels are rising resulting from the house price decline, will immediately lead to a [...] sustained growth recession [...] before 2010”.
Fred Harrison (2005)	“The next property market tipping point is due at end of 2007 or early 2008 [...]”.
Michael Hudson (2006)	“Debt deflation will shrink the real economy, drive down real wages, and push our debt-ridden economy into Japanese-style stagnation or worse”.
Eric Janszen (2006)	“The United States will enter recession within years”.
Stephen Keen (2006)	“Long before we manage to reverse the current rise in debt, the economy will be in a recession”.
Jakob Brøchner Madsen (2005)	“We are seeing large bubbles, and if they burst, there is no backup. The outlook is very bad”.
Kurt Richebächer (2006)	“A recession and bear market in asset prices are inevitable for the US economy [...]”.
Nouriel Roubini (2005)	“Real home prices are likely to fall at least 30 percent over the next 3 years”.
Peter Schiff (2006)	“The US economy is like the Titanic [...]. I see a real financial crisis coming for the United States”.
Robert Schiller (2006)	“There is significant risk of a very bad period, with rising default and foreclosures, serious trouble in financial markets, and a possible recession sooner than most of us expect”.

Source: Adapted from Bezemer (2009).

may adopt more inward-oriented policies, eschewing international trade. It also has the danger that African countries may miss the opportunity to agitate to make globalization better. The crisis may also offer an opportunity to change the nature, not the direction of globalization, so that developing countries can benefit more.

Globalization is not the cause or contributor to the current crisis. Although the subprime crisis did have global repercussions, it is rather surprising that despite the extent of globalisation and the interconnectivity between regions that the impact largely remained centred on the United States – where more than 70 financial institutions went bankrupt since September 2008 to date and the country’s investment banking industry was all but wiped out. This is in stark contrast to much fewer banking failures elsewhere, despite ‘contamination’ of so-called ‘toxic assets’ containing securitised bad loans. Indeed, the contrast could not be greater between the collapse of banks in the United States and the much lesser affected performance of banks in its close neighbour, Canada (Richburg 2008; Kay 2008). Far from heralding the end or slowing down of the process of globalization, the global economic crisis seems to be changing the course, the direction, of globalization.

To be sure, global trade did contract substantially in 2009 (it is forecasted by the IMF to contract by 11 percent). But global trade is already – albeit

slowly – bouncing back. In previous crises, interruptions in the growth of global trade were also temporary. We have seen this in the 1997 Asian crisis (when the trade of affected countries recovered within one year) and we are seeing it now, for instance in the tentative recovery of China’s exports (Zeiner 2009).

Perhaps with (or without) this recovery of global trade we may be seeing a more meaningful pattern of globalization emerging – one that breaks with the centre-periphery pattern that has troubled development economists since the days of Prebisch and Singer. Consider for instance that during the past year we have seen that (1) China has now overtaken the United States as Africa’s largest trading partner, (2) Chinese investment in Africa exceeded 100 billion US dollars in 2007, and (3) Chinese investment and aid to Africa continues apace, despite the crisis. Similarly, trade between Africa and India increased ten-fold from 7 billion in 1997 to over 70 billion US dollars in 2007, and trade between Latin America and Africa more than doubled since 1994 and now exceeds 26 billion US dollars (UN 2009). Within such a rapid growth of South-South trade, the roles of Brazil, China and India in particular stand out. The size of these three economies combined exceeds that of the United States. Unlike the United States, these economies are growing robustly with predictions of growing household demand, as their middle classes grow more prosperous. They will increasingly become less dependent on exports to the West.

Despite the crisis, there is continued investment in Africa to further promote the continent's integration into the world markets. For example, more than 60 percent of the African Development Bank's (AfDB) current loan portfolio is addressed to globalization-enhancing infrastructure like ports, railways, roads, etc. Also in the area of IT infrastructure the continent has invested and coordinated on a fairly extensive scale to extend its broadband connections by the provision of a number of underseas fiber optic cables.

Fallacy 6: developing countries will be less affected than the advanced economies

A sixth fallacy is that developing countries will be less affected than the West. Hopes that developing countries might avoid the worst of the financial and economic crisis in the West due to decoupling of growth rates have turned out to be overly optimistic. Developing country growth rates and expected future growth rates came tumbling down with amazing speed after the crisis erupted in September 2008. Indeed, in some countries the actual decline of growth rates in the first quarter of 2009 was much worse than was expected, and the IMF and the World Bank continued to revise their predictions for developing country growth downwards. For instance, in the case of Africa, the poorest continent, the IMF revised its growth forecasts for 2009 downwards from 5 percent in October 2008, to 3.5 percent in January 2009 to 1.7 percent in April 2009, and more recently the World Bank revised its forecast down to a mere 1 percent (see Table 1).

It is not just the decline of GDP growth in the West which will have a negative impact on African countries, but also the greater volatility of growth brought about by the crisis and the uncertainty it brings. Volatility in growth is bad for economic progress and consumption in developing countries. Hnatkovska and Loazya (2005) calculated, for example, that if the UK GDP volatility was the same as that of Indonesia, its annual per capita GDP growth would be 1.28 percent lower.

There are various channels and feedback effects through which the global economic crisis (both financially and economically) will impact on developing countries. Naudé (2009a and 2009b) as well as Fosu and Naudé (2009) point out that developing countries will not only be affected by the crisis, but

they will be affected to an even worse extent than the West when one considers the impacts on poverty. The reason for this is that households are much more vulnerable and less resilient in most developing countries. They do not have the luxury of social safety nets to buffer them during economic downturns. Consequently, a decline in growth will affect developing country households worse than a similar decline would affect households in the West. Many households will cut back on health expenditure; many children will drop out of school. Even if growth can be re-started again relatively soon, the effects of a growth acceleration and growth collapse are asymmetric. In Africa, "while growth accelerations result in relatively small improvements in human development, decelerations have important negative impacts on education and health outcomes. Under 5 mortality and infant mortality for example, are substantially higher during growth decelerations than in normal times, but they do not improve during growth accelerations" (Arbache and Page 2008, 9).

As a result, the global economic crisis will leave permanent scars on Africa's development. The problem therefore in adhering to this fallacy is that we might be overtly focused on the short-term challenges of getting growth and trade recovering, and omit giving sufficient attention to the fact that developing countries may be worse affected (and even for longer periods), due to permanent effects and adverse coping, which may not be the case in rich countries.

Fallacy 7: developing countries should wait for the West to lead action towards recovery

A seventh fallacy is that developing countries can wait for the West to lead in taking action or to assist them in recovery. It would be a mistake to think that the recovery steps of Western economies, or for Western countries to stick to their aid commitments, will substantially alleviate the impact of the crisis on developing countries. The West is facing an unprecedented economic crisis of its own. Money thrown at bailing out banks and struggling firms, and as a result of fiscal stimulus initiatives, will require spending cuts in the future as these countries manage their high debt and try to steer away from new debt crises.

This is already clear by the fact that that the rich countries have actually so far done very little for de-

veloping countries during this crisis. Commitments of monetary assistance seem inadequate and doubtful. Aid budgets are being cut and aid is declining despite commitments otherwise. And despite the pledges made by the G-20, murky forms of trade protection continue to be implemented. Despite promises made, very few concrete steps have been taken to start the reform of the IMF and the World Bank. There is therefore a considerable responsibility on developing country governments themselves to forge ahead with appropriate recovery measures and initiatives (Naudé 2009b).

The way forward for most developing countries beside China, India and perhaps Brazil (countries with large domestic markets) may hinge on whether or not exports can continue to be relied on to fuel growth. Some believe that this is no longer possible. These countries should now, with sluggish prospects for Western growth and rising protectionism, stop relying on exports. Calls for countries to stimulate import replacement production and to reduce for instance production of commodities for exporting are being widely heard.

But others are less pessimistic about the potential of exporting to continue to be a viable development strategy. Here one can reiterate the benefits to be gained from concluding the Doha Round (Adler et al. 2009). There are also benefits to be gained from greater South-South trade, and for progress in regional integration and coordination. Here an enhanced role of the UN in collaboration with regional development agencies and regional integration initiatives is likely to have an important impact. Even if developing countries are on their own in this crisis, the mechanisms and tools which UN and regional level assistance can provide will be indispensable for the effectiveness of individual level responses.

Fallacy 8: developing countries have plenty of scope for fiscal stimuli

The eighth fallacy or misunderstanding about the global economic crisis is that developing countries have plenty of policy space to increase fiscal spending. The IMF called for a global stimulus equalling 2 percent of global GDP (Freedman et al. 2009). But only a few developing countries will be able to enact substantial expansionary fiscal measures – these include perhaps China, India, Indonesia and South

Africa, to name a few. Even here the problem is that fiscal stimuli are only feasible for a short period. So many short-term measures now being implemented in some developing countries may soon run out of steam or become counter-productive. Indeed, the drop in commodity prices and the declines in trade will rob many governments of significant resources, thereby reducing the extent to which they can support fiscal expansion without accumulating unsustainable debt. Fears of a new debt crisis have been voiced.

Where developing countries can engage in short-term fiscal expansion and avoid some of the pitfalls identified above, these expansionary measures should be limited in that (i) fiscal deficits should exceed public investment, (ii) real interest rates set by the monetary authorities should be such that it is equal to the sustainable rate of per capita income growth, and (iii) exchange rate depreciation should be limited so as not to lead to unsustainable inflation (Hailu and Weeks 2009). The danger is that the better macro-economic balances in many African countries at the start of the crisis, and the example of huge fiscal stimuli in rich countries, will create the impression that African countries should without hesitation embark on fiscal stimuli of their own. Realizing that this is not the case, however, leads to a sober approach of trying to balance the need for counter-cyclical policy with the need to avoid a number of pitfalls which may undermine growth later in the future (Fosu and Naudé 2009).

Fallacy 9: the recovery measures taken by the West will unambiguously benefit developing countries

A ninth fallacy is that the steps taken by the West to recover will also benefit developing countries. Assuming that the West's recovery plans will work and that it will benefit, and not harm, developing countries appears to be rather risky. Indeed, the steps taken by the West to boost the short-term recovery may have adverse longer-term consequences for their own growth and development. There are three broad threats to the poorest countries.

The first is the threat of financial and trade protectionism. Financial protectionism results from the actions of the United States: as the issuer of the world's reserve currency it can pump trillions into its banking sector to guarantee its stability, thereby attracting funds from other countries without this

ability. Trade protection is also evident in Section 1605 of the USD 787 billion stimulus package approved in February 2009 which commits this country to a 'buy American' condition, i.e. to spend these funds largely on goods manufactured domestically. The implications of these clauses on US jobs, trade commitments and foreign relations are discussed by Hufbauer and Schott (2009), who conclude that they are unlikely to create many jobs, will violate US trade commitments and ultimately damage the country's reputation with little to show for it.

The second is the possible fallout from the bank bailouts, such as worse moral hazards, the socialization of risks, privatisation of profits, supporting the 'wrong' industries ('rent-seeking' finance and carbon-intensive manufacturing such as car making), and setting a wrong example (rising protectionism and bailouts across the world). A third is that without fundamental reform of the global financial system, countries will learn from this crisis that it pays to self-insure through accumulating reserves, which will depress global demand. Hence, the danger of this fallacy is that it will lead to complacency and an inappropriate short-term focus. We should not lose sight of the longer-term implications of the crisis on global development.

Fallacy 10: the crisis is over

Despite the recovery in output and trade in some countries the crisis is not yet over. For one, it is not clear-cut that the recovery will be durable. While optimists see a straightforward V-shaped recovery, some see it as being L-shaped (implying sluggish growth for a long time) and others as a W-shaped recovery – a 'double-dip recession' (Roubini 2009).

There may be two reasons to take warnings of a double-dip recession seriously. The first reason is simply that the expansionary policies will run out of steam. Lin (2009) is of the opinion that the improved growth performance in recent months may be merely reflecting the 'mechanic effect of the expansionary' policies adopted. The second is that the growth will again be accompanied by the inflation of a bubble which will burst again. One immediate danger is that banks, having been recognized to be too large to fail and having become even more concentrated after the crisis, will re-engage in similar behavior (see also below). Furthermore, some argue that the lessons of the crisis had not been learned. Schiller

(2009), for instance, expressed the concern that speculative investment in housing is again starting in the United States and that, as before, it is based on the erroneous view that land shortages would keep pressure on house prices to continue rising.

Many others also argue that the crisis could happen again because the response (bailouts, new regulations, fiscal stimuli) have been inadequate, and should also include breaking up too-big-to-fail banks and global restructuring (Johnson 2009c; Stiglitz 2009a). But there have also been steps taken and proposals put on the table to tighten the regulations and oversight of the financial system – indeed much of the G-20 response has been of this nature. Ely (2009) presents a pertinent discussion of new financial regulations in the light of the crisis. He basically warns that if new regulations and new oversight measures come to be the main structural response to the crisis, then it may fall short, since it is essentially reactive measures that will be taken, and ingenious market participants may find a way around these. "These new regulations will set up the global economy for yet another financial crisis, perhaps worse than the present one ... indeed, policy-making that responds to symptoms and consequences of perceived problems, rather than forthrightly addressing the underlying causes of real problems, will introduce greater fragility into the financial system" (Ely 2009, 93).

Concluding remarks

Unless the fallacies discussed in this paper are discarded, and coordinated actions taken to overcome the root causes of the global economic crisis implied to hide behind the fallacies, the danger of a slow recovery for developing countries, in particular those in Africa, remain a real threat.

Indeed those who adhere to these fallacies would probably have thought it unlikely that US banks would soon again engage in subprime securitized mortgages. But it may be happening again. As reported by Moore (2009) there is now, one year after the subprime meltdown, a 'gold rush underway' by banks to sell off 'toxic' subprime mortgage assets, known as Re-Remics (re-securitization of real estate mortgage investment conduits) (Apuzzo 2009). And the too-big-to-fail banks – the Bank of America, J.P. Morgan Chase and Wells Fargo – all saw strong growth in 2009. It has been reported that their assets

grew by respectively 138 percent, 51 percent and 43 percent between June 2007 and March 2009. They are also now apparently finding it much easier to borrow than smaller banks. For instance, at the time of writing banks with assets in excess of 100 billion US dollars were able to borrow at interest rates 0.34 percentage points lower than other banks, while before the crisis the difference was only 0.08 percentage points (Cho 2009).

The problem of concentration in the banking industry is compounded by the similar concentration in related financial services which should provide checks and balances. Thus ‘the analytical foundation for much of the global financial system is now built on the paid-for opinions of just seven firms – the big three rating agencies and the big four accounting firms’ (Ely 2009). Perhaps the penultimate word should go to Johnson (2009b), quoting the chairman of China’s sovereign wealth fund predicting that “it will not be too bad this year. Both China and America are addressing bubbles by creating more bubbles and we’re just taking advantage of that. So we can’t lose.”

Developing countries, and not the world’s big banks, may be the ultimate losers of the crisis. The stark reality of the crisis and its underlying cause in global inequalities, inequities and bubble-cycles has been laid bare in the contrast between two reports published at the end of 2009. On the one hand, the report that Goldman Sachs, which received USD 10 billion in bailout money, highlighted its largest ever quarterly profit in 2009 and plans to pay out USD 11 billion in bonuses (Leonard 2009). And, on the other, findings of a World Bank study reporting that there will be 30,000 to 50,000 excess infant deaths in Africa as a result of the crisis (Friedman and Schady 2009).

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