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Article

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IMPACT OF THE GLOBAL FINANCIAL CRISIS ON THE SOCIAL SERVICES SECTOR IN GHANA AND NIGERIA

OLUSANYA AJAKAIYE*, TAYO FAKIYESI**
AND MUTIU OYINLOLA***

Introduction

The global financial crisis evolved from the bursting of the speculative bubble in the US housing market, as well as the failure of regulation and lacking adherence to strict corporate governance principles in the United States. The crisis came to a head around September 2008 and rapidly spread to other developed countries. Developing countries, which rely chiefly on commodity exports, did not escape the desolating effects of the collapse. The impact on the developing countries became first evident in form of a decline in export volumes, a fall in commodity prices, and a drastically reduced inflow of foreign capital and remittances. But now most of the developed world is already seeing the light at the end of the tunnel as the crisis has begun to wane. However, this cannot be said of the impact on most of the developing economies. They are still faced with a decline in income growth, job losses, declining remittances and budgetary pressures due to the drastic fall of revenue from various exports of primary products that has led to reduced government spending in most areas but most so in the social sector of the various economies. The identification of the extent to which the social sectors are being affected in developing countries with special focus on Ghana and Nigeria is the main issue of the paper.

Global financial crisis

As stated above, the current global financial crisis is the result of a number of factors that include in

the main: (a) the collapse of the housing market in the United States, (b) the lax financial regulatory conditions, and (c) the lack of implementation of strict corporate governance conditions in the United States and most of the developed economies. Preceding the crisis was easy credit accessibility and the subsequent loose loan policy of financial institutions which was not accompanied by stringent credit risk management and control. Large volumes of financial securities not backed by cash flow from mortgages were created. However, this left the capital base of these institutions exposed, with the subsequent adverse development. Indeed, such exposures came to light with the burst of the housing market bubble. Credit dried up and interest rates surged. Subsequently, investments by financial institutions in hedge funds were withdrawn, resources from sister companies and off-shore investments began to dwindle; share values dropped and the ripple effect further led to the crash of the stock markets first in the United States and Europe and later spreading to stock markets around the world including Ghana and Nigeria. With the fall in export demand of countries dependent on commodities, in particular petroleum in the case of Nigeria and cocoa and mineral products in the case of Ghana, the impact of the crisis began to spread throughout the developing nations. Ghana and Nigeria can therefore be regarded as classical examples of the experience of countries in Sub-Saharan Africa.¹

Impact on equity market

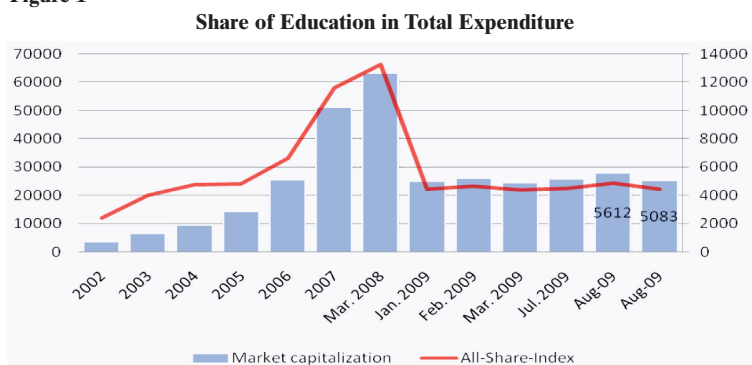
The global financial crisis was transmitted to the economies of the developing countries primarily through the financial/capital market and the real sector. The financial sector channel is represented by those relevant activities usually measured by the performance of financial institutions, the All Share Index (ASI) and the market capitalization of the companies listed on the stock market.

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¹ The chief exports of Ghana are gold and cocoa (61.1 percent of total exports), while that of Nigeria is oil (93.0 percent of total exports); see <http://www.odi.org.uk/programmes/investment-growth/default.asp>.

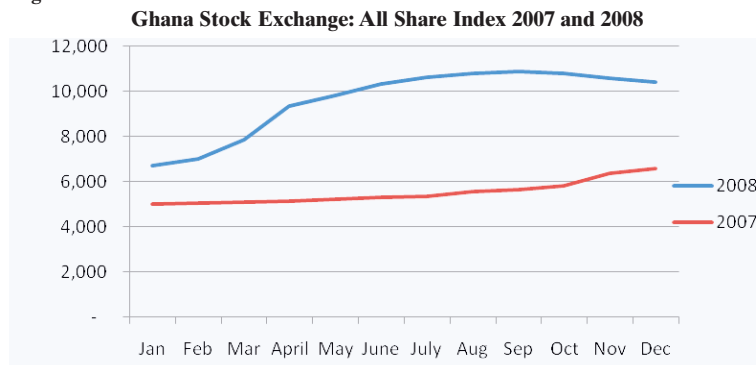
In Nigeria, the two indicators have been increasing over the years. The ASI rose from a value of 12,137 in 2002 to 66,371 in March 2008 with a market capitalization of about NGN 12.640 trillion after which the values fell precipitously to 22,349 points in January 2009 and a market capitalization of NGN 4.998 trillion due to the meltdown. By the end of the first week of March 2009, the values had declined to 21,893 points with a market capitalization of NGN 4.900 trillion (see Figure 1 below). This value had further declined to 21,608 points with a market capitalization of NGN 4.836 trillion by the end of the second week of March 2009. This reveals that between March 2008 and March 2009, the ASI lost a total of 67 percent while the market capitalization lost 62 percent of its value. The exposure of the banking sector to the crash in the stock market and the oil sector (see below) led to a soaring non-performing loans profile of some leading banks and the eventual replacement of their directors at the end of the second week of August 2009. The indicators fell by 9.4 percent within one week. For example, the market capitalization fell from NGN 5.612 trillion to NGN 5.083 trillion. This further lent credence to the fact that the crisis is still leaching into the fabric of the economy of most developing countries and a confirmation of the statement credited to the IMF that the global meltdown would likely further increase credit risks and non-performing assets, thereby weakening the balance sheet of financial institutions and corporations. In Nigeria, Ajakaiye and Fakiyesi (2009) reported that the ratio of non-per-

Figure 1



Source: Nigeria Stock Exchange, daily reports.

Figure 2



Source: Ackah, Aryeetey and Aryeetey (2009).

forming loans (NPL) to gross bank loans may rise to 28 percent if the exposure in the capital market were to go into the NPL profile. The situation may be even more severe than that reported because the huge exposure of the banks to the oil sector was excluded. Thus, in a bid to avert the collapse of the banking system in Nigeria and to maintain the depositors' confidence in the system, the Central Bank of Nigeria (CBN) has devoted a whopping sum of NGN 420 billion (= around USD 2.8 billion) to the five troubled banks, so far identified to be tilting towards insolvency. Reports also show that the ratio in Ghana has been on the increase from 7.9 percent in 2007 to 8.7 percent in 2008.²

Evidence from Ghana also reflects the adverse impact of the crisis on the economy. The indicator of the stock market, the All Share Index, has fallen by more than 11 percent since the beginning of 2009. This is the converse of its performance as at the end of 2008, when it had leaped by 58.1 percent from its 2007 value (see Figure 2). Although the market might have contracted by the last quarter of 2008, as shown by the marginal decline in the trend above, the decline nonetheless did not fully manifest itself until the first quarter of 2009.

Impact on trade

Initial effects of the global financial crisis on most developing economies including Nigeria and Ghana were trans-

² See *Impact of the Crisis on African Economies-Sustaining Growth and Poverty Reduction: African Perspectives and Recommendations to the G20*, a report by the Committee of African Finance Ministers and Central Bank Governors Established to Monitor the Crisis, 21 March 2009.

Table 1

Export revenue and current account balance: before and after crisis

	Export of goods (USD billion)				Current account balance (as % of GDP)			
	Before crisis		After crisis		Before crisis		After crisis	
	2009	2010	2009	2010	2009	2010	2009	2010
Ghana	5.66	5.92	4.72	4.84	-13.17	-12.68	-13.15	-17.86
Nigeria	89.08	99.47	50.40	55.31	0.61	-0.50	-9.05	-6.44
Africa	634.56	691.95	383.17	414.45	1.90	1.56	-4.37	-4.12

Source: African Economic Outlook (AEO) 2009 Projections.

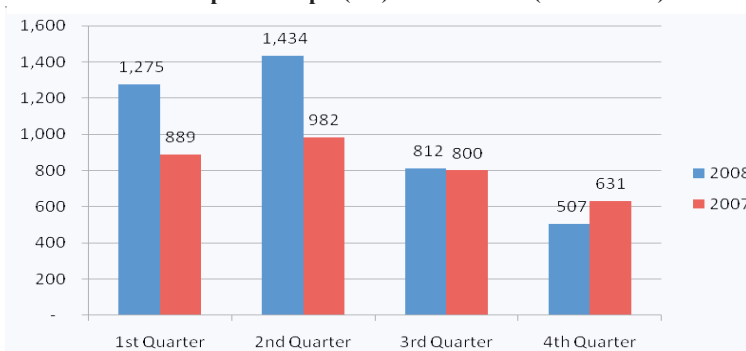
mitted by trade due to the fall of commodity prices (mineral and non-mineral) and plummeting demand from developed countries. This is well shown by the crash in the oil market that has caused grave concern for Nigeria's fiscal policy and the outlook for income earned from exports of crude oil. The global financial crisis has led to a slowdown of growth across the world's economies, resulting in a lower demand for commodities, especially oil. The transmission of the impact can be traced through several stages of the Nigerian economy especially through the impact on: (a) earnings and revenue of governments, (b) the balance of payments through a narrowing of the current account balance, as well as (c) the widening of the deficit on the capital account through the reduction of capital flows because of a re-appraisal of planned investment or the complete stoppage of previously committed investment programs, and (d) contraction of the scope of fiscal policy (Ajakaiye and Fakiyesi 2009). While speculative behavior and investment activities had helped to buoy up crude oil prices internationally, the reality of the global recession is beginning to be fully appreciated across the globe. The adverse impact of the crisis is more direct and more evident on the international price of oil. The recent movement of the oil price is apparent in its unprecedented decline from record highs of about USD 147 per barrel in July 2008 to about USD 50 per barrel in January 2009 before a marginal increase to about USD 72 per barrel in August 2009. The declines in oil prices and export volumes have led to a decrease in export revenue. With exports falling faster than imports, the trade balance has worsened in Nigeria. The expected merchandise exports prior to the crisis were USD 89.1 billion and USD 99.5 billion in 2009 and

2010, respectively, but now revised to USD 50.4 billion and USD 55.3 billion. The current account balance is also expected to dip into deficit in the amount of 9.05 percent of GDP in 2009, from a small surplus of 0.61 percent of GDP before the crisis.

The scenario is not too different in Ghana. The total export revenue free on board (fob) rose by almost 22 percent in 2008 to GHc 4,028 million, from GHc 3,303 million in 2007 making for a 13 percent growth between these two years. There are, however, observable patterns in Ghana's export receipts: they peaked in the second quarter and then followed a downward trend in the fourth quarter in both years. It is noticeable that the declines in export receipts between the second and fourth quarters were larger in 2008 than in 2007. The export sector was buoyant in 2008, culminating at about GHc 1.4 billion in the second quarter of the year. However, starting from the third quarter, it appears that the effects of the credit crunch had begun to bite, resulting in export receipts dropping below the 2007 figures in the fourth quarter (Ackah, Aryeetey and Aryeetey 2009). Consequently, the expected export revenue has been revised downward to USD 4.72 billion from USD 5.66 billion for the year 2009, as shown in Table 1.

Figure 3

Ghana's Export Receipts (fob) 2007 and 2008 (GHc million)



Source: Ackah, Aryeetey and Aryeetey (2009).

The short-term economic outlook

Economic growth

The world economy is estimated to almost come to a halt in 2009. Its annual growth of 0.5 percent will rely on the growth in the developing world, which, in turn, has been gravely hit by the global economic downturn. For example, the economic growth forecast for Africa in 2009 is expected to be only 2.8 percent, barely half of the 5.7 percent expected before the crisis. According to the forecasts made in the *African Economic Outlook (AEO) 2009*, growth is anticipated to rebound to 4.2 percent in 2010. Growth in oil-exporting countries is expected to fall to 2.4 percent in 2009 compared to 3.3 percent of the net oil importers. The IMF has projected a growth rate of 2.9 percent for Nigeria in 2009 and 2.6 percent in 2010, indicating a major decline from last year's growth of 5.3 percent. A decline in the price of oil, which accounts for about 90 percent of the country's revenue, and the global credit crunch are some of the reasons adduced for the country's predicament. Economic performance in Ghana is also expected to slow down, although, at the 5.1 percent forecast in 2009, it will remain higher than that of Nigeria. The relatively higher GDP growth target is driven in part by the country's commitment to the mineral and agricultural sectors, which are relatively more insulated against global developments with stable prices of gold and cocoa, the backbone of Ghanaian economy. The *AEO 2009* notes that Ghana may be well positioned to continue its modest economic expansion in the years to come, in spite of the drop in the growth rate in 2009. Sound macroeconomic policies, structural reforms and the projection of oil production in 2010 underscore these bright prospects.

The fiscal outlook

In response to the downturn of economic activity, the industrialized countries passed a tidal bailout package in the order of trillions of dollars. This is a major fiscal expansion which could trigger inflationary pressure due to increased deficits and debt. The developing countries are economies which have already been plagued by high inflation and high ratios of deficit to gross domestic product. The

Table 2
Economic growth forecast 2009

	Pre-crisis (%)	Current (%)
World	2.2	0.5
Africa	5.7	2.8
Developing countries	6.4	4.5
Sub-Saharan Africa	5.1	3.5
Ghana	6.4	5.1
Nigeria	5.3	2.9

Sources: IMF Regional Economic Outlook for Sub-Saharan African Region, April 2009; World Bank President Statement at G20 Finance Ministers and Central Bank Chiefs Meeting in Sao Paulo, 8 November 2008; and IMF *Survey Magazine*, 28 January 2009.

deficit of the Africa region, for example, has been estimated to be around 5.5 percent of GDP compared to a surplus of 3.4 percent predicted in the AEO one year ago. Specifically, Ghana had a high fiscal deficit of about 14.9 percent of GDP in 2008, up from 9 percent of GDP in 2007. The major challenge facing Ghana is to bring down the deficit.³ The expansionary fiscal stance of the government has caused inflation to rise significantly, reaching 18.1 percent at the end of 2008. Although strong public spending was the major driver of the inflationary pressures, the rapid increase in private sector demand fuelled by strong credit expansion was also a contributory factor. Inflationary pressures, built up in 2008, continued to remain strong during the first three months of 2009, causing the inflation rate to rise from 18.1 percent in December 2008 to 19.9 percent in January and then reached 20.5 percent in March. Nevertheless, the inflation rate has stabilized in the last two months, with a rate of 20.6 percent recorded in April and 20.1 percent in May (Duffuor 2009).⁴

The proposed 2009 budget for Nigeria shows a deficit of NGN 1.09 trillion or 3.95 percent of GDP, based on the assumed 'benchmark' oil price of USD 45 per barrel and forecast production of 2.292 million barrels per day. The deficit is to be financed by outstanding signature bonuses, proceeds from ongoing privatization, the recall of USD 200 million from the Nigerian Trust Fund of the African Development Bank, any unspent balances from the 2008 budget, domestic borrowing and a Naira-denominated international bond issue of USD 500 million. Projected oil production has since declined owing to

³ See <http://ghanabusinessnews.com/2009/03/30/global-financial-crisis-why-africa-could-gain-from-expenditure-increase>.

⁴ *The State of the Economy*, an address delivered by Mr. Kwabena Duffuor, Minister of Finance and Economic Planning to the Association of Ghanaian Industries on 16 June 2009, <http://africanliberty.org/node/737>.

activities of the militant groups in the Niger Delta. This invariably would swell the Nigerian deficit profile for 2009.

Ghana's macroeconomic imbalances were compounded by the global financial crisis from end-2008. Commodity prices moved in Ghana's favor, with gold and cocoa prices – its main exports – remaining strong, while oil import costs receded (see Figure 4). However, this is projected to be more than offset in 2009 by a slump in private remittances and foreign direct investment. Consistent with this, the currency remained under pressure through May 2009, and official reserves declined further in the first quarter, to a little under 2 months of import cover. The commodity prices, however, seem to have peaked in September 2009. The price of crude oil, for example, fell from of USD 72 per barrel in August 2009 to below USD 50 per barrel by September 2009. This means reduced foreign reserves as well as a reduction of capital expenditure by the government. The dramatic reduction of oil prices has had a significant effect on the revenues and expenditure of the government. The oil sector in Nigeria currently contributes 80 percent of foreign earnings and provides about 85 percent of government revenue.

Implications for social services

In spite of the impressive growth performance of the Nigerian economy prior to the global financial crisis, the country is still faced with serious socio-economic challenges at different levels of government (state, local), corporate and financial policies as well as fiscal policies. High dependence on oil and gas, which are exhaustible, as the major sources of government

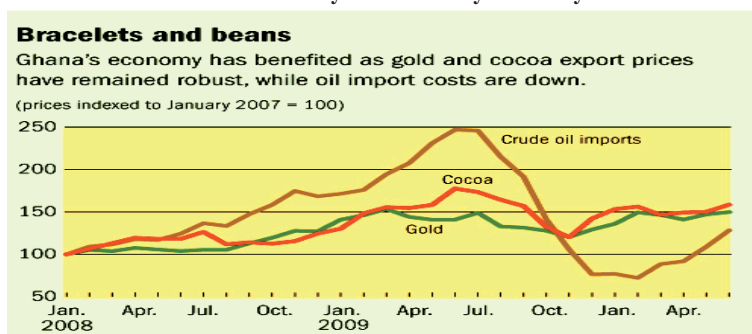
revenue, inadequate pass-through of the benefit of growth to a large segment of the population, the need to link the growth attained with good economic policies as well as the capacity to implement policies that should translate into poverty reduction and the attainment of Millennium Development Goals (MDGs), continue to remain economic problem areas. Poverty and inequality are widespread with about 71 million Nigerians living on less than one US dollar per day and a *Gini* coefficient of 0.50, while that of Ghana is 0.30. Social statistics such as infant (under the age of 5) and maternal mortality as well as unemployment are higher for Nigeria than the averages for Africa. Ghana's indicators are modest: it ranks among the countries with low income inequality that is consistently lower than in Nigeria. This suggests that a higher proportion of households in Nigeria are vulnerable to the financial crisis. Indeed, the poorest 20 percent of households, which represents the vulnerable groups in Nigeria and Ghana, earn less than 4.4 and 8.4 percent of total income, respectively (Nnadozie 2003).

The impact of the ongoing global financial crisis on developing countries has been the dominant theme of discussion among policymakers around the world. In this context, many stakeholders in the Ghanaian and Nigerian economies are deeply concerned about the social and economic implications for these countries of the instability of financial and commodity markets around the globe. This concern is rooted in the developments of the Nigerian economy in the last three decades. A review of Nigeria's economic development between 2000 to date reveals that overall macroeconomic policies and development strategies have failed to provide an environment that could alter the structure of production and consumption activities in order to

diversify the economic base. The country has continued to be a mono-cultural economy, depending on oil, and its export base is yet to be diversified. A widening saving-investment gap, high rates of inflation and unemployment, chronic balance of payment problems and underutilization of resources have continued to be the order of the day. The Ghanaian economy, which also relies solely on a limited number of commodities (gold and cocoa), could also be

Figure 4

Trends in Commodity Prices January 2007–May 2009



Source: IMF Survey Magazine: Countries & Regions,
<http://www.imf.org/external/pubs/ft/survey/so/2009/CAR071609B.htm>.

subject to external shocks if cocoa prices were to decline drastically, although this is not expected to happen. High food prices also continue to affect low-income households. Ghana is very vulnerable to deterioration in the external environment with a current account deficit of 22 percent of GDP. Worrisome is the decline in remittances to Ghana in the last quarter of 2008. Remittances fell by 16 percent in January-February 2009, compared to the same months in 2008. Such shocks put further pressure on the exchange rate, which already lost 23 percent of its value against the USD in 2008.

In spite of several decades of economic reforms and adjustment in Nigeria, all relevant indices of human development are embarrassingly low relative to Ghana. For instance, the Human Development Index, which is a composite measure of three dimensions of human development – living a long and healthy life (measured by life expectancy), being educated (measured by adult literacy and enrolment at the primary, secondary and tertiary level) and having a decent standard of living (measured by purchasing power income at PPP), has not shown any remarkable improvement since 1970. In 2006, the human development index for Nigeria stood at 0.499 (a low HDI country), which gave the country a rank of 158 out of 177 countries compared to Ghana with an index of 0.553 and a rank of 135, classified as a medium HDI country (higher than 0.50). In addition, a comparison of the poverty profile captured by the human poverty index for developing countries (HPI-1)⁵ shows 32.2 (from 108) for Ghana and 37 (from 111) for Nigeria. This reveals that a higher percentage of the population in Nigeria is enmeshed in poverty than in Ghana.

⁵ The HDI measures the average progress of a country in human development. The Human Poverty Index for developing countries (HPI-1), focuses on the proportion of people below a threshold level in the same dimensions of human development as the human development index – living a long and healthy life, having access to education, and a decent standard of living. By looking beyond income deprivation, the HPI-1 represents a multi-dimensional alternative to the USD 1 per day (expressed at PPP USD) poverty measure.

The most vulnerable in society were the worst hit. This is demonstrated by a low level of economic activity in the economy, and especially, the informal sector where most of the vulnerable groups conduct their economic transactions. In addition, social programs like the School Feeding Program were severely hit; other areas include the Youth Employment Program, which was funded mainly by public funds that are severely constrained, as the government attempts to cut down its spending mainly because of the decline in budget support from donor agencies and external governments. Other areas include the direct impact of the global economic and financial crisis on households. As of April 2009, this has remained smaller in Ghana than in Nigeria because the revenue from gold and cocoa was minimally affected by the global financial crisis (as shown in Figure 4). Finally there was the indirect impact of fuel prices on transportation and the price of food.

The figures below present the total federal expenditure on education and health in Nigeria. Figure 5 shows that the trend of the share of education expenditure declined between 1995 and 1999 (military regime). There was an increase between 1999 and 2004 and this increase continued until 2008 after which it declined again. If oil prices continue to decline, we would expect a further cutback in the share of education. Although oil prices have stabilized around USD 72 per barrel in August 2009, oil production, however, has plummeted below the expected level.

In a similar vein, the share of the health sector in total expenditures was insignificant between 1985 and 1999. Specifically, it amounted to merely 1.09 percent in 1990. This share, however, increased from 1999 until 2002 when it dropped rapidly. The rise gradually picked up again until 2008. Just as we saw it in the education sector, the share of health in the total expenditure dropped from 6 percent to 4.6 percent in 2009 (see Figure 6).

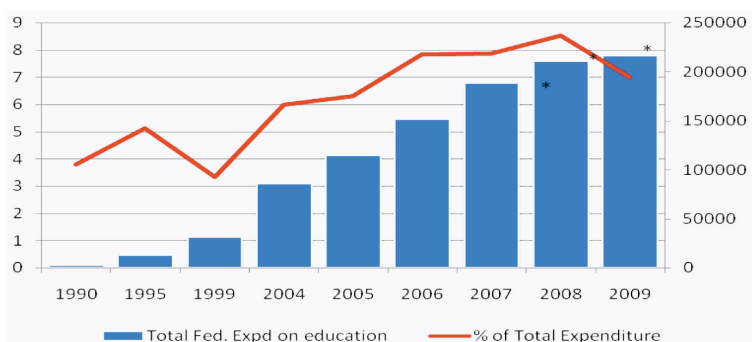
Table 3
Human Development Index (HDI) and other indicators as well as their world rankings for Nigeria and Ghana in 2006

	HDI value	Life expectancy at birth (years)	Adult literacy rate (% ages 15 and above)	Combined primary, secondary and tertiary gross enrolment ratio (%)	GDP per capita (PPP US\$)
Nigeria	154 th (0.499)	168 th (46.6)	111 th (71.0)	151 st (52.5)	139 th (1,852)
Ghana	135 th (0.553)	137 th (59.1)	117 th (52.9)	146 th (50.7)	126 th (2,480)

Source: Human Development Report 2007/2008 Data, <http://hdrstats.undp.org/buildtables/rc-report.cfm>.

Figure 5

Nigeria's Education Expenditure 1990–2009



Note: Asterics (*) implies estimates.

Source: Ajakaiye and Fakiyesi (2009).

In Nigeria, the government continues to appropriate NGN 110 billion, the savings from the Paris Club debt relief, to specific projects and programs to support the attainment of MDGs. In addition, the statutory allocation for universal basic education has increased from NGN 30.5 billion in 2006 to NGN 35.3 billion in 2007. This further increased to NGN 39.7 billion in 2008. This implies that an important element of social welfare, school feeding programs and free education will continue even in the midst of the global financial crisis. It is our belief that before the completion of this project, the facts about the exact impact of the global financial crisis on social services issues in Nigeria, particularly, in the areas of vulnerable groups, unemployment, education, health, and other social welfare areas, would have emerged for clearer picture.

Conclusion

The impact of the financial crisis on the social services sector in developing countries, Ghana and

Nigeria in particular, is reflected in a decline of commitments to social service expenditure. The poorest 20 percent of households, which represent the vulnerable groups in Nigeria and Ghana, earn less than 4.4 and 8.4 percent of total income, respectively. The financial crisis has led to an increase in the proportion of households in the group. In a bid to sustain the goals of poverty reduction and access to basic social services achieved before the crisis, donors and govern-

ments of these countries are encouraged to consider the fact that, given our analysis above, in order to have a 4 percent improvement in health status, we need 100 percent increases in government expenditure on the health sector. Therefore, spending on health, education (including special programs such as school feeding programs), nutrition, and sanitation in both countries must be expanded. The other conclusion is that social safety nets should be financially supported to protect the poor, the unemployed and the socially marginalized. It should be designed in such a way that the poor can be better protected against the effect of external shocks.

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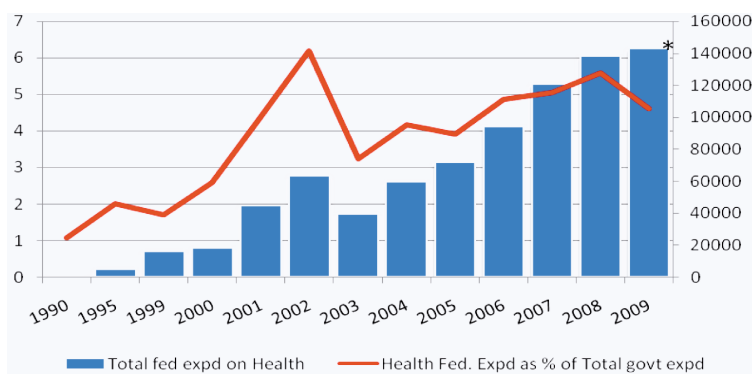
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Figure 6

Nigeria's Health Expenditure 1990–2009



Note: Asterics (*) implies estimates.

Source: Ajakaiye and Fakiyesi (2009).