ECONOMIC MELTDOWN: AN EXAMINATION OF COUNTRY-TO-COUNTRY EXPERIENCES AND POLICY OPTIONS

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Abstract

The 2008 global economic meltdown has its origin largely in the flawed policies of the American government in the last 10 years and the extravagant lifestyles which their system seemed to encourage. When their financial system melted, it reverberated across the globe. Most developed countries acted individually to put in place some emergency measures to stop further slide and cushion, as it were, their people from the effects of the crisis. The top industrialised economies under the G-20 also came together to take harmonised or unified actions against the perceived causes of the meltdown. Their objectives were to avoid such major dislocations in the future and coordinate such actions so that they are not at cross purposes between their members. This study attempted a contrast of these measures with ones taken by Nigeria where top government officials are still not in agreement as to the impact of the meltdown on our economy. It reviewed some of these haphazard actions of the Nigerian government and concluded that if developed countries succeed in coming out of the recession, it would not be by luck; rather it will be the outcome of pre-meditated actions calculated to jolt the economy back into life. In contrast, if the Nigerian economy bounces back, it will not be because its leadership took any fundamental actions to make it happen. It recommends a fundamental shift for the Nigerian economic managers and other less developed countries of the need to gather data, *develop and implement strategic plans that will see the country* out of the woods.

1. Introduction

Life is a cycle of boom and burst. It is, therefore, not entirely strange that the world experienced a burst in 2007/2008. At both the micro and macro-levels, such period of extreme prosperity and periods of major constriction are somewhat abnormal and calls for thorough economic understanding and explanation. This work aims at doing that.

In October 1929, the 1st major depression in the history of the world occurred when the New York exchange crashed. It has since been dubbed the Great Depression. That

Depression was an economic slump in North America, Europe, and other industrialised areas of the world that began in 1929 and lasted until about 1939. It was the longest and most severe depression ever experienced by the industrialised Western world.

Though the US economy had gone through depression six months earlier, the great depression may be said to have begun with a catastrophic collapse of stock-market price on the New York Stock Exchange in October 1929. During the next three years, stock prices in the United States continued to fall, until late 1932, when they had dropped to only about 20% of their value in 1929. Besides ruining thousands of individual investors, this precipitous decline in the value of assets greatly strained banks and other financial institutions, particularly those holding stocks in their portfolios. Many banks were consequently forced into insolvency. By 1933, 11,000 of the United States' 25,000 banks had failed. The failure of so many banks, combined with a general loss of confidence in the economy, led to much-reduced levels of spending and demand and hence of production, thus aggravating the downward spiral. The result was a drastically falling output and a sharp rise in unemployment. By 1932, U.S. Manufacturing output had fallen to 54 per cent of its 1929 level, and unemployment had risen to between 12 and 15 million workers, or 25-30 per cent of the work force.

The Great Depression which began in the United States quickly turned into a worldwide economic slump owing to the special and intimate relationships that had been forged between the United States and European economies after World War 1. The United States had emerged from the war as the major creditor and financier of postwar Europe, whose national economies had been greatly weakened by the war itself, by war debts, and, in the case of Germany and other defeated nations, by the need to pay war reparations. So, once the American economy slumped and the flow of American investment credits to Europe dried up, prosperity tended to collapse there as well. The Depression hit hardest on Britain and Germany because they were heavily indebted to the US. In Germany, unemployment rose sharply beginning in late 1929, and early 1932, it had reached 6 million workers, or 25 per cent of the work force. Britain was less severely affected, but its industrial and export sectors remained seriously depressed until World War II. Many other countries had been affected by the slump.

Almost all nations sought to protect their domestic production by imposing tariffs, raising existing ones, and setting quotas on foreign imports. The effect of these restrictive measures was to greatly reduce the volume of international trade. By 1932, the total value of world trade had fallen by more than half as country after country took measures against the importation of foreign goods.

The great Depression had important consequences in the political sphere too. In the United States, economic distress led to the election of the Democrat Franklin D. Roosevelt to the presidency in late 1932. Roosevelt introduced a number of major changes in the structure of the American economy, using increased government regulation and massive public works projects to promote recovery. But despite this active intervention, mass unemployment and economic stagnation continued through on a somewhat reduced scale, with about 15 per cent of the work force still unemployed in 1939 at the outbreak of World War II. After that, unemployment dropped rapidly as American factories were flooded with orders from overseas for armaments and munitions. The depression ended completely soon after the

United States entered into World War II in 1941. In Europe, the Great Depression strengthened extremist forces and lowered the prestige of liberal democracy. In Germany, economic distress directly contributed to Adolf Hitler's rise to power in 1933. The Nazis' public-works projects and their rapid expansion of munitions production ended the depression there by 1936. At least, in part, the Great Depression was caused by underlying weaknesses and imbalance within the U.S. economy that had been obscured by the boom psychology and euphoria of the 1920s. The Depression exposed those weaknesses, as it did the inability of the nations' political and financial institutions to cope with the vicious downward economic cycle that had set in by 1930.

Prior to the Great Depression, government traditionally took little or no action in time of business downturn, relying instead on impersonal market forces to achieve the necessary economic equilibrium. But market forces alone proved unable to achieve the desired recovery in the early years of the Great Depression, and this painful discovery eventually inspired some fundamental changes in Untied States economic structure. After the Great Depression, government action, whether in the form of taxation, industrial regulation, public works, social insurance, social-welfare services, or deficit spending, came to assume a principal role in ensuring economic stability in most nations with market economies.

The Depression was eventually to cause a complete turn-around in economic theory and government policy. In the 1920s, government and business managers largely believed, as they had since the 19th century, that prosperity resulted from the least possible government intervention in domestic economy, from open international relations with little trade discrimination, and from currencies that were fixed in value and readily convertible. Few people now believe this since the 1930s. The non-monetised economies of Africa were less affected as most were hardly into real use of money.

The problem of economic meltdown has its source in the financial recklessness and limited controls of the US which has caused deterioration of the growth in certain macroeconomic variables of both developed and less developing countries. The question now is: how are the governments of US and other countries of the world reacting to this problem. Of more importance is how coordinated these efforts are? In this study, our major objective is to look at the actions of selected DCs and some LDCs and then make a comparison with a view to recommending best ways out.

Literature Review

Any explanation of the current financial turbulence must begin with the housing bubble, fueled by low interest rates, increased global liquidity and predatory lending by financial giant. In fact, the saying “Enjoy today and pay tomorrow” led most Americans into utilising credit and by a graduated process started living above their means. Ebereonwu (2009) states that there is near unanimity that the current global economic imbroglio has its roots in the mortgage market crisis in the Untied States of America. The mortgage market in the US was riddled by sub-prime loans, which are loans given out even when the borrower has not passed the necessary credit checks. This led to a lot of foreclosures and put strains on financial institutions that suddenly found themselves having a lot of real estate properties in their balance sheet. They started asking themselves what business they were in: in banking or in real estate?

In a speech to the National Association for Business Economies 50th Annual meeting in Washington D. C. October 7, 2008, United State Federal Reserve Chairman Ben. S. Benanke reminded participants that economic activity has been showing signs of deceleration even before the disruption in the credit and financial markets. While noting that housing continues to be a primary source of weakness, he said that the slow down in economic activity has now spread well beyond the housing sector. He declared that one of the main reasons behind the recent negative growth has been the abrupt end of the longest expansion in consumer spending on record. Instead, mounting job losses, fear of further economic meltdown and reduced access to credit are all-leading to a decline in consumer spending.

Reich (2008) has pointed to greed as the main explanatory variable. People were lured into acquiring life luxuries which their economic status would otherwise ill-afford. Americans were living above their means. To worsen the situation, the then Republican government was not making things easier. The Bush administration chose to fight a senseless war in Iraq that was costing the tax-payers of United States a whopping $1 billion per day. President Barrack Obama has rightly put most of the blame for the meltdown on the misguided polices of the Bush administration and the Republican Party. Soros (2001) sees the major villain as Alan Greenspan whose monetary policies allegedly encouraged speculative exuberance even as interest rates were at an all time low and asset prices were spiraling out of control.

The big rating agencies also got a share of the blame as they failed to be more rigorous in their risk assessment. Other economists and public commentators blame the situation on the repeal of the Glassteagall Act 1933, which had made a clear demarcation between general commercial banking, on the one hand, and investment banking activities, on the other. The absence of such demarcation was underlined as one of the factors arising from the speculative exuberance that led to the 1929 Wall Street crash and the current economic meltdown. Linked to all these, is the dwindling capacity of regulatory authorities. Reality is that the world and finance has become so complex in our digital age. Capital now travels at the speed of light and several instruments are engineered using the arcane language of quantum physics. The hedge funds which control over USD 1 trillion in assets are not subject to many of the traditional regulatory regimes. Financial derivations were also in this class.

Inevitably, such power without control was bound to crash. A hypothesis made famous by the late Harvard Economists Charles Kinellebeyer and others posits that a stable international monetary system is possible only where there is a world power able and willing to bear the burdens of responsibility of the preservation of the prevailing system. Such a leader must be prepared to act as a lender of last resort. Britain acted as such in the 19th century. America was to play this role in the 20th and 21st century. This meltdown is a litmus test for America in this regard.

In over extending herself beyond her means and her material capabilities, America has ended up alienating her allies, pursuing a unilateralist course that its statesmen would never have dreamt of. Ebereonwu (2009) summed it up thus: Greed, dishonesty, poor regulation or even lack of it have, among others, been fingered as the main causes of this problem. Economists have also been blamed for the recession. They are being castigated for believing so much in the power of the Federal Reserve, of Central Banks, that they stopped

researching into the use of fiscal policy to fight recession or depression. According to Xavier Gab (2008), you would look old-fashioned if you talked about optimal fiscal policy. Peter (2009), in the April 27 *Business Week,* lamented that that Economists could not predict a depression of this magnitude is depressing; that in the face of such a depression, they still cannot agree on the way out is even more intriguing. He proceeded to ask in apparent exasperation: What good are Economists anyway? Part of the blame is that Economists are overconfident, unrealistic and political. They claim a precision that neither their raw material nor their skill warrants.

Examination of Country Experiences

The Americans and the developed world saw this meltdown early in 2007/8. They accepted the imperatives and the structural implications and immediately stated taking actions to minimise its impact on their economy. The major countries, we shall look at are countries under the banner of the G-20. Specifically we shall X-ray America, United Kingdom, France, China and Japan. Then we look at the less developed countries using South Africa and Nigeria as points of reference.

Action by the Developed Countries

(a) United States of America: The global financial and economic crisis started in the USA. Falling US housing prices led to major problems at US sub-prime lending outfits. In turn this prompted problems at major US financial institutions and a broad credit squeeze which affected the global economy. As the crisis grew, reticent US consumer spending also weighed on global economic prospects, and large-scale spending plans put forth by the government raised fears that the crisis could cause large budget and current account deficits. Yet, despite the US central role in the crisis, the latter part of 2008 saw a rise in the value of the US dollar relative to other currencies as investors fled from more risky investments into the dollar, which they considered a relative safe haven. Still, concern remained about a long-term decline in US power an influence.

Washington has also served as one of the main coordinators for the international response to the crisis. The then US President George W. Bush, along with French President Nicholas Sarkozy, called the first in a series of G-20 heads of states meetings responding to the crisis, hosting a Summit in Washington in November 2008. Then ahead of the April 2009 summit, US President Barrack Obama made a strong push for a coordinated global pressure from Germany, France and other countries on this front.

In the United States, according to Schramm (2009), once the magnitude of financial collapse is fully registered, first among Wall Street and Federal Reserve Analysts, and then among United States politicians and the public, the question of how to deal with the worst economic crisis in decades became the issue of the year.

President Barrack Obama, in his 100 days assessment of his administration, stated that "to have an economy where in one year, 40% of our corporate profit come from a financial sector that was based on inflated home prices, maxed-out credit cards, over-leveraged banks and over-valued assets" is simply not sustainable. He then articulated 7 pillars which government has adopted in the face of the meltdown viz:

- A $787 billion recovery package;
- Massive government spending and Tax cuts/credits;
- $75b to help home owners;
- New rules for Wall Street;
- Alternative energy and health plans; and
- Budget savings (lowering of national debt).

The package seems to be working. America has now witnessed two successive quarters of growth, meaning it is already coming out of the recession. In September 2009, Industrial production increased by 0.7% on top of 1.22% growth in August. From Q3, growth was 5.2%. This is the first quarterly growth since Q1 2003 and the largest gain since Q1 2005. Capital utilisation was at 70.5%. This is 10.4% below the average (of 80.9%) from 1972-2008.

(b) Untied Kingdom

London, alongside New York, entered the crisis as one of the major hubs of global finance. The British Bank, Northern Rock, was the first large common bank to require emergency government funding as a result of the crisis. Falling British housing prices contributed to London's woes. British Prime Minister Gordon Brown was credited for his bank bailout plan, which created a template later followed across Europe and in the US. But Britain's economists expected a persistent recession and the British currency, the pound, fared poorly outside the relative shelter of the euro zone. Britain also played a major role coordinating an international response to the crisis. London hosted the April 2009 G20 summit and Brown drafted on ambitious plan for fixing international financial regulation ahead of the meetings. Following the meetings, however, the British Finance Secretary mostly announced more bad news, revealing that the country would not break even on its banking interventions and could wind up losing roughly $87 billion.

The British government had unveiled a sweeping emergency plan to steer the UK through the recession offering:

$47 billion (20 billion pounds) in tax cuts to boost spending; and

Increase in tax rates for high income earners.

The impact of the interventions was modestly optimistic.

c. France/Western Europe

Western Europe generally faced severe economic problems due to the financial crisis and most experienced an economic slowdown mirroring those of Britain and the US. France, Germany and other countries supported their banks with government loans. The government of Iceland was unable to support her financial sector and was forced to seek assistance from outside the country. Iceland government later collapsed due to the political pressure stemming from the economic turmoil. Belguim and Latvia governments also carved in as well.

On the other hand, French Prime Minister, Nicolas Sarkozy, unveiled a multi-billion dollar stimulus package but admitted upfront that it may not totally shield France from economic recession. This included:

$ 33 billion or 26.5 billion Euro Package;

1.3 billion Euro in aid and hiring subsidies for small businesses; and

220 million euros in bonus.

France and Germany were staunchly opposed to pressures from US for countries with significant trade surpluses to increase their stimulus spending.

(d) China

Some experts saw signs that China's economy might have been overheating even before the financial crisis erupted, and the crisis only exacerbated these concerns. China's leading stock indices declined rapidly beginning in late 2007, shedding well over half their value by end of 2008. Despite Beijing's passage of an economic stimulus package valued at nearly $600 billion, the country's economy limped into 2009, showing rapid declines in exports.

In early 2009, Chinese year, on, year economic growth fell by 6.1%, well below the growth rates the country had averaged for most of the prior decade. Rising unemployment posed separate economic concern for Beijing. Some experts guessed, however, that China might rebound economically before other major world economies due in part to strong domestic demand. At international meetings Beijing pressed to increase its standing as a global decision maker. Most economists agree that IMF voting rights for instance should be reviewed to make China's influence commensurate with its economic clout. China's $600 billion is being spent on a wide array of national infrastructure and social welfare projects including railroads, subways and airports.

(e) Japan

The economic turmoil of 2007/08 had more effects on the Japanese economy. Coming into the crisis, Japanese banks and consumers more generally held much less debt than their counterparts in Europe and the US. As a result, no major Japanese bank collapsed during the crisis and some Japanese financial institutions were well-placed to swoop in and purchase assets at greatly reduced prices as the crisis progressed. Japanese iconic auto maker Toyota, however, experienced the first yearly looses in its history in 2008. The Japanese yen soared in value during the latter half of 2008 as international governments dropped interest rates, undermining the profitability of the "carry trade" through which many investors had bet on interest rate disparities. By April 2009, however, sagging global demand had taken a toll on Japan's economy, nearly halving the country's exports and leaving Tokyo to its first trade deficit in 30 years. Japan's stimulus package is valued at Y1.8 trillion including Y400 billion for credit guarantees that could back Y9 trillion in loans for small businesses.

(f) Action by the IMF

By early 2009, the IMF had made emergency loans to several countries affected by the global economic crisis, including Hungary, Ukraine, Pakistan, Iceland and Latvia.

G20 Leaders pledged $100bn in aid for LDCs;

Promised more voice to LDCs in economic decision making;

Gave $500bn for IMF to lend to struggling economies with prudent managers;
$250bn to boost world trade;
$250bn for IMF overdraft facility that countries can draw on;
$100bn that International Bank for Development can lend to poorest countries; and
IMF to raise $6bn from selling her Gold reserves to increase lending to the poorest countries.

The G-20 summit also led to a direct expansion of IMF power with nations committing to triple the funds available, from $250 billion to $750 billion. They also committed to creating more of the funds special currency, special drawing rights, which can be converted into dollars if a country faces crisis. All the same, there is the contention that the fund still remained too small and would require a full-scale rethink of its operations, including a new Grand bargain, between its leading powers brokers, China and the US, in order for it to attain a size commensurate with the size of the global economy. Secondly, the non-inclusion of Africa in its deliberations and considerations remains a major setback for the fund.

At the end of the negotiations at G20 meeting, the following additional broad agreements were reached:

Financial stability board: they agreed that the financial stability board should be expanded, given a broadened mandate to promote financial stability. That it should be given a stronger institutional basis and enhanced capacity as the Financial Stability Board (FSB);
To strengthen international co-operation;
Strengthen international framework for prudential regulations;
All systemically important financial institutions, markets and instruments should be subject to appropriate degree of regulation and oversight;
Watch closely the compensation structures of financial institutions and ensure consistency with long term goals and prudent risk-taking;
Tax havens and non-cooperative jurisdictions;
Accounting standards setters should improve standard for the valuation of financial instruments; and
Credit rating agencies a more effective oversight and activities of credit agencies.

They equally agreed to strengthen IMF financial muscle with a $1 billion cash injection to enable them assist developing countries. They also asked FSB and IMF to monitor progress.

LDC's Actions in the Face of Global Meltdown: Nigeria as a Reference Point

Attempts to understand the Nigerian government's response to the global crisis shows either of two things: denial and self-delusion or lack of reliable data for a better comprehension of the level and depth of the crises. In Nigeria, the lack of full appreciation was immediately brought to the fore by the then CBN Governor Chukwuma Soludo, who spoke to the National Assembly in 2009 and said the Nigerian economy is immune to the

global financial crisis. According to Soludo, the banking consolidation exercise which the CBN carried out in 2004, had repositioned Nigerian banks and strengthened them to weather whatever storms might rage in the financial system. He also cited the rising foreign reserves at the time and the excess crude accounts as other reasons why Nigeria can stand even when others are failing.

With the fall in the price of crude, the worsening exchange rate of the Naira and the near collapse of the stock market, it is either the government underestimated the severity of the condition or was totally ignorant on account of lack of data. There has been some rationalisation of government apparent lack of response. Some have argued that if the government came out to announce the expected impact of the global meltdown, the Nigerian stock market would have gone into a major announcement shock instantaneously.

With the dwindling oil revenue, it is obvious that the country's hope of joining the G20 by 2020 may be a pipe-dream. Our GDP growth rate between 2006 and 2008 when oil price was going up was between 5.6 and 6.6%. The government needs an uninterrupted growth rate of 12% to achieve the 2020 vision. Unfortunately, the best estimates we have from J.P Morgan is a 4.4% growth. The declining value of the Naira is another major reminder that we are not shielded from the economic meltdown. The devaluation of the Naira by 54% clearly bears testimony to this. The reasons for this are mainly the withdrawal of Global bank investments in Nigeria and the dwindling inflow from oil sales.

Statutory allocation to states and LGAs

There was a significant drop in the available funds shared between the three tiers of government. Analysis of the figure showed a 45% drop in total revenue accruing to the Federated purse. Consequently, the total funds getting to the states and local government (LGs) dropped by 49%, while the LGs received 45% less against their receipts in 2008. Some LGs were then unable to meet their staff salary obligations on a monthly basis.

Table 1. Summary of Statutory Allocation to States and LGAs, (₦ billion).

MONTHS	ALLOCATION TO STATE S	ALLOCATION TO LGAS	TOTAL ALLOCATION
August 2008	128.5	68.5	194.4
Sept. 2008	115.7	61.0	174.3
Oct. 2008	109.6	58.7	159.9
Nov. 2008	101.0	55.1	147.5
Dec. 2008	109.9	57.3	158.5
Jan. 2009	101.9	54.8	147.9
Feb. 2009	73.3	40.1	104.8
March 2009	69.9	37.6	98.6

Source: Revenue Allocation & Fiscal Commission Abuja (2009)

There is evidence of lack of synchrony amongst the top government officials in Nigeria. This shows apparent lack of appreciation of the issues or total lack of leadership. With these discordant tunes by top officials, we cannot expect any coordinated response to the impact of the meltdown.

The meltdown was evident to Nigerians when the stock market crashed in 2008 with a loss of over ₦556 billion. This was partly because foreigners withdrew their investments in response to the meltdown in their own countries. Margin traders saw the value of their investments go down and that equated to the sub-prime loans in the United States. Again, foreign portfolio investors withdrew or withheld their monies in order to attend to problems at their home countries. There was a general credit crunch from lending institutions including inter-bank loans.

The Nigerian government has responded albeit without force of character. It set up a national economic management team to deal holistically with the global meltdown, which recommended a 5% reduction of excise duty on locally produced goods except cigarettes and alcohol; full deregulation of the downstream sector of the oil industry; cancellation of the funding of refineries; and a ₦70bllion injection into the textile industry through guarantees.

Summary of DCs and LDCs Response

The developed countries have information as to the level of distress in their economy. They have mobilised their citizenry and are going through the motion trying to do all it takes to restore growth. Their efforts are geared towards saving capitalism from itself. Fidel Castro contends that "the battle is still on. This time it is the battle of ideas. The battlefield is the world everywhere, in all continents, in all institutions, at every forum. This is the good side of Globalisation".

They have also tried to co-ordinate their efforts through the establishment of the financial stability board and a host of other regulatory apparatus. One thing that is clear is that they want to nip this recession in the bud and prevent it from degenerating into a full blown depression. Whether they succeed or not will not be a chance event. Rather, it will be to their foresightedness, dexterity of their leadership and the co-ordinate actions of their governments and their highly mobilised people. The IMF has opened a website devoted to monitoring all the G20 progress on their activities aimed at restoring stability in the financial market/sector.

While in the less developed countries of Africa, due to her underdeveloped financial markets, the continent's economies remained largely buffered from the financial problems experienced in the United States, Europe and other parts of the world. It has not come through the crisis unscathed however. Falling international demand has dampened Africa's exports. Tightening trade flows have also posed a problem for many of the continents countries. More pressingly, the crisis has strained international aid organisations, limiting their ability to provide humanitarian relief to some of Africa's poorest countries. In Nigeria, the impact was temporarily shielded by the Bank restructuring that had been concluded by the CBN and by the reported statements credited to the CBN that "the Nigerian economy was immune to the global economic meltdown. The growth in the financial market witnessed in

2007/2008 was as a result of share price manipulation, corruption and deceit by a cabal in the financial market. The market collapsed loosing more than 90% of its value in the banking sector and about 50% in the other areas.

Unfortunately, we in the LDCs are still living in denial. The idea of cutting salaries of top government officials in Nigeria just underlines the fact that our government does not understand what to do. It is trivial and almost trivialises the issue. Nigerians know that our elected officials do not live on their salaries. Even if 100% of the salary is taken, it will not mean anything to the persons involved neither will it be of any budgetary significance.

Conclusion/Recommendations

In the light of the above, we recommend that the government of Nigeria wakes up to it responsibility by:

- getting relevant information on the meltdown by economic sectors;
- studying the implications for our mono-product economy;
- looking for ways to strengthen the tax mechanism so that the percentage of Nigerians paying tax increases as a source of revenue in financing investment in the productive sector of the economy;
- encouraging thrift and frugal life styles. Incidentally, the politicians may not allow this to happen except there is strong political will from the highest quarters; and
- taking proactive steps to shield the economy and put it on the right line to achieving her vision 2020 of the best twenty economies in the world.

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