

THE IMPACT OF FINANCIAL CRISIS AND GOVERNMENT REACTION: LESSONS FROM THE EXPERIENCE OF CHINA AND TANZANIA

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Abstract

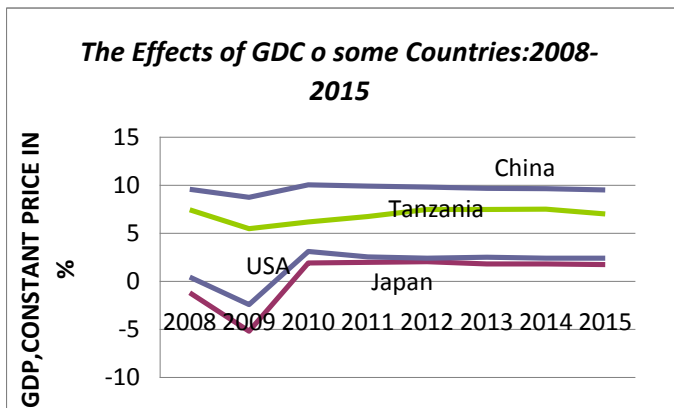
This paper shows the impacts of the Global Financial Crisis by using Tanzania and China. It provides the causes of the current crisis and the measures made to soften it. We learn that the market failure is the government failures as well. The world financial systems are interwoven and impacts spread from a single point to the entire world. Unlike China, Tanzania has inadequate sustainable means to recover from the crisis and there are no long lasting solutions to disentangle Tanzania from the vicious circle of poverty.

Key words: global financial crisis, stimulus package, impacts, lessons

1.0 INTRODUCTION

The challenges of the modern governments range from domestic ones like poverty alleviation, regional disparities, welfare phenomena, environmental issues to security ones. At the international level, cross cutting problems like terrorism and global warming are constantly challenging all administrations. The recent Global Financial Crisis (GFC) is severe and demands the whole world to work mutually. The impacts of GFC vary from consumption behaviours to losing our jobs. People's positive attitude and confidence in financial institutions will take years to return (Shah, 2009). We can deduce the impact from on some countries (see fig. 1).

Figure 1: Data source: IMF staff



The Global Financial Crisis⁸ smote the mighty ones messily and accelerated the developing countries seeking aid further to already hit economies. Large financial institutions have shut down their

⁸ Throughout this work, Global Financial Crisis refers to the current economic crunch (2007 to date/2011).

businesses and stock markets have fallen down around the world (Shah, 2009). The current GFC started to reveal itself in 2007 and became apparent by the end of 2011. While the financial operating systems⁹ tightly bound the global village, solving mechanisms were not proactive until when governments realised that those trusted to keep peoples' money especially in the United States abused market forces. From that moment, the GFC was apparent and responsible governments devised serious measures to suppress it.

The primary aim of this paper is to examine the impacts of the GFC and the reactions taken to address the situation. The paper takes China and Tanzania to answer the following key questions: *how Global Financial Crises occur, what impact has the GFC caused, what measures did the governments take, and what do we learn from the GFC of 2008?*

China and Tanzania are different areas in terms of economic status but practised socialism in the past and switched to market economy differently demonstrate how GFC affected different countries with varying economic status and systems. The study surveyed on other few countries for the purpose of comparison and broadening our vision.

2.0 METHODOLOGY

This paper is mainly the product of the library research. Much of the material about the current global financial crisis (2008) are in the books (very few online), journals, magazines, newspapers, and reliable websites. The author followed closely hot debates on GFC on the TVs and radios. Therefore, all statistics which are shown in this paper were extracted from these sources. However, as the secondary data, they were subjected to scrutiny by using different

⁹ Details see: Rajan G.Raghum (pp.313-314).

reliable and authoritative sources to examine their reliability and robustness. The paper has surveyed the GFC impacts on different countries by using these sources of information. To keep track of the key information; the paper acknowledges all sources and whenever possible websites and web links are given. A comparative approach is employed to reveal the magnitude of the GFC impacts and the measures taken by the developed countries, emerging countries and the developing countries, in particular the thrust is on China and Tanzania.

3.0 THE MEANING AND CAUSES OF GLOBAL FINANCIAL CRISIS

According to the Business dictionary,¹⁰ financial crisis refers to, “*a situation in which the supply money of is outpaced by the demand for money. It is quickly evaporated because available money is withdrawn from banks either to other to make up for the or to A relatively simple explanation of the cause of the recent financial crisis is borrowed from Minja (2009) . He identifies some characteristics as follows: Firstly, irresponsible borrowing and lending led to loans being made to borrowers with poor credit ratings, resulting in the explosion of the sub-prime credit market. Secondly, a regulatory lapse allowed excessive creativity in engineering financial products whose quality proved extremely difficult to establish. Though the products originated in limited markets (mainly in the USA) they ended up being marketed, bought and insured by financial institutions and markets all over the world. Regulators were simply watching as borrowers and lenders engaged in irresponsible lending and borrowing. Lastly, over-reliance on credit for both consumption and investment is both the source of the crisis and a fuel to the crisis that transmits*

¹⁰ More details can be obtained by visiting:
BusinessDictionary.com:<http://www.businessdictionary.com/definition/financial-crisis.html>

the effects to the real sector. On the one hand, reliance on credit is what caused the explosion of the sub-prime credit (Ma,2008).

One of the key arguments against bad financial practises was directed towards the behaviour of the people responsible to manage other people's money. The fraud of Bernard Madoff worth of \$ 50 million is associated with the corruption of financial industry (Krugman, 2008 and Rajan, 2005). It was also recorded that prior to the apparent GFC, financial institutions ignored financial and economic experts' warnings against the high probability of the GFC (Shah, 2009).

4.0 THEORIES/APPROACHES OF FINANCIAL CRISIS

There are different theories such as *Herding models, Minsky's theory, coordination game, and Marxist theories*. This work embarks on the three models/theories: coordination game, Minsky's theory, and Marx's theories.

Coordination game, emphasises on positive feedback between market participants' decisions that may supplement or substitute one another (reinforce or offset one another). Theories that share these ideas (positive feedback) argue that there are several equilibriums. In one equilibrium market, participants tend to value

Figure 2: Data source WDI, World Bank Group



We should bear in mind that the population of China is about 1.4 billion any adverse impact on the population involves millions of people and the government requires a lot and immediate resources to avert the situation.

Figure 3: Data source WDI, World Bank Group



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Countries	Time for Action: Law/Act	Name of Policy/Act	The amount projected/available (US \$ billion) as per 2009)	Targeted Areas	(US \$ bill)	Current Specific Areas	Outcome
1. USA	17 Feb, 2009	HR1, The American Recovery and Reinvestment Act of 2009	939	Spending programs	507		
				Transportation, energy, technology	150		
				Tax relief	282		
2. China	Nov, 2008	First round (Not passed by the National People's Congress-NPC). The government is responsible for everything.	586	1) Low-income housing; 2) rural infrastructure; 3) major infrastructure (railways, airports); 4) health, education and culture; 5) ecological environment ; 6) science and technology, industrial structure and	146	Post-earthquake reconstruction	
					59	Public housing	
					54	Rural infrastructure	
					54	Research and development structural change	
					31	Environmental development	
					22	Healthcare and education	

				rural residents; 9) value added tax reform; and improvement of financial support systems to support economic growth				
	3Feb, 2009	Second round	19	5.1	Central projects			Very little amount of money was expected to come from central government
13.9				Local projects				
3. Canada	27 Jan, 2009	(Bill C-10) /Canada Economic Action Plan ¹¹	24 (For 2009)			9.6	Build and repair infrastructure	To boost real GDP by 2.5 per cent & Create 265,000 jobs by 2010
						16.08	In personal income Tax relief (2009-2014)	
						6.27	Stimulate housing construction	

¹¹ More Details see: <http://www.fin.gc.ca/n08/09-011-eng.asp>

Countries	Time for Action: Law/Act	Name of Policy/Act	The amount projected/available (US \$ billion) as per 2009)	Targeted Areas	(US \$ bill)	Current Specific Areas	Outcome
					160.08	Improve bank financing	
					6.02	Energy, automotive, forestry, clean energy	
4. Argentina	22 Dec, 2008	Law 26476 on Anti-Crisis Measures ¹²		Promote: employment, production & consumer confidence		-Hire and put on books workers, - companies that cooperate get pardon for back taxes and pay only pay 50per cent and 75per cent in 1 st and 2 nd years respectively, -repatriate capital to Argentina (preferential tax rate of 1-8per cent versus current of 10-35per cent	

¹² The name of the policy is called: TAX ADJUSTMENT, Law 26 476: Tax regularization scheme, promotion, and protection of employment registration, externalization, and repatriation of capital. Sanctioned: December 18, 2008. Enacted: December 22, 2008. More details see: <http://www.infoleg.gov.ar/infolegInternet/anexos/145000-149999/148719/norma.htm>

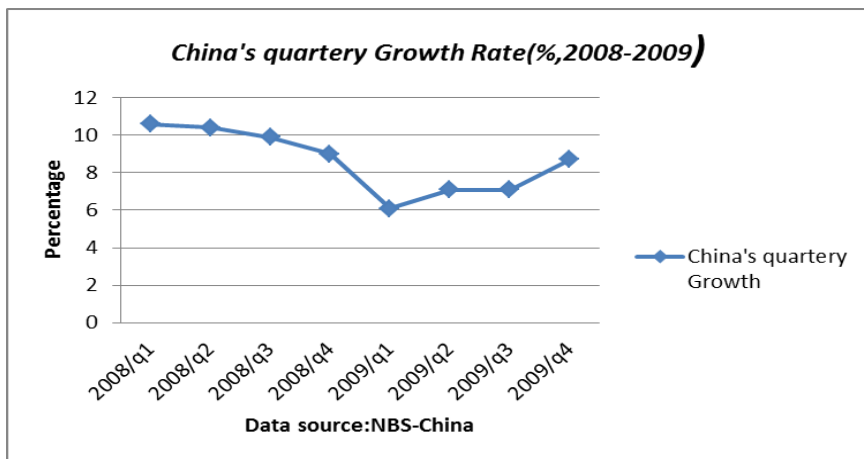
5. Australia	Oct, 2008	1 st Stimulus package	6.6				
	13Feb, 2009	2 nd Stimulus Package (2009-2011)	27	Large part in education,	1.9	Construction School halls, library, indoor sport facilities& performing arts centres,	
					0.6	Science and language labs	
				Community infrastructure projects		Railway gates, local libraries, community centres & sport arenas	
				Public housing	3.75	20,000 new homes by 2010	
				Low & medium income earners	8.0	Bonuses	
				Energy efficiency in homes, support SMEs			
				Tax breaks		To ensure jobs by deduction of tax on purchases made by SMEs	

8.3 Stimulus Package and its results

The China's government tries to maintain the steady and fast growth of the national economy and ensure that no major fluctuation happen. That will be their greatest contribution to the world economy under the current circumstances. China invested in key areas immediately and the alterations were apparent from the second quarter of 2009 (see Table 2).

The initiatives were able to contribute to the 7.3 per cent of GDP in the last quarter of 2009 (Qu, 2009). Statistics also showed that consumption rose by 17.2 per cent. For instance home appliance sales generated 50.8 billion Yuan within the first months and automobile sales hit 10million units by October 2009 with an anticipation of additional 3million units to make China the biggest automobile in the world (Ibid). Due to this progress, the World Bank adjusted its forecast for China from 6.5 per cent to 7.2 per cent and later to 8.4 per cent in 2009. The trend of China's progress in 2008 and 2009 is on figure 4 below.

Figure 4: Data source NBS-China¹³



The achievement according to the government was tremendous. China is the first in the world to turn around, GDP increased to 8.7 per cent, income in rural and urban stood at 8.5 per cent and 9.8 per cent respectively. It was not only the immediate action, which the government of China too like other nations, but also a series of steady achievement after 60 years of founding new China was the firm foundation of the immediate success (Jiabao, 2010).

Domestic consumption increased through subsidies (45billion Yuan) for rural dwellers resulting into 46.1per cent motor vehicle increase and 16.9 percent consumer goods increase in real terms. It promoted rapid growth in non-governmental investments worthy of 4 trillion Yuan for two years. The efforts were directed towards the low-income housing; improve wellbeing of rural

¹³ More information at the websites of the National Bureau of Statistics of China: <http://www.stats.gov.cn/english/>

dwellers, social programs, independent innovation, earthquake recovery, major and infrastructure projects¹⁴.

More strategies are on reduction of regional disparity and improving the standard living of central, western, and north-eastern parts. These regions registered development to a certain extent in distribution, restructuring, and coordination. Furthermore it carried out the reforms and opened up, and constantly improving institutions and mechanisms conducive to developing scientifically.

The contribution of the industry as the proportion of the value-added from the tertiary industry to the total GDP increased from 41.8 per cent in 2008 to 42.6 percent in 2009. By 2009, the target of reducing unemployment rate was only 0.4 per cent lower than the targeted level of 4.6 per cent. Despite of a total of 11million jobs, which were created in 2009, China still faces stiff challenge of new graduates. For example, there were 6.1 million graduates in 2009. Migrant workers pose challenges too, for instance in 2009, migrant workers who went back home, the government created 20 million new jobs so that the unemployment rate remained below 4.6 percent.

9.0 GLOBAL FINAICAL CRISIS IMPACTS AND REACTIONS IN TANZANIA

9.1 Economic Growth before GFC

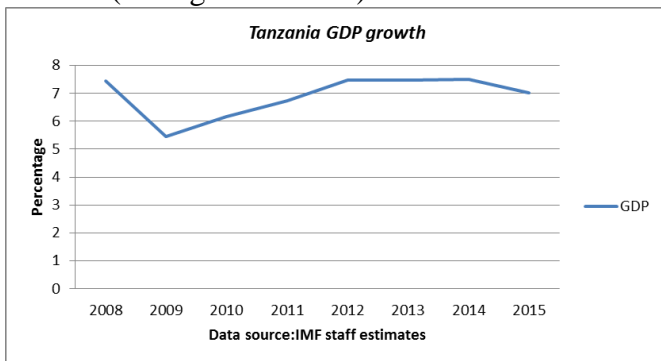
Statistically, the past seven-year period up to 2008, the economy of Tanzania grew at an average of 7.2 per cent mainly driven by growth in mining, financial intermediation, transport and communication, and manufacturing and trade activities. Over the period, inflation remained at a single-digit level until September

¹⁴ Details of 4trillion distribution see: Jiabao W (2010) Report on the work of the Government

2008, when it rose to 11.6 per cent from 9.8 per cent in August and increased to 13.5 per cent in December 2008. Implementation of fiscal and monetary policies remained prudent and focused on sustaining macroeconomic stability, economic growth and price stability (Bank of Tanzania, 2011).

9.2 Economic Status during Global Financial Crisis

The World Bank and IMF project that the global financial crisis will reduce Tanzania’s economic growth from over 7 per cent in 2008 to 5 per cent in 2009 (Lunogelo et al, 2010; Tibandebage & Kida, 2011). With over 40,000 Tanzanian jobs lost already, the poor are invariably hardest hit by economic shocks. For this reason, the \$37.7 million stimulus package targets the *mwananchi*¹⁵ and complements recent Tanzanian initiatives to stimulate the rural economy and increase food production. According to the IMF Tanzania will recover from the economic crunch in 2012 (see figure 5 below).



Figures 5, Data Source: IMF Staff estimates

9.3 Social Impact

The impacts of the GFC in Tanzania go beyond what one can imagine. For instance if nutrition of children is affected the

¹⁵ Mwanachi is the Swahili word that means citizen.

academic performance is adversely affected too. Children are most vulnerable to food insecurity. This Financial Crisis Assistance enables World Food Program (WFP) to yield two-meals a day for a year to 400,000 children in 600 primary schools in drought-prone districts of Arusha, Manyara, Dodoma and Singida regions.

In Tanzania, there are no proper recording systems but like in other countries, families whose relatives used to commit financial assistance back home might reduce the frequency or the amount because they are not making enough money. The projection by the World Bank was that the story of the remittances would fall by 5 to 8 per cent in 2009.¹⁶

9.4 Unemployment

The economic downturn has affected many businesses, therefore, posed impacts to the employees along tall chain of production. For instance, with the decline in exportation of agricultural products, horticulture declined abruptly and unemployed rate is more than in any other sectors. The tourist industry has laid-off some employees due to slow decline inflow of tourists many employees¹⁷. The tourist industry covers a wide range of related businesses like hotels, transportation and communication and handicrafts (Lunogelo et al, 2010).

¹⁶ The world Bank (2009) World Bank Lowers Remittances Forecast for 2009 as Financial Crisis
Deepens <http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:22115303~pagePK:64257043~piPK:437376~theSitePK:4607,00.html>

¹⁷ More details see Minja E.J., (2009) The financial crisis and Tanzania; 2009-10-22, Issue 454

<http://pambazuka.org/en/category/features/59679>

9.5 Some Affected Sectors and actions needed

9.5.1 Tourism

Tourists demand fell by 1 per cent between July and December 28 per cent of the United Republic of Tanzania's service export stagnated, and the hotels were 80 per cent empty during the peak period in late 2008 and early 2009¹⁸.

The approaches taken include the International Tourism Exhibition in Berlin where the marketing of tourist circuits including the game parks such as Selous, Ruaha, Katavi and Mikumi was done. Actions have been taken to explore new sources of tourists by marketing tourism and look at other sources outside the traditional market sources which have been much hit by the ongoing financial meltdown like Asia, India, China, Russia, the Middle East, as well as other African countries. Part of the financial aid from the government of the America (\$ 700mill) was utilized for the Wildlife Management (Tibandebage & Kida, 2011).

9.5.2 Agriculture

Agriculture contributes about 46 per cent of the domestic income and the majorities about 90 percent of Tanzanians are peasants. Therefore, any impact on the agricultural sector affects the entire nation. The global slowdown has also depressed demand and prices of commodities such as coffee, cotton, and tea in the world market (Lunogelo et al, 2010). Due to financial crisis exports has declined significantly both for the raw materials and manufactured goods. For example, the decline in the flower business from October 2008 is between 30 and 50 per cent and some types of flower have zero demand (Ibid). Tanzania invited China to support in agricultural sector Instead of exporting the raw materials, strategies are aimed at exporting manufactured goods.

¹⁸ ILO: 1st African Decent Work Symposium, Recovering from the crisis: the implementation of the Global Jobs Pact in Africa Sep. 2009.

The government is transforming our economy and give agriculture its due weight in resource allocation and use the food and other non food crops to create industries for value. Tanzanian horticulture, with over 10,000 employees and \$50 million annually in exports, will be sustained through support for the Tanzanian Horticultural Association (USA embassy, 2009).

9.5.3 Financial sector

One of the facts is that if the financial systems of the country are not linked with the financial institutions of the affected countries, there is less indirect and relatively less impact¹⁹. The link can be deposits in the affected institutions, holding their shares or debt instruments and holding toxic financial assets most of which have indirect links with the affected institutions (Minja, 2009).

¹⁹ It is argued that countries whose financial institutions like Banking industry in no tied up closely with the mostly hit, say American institutions are less likely to be seriously affected by the crisis. Tanzanian financial institutions are examples and that is why is there is less impact compared with Kenya and South Africa whose economies are integrated with western financial markets.

Table 2: Tanzania: Selected Financial Sector Indicators

	2006	2007	2008
Capital adequacy			
Capital / risk-weighted	16.3	16.2	14.9
Asset quality			
Non-performing loans (net of provisions) to gross loans	6.8	6.3	6.2
Sectoral distribution of loans			
Agriculture	...	11.9	10.4
Mining and manufacturing	...	20.3	14.7
Trade	...	17.0	18.5
Tourism, Hotels, and Restaurants	...	4.3	4.9
Personal	...	16.2	19.9
Earnings and profitability			
Return on assets	3.9	4.7	3.8
Return on equity	26.7	29.0	23.1
Liquidity			
Liquid assets / total assets	48.6	48.0	37.6
Liquid assets to short term liabilities	54.2	53.0	41.1

Source: Bank of Tanzania, End-September for 2008

Since there is no direct link between financial institutions, Tanzanian financial institutions will be less hit and further more laws operating in Tanzania regard the foreign banks as independent banks versus branches of foreign banks. For instance, banks like Citibank and Barclays have been affected more, their Tanzanian operations have not, but in the end, they may get affected (see table 2 above).

9.5.4 Stock Market Exchange

Dar es Salaam Stock Exchange (DSE) is at infancy stage and still the foreigners have no control compared to advance other stock exchange of Nairobi and Johannesburg. Protectionism has been applied in through operating rules and that is why the financial

crisis impact on DSE has been minimal because of the few foreign investors. Tanzania also has some exchange controls that restrict the flow of international capital thus limiting the contagion effect from foreign financial markets (Lunogelo et al, 2009).

9.6 Measures for Curbing the Global Financial Crisis

9.6.1 Domestic initiatives

Some initiatives were and still are being taken by the Government at the domestic level and most jointly with other countries since the problems are to be addressed by all nations to solve long Global Financial Crisis and its recession (Tibandebage & Kida, 2011). During 2009/10, the Government aimed at improving domestic revenue mobilisation by broadening the tax base, curbing tax exemptions, and enhancing revenue administration. It intended to achieve revenue to GDP ratio of an above 15per cent in the short to medium terms and attain an annual average inflation rate of about 7 percent. With the anticipated improvement in the food supply situation, and operation of prudent fiscal and monetary policies, the annual rate of inflation was projected to go down to an average of 7.0 per cent by the end of 2009.

9.6.2 Foreign Financial Assistance

Tanzania has received \$ 37.7 million to help soften the impact of financial crisis specifically Financial Crisis Initiative” to directly benefit poor Tanzanians. Tanzania was also promised to obtain technical assistance from the USA. This stimulus offsets job losses by providing temporary employment opportunities to thousands of Tanzania’s poorest households. Furthermore United States Aid Department (USAID) collaborated with local banks to offer up to \$10 million in credit and financing options for agribusinesses, including over 1,000 Small, Micro-enterprises, and households through micro-finance over a five-year period to stimulate production and improve food security. Tanzania is one

of eight countries receiving Global Financial Crisis funds of more than \$255 million. Other African countries receiving this one-time assistance are Ghana, Liberia, and Zambia (Lunogelo et al, 2010) Foreign Direct Investment increased from \$ 600 million in 2009 to \$700 million in 2010 to the global economic slump (Reuters, 2009).

Since 2006 when the economic turbulences were registered globally, we just experienced not only crises but also a number of attempts to fit it²⁰. The crisis is not yet over but we have learned so far the following things. First, the quick response to the global issues has reduced the magnitude of the problem. Governments injected mass capital in potential sectors and cut public and social spending quickly. However, the response ought to be proactive.

Second, regardless of the epicentre of the GFC, globalization accelerates its speed and the magnitudes vary among states. In developing countries like Tanzania, the crisis created inequality due to an increase in unemployment, social justice problems, and poverty. In developed and developing countries with strong financial systems, the impact so far is more severe.

Third, the crisis is an opportunity. China has emerged as the second economic powerful nation in the world during the crisis. It has bailed out the world economy and its contribution in economic recovery is so big. The current GFC provides opportunity to rethink about the global financial regulations which can avoid the devastating financial management. Proactive measures can reduce the impact.

²⁰ This paper depends very much on the data available by the first quarter of 2010. Most of the data are still incomplete and somehow ambiguous.

Fourth, China could not merely deal with the crisis without firm economic systems and her domestic financial management style. The leaders of China take all reforms cautiously and whenever possible they prefer the Chinese characteristics in dealing with issues to foreign ways. For instance, all reforms are under the control of the government. The government continues to supervise and regulate market forces in China. The financial system is closely under the control of the government.

Six, there are immense problems of the poor nations whenever there is the global crisis. The available examples show that HIV-AIDS is not a serious problem in the developed countries but a catastrophic one in developing countries. While the GFC in US may not lead into starvation, in Tanzania, it increases the degree of malnutrition among school going children and affect their academic performance adversely. Tanzania resorted to seeking more financial aid which adds up to the heavy debt burden.

Seven, global issues may be caused by one person but its impact is felt worldwide. The one who commits the origin sin is not punished at all if s/he belongs to the developed world. The current crisis was caused by the poor financial management in the US but no one has ever apologized despite of the early warnings from the financial experts in from 2005 to 2007. This is another scenario developing countries face whenever there is war or threat of war outbreak in the Middle East; the oil price increases and the economy crumble.

Eight, while openness to trade makes countries more vulnerable to downturns elsewhere, it has frequently increased growth and productivity in developing countries. No country has become rich behind protected borders. Openness to financial markets increases the risks of financial contagion (Minja, 2009) , yet openness to foreign banks has over the long term increases productivity and

innovation in the financial sector. It is easier to reduce spending on infrastructure and long-run capital-intensive tasks in the light of the current crisis, but these tasks are needed for growth and human development in the long run.

Lastly, the developing countries like Tanzania should not make reforms which are uncontrollable. Privatization of the former government parastatals will always keep the economic systems paralysed. It is better to start slowly on any reform. Reforms are inevitable (Prasad, 2004) but Deng Xiaoping advises our leaders in reforming that they should be leaders who are learning by doing and doing by learning. Furthermore he purports that they can pass their economic system, which is among the major pillars of today's economy but in a fashion of a person who is "crossing the river by feeling the rocks under the feet". These are some of the characteristics that minimize failure of the government undertakings²¹.

10. CONCLUSION

Irresponsible financial institutions in the USA have failed the public. The market economy failure in the capitalist systems poses challenges to all nations. The lessons we draw from the current GFC reveal that the crisis has dragged Tanzania far back into a vicious circle of poverty. With crippled economy and poor policy implementation, Tanzania has now failed even to fight against natural calamity like the drought that makes power cut off and eventually goes into severe poverty. Without sustainable policies, responsible and accountable institutions, the stimulus package is not a panacea. There is no guarantee that it is the best solution for the developed and developing nations in the long run. The Chinese strategy in solving the current financial crisis is deep

²¹ Chinese authorities believe that incrementalism allows modifications based on experience before getting into full swing.

rooted in its unique economic characteristics; the socialist market economy, which means each country, should take global measures but creatively contextualize them to conform to their own practical ways of dealing with subjects. Finally, the severity of the impacts of the GFC will depend on the balance between the measures to curb it and its persistence.

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