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Africa: Africa's Counter-Cyclical Policy Responses to the Crisis

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Abstract

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KEYWORDS: Africa, inflation targetting, counter-cyclical policy, crisis

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1. Introduction

While the severe global recession seems to be bottoming out and the global economic outlook is turning cautiously optimistic, the negative impact of the crisis on many African countries continues to deepen. The crisis has hit Africa with a lag, interrupting at best, and ending at worst, the impressive growth record of the last ten years. The crisis has also already started to erode the hard-won improvements in macroeconomic positions. Even though most African countries have managed to avoid recession in 2009, the speed of the continent's recovery and longer-term prospects remain uncertain. Moreover, the human and social cost of the crisis could be devastating: unemployment in Africa could increase by more than 10 percent just in 2009, and the number of the working poor and vulnerable workers could reach unprecedented levels.[1]

Well-targeted and globally coordinated policy interventions are needed to reinvigorate the continent's growth, boost income and employment, and avert a development crisis. On their part, a number of African countries have adopted stimulus packages to soften the damage from a crisis they did not create. At the same time, many, especially low-income and fragile countries with limited fiscal space and international reserves, have lacked resources to implement counter-cyclical measures. In some cases, capacity constraints have presented an additional challenge to effective policy responses. Provision of timely and adequate financial assistance from advanced economies and international financial institutions to Africa thus remains crucial. Moreover, policies in African countries need to be coordinated with actions of advanced economies. Only a global partnership can bring African economies back on a high and sustainable growth path, which would lead to lasting improvements in living standards.

This paper is organized as follows. Section 2 summarizes the impact of the crisis on Africa and the African Development Bank's economic outlook on Africa. Section 3 reviews the actual country responses as well as the Bank's actions. Section 4 discusses the case for stimulus packages in Africa and the need for a global partnership. Section 5 suggests options for gradual modifications to fiscal frameworks that would facilitate effective counter-cyclical fiscal policies in the future. It also discusses conditions under which an inflation targeting regime can help counter-cycles in Africa. Section 6 concludes.

[1] Vulnerable workers are those without formal arrangements. The number of the African working poor could rise by 35 million people and vulnerable employment by 31 million during 2007 – 2010 (ILO, 2009).

2. Impact of the global financial and economic crisis on Africa

Africa's rapid growth during 2000-08 came to an abrupt halt in 2009, due to a severe external shock caused by the global financial and economic crisis.[2] At the onset of the crisis in 2008, many economists underestimated its likely impact on Africa, on the premise that advanced and developing countries had decoupled. By early 2009, it became clear that for most countries on the continent the crisis has caused a serious setback. The key question then became how to contain the crisis' longer-term impact so as to preserve Africa's recent economic achievements.

The global financial and economic crisis hit the continent mostly through real channels, such as deteriorated terms-of-trade, reduced demand for exports, decline in FDI, remittances, tourism, and possibly also aid inflows.[3] The crisis also worked through the financial channel, namely the credit crunch on global financial markets, and especially the limited access to trade credit.[4] The combined effects of these shocks resulted in a sharp decline in Africa's growth in 2009. Specifically, the African Development Bank's October 2009 outlook projects real GDP growth to reach only 2 percent in 2009, a downward revision from 2.8 percent projected in February and a sharp decline from almost 6 percent during 2002 – 08 (Figure 1). It also means that in terms of real GDP per capita, the continent will record its first decline during this decade. The October 2009 outlook for sub-Saharan Africa is even more subdued, with real GDP growth dropping to 1.1 percent in 2009, down from 2.4 percent projected in February 2009. Fueled by the global recovery and domestic policy responses, Africa's growth is also projected to reach only 3.9 percent in 2010, well below the growth rates of the pre-crisis years.

The growth impact of the crisis has varied across countries. While many countries have experienced a sharp deterioration of growth prospects, others have continued to record improvements. In fact, only 6 out of 51 African countries are expected to suffer a contraction in output in 2009 relative to 2008,in contrast to OECD members, where the GDP of all but two countries is projected to fall.[5] Two groups have taken a particularly heavy hit: (i) emerging and frontier markets, such

[2] In 2008, Africa had to cope with two shocks: the oil and food price shock in the first half of the year and the global financial crisis in the second half.
[3] For example, instead of an expected 500,881 visitors only 425,137 arrived to the Tanzanian national parks during July-December 2008. To offset this shortfall, the government worked closely with the Tourism Board to promote Tanzania as a tourist destination (Lunogelo, Mbilinyi and Hangi, 2009).
[4] Detailed analysis of the impact of the crisis on Africa can be found in AfDB (2009), Kamara, Ndikumana, and Kandiero (2009), and Kasekende, Ndikumana, and Rajhi (2009).
[5] The exceptions are Australia and South Korea that are projected to record real growth of 0.8 and 0.1 percent in 2009, respectively (OECD, 2009a).

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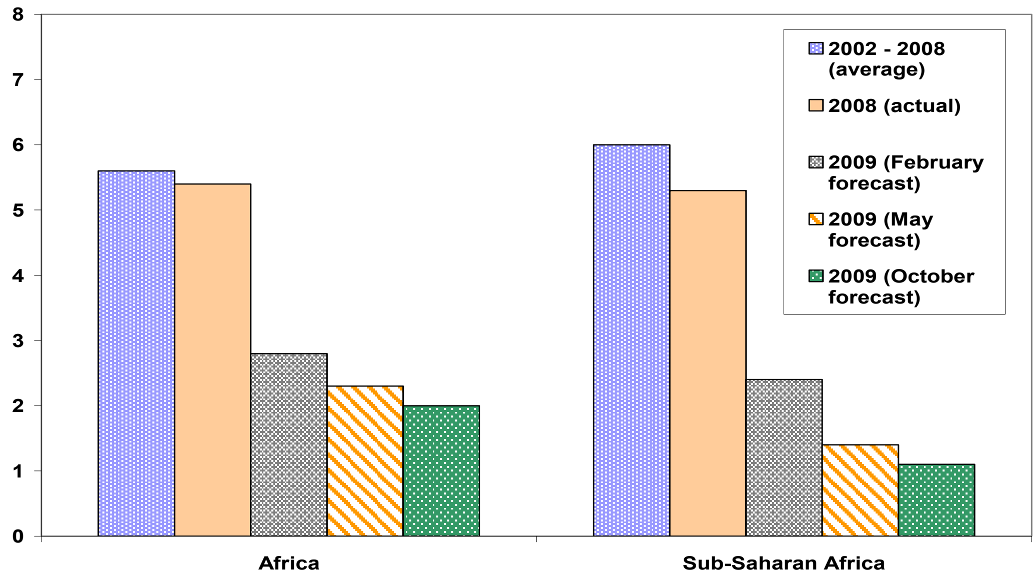
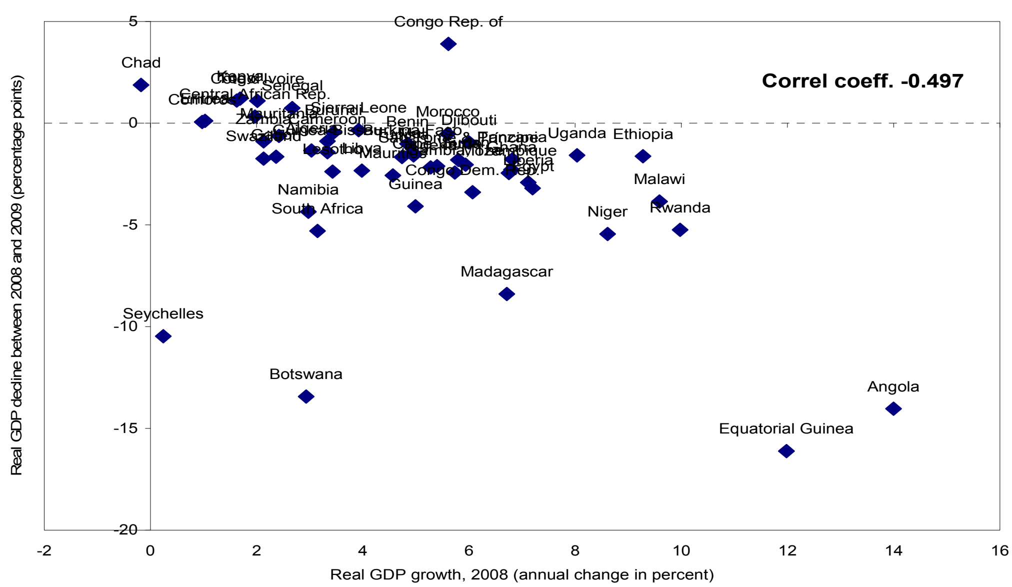
Figure 1. Real GDP growth in Africa and sub-Saharan Africa (annual percentage)



Source: African Economic Outlook database (October 2009). The average rate of growth for Africa and sub-Saharan Africa during the boom period of 2002 – 08 was 5.6 and 6 percent, respectively.

Figure 2. Africa: Pre-crisis (2008) real GDP growth and projected (2009) decline



Source: African Economic Outlook database (October 2009) and authors' calculations.

as South Africa or the Seychelles and (ii) resource-rich countries. Thus, some of the countries that grew the fastest in 2008 have experienced the sharpest falls in 2009 (Figure 2).

It appears that resource-rich countries in sub-Saharan Africa suffered the largest setback. In contrast, resource-poor, land-locked countries have weathered the global downturn relatively well, and are expected to record the highest rates of growth on the continent in 2009 (Figure 3). Similarly, GDP growth in emerging and frontier markets has slowed more rapidly than in the rest of the region. While low-income economies continue to grow at higher rates than middle-income ones, the slowdown is particularly harmful for them, given widespread poverty and the risk of policy reversals. In addition to these risks, in fragile countries, deteriorating growth prospects raise the possibility of return to higher fragility.

Since early 2009, the crisis has led to a deterioration of key macroeconomic indicators. Curtailed import demand in advanced countries and low commodity prices mean that Africa could lose up to half of its 2008 export revenues in 2009. As a result, the trade balance has deteriorated, and a number of countries have faced both deteriorating current account and fiscal balances (Figure 4). In 2009, the continent is projected to move from a current account surplus of 3.5 percent of GDP recorded in 2008 to a 5 percent deficit. The projected outcome for oil exporters is striking – as they are expected to run a current account deficit of 4.2 percent of GDP in 2009, compared to a surplus of 10.5 percent in 2008. Most African countries have also experienced a depreciation of their currencies relative to the US dollar. These outcomes put pressures on accumulated reserves. Hence, unless sufficient foreign direct investment (FDI) and concessional financing is available to cover the deficit, Africa's foreign exchange reserves, which took years to accumulate, could be rapidly wiped out.

The continent's fiscal balance is also projected to worsen as a surplus of 3.3 percent of GDP in 2008 is likely to turn into a deficit of 4.2 percent in 2009, constraining pro-poor expenditures and space for accommodating fiscal policy. The crisis has affected the fiscal space through two channels: (i) directly through revenue losses and (ii) indirectly through automatic stabilizers associated with slower economic activity. Commodity-related revenues have been affected the most, posing challenges especially for countries where such revenues account for a significant share of government revenues (e.g., Angola, Botswana, Chad,

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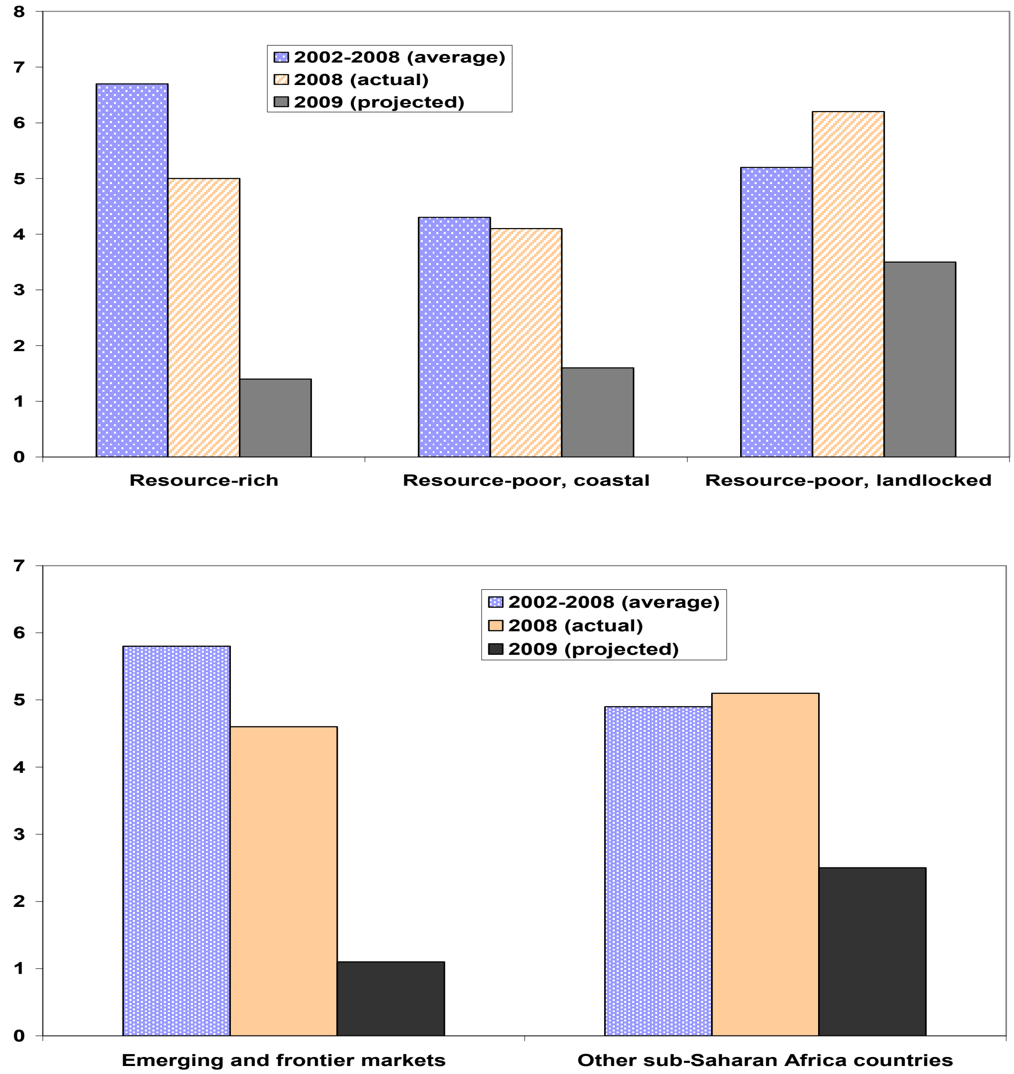
Figure 3. GDP growth in sub-Saharan Africa sub-groups (annual percentage)



Source: African Economic Outlook database (October 2009) and authors' calculations (unweighted averages). The country classification is in the Annex.

Gabon, Republic of Congo, and Nigeria). The fiscal balance in oil exporting countries will turn into a deficit of 5.4 percent of GDP in 2009 compared to a surplus of 6.6 percent in 2008. Oil-importing countries will also experience an increase of the fiscal deficit from 1.3 percent of GDP in 2008 to 2.7 percent in 2009.

3. Domestic policy responses to the crisis

At the onset of the crisis in 2008, Africa was in a markedly stronger macroeconomic position, especially in terms of fiscal balances, external debt, and stock of foreign exchange reserves than prior to the previous global recession (Figure 5). While the good growth performance in recent years was largely due to a favorable global environment, prudent macroeconomic policies have also played an important role. Policies of recent years have not only increased growth but also created cushions in a number of countries. The resulting stronger macroeconomic positions in a number of countries increased the capacity of governments to soften the crisis impact on their economies.

Analysis according to natural resource endowment reveals that for the four years before the crisis (2005 – 08), African oil exporters posted a substantial current account surplus of 11 percent of GDP and a fiscal surplus of 6.7 percent. These current surpluses resulted in a build up of reserves. Several countries, such as Angola, Botswana and Nigeria used these reserves to insulate their economies from the early impact of the crisis. In contrast, oil importers recorded current account deficits of 5 percent of GDP and fiscal deficits of 0.6 percent during that period. Some countries, especially the fragile and post-conflict states, still lack the policy space for counter-cyclical measures that could ease recovery, which makes them particularly vulnerable to any shortfalls in aid and remittance inflows.

The continent has adopted a variety of measures to cushion the impact of the crisis, including setting up special monitoring units to identify causes and responses to the crisis, fiscal stimulus packages, targeted sectoral assistance, capital and exchange controls, and new regulations in the banking sector. Several middle-income countries have applied expansionary monetary policies such as lowering policy interest rates. Specific examples are provided below.

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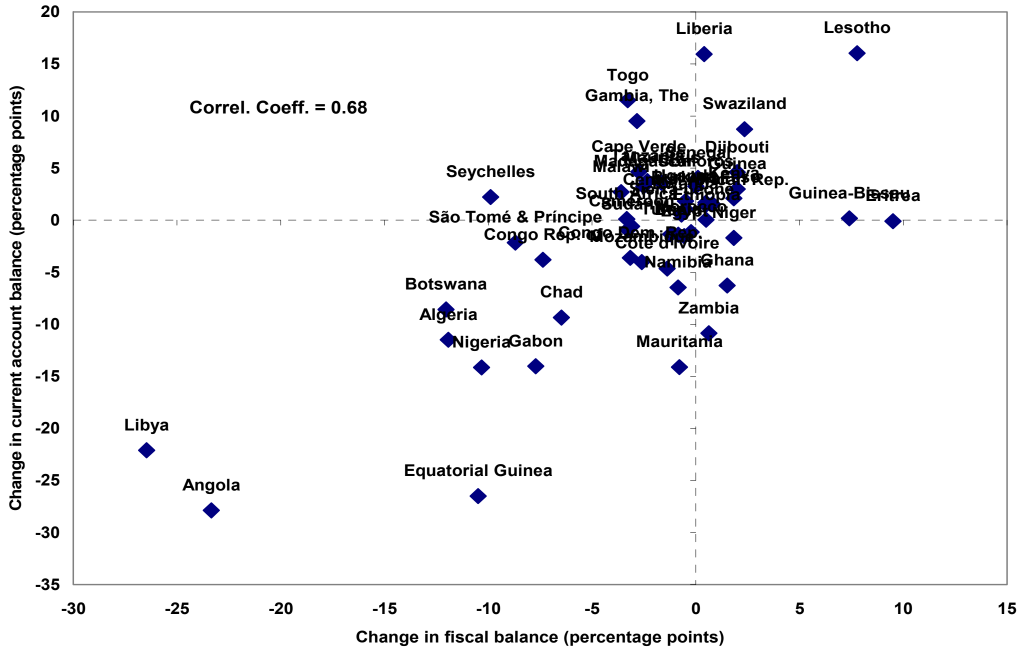
Figure 4. The “twin deficits”: changes in fiscal and current account balances, 2009



Source: African Economic Outlook database (October 2009) and authors’ calculations. A negative sign means deterioration in 2009. Both fiscal and current account balances include grants. The change is calculated as the balance as a share of GDP (in percent) in 2009 minus balance in 2008.

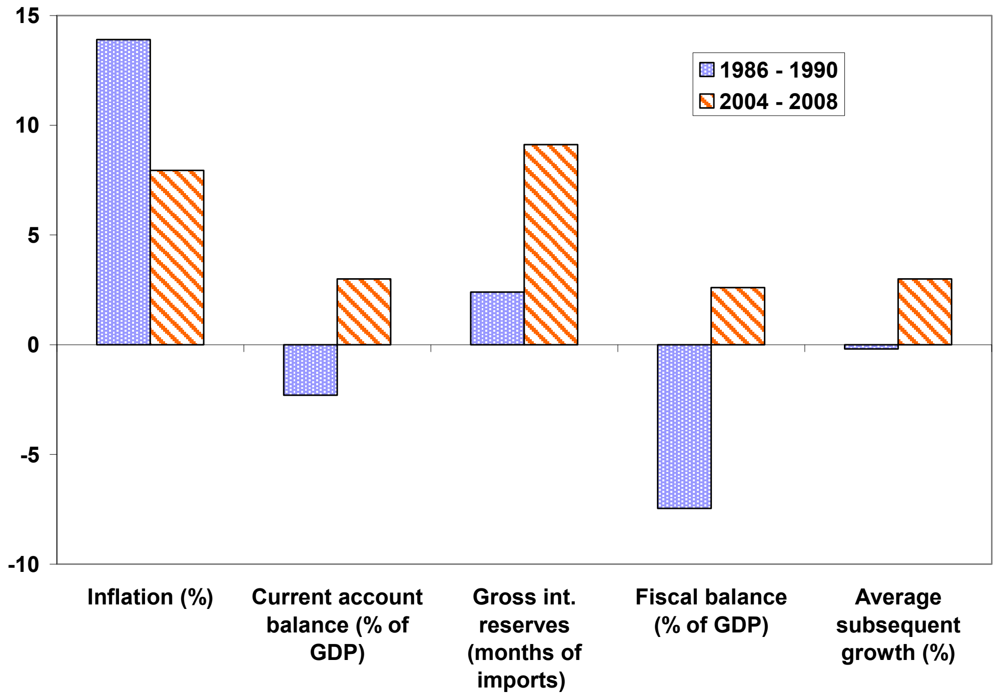
3.1 Fiscal and monetary policy responses of emerging and frontier markets[6]

Some countries, such as, for example, South Africa or Mauritius, introduced a policy mix, with the fiscal stimulus packages being accompanied by timely reductions in interest rates. Others, such as Tunisia, Botswana or Morocco, have focused primarily on easing long-term supply bottlenecks through increased public investment.

- In South Africa, the government has adopted a countercyclical fiscal stimulus amounting to R 787 billion (about USD 100 billion) for public investment during 2010-12. These measures aim at promoting high growth with job creation. The South African Reserve Bank eased monetary policy

[6] In addition to emerging and frontier markets specified in Annex, this section covers North Africa. East African countries are treated in more detail.

Figure 5. Africa's macroeconomic indicators before the two latest crises



Source: African Economic Outlook database (October 2009). Fiscal and current account balances include grants. Average of actual growth rates in 1991 and 1992 for the first recession and of forecasted growth rates for 2009 and 2010 for the second recession.

between December 2008 and October 2009, through cutting its policy rate by cumulative 500 basis points. As the banking and financial system has remained sound, unconventional measures or focus on financial stability issues were not necessary (Mminele, 2009).

- To mitigate the impact of the crisis, Mauritius implemented a monetary and fiscal policy mix. In May 2008, the government adopted an expansionary budget for the 2008-09 fiscal year. The stimulus package amounted to 3.4 percent of GDP. Most of the expenditures went to infrastructure and other growth-enhancing outlays (financing education; raising competitiveness of domestic-oriented industries and SMEs). The fiscal stimulus package, launched in October 2008, was well coordinated with monetary policy: the Bank of Mauritius reduced its policy rate by cumulative 400 basis points between January 2008 and March 2009. In parallel, the regulation of domestic prices of gas and oil was changed, so

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that consumers and producers became able to benefit from declining international prices.

- In February 2009, the government of Egypt doubled its fiscal stimulus plan to US$5.4 billion, to be spent on infrastructure projects. A further increase in the fiscal stimulus, US$1.8 billion, is now being considered. Expansionary fiscal policy was supported by easing the monetary stance, as the Central Bank continued to lower its policy rate, down to its lowest level in three years in September 2009.

- In Botswana, the Central Bank also reduced its policy rate several times. On the fiscal side, the revenue loss due to collapsed exports prevented the government from considering a major stimulus package. But the government has sustained support of the private sector through infrastructure development. Currently, large investment projects are under way, including the coal-fired Morupule B Power Station.

- In Tunisia, public investment increased by more than 20 percent in 2009 relative to the 2008 budget, to compensate for a 35 percent decrease in FDI.

- The Moroccan government introduced an emergency plan in early 2009. Under the program, public investment is expected to increase from 3.4 percent to 3.6 percent of GDP in 2009, to sustain growth and support structural reforms. The financing component of the program focuses mainly on major export industries (textile, leather and manufacturing), and provides state guarantees for a substantial portion of bank credit to these industries.

3.2 Fiscal measures in East Africa

In relative terms, East Africa has fared well. Among sub-Saharan Africa's sub-regions, it is projected to post the highest real GDP growth in 2009, while inflation is expected to decline significantly in 2010. Two sets of factors have contributed to the continued solid growth performance of this sub-region: (i) greater regional integration combined with lower dependence on the global economy than in most other Africa sub-regions and (ii) policy interventions that these countries adopted. Given inflationary pressures, these countries focused mainly on supply-side fiscal measures, even though the monetary stance was also accommodative. Steps were also taken to improve the business environment. Specifically:

- In Kenya, government expenditures in 2009-10 increased by about 25 percent relative to the previous year, while the fiscal deficit (after grants) is targeted to reach 6 percent of GPD, most of which will be financed by the proceeds from local infrastructure bonds, and the rest from foreign aid.[7] Measures to stimulate the economy included a reduction of VAT on electricity, the removal of duties on maize and related products, as well as a public works program. The objectives of the package are (i) to boost domestic demand to compensate for lower export earnings; (ii) to enhance competitiveness through increased investment, including in infrastructure; (iii) to create more employment opportunities; and (iv) to expand the food subsidy scheme. The central bank pursued more accommodative monetary policies, including through cutting the policy rate (Mhango, 2009).

- Tanzania's fiscal space (provided by low public debt and adequate reserves) also allowed accommodating policies. Government expenditures on infrastructure (road and energy projects) increased in the 2009 -10 budget by about 30 percent. At the same time, the country adopted fiscal measures to raise tax revenues, including through widening the tax base and revoking various exemptions. The net effect is expansionary – over the two fiscal years (2008-09 and 2009-10), the total fiscal stimulus is projected to reach about 4 percent of GDP. The package will rely partly on domestic financing of the deficit, thus deviating from the pre-crisis pro-cyclical stance of zero net domestic financing. Tanzania's Central Bank also increased the money supply growth by several percentage points, capitalizing on reduced inflationary expectations due to low food prices (Mhango, 2009).

- In Uganda, past prudent economic policies also provided scope to implement counter-cyclical fiscal policies, and in particular to raise expenditures in the 2009-10 budget by about 20 percent relative to the previous year. The package aims at supporting infrastructure and agriculture. This stimulus is to be accompanied by an improved business environment to enhance competitiveness. Monetary policy was gradually relaxed (Rand Merchant Bank, 2009).

[7] Due to delays, most of the stimulus projects will be implemented in 2010.

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3.3 Financial sector interventions and other measures

- Some countries also introduced financial sector measures in response to the crisis. For example, the Central Bank of Nigeria injected funds into the banking system in August 2009, when the country's five leading banks posted losses due to excessive lending to the energy sector and the burst of the stock market. In addition, management in the banks was replaced due to weak governance (Africa Research Bulletin, 2009).[8]

- African countries have been seeking new ways to increase their fiscal space. For example, the Central Bank of Kenya issued its first government infrastructure bond (in the domestic market) in early 2009. Proceeds were used to finance targeted infrastructure projects (roads, energy, and water). A second infrastructure bond was sold in early December 2009. In addition to raising funds, the bond issuance helps develop domestic capital markets.[9]

- Similarly, the government of Angola has been planning to raise additional revenues through its first international bond issue, to offset the revenue loss from low oil prices. The targeted amount is around US$4 billion.

- Reserves accumulated during the boom period also provided a buffer, especially among commodity exporters, such as Nigeria. Others though, such as Ghana or Ethiopia, saw their reserves fall to precarious levels. In Ghana, limited reserves, together with an unsustainable fiscal position, have prevented the government from implementing a stimulus package.

Thus, not all African countries were in a position to implement expansionary policies when the crisis hit. The precarious macroeconomic situation in Ghana, for example, requires the country to focus on macroeconomic stability. Specifically, in 2009 Ghana is projected to post sizeable twin deficits (fiscal

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[8] The case of the Nigerian banking sector has been so far an exception. In other African emerging and frontier market economies the financial sectors have remained resilient. For example, an earlier assessment by the Bank of Tanzania concluded that the domestic financial sector was sound; this was confirmed by the banks' profitability in the 3rd quarter of 2009 (Lunogelo, Mbilinyi, Hangi, 2009). However, the financial crisis negatively impacted access to international finance, especially trade credit throughout the continent.

[9] The Central Bank of Kenya received 44.1 billion shillings (USD 589.6 million) in bids for an infrastructure bond sale. It accepted 18.4 billion shillings of bids for the 12-year securities with a coupon of 12 percent. A third infrastructure bond will be issued in February 2010: Central Bank of Kenya at: www.centralbank.go.ke).

deficit of about 10 percent of GDP and a current account deficit of over 10 percent of GDP, both after grants), high inflation, and low reserves (IMF, 2009). To reach high and sustainable growth, Ghana's key policy challenges include consolidating its fiscal position so as to prevent the crowding-out of private sector credit due to domestic financing of large deficits and maintaining debt sustainability.[10]

4. The broader context of Africa's responses

4.1 Is there a case for a fiscal stimulus in Africa?

In general, the scope for rule-based countercyclical fiscal policies in African countries is limited. Given limited social safety nets, automatic stabilizers can only play a role on the revenue side. And even there, the room is constrained by the generally low share of revenues in GDP, especially among low-income and resource-poor countries. This has left the majority of the Bank's regional member countries with limited options to adopt discretionary counter-cyclical fiscal measures. Accordingly, past discretionary fiscal policies in Africa tended to be pro-cyclical. As government increased expenditures and cut tax rates during booms, the policy space for the downturns was eroded (Thorton, 2008 and Kaminsky et al., 2004). The volatile and pro-cyclical pattern of foreign aid has further amplified the fiscal cycle (Bulir and Hamann, 2008).

In the context of the current crisis, even countries that have the space to adopt discretionary fiscal stimulus would need to do so cautiously. Past evidence from emerging countries indicates that while the effects of a fiscal stimulus tend to be positive, they remain modest, especially for small open (import dependent) economies (IMF, 2008). Moreover, a broad consensus has been reached among economists and international financial institutions (IFIs) on the properties of an effective fiscal stimulus package. Specifically, discretionary measures should be timely, targeted, and temporary.

Taking these criteria into account, how have the comprehensive packages adopted in East African countries, or in emerging economies such as South Africa and Mauritius, fared? With the exception of Kenya where implementation has been delayed, measures adopted in these countries seem timely, as they were introduced shortly after the first signs of the negative impact of the global crisis. The measures also seem well-targeted: while some measures stimulate domestic demand (thus aiming to offset declining exports), many strive to ease the supply

[10] Using the latest debt sustainability analyses of the World Bank and the IMF, Hernandez and Gamarra (2009) found that debt burden indicators in African low income countries would deteriorate significantly with the severity of the crisis. This underscores the need for concessional financing in these countries.

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bottlenecks and support businesses as well. As most of the measures are temporary, they are not expected to interfere with the medium term fiscal targets.

More generally, most measures discussed above also support longer-term growth.[11] First, they are aimed primarily at the supply side and are accompanied by efforts to improve the business environment. As the above examples of Kenya, Botswana and others illustrate, infrastructure projects are at the core of the countries' response measures. Such steps are likely to encourage longer term production and boost investor confidence. Second, while some of the packages contain demand measures (reduction of VAT rates, for example), these are limited, and populist measures seem minimal. Third, with a few exceptions, the absence of significant foreign debt (or debt denominated in foreign currencies) makes the devaluation of the currencies less of concern. In most countries, the risk of future inflation is of a secondary order at this point and can be addressed in due course as the need arises. Fourth, the governments have made debt sustainability one of the key priorities and are aware that while they undertake short-term stimulus measures, they need to stay the course with longer-term structural reforms.

4.2 The global partnership and the role of the African Development Bank

Even if the packages that African countries have designed are economically sound, many countries do not have adequate domestic resources to counter the crisis. The example of Ghana is illustrative for many similar cases on the continent. While reforms aimed at increasing domestic resource revenue mobilization are high on the policy agenda, the results are likely to take time. Even countries that have adequate domestic resources to counter the crisis, such as Uganda or Tanzania, still need to strike a balance between preserving the hard-won policy space and stimulating demand through short term measures. Also, hard questions are being asked as to whether low income countries should spend the reserves accumulated during the boom to mitigate a crisis that originated elsewhere, especially if these outlays would consist of populist measures instead of expenditures to stimulate sustainable growth. This is more so since in many cases the demand stimulus would rather benefit the rest of the world, as a substantial fraction of the spending is on imported consumption goods, thus creating jobs elsewhere.

Regardless of the source of financing, the stimulus measures of African countries should be carefully selected in coordination with measures of the international community, whose economic recovery is a prerequisite for their

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[11] Utilizing a database of past financial crisis episodes (118 episodes in 99 countries during 1980 – 2008), Baldacci and Gupta (2009) found that fiscal responses that had a greater share of public investment may not have helped shorten recessions as much as consumption spending, but had a positive effect on output growth in the medium term.

success. Given Africa's strong dependence on exports, stimulating the aggregate demand from the domestic side is likely to have only a limited impact, as the required sectoral responses tend to take time to materialize. In low-income countries, such as Ethiopia or Sudan, the response of firms would also be constrained by the shortage of credit and foreign exchange. At the same time, much of the outcomes of the support to struggling export sectors will also depend on a healthy global recovery.

Two conclusions pertaining to stimulus policies seem to emerge: (i) There needs to be coordinated global action, with easing measures of African countries being accompanied by a deliberate effort of developed countries to refrain from any protectionist measures and ensure that their demand for African imports picks up; and (ii) domestic measures should aim at easing long-term supply bottlenecks through expenditures for infrastructure and support to private sector development, as was done, for example, in East Africa. In this context, countries could also consider easing regulations and taxation to stimulate entrepreneurship, as was done in some emerging European economies (the Czech Republic, for example). In sum, it is critically important for African countries to stay focused primarily on easing structural supply bottlenecks through financing of infrastructure and private sector development. The African Development Bank has been supporting them in this endeavor.

While the Bank has been actively supporting the continent during the crisis, its interventions have been consistent with its strategic orientation. The four pillars of its Medium-Term Strategy 2008-2012 – infrastructure, private sector development, governance, and higher education – have provided the framework for meeting the scaled up demand in these areas during the crisis. For example, the Bank approved a loan of 153 million Euros to the Government of Botswana, to finance components of a power station and associated infrastructure. This comes on top of a US$1.5 billion loan for general budget support extended in June, to help diversify Botswana's production, create jobs and enhance competitiveness. The budget support provided by the Bank has also a social dimension, as it helps protect the country's social outlays. In early November, the Bank agreed to lend US$85 million to Ghana for a road project. Moreover, to address market constraints related to the crisis, and in particular the trade finance shortage , the Bank has established a multiphase US$1bn Trade Finance Initiative in early 2009.[12] Even with its commitment to play a counter-cyclical role, the Bank's interventions have very much remained aligned with its strategic focus to finance longer-term development.

[12] The demand for this facility has been strong; operations in 2009 are expected to range in $600-$800 million.

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5. Considerations for future macroeconomic frameworks

5.1 Fiscal policies

Going forward, African countries may want to phase out pro-cyclical fiscal policies that in many cases characterized their economies in the run up to the crisis, especially because of the negative implications of such policies for longer-term growth.[13] In doing so, the countries could aim for balanced budgets (after grants) over the medium term. However, this would require modifying past practices and accumulating sufficient reserves during the booms to cushion the downturns. Some countries, especially commodity exporters, would also need to eliminate ad-hoc fiscal expenditure practiced during upturns, thus decoupling expenditure decisions from revenue booms.[14] On the donors' side, there is a need for timely and predictable aid delivery, without a pro-cyclical bias so that aid does not amplify the cycle.

The international practice also shows that to maintain fiscal credibility, it is helpful if the annual fiscal budgets are anchored in a medium-term expenditure framework, preferably with nominal ceilings (Lindh and Ljungman, 2007).[15] Another key lesson from emerging market economies in other regions is that well-functioning government bond markets are necessary for a smooth financing of deficits. Moreover, government bond markets would foster financial sector development through increasing competition, expanding savings instruments, and providing price benchmarks (OECD, 2009b).

When considering modifications of their fiscal frameworks, all African countries can draw on good international practices from other countries. These suggest that fiscal policy frameworks need to strike a balance between credibility and flexibility, reflecting country-specific circumstances (Kopits, 2005). For most African countries, allowing enough room for counter-cyclical measures, while adhering to the longer-term fiscal sustainability goals, would be important. The chosen framework needs to be simple, transparent and easily monitored, to be successfully implemented. Finally, like any substantial reform, the rules require strong political will and broad societal consensus to be implemented.

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[13] Ocampo and Vos (2008) document a strong negative correlation between procyclical fiscal behavior and the rate of long-term growth when measured for a large sample of developing countries.

[14] However, it needs to be acknowledged that in low-income countries the tension between the political pressure to spend resources quickly and the need to establish counter-cyclical policy is particularly large.

[15] In addition to raising credibility, such a rule can foster counter-cyclical fiscal policy.

5.2. Monetary policies and inflation targeting

In the years prior to the crisis, inflation targeting has gained popularity all over the world as a framework for conducting monetary policy. In Africa, countries practicing formal inflation targeting include South Africa and more recently (since May 2007) also Ghana, while others, such as Egypt, intend to adopt this framework in the future.[16] Given this trend, it is important to understand whether and how the inflation targeting regime can be effective in Africa where the majority are subject to frequent exogenous shocks.

The concept of inflation targeting encompasses five elements: (i) the public announcement of medium-term numerical targets for inflation; (ii) a commitment to price stability as the primary goal of monetary policy, to which other goals are subordinated; (iii) using all available information for setting the inflation target; (iv) transparency of the goals and conduct of monetary policy and (v) accountability of the monetary policy authority for attaining these goals (Miskhin, 2000).[17] In practice, all inflation-targeting central banks, including those of advanced economies where most of them operate, have conducted flexible inflation targeting, that is they have targeted the inflation rate while flexibly accommodating for shocks hitting the real economy (Svensson, 2009).[18] The ongoing global financial and economic crisis has only heightened this requirement for flexibility in the implementation of the inflation targeting regime.[19]

In discussing options to monetary policies in sub-Saharan Africa, Heintz and Ndikumana (2009) emphasize that the strict rule-based inflation targeting regime, with little discretion, is not a suitable framework for these countries. In contrast, an inflation targeting regime that allows for 'constrained discretion', one that takes into account real sector shocks, is more appropriate. However, its

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[16] According to the IMF classification, 44 countries out of 192 practiced formal inflation targeting as of April 31, 2008, a sharp increase from 19 countries (among 187) that had this regime in place in 2003: www.imf.org/external/np/mfd/er/index.asp . Moreover, some countries target inflation informally. Utilizing clarity and credibility of the central bank as criterion, Carare and Stone (2006) divided monetary frameworks of 44 countries that had floating exchange rate arrangements in 2001 into three regimes: (i) full-fledged inflation targeting, (ii) implicit price stability anchor, and (iii) inflation targeting lite.

[17] Monetary policy depends on deviations of forecasts of future inflation from the inflation target, that is the inflation forecast is the *de facto* intermediate target of monetary policy.

[18] As Heintz and Ndikumana write: "In practice, inflation targeting is often not strictly rules-based… the targets represent rules that can be broken, but with a heightened degree of transparency and accountability."

[19] What distinguishes inflation targeting monetary policy from macroeconomic management with a dual concern for the real economy and inflation is that inflation targeting makes inflation its primary goal.

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success hinges on addressing institutional and structural constraints that prevent central banks from playing a stronger developmental role. In this context, due consideration must be given to the level of development of the banking sector, the scope for managing capital flows, and the structure of international trade. In addition, an important challenge for central banks is the lack of sufficient instruments to pursue multiple goals.

6. Conclusions

This paper summarized the responses by African countries to the global financial and economic crisis. It showed that due to improved macroeconomic positions achieved before the crisis, a number of African countries were able to take counter-cyclical measures without jeopardizing their longer-term macroeconomic positions. The paper also laid out steps that African countries could take to reduce the pro-cyclical nature of their macroeconomic frameworks in the future. These include building up adequate reserves during the boom times, while targeting cyclically-adjusted fiscal balances and anchoring budgetary expenditures in medium-term expenditure frameworks. Countries that have adopted or aim to adopt inflation targeting as monetary policy regimes must keep these frameworks flexible to be able to respond to shocks.

As these recommendations suggest and the experience of emerging markets in other regions during the crisis illustrates, the importance of maintaining some flexibility in national macroeconomic frameworks cannot be overstated. And it goes without saying that the counter-cyclical measures extend beyond macroeconomic frameworks. In particular, evidence from other regions has shown that the prevailing domestic banking regulations tend to exacerbate the pro-cyclicality of capital flows and bank lending, which amplifies the impact of exogenous shocks.[20] This must be taken into account in the design and reform of financial sector policies.

Finally, taking a longer-term perspective, African countries could turn the crisis into an opportunity to restore their economic potentials and bring their economies on high growth paths. In this context, policies should focus on key structural reforms such as enhancing competition in the financial sector, streamlining labor market regulations, developing financial markets and strengthening governance, in order to improve domestic fundamentals, promote private sector development and enhance economic diversification. These reforms need to be accompanied by measures to establish social safety nets for the most

[20] See, for example, Ferri, Liu and Stiglitz (2003) for analysis of the role of rating agencies in the Asian crisis and Ocampo and Vos (2008) on capital account and financial market policies to mitigate cycles. Murinde (2009) discusses issues in capital account liberalization in the post-financial crisis era in Africa.

vulnerable segments of the population. Prudent responses to the current crisis and increased demand of African constituencies for transparency in public policies heighten the prospects for sustainability of these reforms.[21]

Annex – Country classification

Sub-Saharan Africa emerging and frontier markets	***Resource-rich***	***Resource-poor***
Botswana	***Oil***	***Coastal***
Cape Verde	Angola	Benin
Mauritius	Cameroon	Cape Verde
Namibia	Chad	Comoros
Nigeria	Congo, Rep. of	Gambia
Seychelles	Equatorial Guinea	Ghana
South Africa	Gabon	Guinea-Bissau
Ghana	Nigeria	Kenya
Kenya	Sudan	Madagascar
Mozambique	***Other***	Mauritius
Tanzania	Botswana	Mozambique
Uganda	Cote D'Ivore	Senegal
Zambia	Guinea	Seychelles
	Namibia	South Africa
	Sao Tome	Tanzania
	Sierra Leone	Togo
	Zambia	***Land-locked***
		Burkina Faso
		Burundi
		Central African Republic
		Congo, Dem. Rep.
		Ethiopia
		Lesotho
		Malawi
		Mali
		Niger
		Rwanda
		Swaziland
		Uganda

[21] The political economy of the policy responses to the crisis is discussed in African Development Bank and World Bank (2009).

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