

AFRICA'S MACROECONOMIC PERFORMANCE AND PROSPECTS

1

KEY MESSAGES

This chapter reviews Africa's economic performance in 2017 and presents forecasts of GDP growth for 2018–19. It analyzes growth outcomes and discusses some of the macroeconomic shocks and vulnerabilities African countries face and how they have affected development financing. Several key findings and recommendations emerge from the analysis:

- Growth in real output recovered in 2017. Many African economies are better placed to cope with harsh external conditions than they were in the past two decades. Global conditions have eased slightly since mid-2016, improving the outlook for Africa, but countries in the region still face major macroeconomic challenges. Commodity prices have recovered but not to precrisis levels, and demand for traditional and nontraditional exports from Africa remains modest. Although current account positions have improved, they are not sufficiently robust; dollar interest rates are expected to edge up, bidding up the cost of capital; and external debt ratios have begun to rise across the region.
- The infrastructure investment drive in the region, financed largely by external borrowing, needs careful monitoring to ensure that revenue streams (generated in local currencies) are strong enough to meet the debt obligations when they fall due. Fiscal policy should not undercut the growth-promoting effects of the recent surge in public investment and reverse the inroads made in poverty reduction, health, and education across the continent.
- In the short term, macroeconomic policy must blend real exchange rate flexibility and judicious demand management. Real exchange rate depreciations will be important, but given the strengthening of the U.S. dollar, competitive currency depreciations may not necessarily translate into a strong price advantage in export markets. Domestic demand management may have to bear a larger share of the burden in restoring external balance. Ongoing infrastructure projects will need to be completed and maintained, and projects in the pipeline balanced against other needs. Recurrent expenditures, including the public sector wage bill, should be watched carefully.
- In the medium to long term, the most important area of fiscal policy is tax reform. Domestic revenue mobilization improved substantially in recent decades, but tax-to-GDP ratios are still below the 25 percent threshold deemed sufficient to scale up infrastructure spending. There is an urgent need for better revenue regimes—including progressive elimination of the vast array of exemptions and leakages that pepper tax systems—to capture the gains from growth and rapid structural change that some countries are experiencing.
- None of these fiscal choices is straightforward. Intensely political, all have difficult distributional and welfare consequences. Adopting and implementing a coherent and equitable fiscal policy holds out the best prospects for sustained growth when external conditions improve.

Africa needs more development financing. But the build-up of debt should be consistent with countries' development needs and capacities to service the loans

Regional and global shocks in 2016 slowed the pace of growth in Africa, but signs of recovery were already manifest in 2017. Real output growth is estimated to have increased 3.6 percent in 2017, up from 2.2 percent in 2016, and to accelerate to 4.1 percent in 2018 and 2019.

There is significant heterogeneity across African countries. Some are performing remarkably well while others experience tepid growth. Structural transformation and productivity improvements are evident in some non-resource-dependent countries. Expanding this process across the continent is critical to sustain growth, create employment, and accelerate poverty reduction.

The recovery in growth could mark a turning point in net commodity-exporting countries, among which the protracted decline in export prices shrunk export revenues and exacerbated macroeconomic imbalances. Although revenues declined and expenditures rose in these economies, inflation and current account positions for the continent as a whole improved in 2017, thanks to better exchange rate policies. Overall, the recovery in growth has been faster than envisaged, especially among non-resource-intensive economies, underscoring Africa's resilience. Structural reforms, sound macroeconomic conditions, and buoyant domestic demand are sustaining the growth momentum in resource-intensive economies. African countries should strengthen this economic dynamism to lift their economies to a new growth equilibrium driven by innovation and productivity rather than by natural resources.

Economic fundamentals and resilience to shocks improved in a number of African countries. In some, domestic resource mobilization now exceeds that of some Asian and Latin American countries at similar levels of development. But it is still insufficient to meet the high level of financing to scale up infrastructure and human capital.

With external official development assistance per capita sharply lower, and an increased appetite for debt to finance infrastructure and social sectors, many African governments have turned to international capital markets to meet their financing needs. The result has been a build-up of debt, much of it on commercial terms. Despite the increase, levels for most countries have not yet breached the traditional threshold indicators. Debt

levels have actually declined in nine African countries, and they have remained stable in others.

Africa needs more development financing. But the build-up of debt should be consistent with countries' development needs and capacities to service the loans without compromising fundamentals for future growth. Debt must be deployed in productive investments that yield income streams for self-financing and grow the economy, in order to build capacity for increased domestic resource mobilization that helps wean countries from foreign debt and prevents potential debt distress.

The chapter is organized as follows. The next section looks at the performance of African economies. Section 2 discusses external shocks and macroeconomic imbalances. Section 3 examines domestic savings, tax revenues, and debt dynamics. The last section summarizes the chapter's policy implications.

AFRICAN ECONOMIES HAVE BEEN RESILIENT TO NEGATIVE SHOCKS

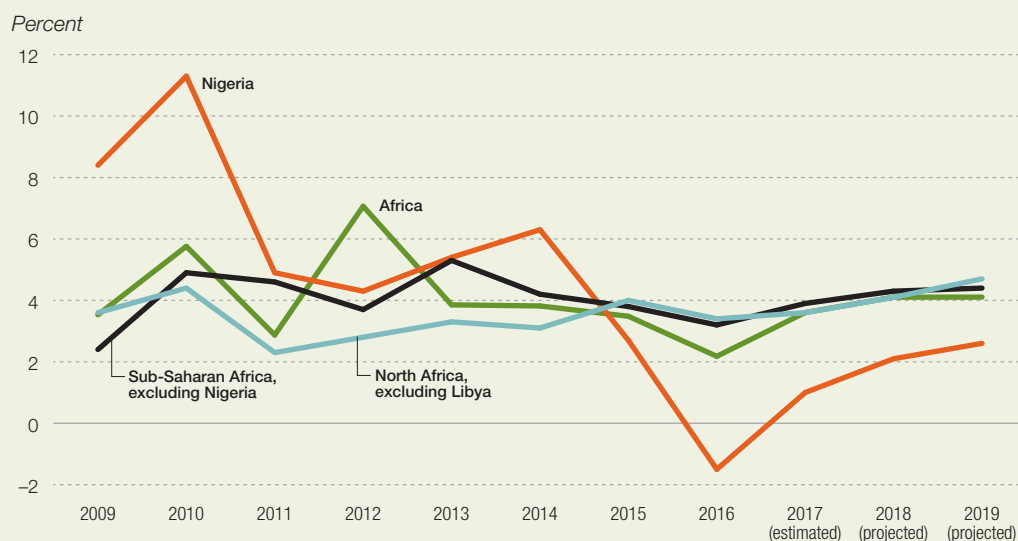
After tepid annual growth of 2.2 percent in 2016, average real GDP rebounded, reaching 3.6 percent in 2017. It is projected to grow 4.1 percent a year in 2018 and 2019 (figure 1.1).

No single factor accounts for this improvement. It reflects better global economic conditions; the recovery in commodity prices (mainly oil and metals); sustained domestic demand, partly met by import substitution; and improvements in agricultural production.

Country-level variation is significant. Indeed, much of the downturn is linked to the recession in Nigeria, where output shrunk 1.5 percent in 2016, a result of low oil prices and policy challenges, including delays in exchange rate adjustments. The recovery in oil prices bolstered production in 2017. Coupled with strong performance in agriculture, it lifted the economy out of last year's recession, but growth was still tepid, at 0.8 percent. Nigeria is set for a rebound, but is projected to be weaker than the average for the continent.

Among the continent's other large economies, South Africa was a drag on growth in 2016

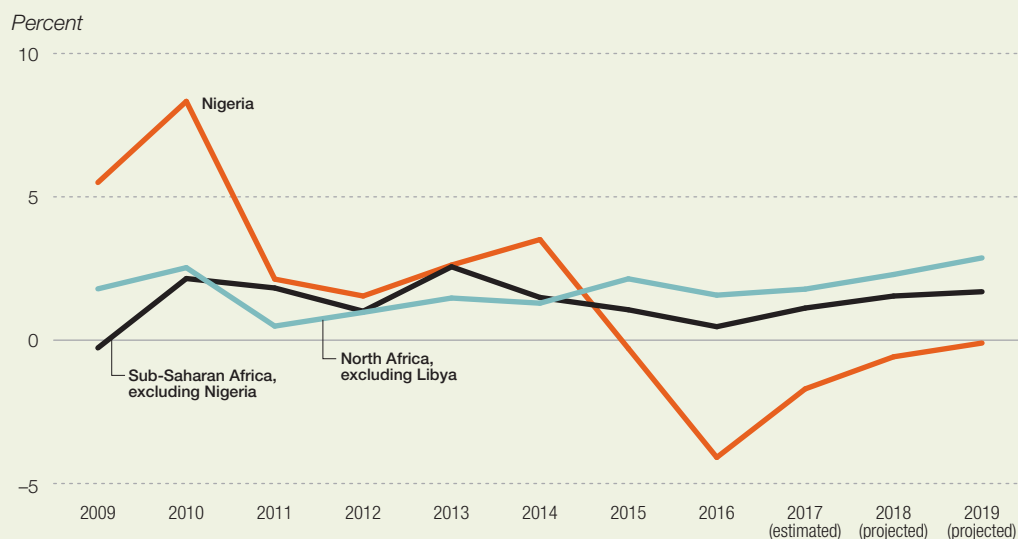
FIGURE 1.1 Real GDP growth in Africa, 2009–19



Source: AfDB statistics.

Debt must be deployed in productive investments that yield income streams for self-financing and grow the economy

FIGURE 1.2 Real per capita GDP growth in Africa, 2009–19



Source: AfDB statistics.

(0.3 percent), while Egypt enjoyed above-average growth (4.3 percent).

In North Africa excluding Libya, the 2016 downturn was milder than elsewhere, with growth slowing from 4.0 percent in 2015 to 3.4 percent in 2016

(Libya is excluded because the country's extremely volatile growth distorts the picture, even though it accounts for less than 5 percent of Africa's GDP). Growth rebounded to 3.6 percent in 2017 and is set to accelerate to 4.1 percent in 2018 and gain

Africa's economic performance has been resilient against the background of a difficult external environment in recent years

momentum in 2019 to 4.7 percent. Growth in Sub-Saharan Africa excluding Nigeria slowed from 3.8 percent in 2016 to 3.2 percent 2017. It is projected to increase to more than 4 percent a year in 2018 and 2019. Growth among net oil-importing countries grew at an average rate of 3.9 percent in 2017, up from 2.9 percent in 2016.

Africa as a whole saw growth fall behind the global average in 2016; in 2017 it grew at about the same rate as the global economy. But because population growth is greater than in most other regions, per capita growth was below the world average. In North Africa excluding Libya, it rose by just 1.8 percent in 2017 and is projected to increase by just 2.3 percent and 2.9 percent in 2018 and 2019, respectively. In Sub-Saharan Africa excluding Nigeria, per capita income rose by just 1.1 percent in 2017 and is projected to increase by just 1.5 percent in 2018 and a further 1.8 percent in 2019. In Nigeria per capita income fell 1.7 percent in 2017 but the contraction is projected to reduce to 0.6 percent in 2018 and narrow further to just 0.1 percent the following year.

Global economic growth is estimated to rise from 3.1 percent in 2016 to 3.6 percent in 2017 and 3.7 percent in 2018.¹ This growth may lead

to higher commodity prices, which would benefit some African countries.

Africa's economic performance has been resilient against the background of a difficult external environment in recent years. The continent's main exports are commodities. Commodity prices enjoyed a long boom, both before the 2008 crash and for many years after it. That boom has ended. The prices of many commodities fell to local lows at the start of 2016, and the value of many of Africa's exports, including oil, gold, and coffee, declined between 2014 and 2016. The prices of oil and metals recovered significantly in 2016 and 2017, if well below the highs of 2010–14. The rise in prices boosts demand for (and in many cases production of) African commodity exports.

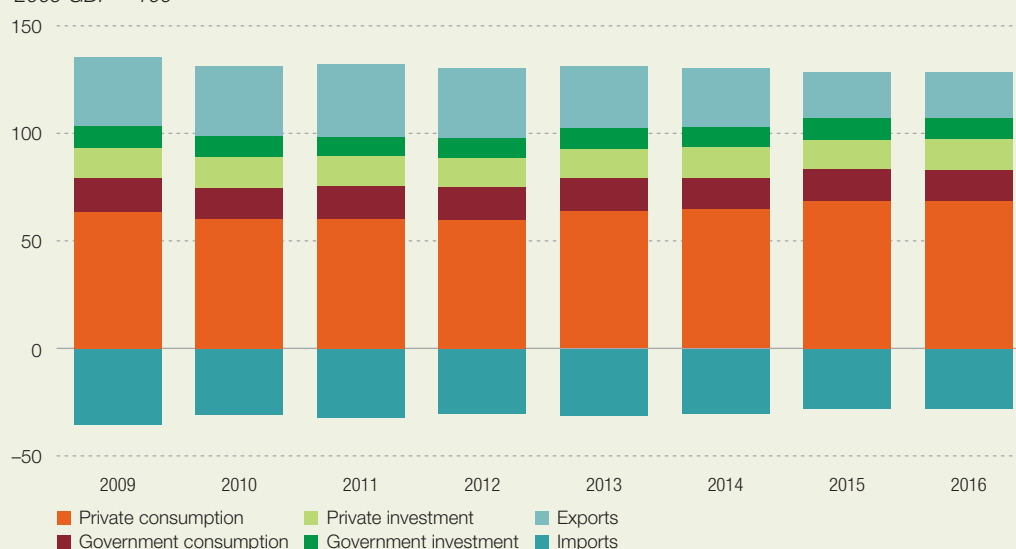
GDP and all of its components rose

GDP in Africa has grown in real terms every year since 2009—despite the hit to export earnings by the decline in commodity prices in 2013–15. Public and private investment grew every year between 2012 and 2016 (figure 1.3). Private investment slowed in 2015 but recovered in 2016.

The real value of exports fell in 2013–15, recovering slightly in 2016. Weaker export earnings

FIGURE 1.3 Components of GDP in Africa, 2009–16

2009 GDP = 100



Source: AfDB statistics.

reduced the demand for imports as a share of GDP. Imports grew only 1.5 percent a year between 2012 and 2015, actually falling in some years.

Consumption growth was strong, especially in 2013 and 2015. It grew faster than imports, leading to import substitution—a healthy adjustment to weaker export earnings and a major reason why GDP did not fall between 2013 and 2015.

Structural change has been slow

Structural transformation involves large, permanent changes in the structure of production. This process may take decades.

There is little evidence of structural change for the continent as a whole (although the aggregate data may conceal structural change in individual countries). The sectoral make-up of GDP remained roughly constant between 2000 and 2016 (figure 1.4). The share of extractives in GDP increased between 2000 and 2008, declining in 2009 and then again in 2012–15. But most of this movement reflected changes in international demand and international prices rather than structural shifts. Excluding extractives reveals just how little structural transformation occurred over this period for the continent as

a whole (panel b of figure 1.4). Agriculture represented 18.9 percent of nonextractive output in 2000 and 19.2 percent in 2016. In 16 years, services took away just 2 percentage points from manufacturing.

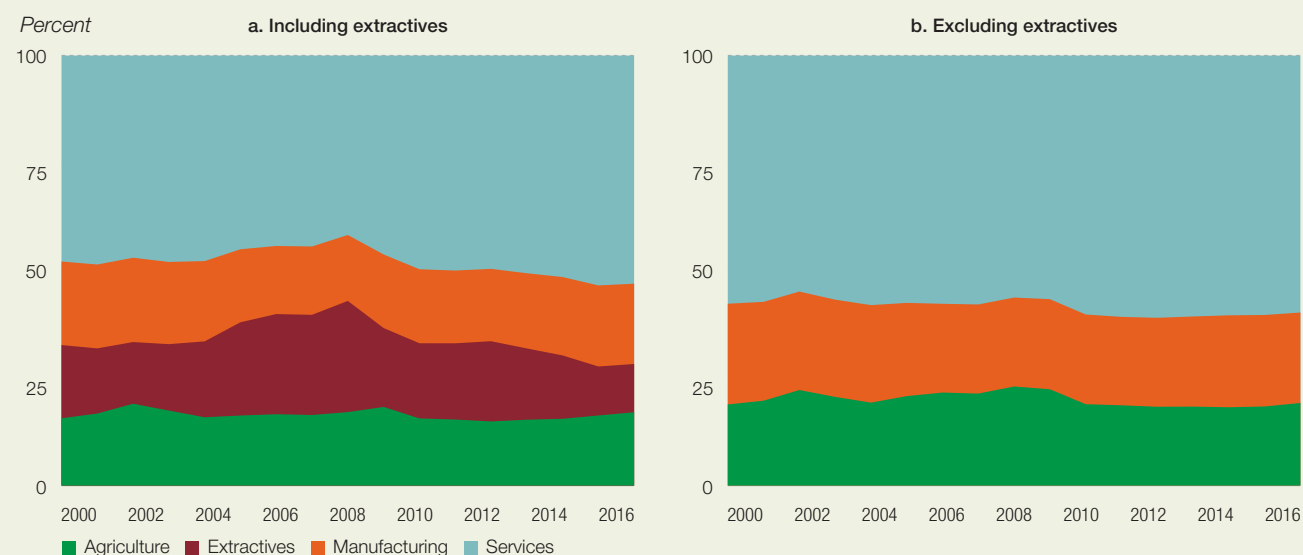
There was a marked decline in the share of extractives between 2012 and 2016. But it represented medium-term adjustments to commodity prices rather than a structural shift.

Nigeria's downward adjustment in the share of extractives was stronger than in other African economies. Between 2012 and 2016, the share of extractives fell from 16 percent to 6 percent of output, with manufacturing and services increasing their shares.

Labor has not moved from low- to high-productivity sectors: For the region as a whole, the distribution of labor across productive sectors has been even less dynamic than changes in output shares (figure 1.5). This pattern is much more static in Africa than in other regions. In Asia and Latin America, labor shifted from agriculture to services between 1990 and 2005. In Europe and North America, the shift was from industry to services. In Africa as a whole, there was very little movement, although this aggregate picture conceals structural change in some countries.

GDP in Africa has grown in real terms every year since 2009—despite the hit to export earnings by the decline in commodity prices in 2013–15

FIGURE 1.4 Sectoral composition of GDP in Africa, 2000–16



Source: AfDB statistics.

FIGURE 1.5 Sectoral employment shares in Africa and other world regions



Source: AfDB statistics.

Note: Industry includes extractives.

After a persistent decline throughout the 1990s, labor productivity increased at the dawn of the millennium. Labor productivity can arise from within-sector gains and from shifts of workers from less productive to more productive sectors. In 2000–13, labor productivity grew 2.2 percent a year. Within-sector growth accounted for about 73 percent of the increase, indicating that at the continental level very little labor reallocation took place.

Some structural change did take place in some countries (table 1.1). In Senegal, for example, all of the growth in labor productivity reflected structural changes. But in many other countries, the increase in labor productivity largely reflected within-sector productivity growth. Increasing labor productivity through a shift of workers from low- to high-productivity sectors is vital to long-term growth.

Côte d'Ivoire experienced moderate structural change—but within-sector gains dwarfed between-sector shifts. Between 2000 and 2016, about 3.5 percent of workers moved from agriculture to services. Because average productivity in services was 3.2 times the level in agriculture, even

this small shift generated significant between-sector productivity gains. Output per worker in agriculture and services rose 50 percent over the period. In industry, which employed just 5.2 percent of the workforce but accounted for 23.4 percent of output in 2000, productivity gains were even faster. As a result, by 2016 it contributed 31.7 percent of GDP.

Growth performance varied widely across countries and subregions

Economic growth varied widely across countries (figure 1.6) and across Africa's five subregions (figure 1.7).

East Africa. East Africa remains the fastest-growing subregion in Africa, with estimated growth of 5.6 percent in 2017, up from 4.9 percent in 2016. Growth is expected to remain buoyant, reaching 5.9 percent in 2018 and 6.1 percent in 2019. Strong growth is widespread in the subregion, with many countries (Djibouti, Ethiopia, Kenya, Rwanda, Tanzania and Uganda) growing 5 percent or more. Private consumption is the most important driver of growth in Comoros and Kenya;

TABLE 1.1 Decomposition of annual growth in labor productivity in selected countries in Africa

Country	1975–90			2000–13		
	Average annual labor productivity growth	Within-sector labor productivity growth	Between-sector labor productivity growth (structural transformation)	Average annual labor productivity growth	Within-sector labor productivity growth	Between-sector labor productivity growth (structural transformation)
Botswana	3.77	1.34	2.43	2.38	2.23	0.15
Egypt	4.47	3.56	0.91	3.14	2.43	0.70
Ethiopia	–1.63	–1.59	–0.03	2.07	1.63	0.44
Ghana	–1.31	–1.33	0.03	2.20	1.07	1.14
Kenya	–0.02	–0.44	0.42	0.71	–0.02	0.73
Malawi	–0.55	–0.49	–0.06	0.60	–0.61	1.21
Mauritius	2.80	2.00	0.80	4.94	4.18	0.76
Nigeria	–1.04	–1.48	0.44	2.88	2.98	–0.11
Senegal	–1.78	–2.31	0.53	0.76	–0.12	0.88
South Africa	0.05	–1.03	1.08	3.72	3.40	0.32
Tanzania	0.03	–0.16	0.19	1.21	0.34	0.87
Zambia	–0.80	0.09	–0.89	1.85	1.76	0.09
Average	0.33	–0.15	0.49	2.21	1.61	0.60

Source: Data from the Groningen Growth and Development Centre.

Note: Unweighted averages and values may not add up because of rounding.

public investment in infrastructure has been instrumental in Djibouti and Ethiopia. Agriculture will rebound after poor harvests in 2017, particularly in parts of East Africa.² Construction activity will remain strong. In a few countries, continued expansion of services, including information and communications technology, will be key. Manufacturing activity may increase the share of industry, particularly in Kenya and Tanzania.

North Africa. North Africa recorded the second-highest growth rate in Africa, at 5.0 percent in 2017, up from 3.3 percent in 2016. The subregion's growth is projected to accelerate to 5.1 percent in 2018, slowing to 4.5 percent in 2019.

Recovery of Libya's oil production underpinned this growth. Its GDP increased 55.1 percent in 2017, after declines in previous years—but output still remained about a third lower than before the 2011 Arab revolution.

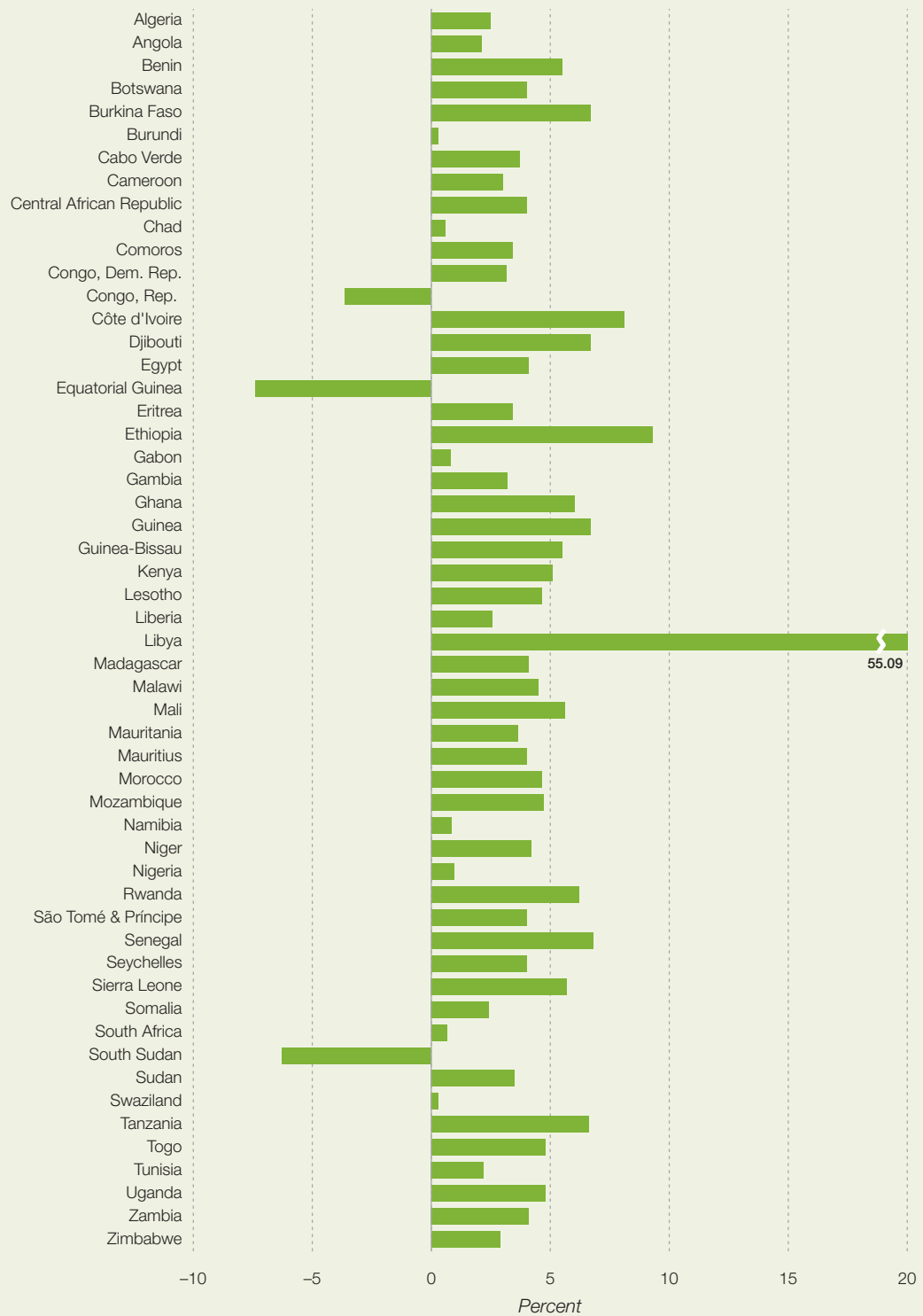
Egypt continued to record stable growth, of 4.1 percent in 2017, down slightly from 4.3 percent

in 2016. Growth benefited from the return of foreign direct investment (FDI) and net exports, which were boosted by the depreciation of the real exchange rate after its liberalization.

Wider fiscal and monetary space allowed Algeria to mitigate the adverse effects of lower oil prices on the economy, averting a sharper decline in growth after the fall in oil prices. The government responded to lower government revenue in 2017 by significantly reducing public expenditure (to 36 percent of GDP, down from 42 percent of GDP in 2016).

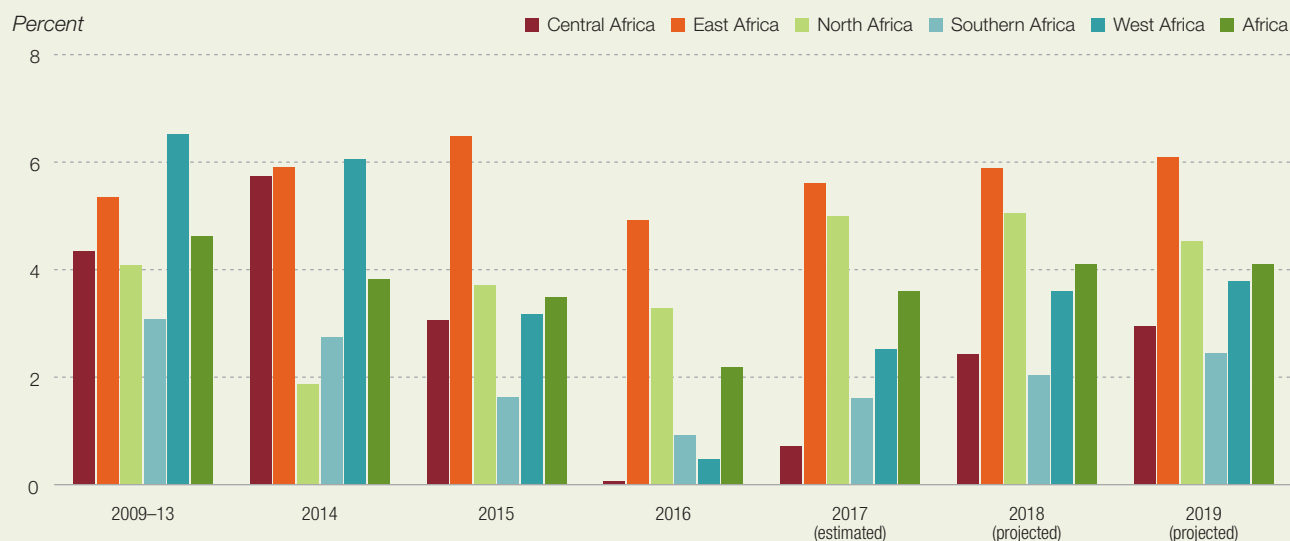
Southern Africa. Growth in Southern Africa nearly doubled in 2017, to 1.6 percent, up from 0.9 percent in 2016. The improvement reflects better performance of the three main commodity exporters: South Africa, which doubled its growth (still low, at 0.9 percent); Angola, where output expanded by 2.1 percent; and Zambia, which grew 4.1 percent. The three countries accounted for about 1 percentage point of Africa's growth rate.

FIGURE 1.6 GDP growth in selected countries in Africa, 2017



Source: AfDB statistics.

FIGURE 1.7 Real GDP growth in selected subregions of Africa, 2009–19



Source: AfDB statistics.

Growth is forecast to increase to 2.0 percent in 2018 and 2.4 percent in 2019, underpinned by expansion in agriculture, mining, and services. These figures are lower than the African average, mainly because of slow growth in South Africa, which has strong neighborhood spillover effects (through trade and revenues sharing) on the subregion's customs union. Policy uncertainty in South Africa could delay much needed fiscal adjustments, especially of support to state enterprises. Lesotho, Malawi, Mauritius, and Mozambique are expected to grow about 4 percent or more, but their contribution to the subregion's GDP is small.

West Africa. Supported by increased oil production and output growth in agriculture, Nigeria is expected to consolidate the gains made in 2017. As a result, growth in West Africa is projected to accelerate to 3.6 percent in 2018 and 3.8 percent in 2019. Other large countries accounting for the expansion include Côte d'Ivoire, Ghana, and Senegal; smaller countries (Benin, Burkina Faso, Sierra Leone, and Togo) are also expected to grow at 5 percent or more.

Central Africa. The Central Africa region has continued to underperform, even with the recovery

in oil prices. Output contracted sharply in the Republic of Congo (-4.0 percent) and Equatorial Guinea (-7.3 percent), weighing down the region's overall growth to 0.9 percent in 2017. Moderate recovery in the Republic of Congo will bolster growth in the region, which is expected to pick up to 2.6 percent in 2018 and 3.4 percent in 2019, respectively.

Macroeconomic conditions have deteriorated sharply, stoked largely by the fall in oil revenues. The subregion's deep-seated dependence on oil, together with the fixed exchange rate and lack of independent monetary policy levers to adjust to changing economic conditions (because of all five countries' membership in the Central African Economic and Monetary Community [CEMAC]), have slowed growth.

Economic and political changes could slow growth

Lingering vulnerabilities from a variety of sources call for cautious optimism in the medium term. The recovery in commodity prices remains fragile and conditional on continued strengthening of the global economy, particularly in emerging market economies, such as China. Prices are at precrisis levels, suggesting slower recovery. Structural

Lingering vulnerabilities from a variety of sources call for cautious optimism in the medium term

The tightening of global financial conditions constrains global liquidity, which may reduce global demand

changes in the energy market—particularly the shale oil and gas revolution, which has catapulted the United States to the top of the oil export market—may prevent the price of oil from recovering fully to its precrisis level. Over the next 20 years, the United States will account for 17.03 trillion cubic feet of shale-gas output, ahead of Canada (3.82 trillion); 1.36 trillion cubic feet will come from other producers. Saudi Arabia is also seeking to diversify away from oil. These structural changes could alter the dynamics of the global oil market

(box 1.1). African policy makers should devise mechanisms to adjust to such potential changes.

The tightening of global financial conditions (because of the raising of the U.S. benchmark interest rate in June 2017 and the winding down of the stimulus program) constrains global liquidity, which may reduce global demand. Protectionist sentiments in countries such as Tanzania and policy uncertainty in South Africa could also reduce investor confidence and curtail resource flows, slowing growth.

BOX 1.1 Effects of commodity prices on Africa's growth

Output and commodity prices move in tandem in resource-dependent economies, with a correlation coefficient of 0.49 (box figure 1). For this reason, many of these countries find themselves with heavily depleted buffers with which to cushion against external shocks, such as the recent decline in commodity prices.

BOX FIGURE 1 Real GDP growth and commodity prices in Africa, 2000–16



Source: AfDB statistics.

An autoregressive lags distributed (ARDL) model is used to estimate the effect of changes in commodity prices on real output growth for African countries:

$$\Delta \ln GDP_{it} = (\alpha_1 - 1) \Delta \ln GDP_{it-1} + \sum_{j=1}^{m-1} \beta_j \Delta \ln P_{it-j} + \sum_{j=1}^k \alpha_j \ln GDP_{it-j} + \sum_{j=0}^m \beta_j \ln P_{it-j} + f_i + f_t + \epsilon_{it}$$

where $\ln GDP$ denotes the logarithm of real GDP; $\ln P$ is the logarithm of the Deaton-Miller commodity prices index; Δ is the change operator; f_i and f_t indicate country-fixed effects and time effects, respectively; and ϵ_{it} is a white noise error term.

(continued)

BOX 1.1 Effects of commodity prices on Africa's growth (continued)

In the short run, real GDP would increase 0.2–0.36 percentage points if commodity prices increase 1 percent, underscoring the importance of commodity prices to Africa's growth performance (box table 1).

BOX TABLE 1 Growth effect on Africa of a 1 percent increase in commodity prices

	All commodities	Soft	Hard	Food	Energy	Metal	Agricultural raw materials
Short-run impact	0.2055	0.1990	0.2616	0.3608	0.2701	0.2714	0.3719
Long-run impact	1.7513	0.9044	0.9412	1.1690	1.1290	1.1483	2.1800
Adjustment duration (years)	4.1150	5.4640	4.444	5.7470	5.1810	5.405	5.555

Source: Data from AfDB, COMTRADE and IMF.

Note: Results are based on a sample that included the following countries: Algeria, Angola, Benin, Burkina Faso, Botswana, Burundi, Cabo Verde, Cameroon, the Central African Republic, Comoros, the Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Gabon, Gambia, Ghana, Guinea, Guinea-Bissau, Kenya, Liberia, Libya, Lesotho, Madagascar, Mali, Mauritania, Mauritius, Morocco, Mozambique, Namibia, Niger, Nigeria, Rwanda, São Tomé and Príncipe, Senegal, Seychelles, Sierra Leone, South Africa, Somalia, Swaziland, Sudan, Tanzania, Togo, Tunisia, Zambia, and Zimbabwe.

Political risks are lurking on the horizon, particularly in countries that have recently held general elections

A number of political risks are lurking on the horizon, particularly in countries that have recently held general elections (Kenya and Liberia) or plan to hold them in 2018 (Zimbabwe) and 2019 (South Africa). They could adversely affect the macroeconomic environment, already destabilized by recent shocks.

EXTERNAL SHOCKS HAVE EXACERBATED MACROECONOMIC IMBALANCES

The recent commodity price shock exacerbated macroeconomic imbalances in a number of resource-intensive African economies.

Inflation rose sharply

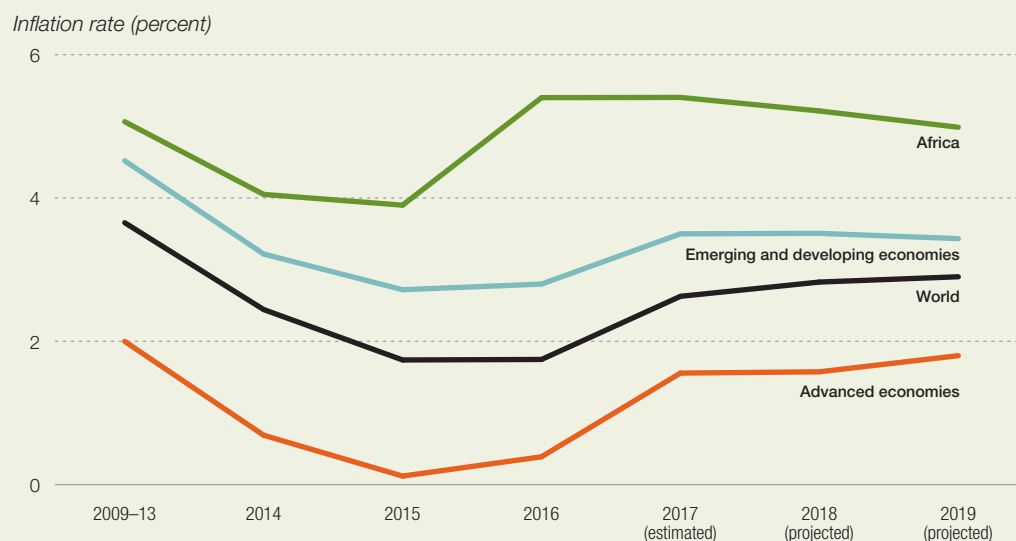
The median rate of inflation rose sharply in Africa, from 3.6 percent in 2015 to 5.4 percent in 2016, above the rate for comparator regions and the world (figure 1.8). The increase was fueled partly

by the depreciation in exchange rates and the widening of fiscal deficits, stoked by the commodity price shock. Africa's median inflation rate is expected to fall in 2018 and 2019 and remain in single digits, as the effect of the commodity price shock peters off and fiscal positions improve.

Inflation in CFA franc countries is generally lower than the median for Africa (figure 1.9). These countries are protected by lower inflation in the euro zone, whose currency is the anchor for the monetary union.

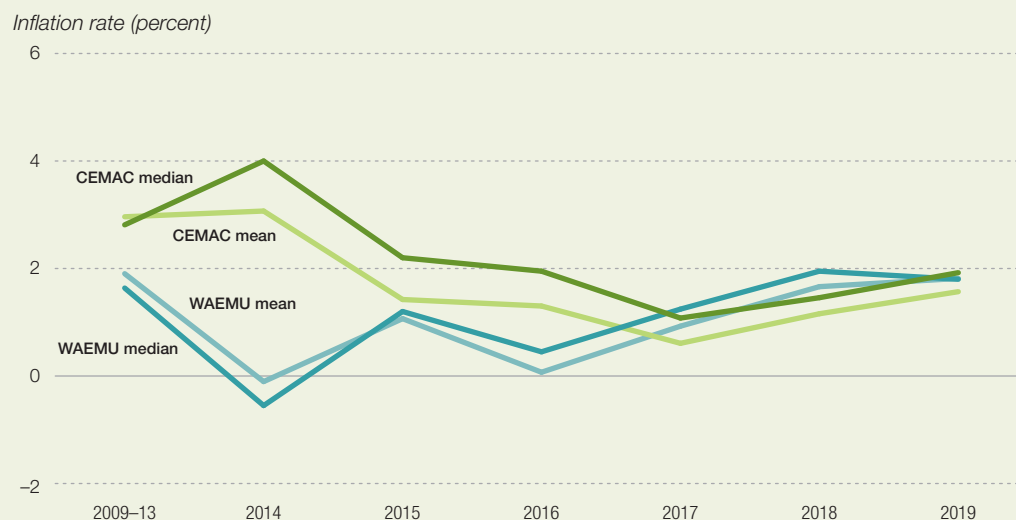
All regions except Central and Western Africa recorded inflation rates of 5 percent or more in 2017 (figure 1.10). Inflation spiked to nearly 10 percent in East Africa, fueled by a rise in food prices, especially in Kenya, where the effects of the drought reduced the maize harvest, causing chronic shortages of the staple. Median inflation is projected to fall sharply in East Africa, partly as a result of an improved harvest. Oil-exporting countries in particular experienced a difficult year in 2017, with inflation reaching 18.3 percent, up from 12.7 percent in 2016. In these countries, the fall

FIGURE 1.8 Median inflation rates in Africa and selected country groups, 2009–19



Source: AfDB statistics and IMF, World Economic Outlook (October 2017).

FIGURE 1.9 Median and average inflation rates in CFA franc countries, 2009–19



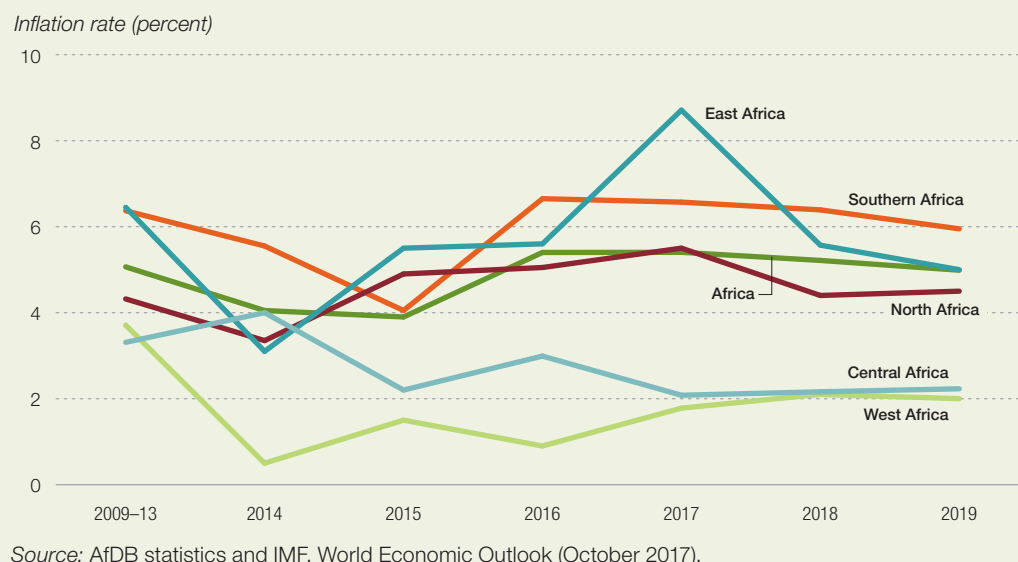
Source: AfDB statistics and IMF, World Economic Outlook (October 2017).

in oil prices stoked exchange rate depreciations, which fueled imported inflation.

Inflationary pressures have raised the cost of living in affected countries. The cost of running government has also gone up, expanding financing needs and widening fiscal deficits.

Africa's oil-importing countries benefited from lower prices; inflation declined slightly, from 6.0 percent in 2016 to 5.7 percent in 2017. For several African countries, notably countries in currency unions, inflation remained low or moderate, at 1–4 percent, thanks to exchange rate stability.

FIGURE 1.10 Median inflation rates in Africa and other regions, 2009–19



The average fiscal deficit for Africa as a whole narrowed to 5.7 percent of GDP in 2017, down from 7 percent

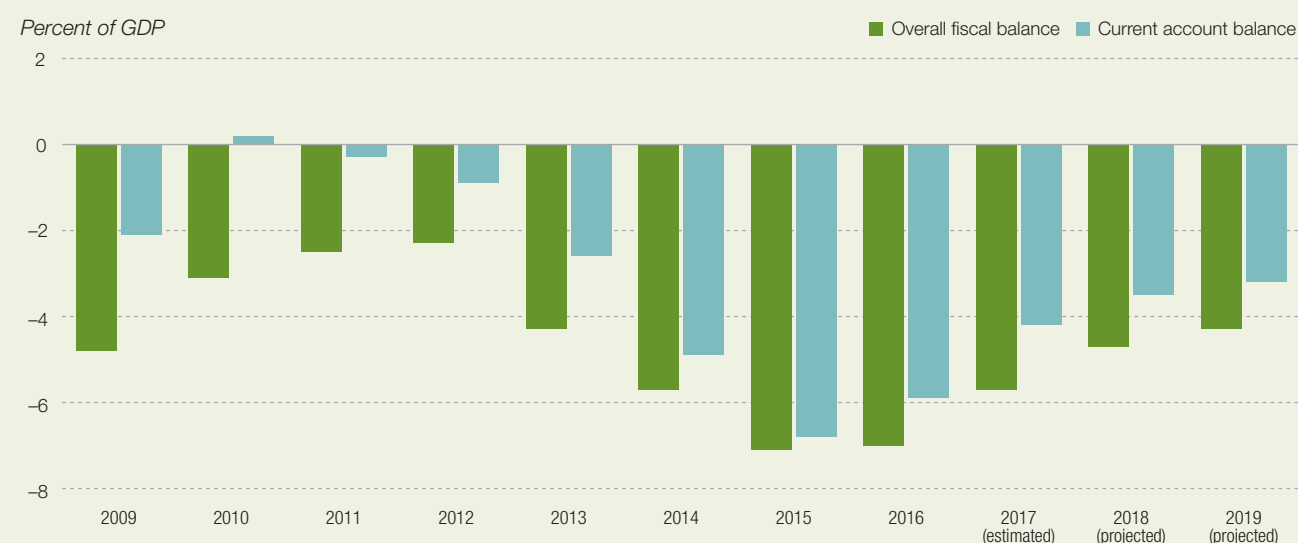
Fiscal and current account positions improved but remain worrisome

The fall in commodity prices increased Africa's fiscal and current account deficits. The average fiscal deficit for Africa as a whole narrowed to 5.7 percent of GDP in 2017, down from 7 percent,

largely because of fiscal adjustment measures in both resource- and non-resource-dependent economies (figure 1.11).

The continued rise in the price of crude oil—from an average of \$44 a barrel in 2016 to more than \$50 a barrel in 2017—provided relief to both

FIGURE 1.11 Fiscal and current account balances in Africa, 2009–19



The terms of trade for oil-exporting countries declined precipitously between 2011 and 2016

government budgets and current accounts. The fiscal deficit among oil exporters was 6.7 percent of GDP in 2017, higher than for net oil-importing countries, where the average was 4.6 percent of GDP. Other commodity prices, particularly the price of metals, also increased, benefiting exporting countries. Countries also responded to lower revenues by reducing government spending.

The average fiscal deficit in Africa is projected to reach 4.5 percent of GDP in 2018–19. Its narrowing reflects gains in net oil-exporting countries, where the deficit is expected to fall to an average of 4.7 percent of GDP in 2018–19, down from 6.7 percent in 2017.

To contain the rise in debt levels, further fiscal consolidation will be necessary, particularly reduction in recurrent expenditure. Angola's fiscal consolidation was achieved at the expense of capital expenditures. Given the importance of public investment in catalyzing private investment, particularly in core infrastructure (such as energy and transport), public expenditure should be well targeted to ensure that poverty-reducing social sectors and key infrastructure investments are adequately protected.

Current account positions are expected to improve with the recovery in commodity prices

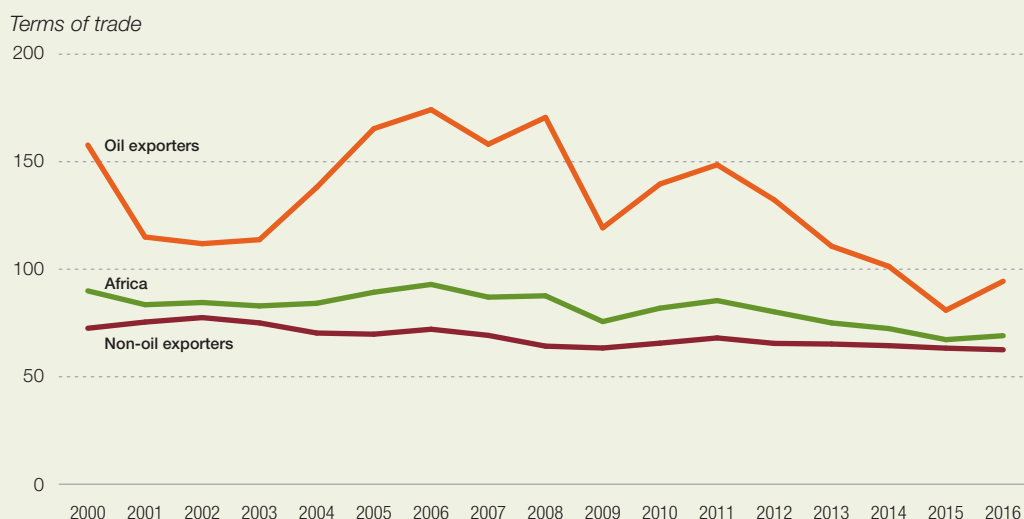
and subsequent increases in export revenues. Current account deficits reached 4.2 percent of GDP in 2017, down from 5.9 percent in 2016. They are expected to narrow to 3.5 percent in 2018 and 3.2 percent in 2019.

External shocks and exchange market pressures bode ill for growth

Macroeconomic imbalances have weakened currencies in many African countries. In 2015–16, most experienced nominal exchange rate depreciations and the effect of the commodity price shock, which manifested itself in a decline in the terms of trade, especially in oil-exporting countries. The terms of trade for this group of countries declined precipitously between 2011 and 2016 (figure 1.12). Higher commodity prices in mid-2016 raised prospects for improved terms of trade and growth and reduced the pace of exchange rate depreciation.

The commodity price shock caused depreciation of exchange rates, particularly in oil-exporting countries. In some of these countries, including Algeria, Angola, and Nigeria, this trend recently reversed. A few countries, including Botswana, Kenya, Morocco, Namibia, and Zambia, experienced appreciation in 2016/17. But most African countries experienced depreciations, in both

FIGURE 1.12 Terms of trade of oil exporters and nonexporters in Africa, 2000–16



Source: AfDB statistics.

2015/16 and 2016/17 (figure 1.13). The accelerated pace of depreciation has had adverse impacts on several countries' macroeconomic variables, including debt repayment obligations and inflation.

Membership in a monetary union has benefits—and costs

Countries in monetary unions faced a different challenge from falling commodity prices: deteriorating competitiveness. Membership in a monetary union yields benefits—but the costs can be high (box 1.2). The lack of policy flexibility may outweigh the benefits of membership, which requires countries to put in place conditions to ensure the success of the union.

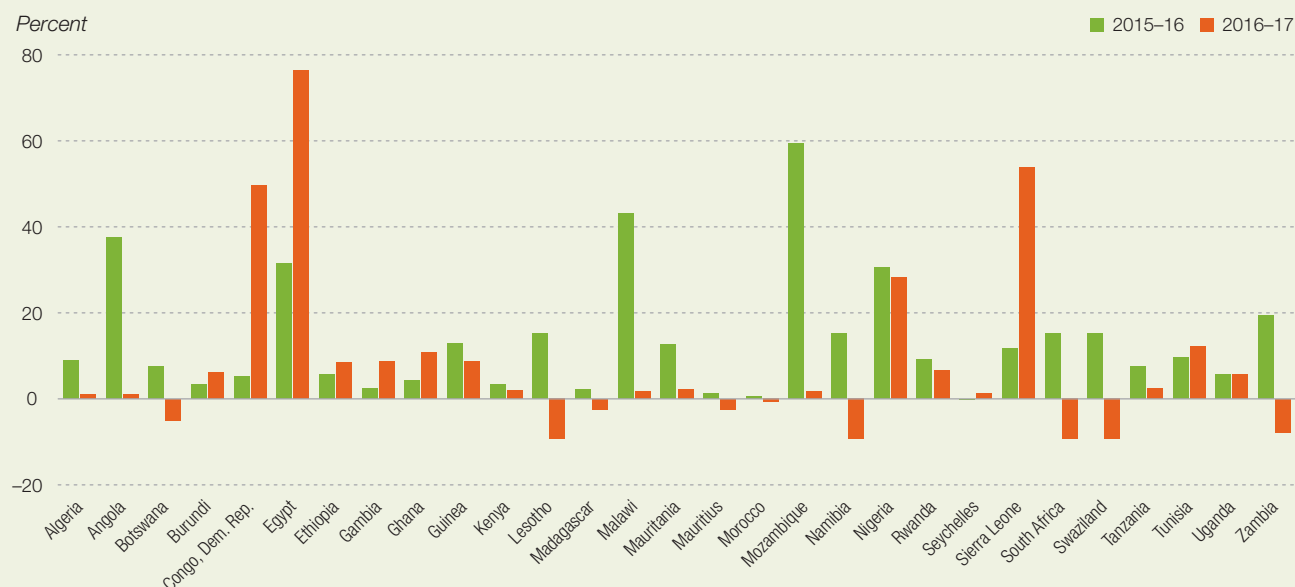
In Africa's two CFA franc zones, the currency is pegged to the euro and external currency convertibility is guaranteed by a commitment from France. The lack of differentiated exchange rate instruments is a general issue for all monetary unions when shocks are asymmetric (since a common monetary policy response while

appropriate on average will not be optimal for any individual member state). But circumstances for the CFA are doubly difficult since in none of the CFA zones are central banks choosing the optimal common monetary/exchange response for their member states. Instead, the CFA zone is a combination of a monetary union of the African countries and a fixed exchange rate with the Euro (underpinned by France). So, unlike the Eurozone or the putative East African Monetary Union, the WAEMU and CEMAC central banks are not asking, "What is the best monetary response for the zone"? In effect, the European Central Bank sets the monetary policy for the Eurozone, which may not be at all appropriate for the WAEMU and CEMAC zones.

In sum, while monetary unions can deliver low inflation and greater stability *in good times*, they may find that the absence of the nominal exchange rate anchor may mean they are vulnerable to persistent real exchange rate misalignment. That makes it all the more important to focus on issues of fiscal flexibility.

Countries in monetary unions faced deteriorating competitiveness

FIGURE 1.13 Percent change in nominal exchange rates in selected countries, 2015–16 and 2016–17



Source: AfDB computations.

Note: Sample covers countries with free-floating or dirty float exchange rate regimes for which data were available. Variations in nominal exchanges rates are expressed as a percent of the $t - 1$ exchange rate. Positive (negative) numbers indicate nominal depreciations (appreciations) of the nominal exchange rate. Countries with fixed exchange rate regimes are excluded.

Monetary unions
may be vulnerable
to persistent real
exchange rate
misalignment

BOX 1.2 The costs and benefits of monetary unions

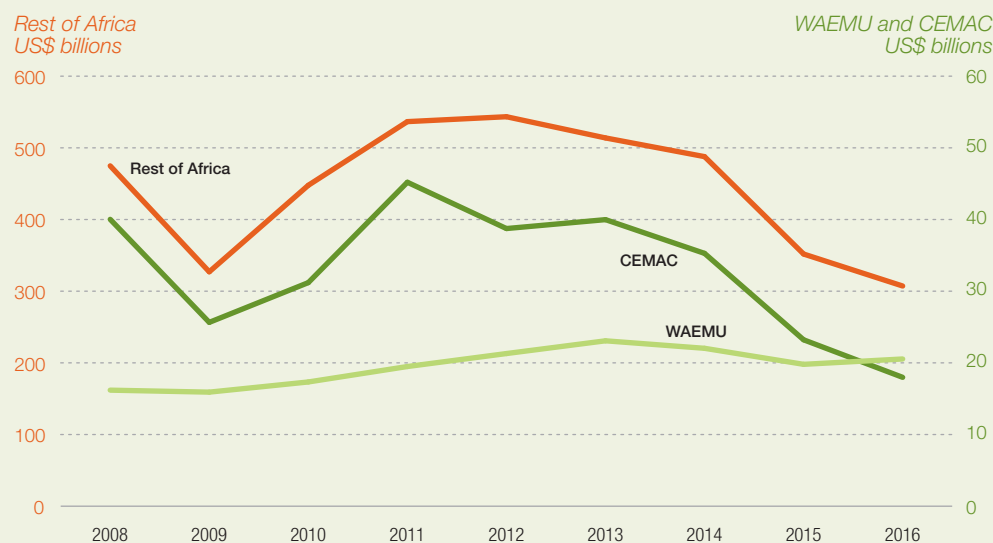
Countries adopt currency unions in the hope of reaping macroeconomic and structural benefits. The benefits include a stable exchange rate, reduced external volatility, a stable macroeconomic environment, increased intraregional trade, lower transactions costs (as currency conversion costs are reduced), more financial integration, and convergence among participating countries.

But there are also costs. Monetary unions limit the flexibility of individual countries to adjust to external shocks using monetary policy instruments. The shocks affecting West African states are mostly country specific (asymmetric). They therefore call for differentiated policy responses, which are not possible within a monetary union.

To be effective, monetary union needs to have well-functioning, cross-country fiscal institutions and rules, which can be enforced in the context of good economic governance to help members respond to asymmetric shocks. For instance, a central authority should be able to organize financial transfers to member countries suffering from a negative shock. Free movement of goods and labor should be reality—not just a goal. Deficits and debt policies should be consistent across the union and monitored carefully by a credible central authority. The financial and banking sector should be under careful supervision by a union-wide independent institution capable of enforcing strict prudential rules. Policies across the union should aim at real convergence among member countries. Despite some progress, CFA countries do not yet meet these important conditions.

At the height of the commodity price crisis, the Central African Economic and Monetary Community (CEMAC) region recorded a sharp fall in exports. The decline was steeper than in the West African Economic and Monetary Union (WAEMU) and the rest of Africa, because CEMAC countries export mainly oil.

BOX FIGURE 1 Exports from CFA countries and the rest of Africa, 2008–16



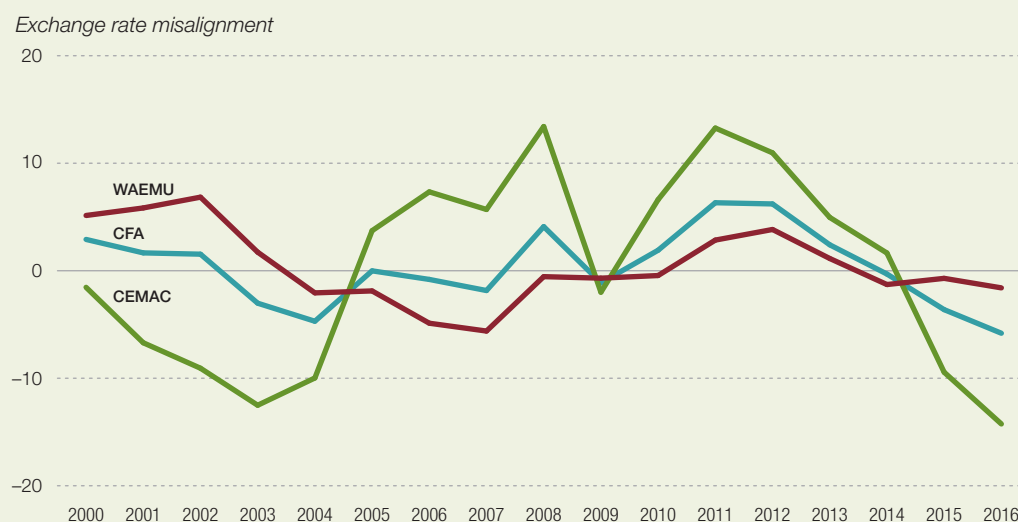
Source: AfDB computations.

The real exchange rates of these countries have also been subjected to immense pressure. Box figure 2 shows the extent of real exchange rate misalignment in WAEMU, CEMAC, and the CFA as a
(continued)

BOX 1.2 The costs and benefits of monetary unions (continued)

whole. Both WAEMU and CEMAC countries experienced exchange rate overvaluation when commodity prices started to fall in 2014, although the severity of the real exchange rate misalignment was more pronounced in CEMAC than in WAEMU, whose members are not net oil exporters and are more diversified. For the CEMAC region, the misalignment deepened as oil revenues dipped in 2014–16. After the commodity price shock in 2014, CFA countries experienced a real overvaluation; other countries had (on average) undervalued real exchange rates.

BOX FIGURE 2 Exchange rate misalignment in Africa, 2000–16



Source: AfDB.

Note: Negative (positive) numbers indicate real overvaluation (undervaluation). Rand-pegged countries include Lesotho, Namibia, and Swaziland.

As African countries set their eyes on economic transformation, improving domestic revenue mobilization will be critical

DOMESTIC SAVINGS, TAX REVENUES, AND DEBT DYNAMICS

Domestic resource mobilization needs to increase and debt levels contained

Domestic savings and per capita GDP are positively correlated in Africa, Latin America and the Caribbean, and East Asia and Pacific. A higher domestic savings rate seems to be associated with a higher investment-to-output ratio and thus higher per capita GDP.

During 1990–95, this correlation was steepest in Africa, where the correlation coefficient between GDP and the domestic savings rate was 0.74. During 2011–16, it fell to 0.58. Africa's coefficient

converged to that of East Asia and Pacific, as the level of development increased. But most African countries still have lower domestic savings rates and per capita GDPs than their East Asian and Pacific counterparts.

As African countries set their eyes on economic transformation, improving domestic revenue mobilization will be critical. The increase in domestic savings that occurred, particularly in the past decade, bodes well for domestic resource mobilization.

Over the past 15 years, tax revenues increased significantly in absolute terms, as African countries grew wealthier. Tax revenues increased 2.3 percent in absolute terms between 2006 and 2016. Controlling for the level of per capita income, some countries in Africa collected higher

Some countries
in Africa collected
higher tax revenues
than their Asian
and Latin American
counterparts

tax revenues than their Asian and Latin American counterparts. Despite this increase, the average tax-to-GDP ratio in Africa was only about 17.1 percent in 2014 (figure 1.14), much lower than the optimal threshold of about 25 percent required to finance development.

Cross-country variations are wide. Lesotho's tax-GDP ratio exceeds 50 percent, whereas Nigeria's is only about 3 percent (excluding oil rents). Nontax revenues for Africa on average are even lower and have been declining. To compensate, Nigeria raised taxes, but the increases have not been sufficient to offset the fall in nontax revenues.

Recent reforms and taxation of resources have helped African countries, but challenges remain. They include weak tax and customs administrations; low taxpayer morale; poor governance; the prevalence of hard-to-tax sectors, including small businesses, small farms, and professionals; and the struggle by many resource-rich countries to design and implement fiscal regimes that are transparent and capable of taxing natural and mineral resources.

The small modern sectors in most African countries suggests that imposing higher marginal taxes on domestic production and incomes may not be effective. Imposing such tax rates could

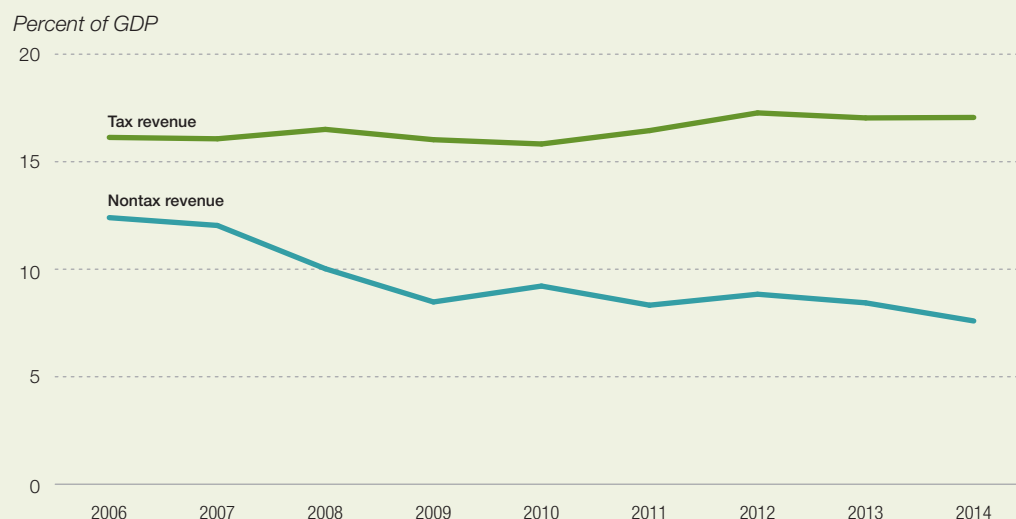
also be counterproductive and distortionary, because it might induce switches to the informal sector.

Table 1.2 presents the results of a regression on a pooled, unbalanced panel of African countries. It shows that an increase in tax rates could have significant negative impact on total government revenues in Africa (columns 2 and 3) and that a 1 percent increase in tax revenue leads to a 0.8 percent increase in total government revenue on average (column 1).

Economic prosperity remains a powerful driver of revenue mobilization. Per capita incomes are still low in many African countries, even in the region's middle-income countries, but tax revenues and domestic savings tend to increase more than proportionally with per capita income, as panel a of figure 1.15 illustrates. High domestic savings and tax revenues increase the domestic resources needed to fund growth-enhancing public investment, which boosts per capita income. Rising income boosts domestic savings and increases tax revenues, in a powerful virtuous circle.

Effective financial intermediation can increase the rate of domestic savings. But many African countries are characterized by low financial sector development, with a limited array of financial

FIGURE 1.14 Tax and nontax revenue in Africa as a percent of GDP, 2006–14



Source: AfDB statistics.

TABLE 1.2 Elasticity of government revenues to tax rates in Africa

Depend variable: Revenue, excluding grants (percent of GDP)	1	2	3
Log tax revenue (percent of GDP)	0.774*** (0.0283)		
Log total tax rate (percent of commercial profits)		−0.0830** (0.0405)	−0.086** (0.0407)
Log real per capita GDP	−0.00752 (0.0047)	−0.00195 (0.0079)	
Log real GDP			−0.00347 (0.00442)
Constant	0.904*** (0.0828)	3.302*** (0.164)	3.377*** (0.191)
<i>R</i> -squared	0.57	0.015	0.017
<i>N</i>	610	317	317

Source: AfDB statistics.

Note: Definition of variables: Revenue, excluding grants: Cash receipts from taxes, social contributions, and other revenues, such as fines, fees, rent, and income from property or sales. Grants are also considered revenue but are excluded here. Tax revenue: Compulsory transfers to the central government for public purposes. Certain compulsory transfers, such as fines, penalties, and most social security contributions, are excluded. Refunds and corrections of erroneously collected tax revenues are treated as negative revenue. Total tax rate: Taxes and mandatory contributions payable by businesses after accounting for allowable deductions and exemptions. Taxes withheld or collected and remitted to tax authorities (such as value added, sales, and goods and service taxes) are excluded. Standard deviations are in parentheses.

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$.

Improving the efficiency of public expenditure ensures that fiscal policy does not undercut the growth-promoting effects of public investment

instruments to attract savings. Africa performs better than even China and India in mobilizing domestic resources through taxes: At the same level of income, tax revenues are higher in Africa than in India or China, in both resource-intensive and non-resource-intensive economies (panels b and c of figure 1.15).

Tax capacity refers to the structural characteristics that determine the amount of revenue a state can raise. Its counterpart is *tax effort*—the extent of tax exemptions and rebates, for example—which is determined by policy choices, administrative efficiency, and corruption. Reforms that enhance compliance, curb fraud, and strengthen internal tax administration processes can play an important role in boosting revenues (box 1.3).

Most African countries grapple with taxation of the informal sector, which forms a large part of the economy in most countries. Policymakers should adopt innovative ways to increase tax compliance, particularly of the informal sector. They need to assess the capacity of firms and individuals to pay

taxes and user fees and promote their ability to upgrade into formal activities.

African countries are now strengthening their tax laws to improve compliance. Eight African countries (Ethiopia, Lesotho, Kenya, Nigeria, Rwanda, Somalia, South Africa and Zimbabwe) implemented property tax reforms during 2011–15.³ Several countries have taken additional measures to improve tax administration. Botswana, Kenya, Morocco, and Rwanda, for example, have online systems for paying taxes.⁴

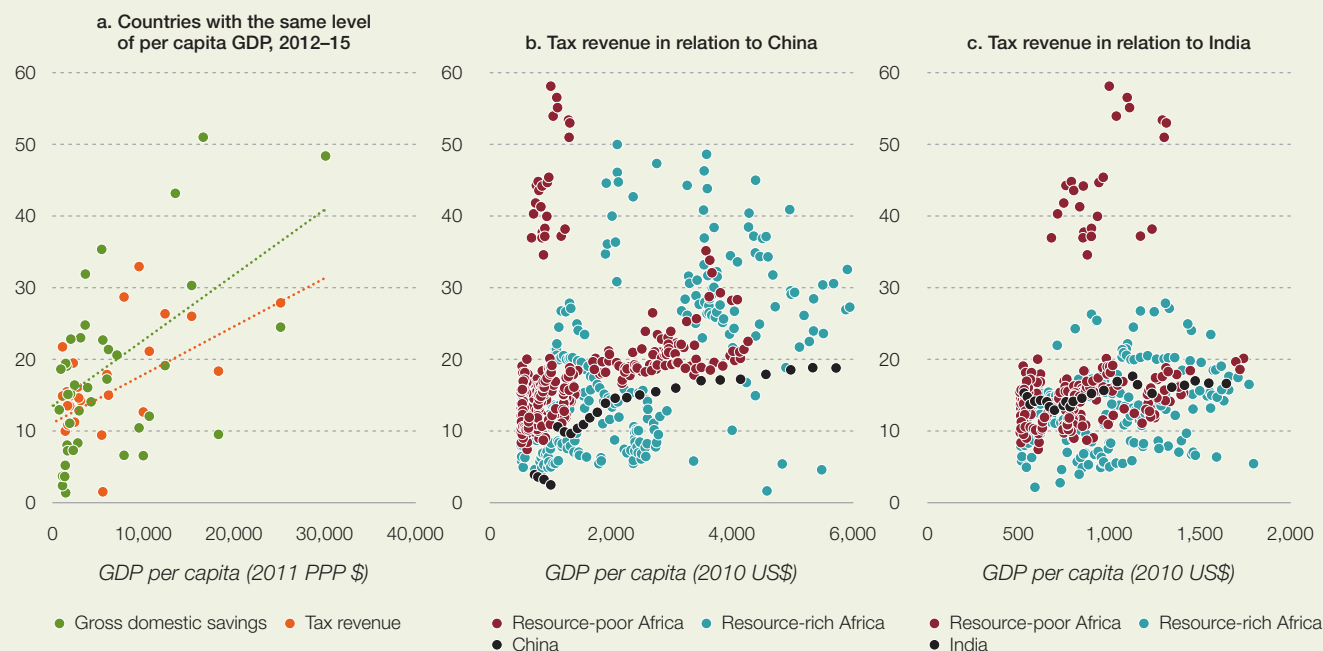
Efficient public expenditures can shore up socio-economic outcomes

Improving the efficiency of public expenditure ensures that fiscal policy does not undercut the growth-promoting effects of public investment and reverse the inroads made in poverty reduction and service delivery in the health and education sectors.

The efficiency of public expenditure can have an enormous impact on health outcomes (and

FIGURE 1.15 Relationship between tax revenues/domestic savings and per capita income

Percent of GDP



Source: AfDB statistics.

Note: Panel a plots groups of African countries with similar level of income; the points are groups of countries. Panels b and c plot pooled data for countries with GDP per capita lower than or equal to China or India during 1990–2014. PPP is purchasing power parity.

other social services as well). Improving internal financial controls and closely monitoring public spending, by strengthening the oversight role of parliamentary public accounts committees and the offices of the auditor general, could help curb the hemorrhage of resources, ensuring that they reach the targeted beneficiaries.

Public investment needs to be reevaluated, to prevent debt levels from growing too high

Many countries find it difficult to find the means to finance the infrastructure development projects they need to boost economic growth and improve living standards. In recent years, this challenge has been made more difficult by the decline in concessional financing that has occurred as major donor countries continue to experience tight budget constraints. The ratio of total government revenue to GDP remained flat while the ratio of expenditure to GDP ratio increased between 2008

and 2015, leaving African governments with no option but to rely on deficit financing through borrowing (figure 1.16).

Concessional financing has gradually declined since the financial and economic crisis of 2008/09, although there was a small increase in 2015. To bridge the revenue gap, some African countries have turned to international capital markets as an alternative source of financing. This practice has resulted in rising debt levels, renewing concerns about the debt burden. In Ghana, for instance, where external debt increased by 41 percent in 2016 alone, 92 percent of the debt was non-concessional. Sovereign euro bond borrowing accounted for 70 percent of total nonconcessional borrowing in 2016. Loans from multilateral and bilateral donors accounted for 24 percent of African debt and loans from non-Paris Club members for 71 percent.

Following a long period of decline, supported in part by the Heavily Indebted Poor Countries

BOX 1.3 Increasing tax revenue in Lagos through sensible reforms

Lagos State has distinguished itself as a role model in domestic resource mobilization in Nigeria. The state has consistently generated the largest share of internal revenue, accounting for 40 per cent of the US\$2.2 billion collected in Nigeria in 2015, according to Nigeria's National Bureau of Statistics. This tax revenue buoyancy makes Lagos one of the very few states in Nigeria with a solid sovereign long-term credit rating (B+).

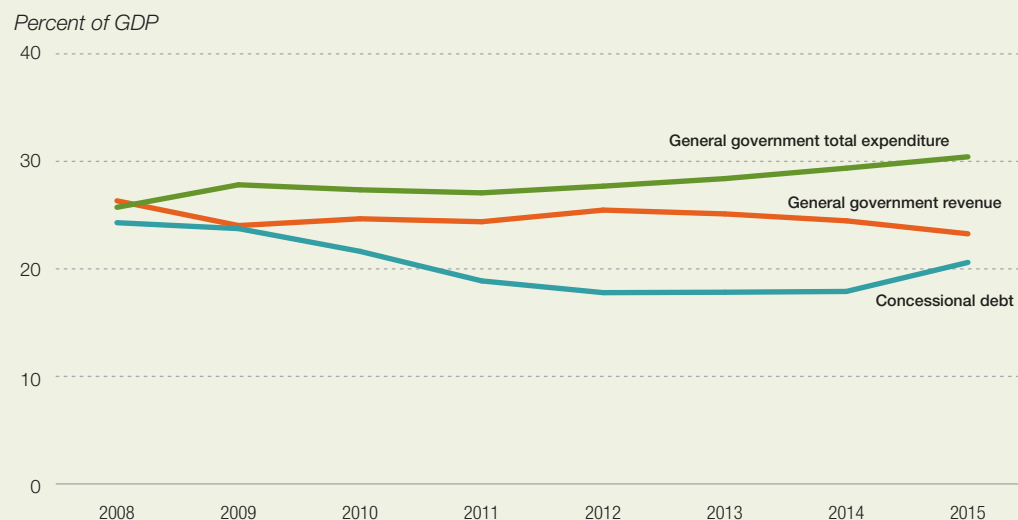
The success of Lagos State hinges largely on its innovative tax effort, revealed in its tax administration and management reforms. The reforms were driven by the state's realization that ineffective tax administration was responsible for weak compliance. To tackle the challenges, the Lagos State Internal Revenue Service implemented far-reaching tax reforms:

- It simplified filing, reducing the tax assessment form from six pages to two, modifying it for use in filing both direct and self-assessment taxes, and translating it into Yoruba and Pidgin English.
- It provided incentives for voluntary compliance.
- It improved access to tax administration and support, opening additional tax administration offices to promote easy access to taxpayers; establishing a customer care desk in all tax stations; and setting up a hotline that provides customer service in English, Pidgin English, and Yoruba.
- It invested in technology to ease the tax payment process, introducing electronic tax clearance certificates, online multimodal payment portals, e-submission of annual reforms, and a web-based tax calculator.
- It deployed an effective communication strategy through all mass media platforms and the Tax Simplification Unit.
- It forged partnerships and coordinates with relevant state and federal institutions to tackle multiple taxation and ensure tax harmonization.

These efforts have increased tax certainty and compliance, promoted enforcement, and resulted in significant tax revenue gains.

The ratio of total government revenue to GDP remained flat while the ratio of expenditure to GDP ratio increased between 2008 and 2015

FIGURE 1.16 Government revenue, government expenditure, and concessional debt in Africa, as a percent of GDP, 2008–15



Source: AfDB statistics.

The potential for debt to unlock long-term growth depends on the ability of countries to strengthen the debt–public investment link

(HIPC) Initiative and *Multilateral Debt Relief Initiative* (MDRI), public debt ratios are again rising. The upturn reflects increased macroeconomic stress across the continent, increased development financing needs, and greater access to international commercial capital markets.

During the commodity price boom, countries had in place ambitious spending plans, mainly targeting improvements in infrastructure. Low interest rates made sovereign borrowing historically cheap. After the fall in commodity prices, in mid-2014, countries used debt financing to maintain their spending plans. Both external and domestic debt increased significantly (figure 1.17). General government gross debt increased in 84 percent of countries during 2013–16, and 73 percent of countries in the region recorded increases in external debt. Debt ratios among oil exporters increased by about 15 percentage points of GDP between 2014 and 2016, to a median value of 50 percent.

When debt is used to finance growth-enhancing investments, it can support a virtuous circle in which higher growth not only eases the debt burden (a stock effect) but improves the fiscal and current account balances (flow effects). Many African countries are at this critical stage of their development, urgently needing to finance infrastructure projects with the potential to raise growth and living standards.

Public infrastructure investment can indirectly boost growth by crowding in private investment. Debt has strong and significant impacts on real GDP growth in Africa. There is a strong and positive correlation between public investments and debt, particularly in highly indebted African countries. Although correlation does not imply causation, these results suggest that increased debt accumulation in some African countries may have promoted economic growth.

The share of public investment in GDP in Africa has risen steadily since 2000. In 2015 public investment accounted for 7.7 percent of GDP in Africa—a larger share of output than in Latin America (5.2 percent) or in the emerging and developing economies of Asia (6.2 percent).

Given its catalytic effect on investments, debt may be necessary to unlock long-term growth potential in investment-deficit low-income countries. The important condition is that debt be

used for productive investment. Countries that are highly indebted also have lower public investment-to-GDP ratios, and their investments are much more volatile than those of low- and medium-debt countries, suggesting that these countries are not using their debt to finance infrastructure investment.

Countries are increasingly relying on international sovereign bonds as a source of infrastructure financing (table 1.3). The role of domestic capital markets in infrastructure financing is also expanding, although in most countries they are dominated by commercial banks, which prioritize short-term financing.

The potential for debt to unlock long-term growth depends on the ability of countries to strengthen the debt–public investment link. Doing so requires strengthening countries' absorptive capacity. Estimates suggest that about 40 percent of the potential value of public investment in low-income countries is lost to inefficiencies in the investment process because of time delays, cost overruns, and inadequate maintenance.⁵

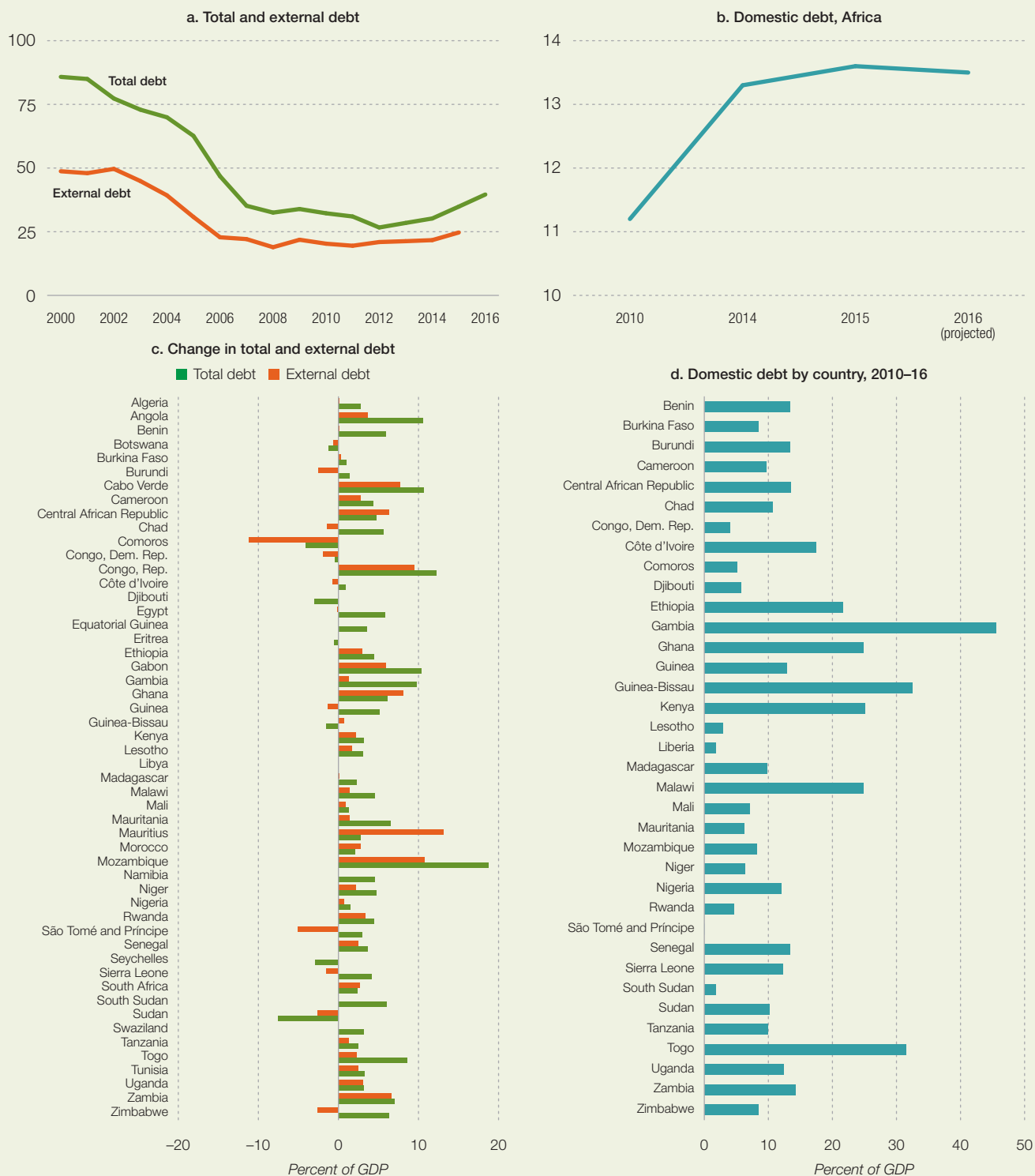
Some African countries have used debt to reduce fiscal deficits. The correlation between the twin deficits and external debt was more strongly negative in 2005–09 than in 2010–16, suggesting that African countries are using external debt less and less to solve fiscal and current account deficit problems, instead channeling those resources into public infrastructure (box 1.4).

Debt levels have not reached pre-HIPC levels in most countries (figure 1.18), and the risk of debt distress is still low or moderate in more than 60 percent of African countries. Although debt levels have risen, only a few countries that benefited from HIPC have recorded debt accumulation beyond HIPC levels. In most countries, debt has remained lower than it was before HIPC. But in some countries (such as Gambia, Mauritania, São Tomé and Príncipe, and Uganda), the debt-to-GDP ratio remains above 50 percent. Unless measures are implemented to curtail growth in debt, these countries could face an implosion in the stock of external debt and servicing costs.

The recent downgrading of sovereign credit ratings of some countries is illustrative of the

FIGURE 1.17 Total, external, and domestic debt in Africa

Percent of GDP



Source: AfDB statistics.

The continent is therefore heavily dependent on foreign sources for the financing of its current account deficits

TABLE 1.3 Intended use of selected sovereign bond issues in selected African countries

Country	Year	Value (millions of US dollars)	Use
Côte d'Ivoire	2014	750	Public investment, especially in health care and education
	2015	1,000	National Development Plan (NDP), which focuses on infrastructure, education, health care, and poverty reduction
Ethiopia	2014	1,000	Infrastructure, notably the Renaissance Dam
Ghana	2013	750	Capital expenditure and refinancing of public debt to reduce the cost of borrowing
Kenya	2014	2,000	Infrastructure projects and repayment of a \$600 million loan that matured in August 2014
Nigeria	2013	1,000	Projects in the electricity sector, which is undergoing privatization, and support of the shift from domestic borrowing toward cheaper foreign credit
Rwanda	2013	400	Construction of a 28-megawatt hydropower plant, construction of a hotel, and payment of some state-owned RwandAir debt
Senegal	2014	500	Construction of a major highway and the upgrading and repair of energy infrastructure

Source: AfDB compilation, based on various sources.

BOX 1.4 Financing Africa's current account balance

Current account imbalances are a persistent feature of African economies. Driven largely by trade deficits, Africa's current account deficits have risen steadily, especially between 2009 and 2015, raising concerns about their sustainability.

Unsustainable current account deficits are an indicator of a poor state of the economy. They discourage foreign investors from holding assets denominated in African currencies. Large current account deficits also increase the probability of a currency crisis. They lead to the accumulation of foreign debt, which has to be repaid at some point, triggering expectations by domestic investors of higher taxes to service and repay the debt. These expectations reduce investment—and hence output and employment.

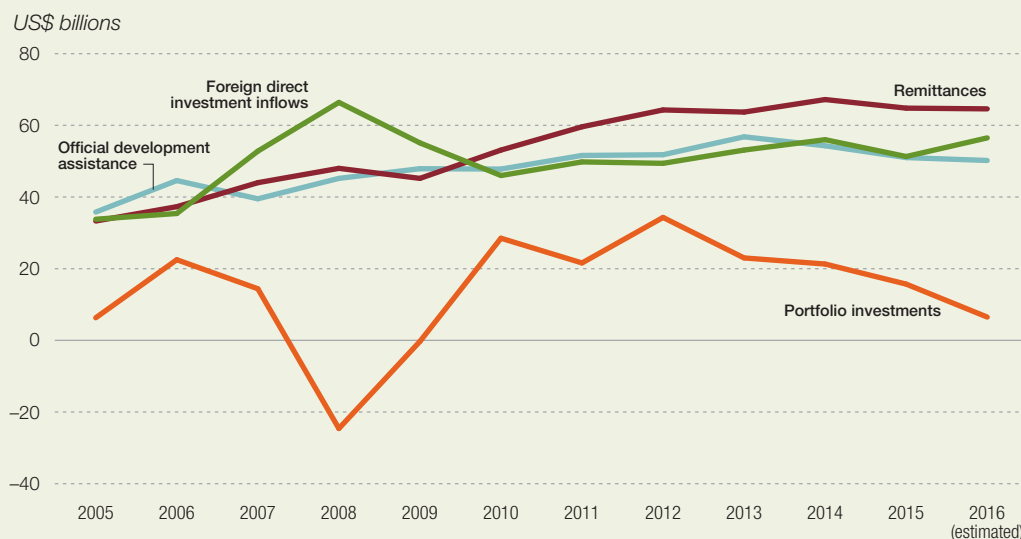
Because of volatility in the components of the current account, mainly the trade balance, deficits fluctuate widely. Most of the volatility arises from fluctuations in commodity prices and exports. During periods of commodity booms, net resource exporters tend to experience current account surpluses and net resource importers experience large current account deficits. The upward trend in Africa's current account deficit reversed in 2016; it is projected to continue to fall, especially with recent rising commodity prices.

Despite recent progress, domestic revenue mobilization remains low in Africa. The continent is therefore heavily dependent on foreign sources for the financing of its current account deficits. They include FDI, portfolio investment, remittances, official development assistance, and external debt (box figure 1).

(continued)

BOX 1.4 Financing Africa's current account balance (continued)

BOX FIGURE 1 Sources of Africa's external financing, 2005–16



Source: AfDB computations.

Remittances have been the largest source of international financial flows to Africa since 2010, accounting for about a third of total external financial inflows. They represent the most stable source of flows.

FDI inflows are rising, driven by international and regional investment in the extractive sector, infrastructure, and consumer-oriented industries. The resources boom reshaped the capital account by promoting a sharp rise in inward FDI.

Though recently falling, primarily as a result of economic conditions in donor countries, official development assistance has remained a large source of financing in many African countries.

Because of the relatively undeveloped capital markets in most African countries, portfolio investment inflows (equity and bonds) are not significant. These inflows, including international investments in both equity and debt securities issued by nonresident entities, have tended to be more volatile than FDI inflows. Portfolio investment inflows experienced persistent volatility, reaching a trough in 2008 before recovering significantly in 2010 but declining since 2013.

Many African economies are more resilient and better placed to cope with harsh external conditions

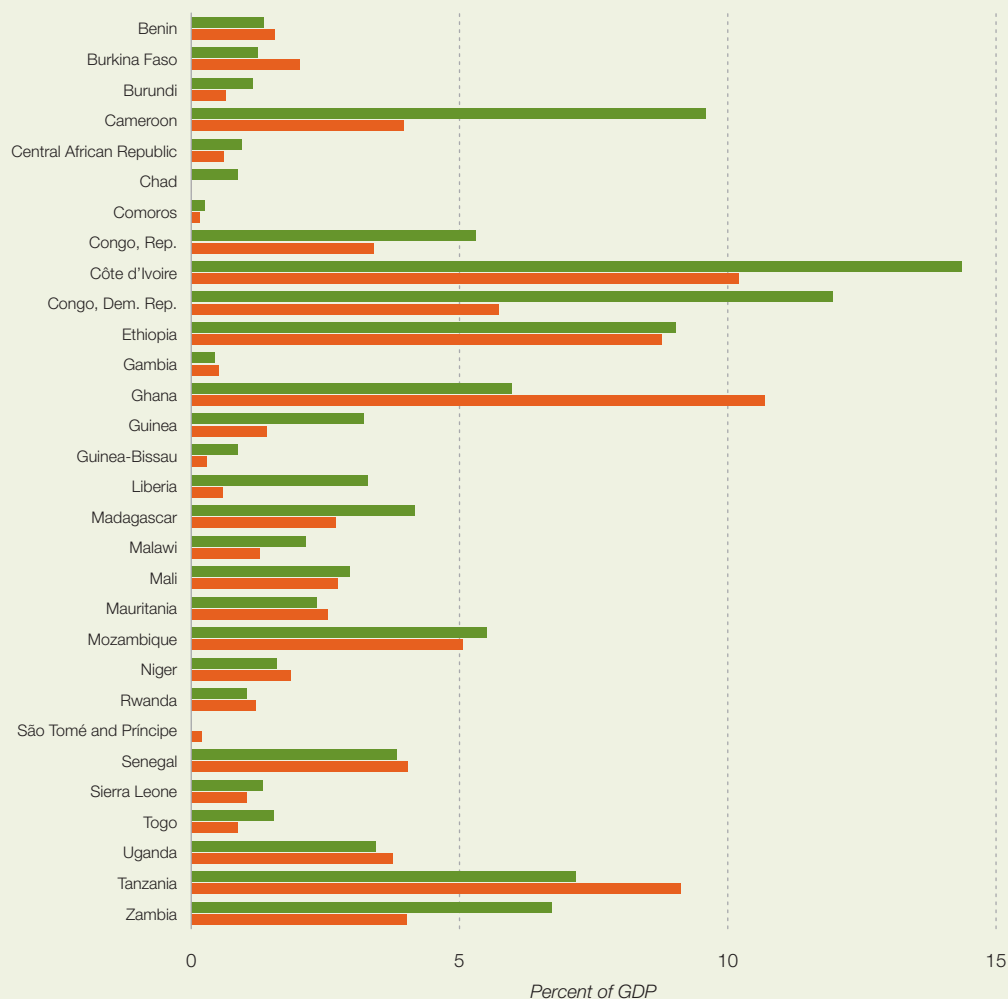
potential market risk. If left unchecked, the rate of debt accumulation could morph into a major source of macroeconomic instability. However, the calibration of debt indicators should be consistent with financing needs for African countries and their capacity to repay, as economies grow and revenues from public investment projects accrue largely in domestic currencies, possibly making payment of debt more difficult when obligations fall due.

CONCLUSIONS AND POLICY IMPLICATIONS

Many African economies are more resilient and better placed to cope with harsh external conditions than they were in the past. But the end of the commodity price supercycle has cut earnings from primary exports in many countries, undermining planned investments. Weaker external conditions have exposed latent domestic fiscal

Major investments in infrastructure financed principally by external borrowing have raised concerns about a currency and maturity mismatch

FIGURE 1.18 External debt as a percent of GDP in African countries before and after the Heavily Indebted Poor Countries (HIPC) Initiative



Source: AfDB computations.

Note: See table A1.2 in the annex for the decision and completion points for all countries.

vulnerabilities, in natural resource-dependent economies as well as other countries. Dollar interest rates are expected to edge up and bond spreads widen, increasing the risk of sudden stops to private capital flows. Most African currencies have lost about 20–40 percent of their value against the dollar since the beginning of 2015. But the resulting competitive currency depreciation will not necessarily translate into a strong price advantage in exports markets. Expenditure-reducing measures will have to bear a large share of the burden of restoring external balance.

Major investments in infrastructure financed principally by external borrowing have raised concerns about a currency and maturity mismatch in debt service, as revenue streams accrue predominantly in local currencies and debt obligations mature before these streams begin. Policy makers need to ensure that fiscal policy does not undercut the growth-promoting effects of public investment, reversing the inroads made in poverty reduction, health, and education across the continent. Projects in the pipeline should therefore be balanced against other needs. Recurrent

expenditures have to be kept in check, including by preventing growth of the public sector wage bill.

Macroeconomic policy strategy must blend real exchange rate adjustment, domestic revenue mobilization, and judicious demand management. In the medium term, the most important area of fiscal policy is tax reform. Although domestic revenue mobilization improved substantially in recent decades, tax-to-GDP ratios are still low in most African countries. There is an urgent need to put in place revenue regimes that capture more effectively the gains from growth and structural change that some countries are experiencing as economies formalize and become more urbanized. The

widening of the tax base (which will entail the progressive elimination of the vast array of exemptions and leakages that currently pepper tax systems on the continent) rather than any hike in already high marginal tax rates will be indispensable to boosting tax revenues.

None of these fiscal policy options is straightforward. All of them have difficult distributional and welfare consequences—and all are intensely political. Coherent and equitable fiscal adjustment holds out the best prospects for supporting a smooth adjustment to current conditions and allowing for sustained growth when external conditions improve.

Coherent and equitable fiscal adjustment holds out the best prospects for supporting a smooth adjustment

ANNEX 1.1

TABLE A1.1 Macroeconomic developments in Africa, 2013–19

Variable	2009–19	2014	2015	2016	2017 (estimate)	2018 (projected)	2019 (projected)
<i>Real GDP growth (percent)</i>							
Central Africa	4.3	5.7	3.1	0.1	0.7	2.4	3.0
East Africa	5.3	5.9	6.5	4.9	5.6	5.9	6.1
North Africa	4.1	1.9	3.7	3.3	5.0	5.1	4.5
Southern Africa	3.1	2.7	1.6	0.9	1.6	2.0	2.4
West Africa	6.5	6.0	3.2	0.5	2.5	3.6	3.8
Africa	4.6	3.8	3.5	2.2	3.6	4.1	4.1
Africa excluding Libya	4.3	4.3	3.6	2.2	3.1	3.8	4.2
North Africa, including Sudan	3.9	1.9	3.8	3.3	4.9	4.9	4.5
Sub-Saharan Africa	4.9	4.9	3.3	1.5	2.8	3.5	3.9
Sub-Saharan Africa excluding South Africa	5.8	5.7	3.8	1.8	3.3	4.1	4.4
Oil-exporting countries	4.8	3.8	3.4	1.7	3.4	4.1	3.9
Oil-importing countries	4.3	3.9	3.6	2.9	3.9	4.2	4.5
<i>Consumer price inflation (percent)</i>							
Central Africa	5.5	2.4	1.3	2.6	9.4	10.3	8.8
East Africa	13.6	12.1	10.3	12.7	15.1	9.4	8.1
North Africa	7.3	6.3	7.6	7.8	14.4	13.2	9.3
Southern Africa	6.8	6.2	5.7	10.5	9.5	7.9	6.9
West Africa	9.8	7.3	8.2	12.7	13.3	11.6	11.0
Africa	8.5	7.1	7.4	10.0	13.0	11.1	9.0
Africa excluding Libya	8.6	7.1	7.4	9.9	12.9	10.9	8.8
North Africa, including Sudan	8.3	8.3	8.3	8.5	15.7	13.6	9.8
Sub-Saharan Africa	9.8	7.5	7.3	11.2	12.2	9.8	8.9
Sub-Saharan Africa excluding South Africa	8.4	6.3	6.4	9.9	11.0	8.8	7.9
Oil-exporting countries	9.8	8.3	8.8	12.7	18.3	15.3	11.9
Oil-importing countries	6.3	5.4	5.3	6.0	5.7	5.2	5.1
<i>Overall fiscal balance, including grants (percent of GDP)</i>							
Central Africa	0.0	-2.5	-5.3	-4.1	-2.1	-0.7	-0.2
East Africa	-3.0	-4.0	-4.6	-4.2	-3.9	-3.9	-3.8
North Africa	-4.8	-10.9	-13.9	-12.7	-9.1	-6.3	-5.7
Southern Africa	-3.2	-4.6	-4.5	-4.5	-5.0	-4.6	-4.2
West Africa	-2.9	-2.8	-3.7	-5.0	-4.8	-4.4	-4.0
Africa	-3.4	-5.7	-7.1	-7.0	-5.7	-4.7	-4.3
Africa excluding Libya	-3.7	-5.0	-6.1	-6.1	-5.1	-4.3	-3.7
North Africa, including Sudan	-4.5	-10.0	-12.6	-11.4	-8.0	-5.6	-5.1
Sub-Saharan Africa	-2.8	-3.6	-4.3	-4.6	-4.5	-4.1	-3.8
Sub-Saharan Africa excluding South Africa	-2.2	-3.5	-4.2	-4.7	-4.5	-4.0	-3.7
Oil-exporting countries	-2.7	-6.4	-8.7	-8.7	-6.7	-5.0	-4.5
Oil-importing countries	-4.3	-4.5	-4.8	-4.7	-4.5	-4.3	-3.9

Variable	2009–19	2014	2015	2016	2017 (estimate)	2018 (projected)	2019 (projected)
<i>(continued)</i>							
External current account, including grants (percent of GDP)							
Central Africa	-2.3	-5.0	-9.3	-11.2	-6.1	-3.7	-4.0
East Africa	-6.5	-9.1	-8.5	-6.8	-5.4	-5.6	-5.3
North Africa	0.3	-6.2	-8.3	-8.9	-6.5	-3.4	-2.4
Southern Africa	-2.5	-5.1	-6.3	-4.8	-3.8	-4.3	-4.7
West Africa	1.0	-1.6	-4.2	-1.8	-1.0	-1.4	-1.1
Africa	-1.2	-4.9	-6.8	-5.9	-4.2	-3.5	-3.2
Africa excluding Libya	-1.7	-4.2	-6.4	-5.8	-4.3	-3.8	-3.3
North Africa, including Sudan	-0.2	-6.3	-8.2	-8.5	-5.8	-3.1	-2.2
Sub-Saharan Africa	-1.9	-4.4	-6.2	-4.6	-3.4	-3.6	-3.5
Sub-Saharan Africa excluding South Africa	-1.3	-4.2	-6.6	-4.9	-3.6	-3.7	-3.5
Oil-exporting countries	2.4	-3.1	-6.8	-5.7	-3.2	-1.8	-1.3
Oil-importing countries	-5.9	-7.5	-6.7	-6.2	-5.5	-5.7	-5.7

Source: AfDB Statistics Department.

TABLE A1.2 Decision and completion points for African countries under the Heavily Indebted Poor Countries (HIPC) Initiative

Country	Decision point	Completion point	Country	Decision point	Completion point
Benin	2000	2003	Liberia	2008	2010
Burkina Faso	2000	2002	Madagascar	2000	2004
Burundi	2005	2009	Malawi	2000	2006
Cameroon	2000	2006	Mali	2000	2003
Central African Republic	2007	2009	Mauritania	2000	2002
Chad	2001	2015	Mozambique	2000	2001
Comoros	2010	2012	Niger	2000	2004
Congo, Rep. of	2006	2010	Rwanda	2000	2005
Congo, Dem. Rep. of	2003	2010	São Tomé and Príncipe	2000	2007
Côte d'Ivoire	2009	2012	Senegal	2000	2004
Ethiopia	2001	2004	Sierra Leone	2002	2006
Gambia	2000	2007	Togo	2008	2010
Ghana	2002	2004	Uganda	2000	2000
Guinea	2010	2012	Tanzania	2000	2001
Guinea-Bissau	2000	2010	Zambia	2000	2005

Note: "Decision point" refers to period at which the World Bank and the IMF formally determine whether the country is eligible for debt relief. "Completion point" period when countries receive the balance of the debt relief that the international community committed to at the decision point, usually after successful implementation of key reforms and concrete steps taken to reduce poverty.

NOTES

1. OECD 2017.
2. In Kenya, for instance, off-season rains, especially in the western part of the country, improved the

outlook for crop and livestock productivity (Fewsnet 2017).

3. Franzsen and McCluskey (2017).
4. World Bank (2017).
5. IMF (2014).

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