Committee of Ten Policy Brief

Africa in the Post-crisis Global Economy: Turning the Recovery into Strong, Sustained and Shared Growth

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AFRICAN DEVELOPMENT BANK GROUP

Africa in the Post-crisis Global Economy: Turning the Recovery into Strong, Sustained and Shared Growth

COMMITTEE OF TEN MEETING
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I. Introduction

In the aftermath of the global financial and economic crisis, African policy makers have been rethinking their economic strategies for the next decade. Africa's high pre-crisis growth and a quick rebound from the crisis highlighted its vast economic potential. At the same time, poverty is still wide-spread across the continent. The key question then is how to turn Africa's potential into strong, sustained and shared growth and achieve tangible improvements in people's lives.

This note first reviews macroeconomic policies in Africa prior to the crisis and factors behind the continent's good performance during the crisis. It then discusses policies that would support the ongoing recovery and help turn it into strong medium term growth. The note underscores that going forward, the emphasis of the macroeconomic policy, especially in low income countries, needs to shift from overemphasizing the objective of short term stabilization and very low inflation towards strong, sustained and shared growth. It draws on and expands the growth analysis of the recent paper prepared for the KOAFEC Ministerial Meeting in Korea by the African Development Bank, the UNECA, the AUC and the Korea Institute for Economic Policy.

II. Background -- highlights on Africa's pre-crisis growth

Africa's vast economic potential has been demonstrated by the high pre-crisis growth (5.7 percent a year on average during 2001-08)**.** A combination of factors underpinned the continent's growth, including favorable external environment and domestic factors such as reduced conflict, greater political stability, and prudent macroeconomic policies. A number of countries improved their business environments (e.g., Rwanda), regulation of the financial sector (Nigeria), public administration (Sierra Leone), and tax collection (Liberia).[1] Intensified trade and investment flows between Africa and China, India and the Gulf countries have increasingly contributed to Africa's growth during this period.

While the continent's growth performance in 2001-08 was strong, it was below the rates required to sustainably reduce poverty. Only about 25 percent of African low-income countries (LICs) grew at 7 or more percent a year. At the same time, about 40 percent of the LICs had inflation below 5 percent and 75 percent of them below 10 percent during 2001 – 08 during this period. Hence while most countries stabilized inflation at low levels, the high growth needed to improve people's lives has remained elusive for most African LICs.

Yet in most cases very low inflation rates (below 5 percent) are not appropriate inflation objectives for LICs. Inflation hampers growth only if it exceeds a certain threshold (typically 10-20 percent); the positive impact of reduced inflation on growth is insignificant below such threshold. Moreover, LICs that target very low inflation (below 5 percent) can negatively impact growth in the process. At least some of the LICs that

[1] A separate brief discusses trends and challenges of domestic resource mobilization in Africa.

achieved very low inflation rates may have done so at some cost to their growth. In sum, most LICs should keep inflation between, 5 and 10 percent, but not at very low levels.

III. The impact of the crisis on Africa in 2009

In 2009, Africa's high growth was interrupted by a severe external shock in the form of the global financial and economic crisis (Figure 1a, Annex I). Most African countries were hit hard through the real channels such as declining exports and FDI and in some cases also aid, remittances, and tourism receipts. In 2009 most key macroeconomic indicators thus deteriorated. The real GDP grew on average by only 2.5 percent, but the performance varied from 6.8 percent decline in Seychelles to 9.9 percent growth in Ethiopia. The impact on SSA was more severe, as growth collapsed from an average of 6.1 percent during 2001-08 to 1.6 percent in 2009 – the weakest growth since the early 1990s and a decline of output in per capita terms. Since the crisis was an external shock, the countries that were more open to trade and grew faster before the crisis (e.g. oil exporters and emerging market countries) experienced larger growth falls in 2009. They are expected to bounce back quickly, alongside the global revival (Figure 1b, Annex I).

The crisis experience underscores the importance of export diversification – both in terms of products and trading partners. Specifically, countries with closer ties with the BRICs and especially China and India, such as frontier market and transition LICs, did not record such sharp declines in trade and growth as the other countries (Table I, Annex I).

Regarding other key macroeconomic indicators, trade and current account balances markedly deteriorated with plummeting external demand, especially among oil exporters. A number of countries experienced 'twin deficits', as worsening current account balances were accompanied by rising fiscal deficits. In low income fragile countries the marked deterioration of the current account balances has raised questions about how to maintain debt sustainability over the medium term (Figures 2a and 2b, Annex I). Working poverty (people living on less than 1.25 dollar a day) has also escalated due to the crisis. ILO estimated that it may have increased up to 15 percent in 2009 due to the crisis, which would raise the rates back to 2003 levels.

Lessons from policies adopted during the crisis

Due to the built up reserves and the debt relief prior to the crisis, a number of African countries were in a position to adopt counter-cyclical measures when the crisis hit. Fiscal policies played a key role, especially increased government expenditures on infrastructure. This policy choice was appropriate given the continent's vast infrastructure gap since it stimulates short run aggregate demand and medium term growth by easing supply side bottlenecks. These measures can be particularly effective when accompanied by improvements in business environments.

A few exceptions aside (e.g., South Africa), monetary policy was less effective in countering the crisis, due to structural rigidities in financial markets and limited links between interest rates and credit. Specifically, due to the inefficiencies in the banking sectors, cuts in policy rates often did not increase credit to the private sector, as examples of Uganda and Tanzania illustrated. With these rigidities, the private sector alone cannot drive Africa's recovery, and continued effective state interventions will be needed.

IV. Policies to support recovery in 2010 and 2011

Africa has shown a surprising resilience during this crisis and is now staging a robust comeback. The continent as a whole avoided recession, and output in only 10 out of 53 countries contracted in 2009. The growth is expected to reach 4.5 percent in 2010 and 5.2 in 2011. Except Madagascar, all African countries are projected to record positive growth in 2010 and in 2011. Many, including some fragile states, are recovering fast as the commodity prices rebound. According to the African Development Bank's projections, in 2011 Africa will be one of the fastest growing developing regions, second only to Asia. This strong rebound has brought a renewed recognition and increased optimism about the continent's substantial economic potential.

Several factors have helped Africa weather the crisis relatively well, especially: (i) cautious macroeconomic policies adopted across many countries prior to the crisis; (ii) appropriate counter-cyclical measures were adopted where feasible (East Africa), focusing mostly on removing supply-side bottlenecks (infrastructure); (iii) increased trade and investment linkages with Asia and other emerging market countries; and (iv) in some sub-regions (East Africa), more intensive regional integration also played a positive role. The counter-cyclical policies in particular constituted a welcome deviation from the past pro-cyclical stance. In that context, timely financial support from the multilateral financial institutions, including the African Development Bank, also helped prevent large pro-cyclical cuts in fiscal expenditures.

With Africa rebounding, how should the continent exit from the crisis measures? Despite the positive outlook, uncertainties stemming from a fragile global outlook surround also Africa's recovery. Given that in 2010 and even 2011 many countries are projected to grow below their trend growth, the key policy challenge is to bring them on a path of strong, sustained and shared growth, including through temporary demand management policies. In 2010, this is in line with policies that actually have been adopted -- about 40 percent of countries are projected to have higher fiscal deficits in 2010 than in 2009.

African governments may want to maintain somewhat accommodative policies also in 2011, while gradually refocusing on medium term objectives and fiscal consolidation. Exit strategies from the crisis intervention policies should thus be gradual and well coordinated across countries and policies. Still, short-term stabilization policies need to be phased out not to jeopardize debt sustainability and undermine investor confidence. When exiting the interventionist policies, fiscal consolidation should in most cases precede monetary tightening, since it is more effective even if it may be technically and politically more complex. Social outlays and public expenditures on infrastructure need to be protected, and even scaled up to support social stability and post-crisis growth.

Given the case for gradual exits from accommodative policies and focus on medium term growth, the key question is how much policy space African countries have to pursue such accommodative stances in 2011. Despite deterioration in a number of countries, most African countries have emerged from the crisis with stronger fiscal positions than the advanced economies. Debt sustainability has not been so far a major concern in most countries, even though the issue may arise over the medium term unless appropriate policies are undertaken. Often, the countries underperforming on growth (i.e. growing below their trend growth rates) are over-performing on inflation (i.e. with inflation rates either below 5 percent or within 5 -10 percent, but below their trends). Such countries should not avoid stimulating aggregate demand for the fear of raising slightly inflation, as reaching high growth path is a much more important priority.

V. Beyond the crisis: pro-growth macroeconomic policies

With the policy objectives shifting to growth, how can macroeconomic frameworks become more flexible but maintain credibility? During the crisis, countries with more flexible macroeconomic frameworks fared better. To achieve greater flexibility of macroeconomic frameworks, pro-cyclical fiscal policies could be replaced by rule-based and counter-cyclical frameworks that leave room for discretion in case of unexpected shocks. African countries could aim for balanced budgets (after grants) over the cycle, with annual budgets anchored in medium-term expenditure frameworks.

On the monetary side, where conditions allow, flexible inflation targeting (IT) regimes, now in place in South Africa and Ghana, could be considered by other emerging and frontier markets. Recent global developments also showed once again the negative effects that freezing up of credit can have on growth. As the view that in developing countries monetary policy affects output mostly through the credit channel has gained acceptance, African central bankers have increasingly focused on credit as the key part of the monetary transmission mechanism. Hence going forward, a key task of monetary policy in Africa's LICs would be to ensure that sufficient private sector credit is available to finance private investment and growth.

African countries in general and LICs in particular also face a range of structural constraints that undermine competitiveness, private sector development and growth. Key among these are the infrastructure deficits that raise production and trade costs, rigid regulatory frameworks that discourage entrepreneurship, and weak regional integration that reduces intra-African economic linkages as well as the gains from economies of scale. These constraints existed before the crisis and they will need to be addressed to create the foundation for accelerating growth.

Unlocking productive entrepreneurship across regions and sectors, accompanied by well-designed and implemented policy, would especially help Africa develop the private sector and achieve strong, sustained, and shared growth. While the formal private sector remains limited, in some countries it has been thriving (e.g., Kenya, Mauritius, South Africa, Tunisia). Private sectors have also shown dynamism in specific areas in a number of countries, including the flower business in Ethiopia, Kenya and Uganda or leather processing in Ethiopia. Industrial policy can be important -- not by picking winners, but by removing obstacles to entrepreneurship in high-potential sectors and industries.

A stronger human capital base is needed to transform African countries into knowledge-based societies. In today's knowledge-based world, no country can thrive without a capacity to generate, transmit, and utilize new knowledge. There is substantial mismatch between the demands of modern economies and skills possessed by the recent university graduates in most African countries. Shortages of skills especially in ICT, high-level technical skills and foreign languages persist. A comprehensive overhaul of Africa's higher education systems and new sources of financing for higher education are needed, including from the private sector. Policy makers may want to explore different forms of state support, including credit-guarantees, loan subsidies, and grants.

Building social safety nets would help ensure that growth is shared with the most vulnerable. The recent global financial and economic crisis has again underscored the importance of creating mechanisms in Africa to protect the most vulnerable segments of population against unexpected external shocks. As the global financial crisis has turned into a job crisis, African countries realized that they should be paying more attention to public works programs, such as labor-intensive infrastructure investment. Moreover, short-term social safety nets should be supplemented by well-targeted longer term protection programs to ensure shared growth in the medium term.

V. Conclusions and key messages

In the aftermath of the crisis, the key issue facing Africa is what should be the poverty agenda beyond the MDGs. Given the continent's vast economic potential, the objective should be building prosperous Africa, which can be achieved through strong, sustained and shared growth. This note highlighted actions pertaining to the macroeconomic policy that would help achieve this type of growth. Key messages are listed below.

Key messages

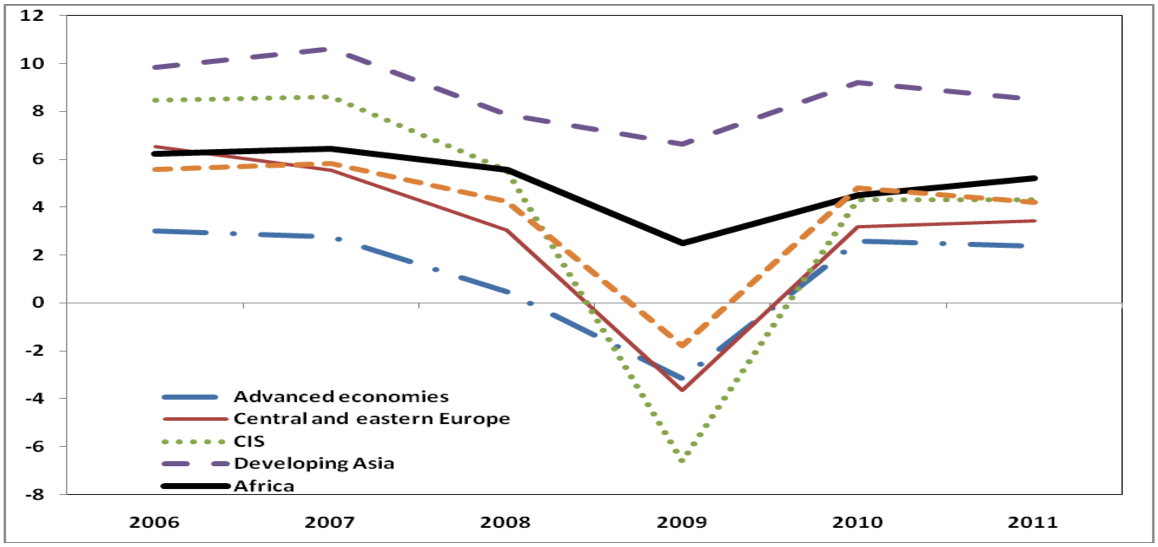
- As the uncertainties around the global outlook remain, where feasible African governments may want to **maintain broadly accommodative policies in 2011,** while gradually refocusing on medium term objectives and fiscal consolidation. However, social outlays and public expenditures on infrastructure need to be protected and even scaled up to support social stability and post-crisis growth.

- The medium term objectives should be centered on development and poverty reduction through **strong, sustained, and shared growth**. The focus of the macroeconomic policy thus needs to shift **from overemphasizing stabilization and very low inflation towards growth**.

- To be effective, macroeconomic policies should be accompanied by **structural reforms** (**building infrastructure, unlocking productive entrepreneurship** and **developing human capital base, and others) and development of social safety nets to protect the vulnerable.**

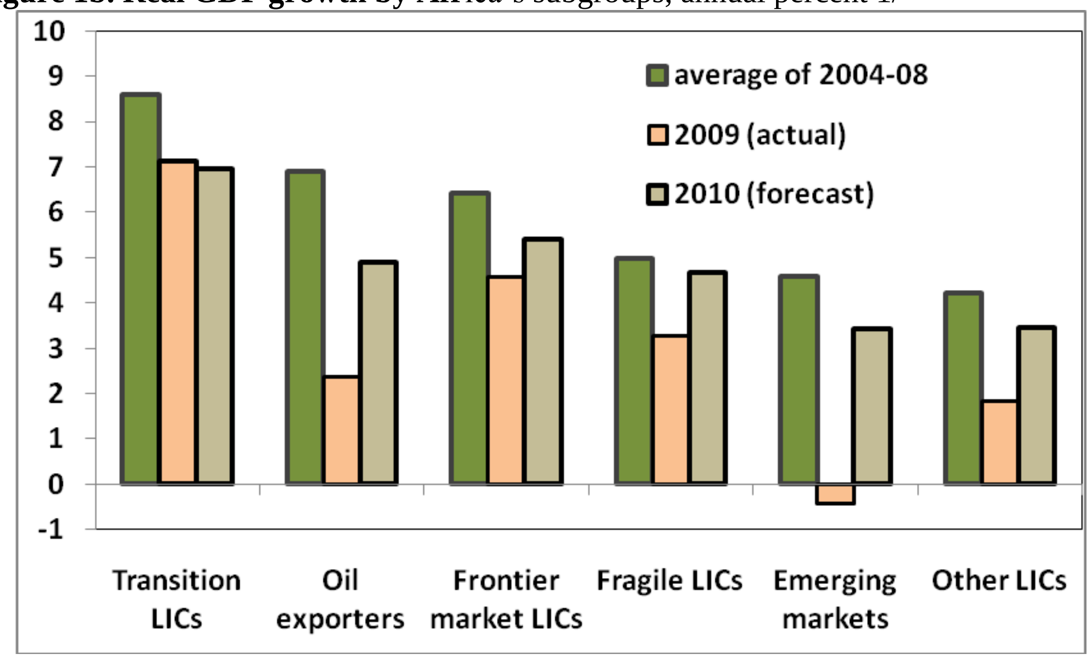
ANNEX I

Figure 1a. Africa and other regions, real GDP growt**h (2006 – 2011, for**ecasted), percent



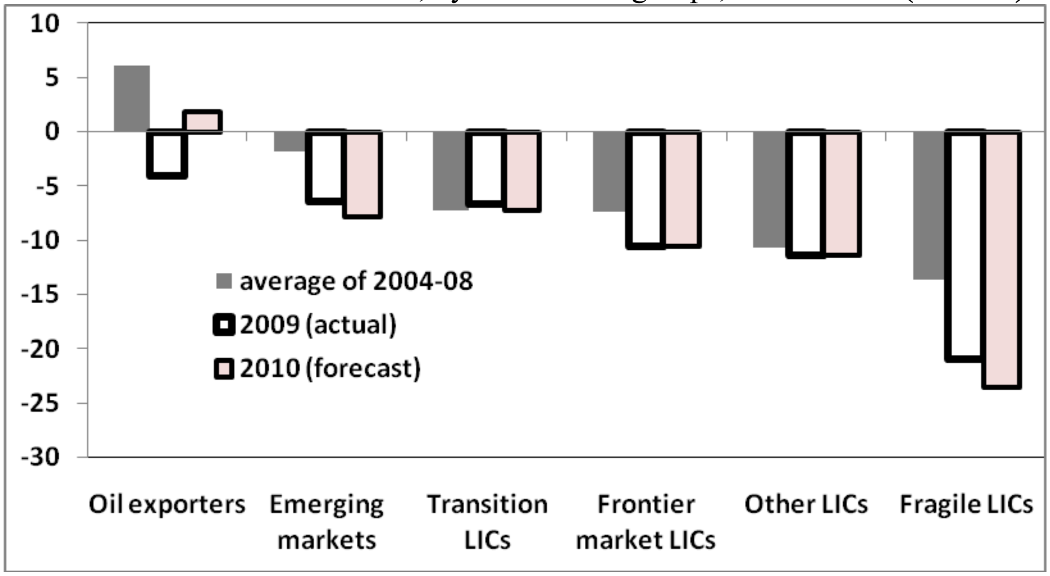
Sources: African Development Bank database for Africa and IMF WEO database for other regio**ns.**

Figure 1b. Real GDP growth by Africa's subgroups, annual percent 1/



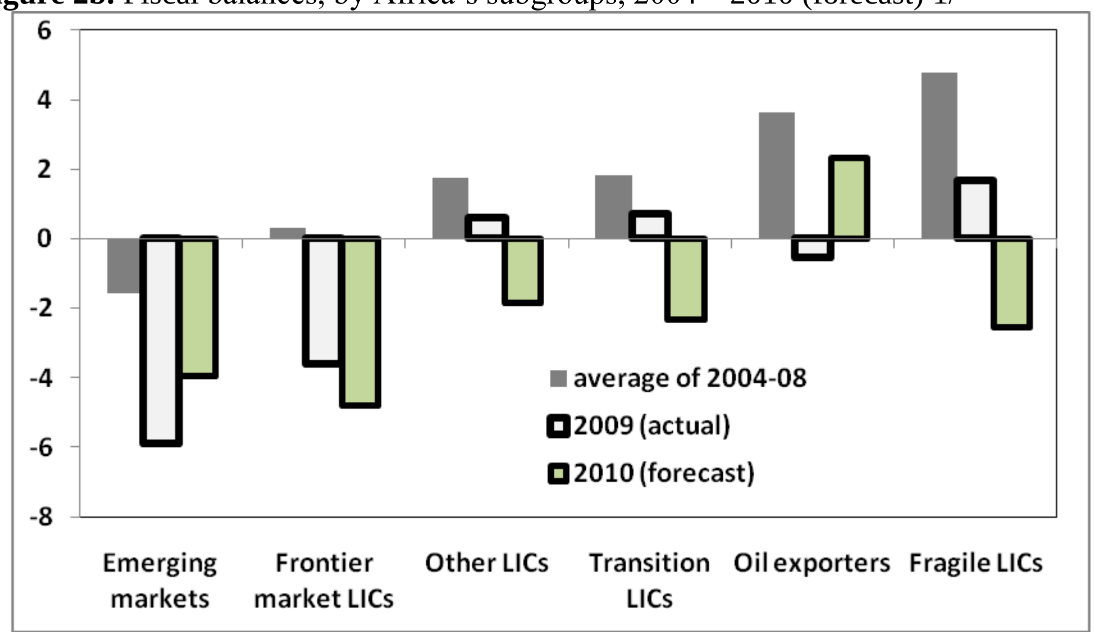
Source: Authors' calculations based on the African Development Bank database. 1/ Unweighted averages. Country classification is in Annex II.

Figure 2a. Current account balances, by Africa's subgroups, 2004 – 2010 (forecast) 1/



Source: Authors' calculations based on the African Development Bank database. 1/ Unweigthed averages.

Figure 2b. Fiscal balances, by Africa's subgroups, 2004 – 2010 (forecast) 1/



Source: Authors' calculations based on the African Development Bank database. 1/ Unweighted averages.

Table 1a. Correlation coefficients between Africa's subgroups and BRICs, 1996 – 2009

	Oil	EMEs	LIC, Fragile States	LIC, Frontier Markets	LICs, other	LICs transition	BRICs	China	India
Oil	1								
EMEs	0.1127	1							
LIC, Fragile States	0.2320	0.1447	1						
LIC, Frontier Markets	-0.1118	0.6261	-0.0484	1					
LICs, other	0.0274	0.4710	-0.2358	0.7217	1				
LICs transition	0.2399	-0.0001	-0.0379	0.0086	0.1565	1			
BRICs	0.2012	0.2277	-0.0852	0.5762	0.4249	0.2565	1		
China	0.3678	0.1621	-0.1755	0.3034	0.2224	0.5094	0.8074	1	
India	-0.0319	0.2102	-0.3857	0.4250	0.3273	0.4941	0.6776	0.7475	1

Source: Authors' calculations based on the African Development Bank.

Table 1b. Exports of Africa's subgroups into BRICs, 2004 – 2009

	Growth in export revenues (percent)		Share of BRICs in total exports (percent)		
	2004 - 08 (av.)	2009 act.	2004 - 07 (av.)	2008 act.	2009 act.
Oil Exporters	44.2	-27.4	14.9	17.7	18.5
Emerging Markets	39.1	-9.2	5.8	9.9	10.6
Fragile States LICs	85.6	-13.6	6.0	9.4	9.6
Frontier Market LICs	32.7	32.6	6.3	8.5	13.1
Transition LICs	37.0	83.9	8.1	7.2	13.1
Other LICs	51.0	-11.5	16.4	23.5	24.1

Source: Authors' calculations based on the African Development Bank.

ANNEX II – COUNTRY CLASSIFICATION

Table 1. Country classification 1/

Oil Exporters	**LICs, Frontier Markets**	**LICs, Other**
Angola	Cape Verde	Benin
Cote d'Ivoire	Ghana	Burkina Faso
Cameroon	Kenya	Comoros
Congo, Rep.	Mozambique	Djibouti
Algeria	Senegal	Gambia
Egypt	Tanzania	Guinea
Gabon	Uganda	Guinea-Bissau
Equatorial Guinea	Zambia	Lesotho
Libya		Madagascar
Nigeria	**LICs Fragile States**	Mali
Sudan	Burundi	Mauritania
Chad	Central African Republic	Niger
Congo, Dem. Rep.	Liberia	Sao Tome and Principe
	Sierra Leone	Togo
Emerging Market Economies		
Botswana	**Transition**	
Mauritius	Ethiopia	
Morocco	Malawi	
Namibia	Rwanda	
Seychelles		
South Africa		
Swaziland		
Tunisia		

1/ LICs stands for low income countries.

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