



# Economic Premise

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## Africa: Leveraging the Crisis into a Development Takeoff

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*Africa's precrisis growth and poverty reduction was the result of increased external resources, a buoyant global economy and—crucially—improved economic policies. Although it is still the world's poorest region, the prospects for resuming growth are good. Additional resources and further policy reforms could launch the continent on a path of sustained growth and poverty reduction.*

### Growth and Poverty Reduction before the Crises

Until the onset of the food, fuel, and financial crises of 2007–9, the countries of Sub-Saharan Africa had been experiencing relatively rapid economic growth for over a decade. Between 1997 and 2007, gross domestic product (GDP) grew at almost 5 percent a year—the same rate as all developing countries except China and India—and accelerated to over 6 percent in 2006–7. Poverty was declining: the percentage of Africans living on US\$1.25 a day fell from 59 percent to 50 percent. Unlike previous episodes of rapid growth, this period was not driven solely by the boom in oil and commodity prices of the early 2000s: about 22 non-oil-exporting countries, accounting for one-third of the African population, had an average annual growth of more than 4 percent during 1998–2008. The oil exporters, home to another third of the population, also enjoyed rapid growth—over 6.5 percent annually for the decade—thanks to high oil prices and, as detailed below, sound macroeconomic management. The remaining third of the population lived in countries that were growing slowly or not at all. Most of these countries were either in conflict or emerging from it, although some countries, such as Zimbabwe, were simply stuck in a disastrous policy environment.<sup>1</sup>

Africa's precrisis growth and poverty reduction were due to a combination of three, mutually reinforcing factors. First, there was an increase in external resources. Foreign aid, fueled by debt relief, increased by about US\$14 billion—although the

increase falls about US\$11 billion short of the Gleneagles pledge to double aid to Africa by 2010 (World Bank 2010b). Private capital flows to Africa also increased, reaching a peak of US\$53 billion in 2007 (IMF 2010). And remittances grew at double-digit rates, peaking at US\$20 billion in 2007 (Ratha, Mohapatra, and Silwal 2010). Second, African countries benefited from a buoyant global economy and rising commodity prices. But perhaps the most important factor was that the underlying economic policy environment in Africa had improved significantly since the mid-1990s. Most countries had undertaken macroeconomic and fiscal policy reforms, and they were beginning to pay off: the median inflation rate in the mid-2000s was half that in the mid-1990s, and in 1996, there were 13 African countries with inflation above 20 percent, by 2007, there were only 2.

### The Crises of 2007–9

The triple crises of 2007–9 threatened to bring Africa's resurgent growth and poverty reduction to an abrupt halt. The doubling of food prices (in dollar terms) in 2007 hurt poor Africans, many of whom spend over half of their budget on food. Analysts estimated that poverty would increase by about 4 percentage points (Ivanic and Martin 2008). Riots broke out in cities such as Ouagadougou, Maputo, and Douala. African governments responded by lowering taxes, including import tariffs on food and, in some cases, increasing existing subsidies. Countries that had reasonably well-functioning safety net programs scaled them up. Ethiopia, for instance, doubled the wage paid

to participants in its Productive Safety Nets Program. Unlike in previous crises, very few countries resorted to price controls. Those that introduced export restrictions, as a means of keeping domestic prices low, soon abandoned them. Nevertheless, the food price crisis highlighted two weaknesses in the African policy environment. One weakness was that poor agricultural infrastructure, not to mention in some cases the abandonment of food production, prevented farmers from benefiting fully from higher food prices. The other weakness was that very little was known about the effectiveness of existing safety nets in Africa, so it was not clear which programs could or should be scaled up during a crisis.

The near-doubling of world oil prices in 2007–8 had an asymmetric effect, with oil importers suffering a terms-of-trade shock of 5 to 7 percent of GDP, while oil exporters enjoyed a windfall of double that magnitude. The oil importers responded by increasing subsidies or lowering fuel taxes. In contrast to their behavior during previous oil booms, most of the oil exporters saved the additional revenues. When the price of oil was US\$140 a barrel, Angola, Gabon, and Nigeria used a reference price of about US\$80 a barrel.<sup>2</sup>

The global financial crisis that started in September 2008 initially had only a mild effect on African economies. Most African banks were not sufficiently integrated with the global financial system to suffer from the fallout. The few countries with globally integrated financial systems, such as Mauritius and South Africa, had strong prudential regulations that protected them.

But when the financial crisis turned into an economic crisis, most African countries were severely affected. Private capital flows, which had been increasing faster in Africa than in any other region, dried up. The Democratic Republic of Congo (DRC) saw a decline of foreign direct investment of US\$1.8 billion. Kenya and Ghana postponed sovereign bond offerings worth US\$800 million. Remittances, which had been rising at about 13 percent a year, slowed to a trickle. Africa was particularly hard hit because 75 percent of its remittances come from the United States and Western Europe, the epicenter of the crisis. The decline in commodity prices reversed the terms-of-trade shock of the previous year, with oil importers gaining and exporters losing. While the savings during the oil boom helped cushion some of these exporters, the fact that their economies were so heavily dependent on oil meant that GDP growth suffered. Angola's GDP, for instance, went from growing at over 15 percent a year during 2004–8 to 1 percent in 2009. Finally, foreign aid was unlikely to increase given the fiscal problems in donor countries.

## Policy Responses to the Crises

The net result was that Africa's GDP growth rate fell from 5.8 percent in 2008 to 1.4 percent in 2009 (World Bank 2010a). Although growth was still positive (in contrast to most of the

developed world), the decline in per capita GDP meant that poverty would rise. An estimated additional 7 to 10 million Africans would be thrown into poverty. Furthermore, such sharp declines in growth are associated with increases in infant mortality: some 30,000 to 50,000 additional infants were likely to die before their first birthday (Friedman and Schady 2009). Perhaps most troubling was the prospect that the economic reforms, which had been delivering strong growth and poverty reduction until 2008, would be slowed or reversed. The payoffs to these reforms had suddenly disappeared. And the policies being pursued by developed countries—increasing fiscal deficits and nationalizing banks—were precisely in the opposite direction of what African governments were undertaking.

These policy reversals did not happen. Those African countries that had some fiscal space, thanks to debt relief and prudent macroeconomic management before the crisis, ran modest countercyclical policies, dampening the impact of the global crisis on the domestic economy. Zambia, for instance, ran a fiscal deficit of 2.6 percent of GDP. Most of the increase in the fiscal deficit (which averaged about 2 percentage points) was the result of the decline in government revenues. Government expenditures did not increase because implementation difficulties would have prevented them from stimulating the economy. The increased deficits were financed by a combination of domestic borrowing (which expanded by 2 percentage points of GDP) and front-loaded, concessional resources from the World Bank and the African Development Bank.

Furthermore, those countries that did not have fiscal space chose to run contractionary fiscal policies to maintain long-term sustainability. For example, Ghana, which, unrelated to external shocks, had a fiscal deficit of 14 percent of GDP in 2008, has now embarked on a program to reduce that deficit by 2 percentage points a year for the next six years.

Not only did African countries respond quickly and pragmatically to the global crisis, but many of them innovated and in some cases accelerated reforms. Tanzania, for instance, introduced an emergency program for the banking sector that provides loan guarantees that are strictly time bound (two years), a feature that is lacking in comparable programs in the United States and Europe. Recognizing that public investment typically suffers in recessionary times, South Africa provided countercyclical funds of about US\$100 billion exclusively for public investment (this was also necessary so the country could host the 2010 Soccer World Cup). Mauritius introduced an innovative burden-sharing program among business, labor, and government to restructure distressed companies. Finally, Nigeria used the weakness in oil prices to begin deregulating its downstream petroleum sector.

## Longer-Term Challenges and Opportunities

The growth recovery across a large swath of the continent since the mid-1990s and the pragmatism that has characterized the

policy responses of most countries to the crises of 2007–9 are encouraging. Nevertheless, much of the African continent continues to face a number of challenges in the medium term. In what follows, four such challenges are noted, along with the opportunities to address them, while recognizing that the specifics will necessarily differ across countries.

*Infrastructure gaps.* In almost every African country, the lack of physical infrastructure is a constraint to growth and poverty reduction. Not only is infrastructure lacking, it is also significantly more expensive than elsewhere in the developing world. Average electricity costs of US\$0.18 per kilowatt hour are about double the costs in other developing countries. Infrastructure gaps are largest by far in energy, with citizens in 30 of the 47 countries in sub-Saharan Africa facing regular power shortages and service interruptions. Furthermore, only one in four Africans has access to electricity. Collectively, the countries of the subcontinent (with more than 800 million people) have about the same power generation capacity as that of Spain, which has about one-twentieth of the population (Foster and Briceno-Garmendia 2010).

Filling these gaps and lowering service costs will require both more money and reforms in the provision of infrastructure. The additional money will need to come from domestic and external sources, including donors. And there will need to be a balance between spending on new investment and on operations and maintenance, so that the latter is not crowded out. To get the level of infrastructure of all African countries to the level of Mauritius, an additional US\$48 billion per year will be needed, a third of which will be needed to cover maintenance. The complementary policy and institutional reforms in infrastructure sectors will both ensure that new investment is well spent and help bring the private sector into financing and operating these facilities. Nevertheless, even if potential efficiency gains are fully realized, a funding gap of about US\$31 billion will remain (Foster and Briceno-Garmendia 2010).

A specific infrastructure investment that will be important in almost every African country is irrigation expansion. Despite its importance to economic activity and its potential role in reducing poverty, agriculture in most African countries has been ignored until relatively recently; the adverse impacts of this neglect were highlighted during the food crisis of 2008. And with less than 5 percent of cultivated land irrigated, African agriculture remains extremely vulnerable to the effects of global climate change—more frequent floods and droughts and what appears to be a long-term drying trend in many parts of the continent.

*The demographic transition and job creation.* In many countries in sub-Saharan Africa, the demographic transition has not even begun. There are still many Sahelian countries, such as Mali, Niger, and Burkina Faso, where the population growth rate is over 3 percent per year, with total fertility rates of more than 7 children per woman. Even where the transition has

started, there is a bulge in the under-15 population that will work its way into the labor force in the coming decades. These factors will exacerbate the problem of youth unemployment, with 7 million to 10 million young people entering the labor force every year and formal sector job growth not fast enough to absorb them. The creation of productive employment opportunities, especially for the youth, will be an important economic and political challenge for African governments (World Bank 2009a).

Part of the solution will be to reduce the demographic pressures, especially where fertility rates are still high. These efforts will need to go beyond providing access and information to family planning services and include the empowerment of girls and women, particularly through access to education. There will also need to be efforts to increase the demand for youth labor, including in the informal sector where most jobs in low-income African economies are created. The informal sector is estimated to employ about 80 percent of Africa's labor force. Improving the investment climate is critical in this regard both for formal and informal sector firms. And targeted efforts to expand youth employment, such as wage subsidies or vocational training schemes, will need to take into account and build on global experience with such interventions.

*Governance and state capacity.* The challenges of governance and limited state capacity are starkest in the 20 fragile states of Africa—whether as a result of earlier conflicts, such as for Côte d'Ivoire and the Central African Republic, or because they are still in conflict, such as Somalia. But as with the issue of job creation, governance challenges cut across all of Africa. Even resource-rich countries show significant weaknesses in governance, which means they gain much less than they should from their natural resource wealth. In general, although there are exceptions such as Mauritius, the quality of public sector management and institutions is lower in sub-Saharan Africa than in other regions. The most significant adverse outcome of these governance weaknesses is the poor quality of service delivery in health, education, and water and sanitation. Public school teachers in Uganda are absent about 20 percent of the time (Habayiramana 2010). In Chad, the share of nonwage public health resources that reaches the primary clinics is 1 percent (Gauthier and Wane 2009). These service delivery failures have hindered faster progress toward the Millennium Development Goals.

Improving governance will necessarily be a long-term and country-specific effort. However, where conflict is still prevalent, such as in DRC, or the risks of conflict resumption are high, such as in Sudan, the root causes will still need to be addressed, including through long-term coordinated support from development partners. In resource-rich economies, priority needs to be placed on ways of increasing transparency, promoting accountability, and improving decision making throughout the chain of resource extraction and use. This will

cover such areas as the awards of licenses and contracts, the macroeconomic management of windfall revenues, and public spending decisions. All countries must focus on improving their capabilities and incentivizing the public sector to better plan and implement development policies that are tailored to their country circumstances.

*Aid volumes and modalities.* Much of Africa will remain aid dependent in the medium term. However, as the developed countries assess the full impact of the financial crisis, aid flows from the Development Assistance Committee (DAC) donors are not likely to grow as robustly as they have over the past decade. Even before the crisis, projections were that overseas development assistance would be about US\$11 billion short of the Gleneagles commitment to double aid to Africa by 2010. With the impact of the crisis, the gap has only widened. Alongside tightening aid budgets, there is also a backlash emerging against budget support as the preferred modality of aid provision in many Western European countries—despite the evidence that this instrument lowers transaction costs, supports capacity building, and helps harmonize donor support. Ironically, these developments are happening when the productivity of aid to Africa—as a result of the policy reforms undertaken over the last 15 years and the continued pursuit of prudent policies during the crisis—has never been higher.

## Conclusion

Africa is the world's poorest region and faces development challenges of monumental proportions. Nevertheless, the continent's prospects for resuming growth are good because policy reforms generated relative rapid economic growth and poverty reduction before the global crisis, and because policy makers by and large continued to pursue these policies during the crisis. It also means that there is increasing political support for pro-poor reforms—the very reforms that will help the continent address the challenges of infrastructure improvement, job creation, governance, and shrinking aid. If the international community continues to support Africa, the combination of additional re-

sources and policy reforms could launch the continent on a path of sustained, rapid growth and poverty reduction.

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## Endnotes

1. All data in this note are from World Bank (2009b) unless otherwise noted.
2. <http://blogs.worldbank.org/africacan>.

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