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Priority Actions to Address Africa's Economic Recovery

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Abstract

As we begin 2023, Africa's development is threatened by multiple crises. This time is distinctly different from past episodes, first in the increased frequency of crises, as well as the persistence and deepening of climate and conflict crises. While in 2008/2009 Africa was able to use debt to weather the financial crisis, today, rapidly rising global interest rates and the absence of a well-functioning framework for comprehensive debt reduction and relief, threaten to cut access to international financial markets for many countries. Moreover, deglobalization trends could limit Africa's ability to use international trade to drive growth. While the external environment is precarious and may remain that way for some time given the evolving geopolitical tensions, domestic policy actions do matter, and Africa's policymakers are not helpless. The time to act is now, in order to regain lost ground and move towards prosperous economies and resilient, inclusive societies.

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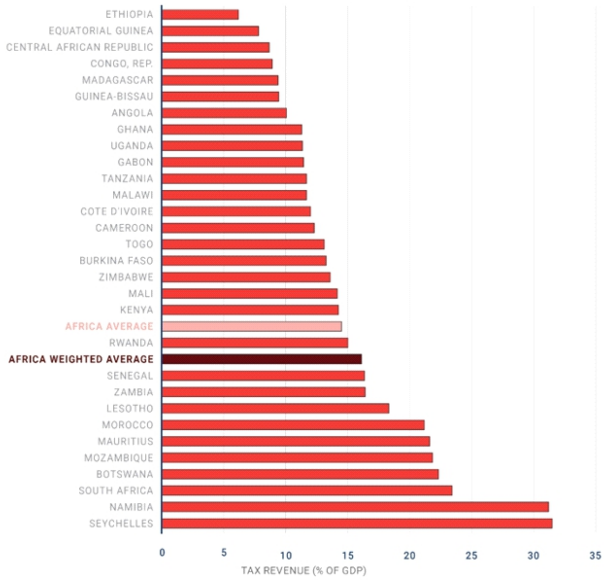
Background to the Study

Raise More Domestic Revenues and Spend More Efficiently

This is foundational to any credible home-grown solution. The continent collects less revenue than can be generated domestically at current levels of income, with tax revenue as a share of GDP averaging 16.1 percent of GDP for sub-Saharan Africa as a whole—see Figure 1. Strengthening tax administration and expanding tax sources to real estate, sugary products, and eventually carbon, are important opportunities to significantly raise domestic revenue. It is also important to eliminate excessive inefficiencies in both recurrent and capital spending. Countries need to move away from expensive (and often regressive) large-scale generalized subsidies and towards more selective, well-targeted approaches including technology-enabled social protection programs and high value investments such as research and development and infrastructure. Targeted programs allow governments to support the most vulnerable, while effectively supporting specific strategic objectives, and eliminating wasteful expenditure. Public investment programs need to be thoroughly reviewed to weed out poorly conceived investments and ensure limited resources are truly supportive of long-term growth, while strengthening programs that build long-term public investment capacity. Commodity exporters have a huge opportunity to fully leverage current commodity windfalls to build macroeconomic buffers and invest in flagship programs that will address long-term challenges. Finally, African countries need to develop deep domestic (or regional) financial markets, anchored by high savings from national pension funds—and regional sovereign wealth funds more broadly which will require addressing regulatory constraints.

FIG.1 MOBILIZING DOMESTIC REVENUE WILL BE A KEY PRIORITY AS AFRICA'S TAX-TO-GDP RATIO REMAINS COMPARATIVELY LOW

Most African countries experienced a decline in nominal tax revenues in 2020. The capacity for African tax systems to gather revenue varies widely by country. At 16.5 percent of GDP, however, Africa's average tax-to-GDP is lower than other regions, such as Asia and Pacific (19.1 percent), Latin America and the Caribbean (21.9 percent), and OECD countries (33.5 percent).



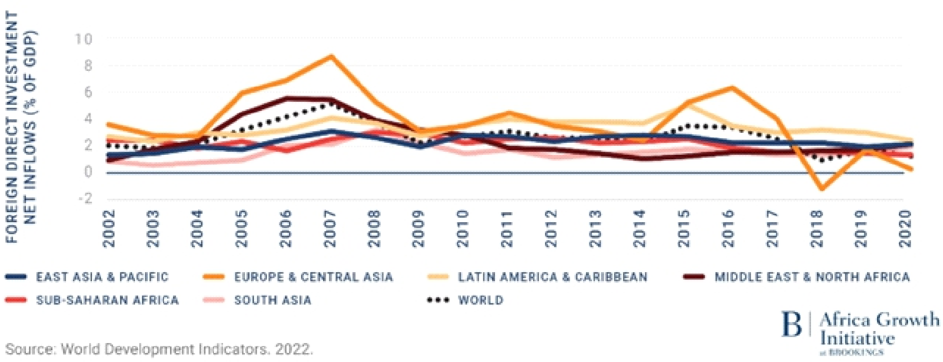
Note: Data from 2020 or latest year.
Source: World Bank. 2022. World Development Indicators. OECD. 2022. Revenue Statistics in Africa.

Enable African Entrepreneurship to Flourish and Support Modern Competitive Economies

African entrepreneurial talent is evident across the continent. Yet it remains largely untapped.1 African economies are also largely informal and operating at low levels of productivity, making it challenging to provide the requisite number of decent jobs for poverty reduction and to grow the middle class.2 Policymakers can enable the emergence of a more formal, competitive domestic private sector by building competitive markets characterized by stable, transparent, and fair regulatory regimes. Much can be done in the near term and complemented with more medium-term reforms. This will also support foreign direct investment (FDI) inflows which remain at low levels compared to other developing regions, see Figure 2. A related opportunity is enabling the private sector to play a much greater role in closing key energy, transport, and digital infrastructure gaps which is essential for competitiveness. In energy, private sector participation in off-grid solutions is already contributing to increased energy access in some countries. The private sector is also delivering huge gains in financial inclusion through use of digital technology, widespread connectivity using mobile phones, and telemedicine. Policymakers can help address constraints to scaling up these successes and extending them across the continent. In order to close the infrastructure access gaps, governments will also need reforms to strengthen the performance and financial viability of public sector utilities.

FIG.2 **FDI NET INFLOWS (% OF GDP)**

Sub-Saharan Africa's foreign direct investment inflows have been below the global average for much of the last two decades. The region experienced its strongest inflows between 2007 and 2015, when FDI grew by 2.6 percent per year. Since 2015, however, sub-Saharan Africa's FDI growth has been more subdued, growing at just 1.6 percent per year.



Source: World Development Indicators, 2022.

Tap Africa's Huge Demographic Bulge

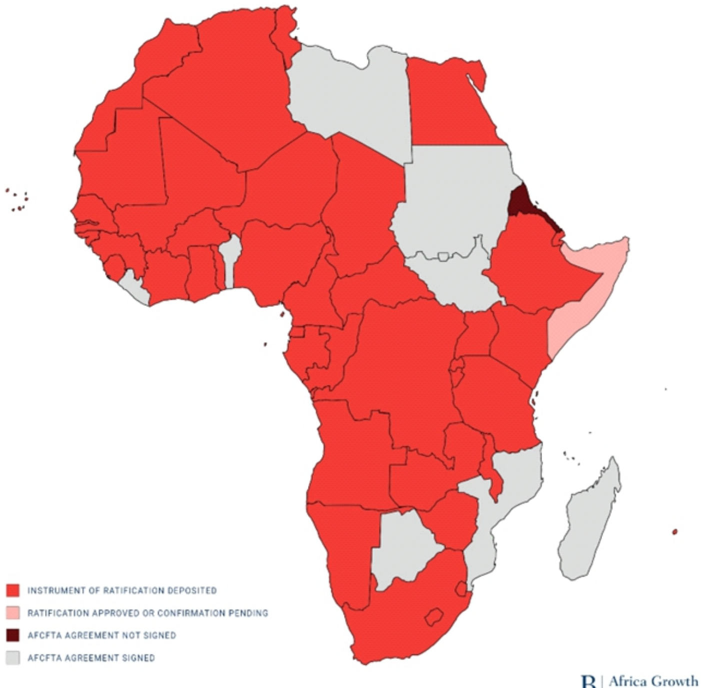
Africa's population is the most youthful globally, with about 60 percent below 25 years. The time is now to turn this youth bulge into a demographic dividend to drive growth and development. Investing in the human capital of Africa's youth is fundamental. Action is needed first to address the significant human capital losses from COVID-19, and to implement clear plans to tackle the silent learning crisis in the region. Children in sub-Saharan Africa are, on average, learning for only five out of the eight years in school due to weaknesses in education systems. A second area for attention is providing jobs for the rapidly growing numbers of unemployed youths. Technical and vocational educational training (TVET) programs, in partnership with the private sector, alongside well-designed apprenticeship programs need to be expanded and strengthened to provide requisite labor market skills. The entrepreneurial talent of Africa's youth, especially in the startup sector, will also need to be supported to thrive. Finally, the high fertility rate on the continent (4.8 against 2.4 globally), which drives up household consumption and reduces per capita investments in human capital, needs to be tackled. A multipronged approach including keeping girls in school, which will likely reduce child marriages and teenage pregnancy, improving access to family planning programs, and enhancing support to women's labor force participation is needed.

Accelerate the Rollout of the African Continental Free Trade Area (AfCFTA)

This bold initiative by African leaders is a historic opportunity to integrate the continent. Trade within the continent is currently low, compared to intra-continental trade in other regions. A truly integrated continent will support broad improvements in competitiveness over time and is likely to build resilience to global shocks and mitigate, in part, the impacts of deglobalization.5 Implementation of the AfCFTA could also reduce food security risks by promoting intraregional agricultural trade. As of May 2022, 54 out of 55 countries have signed the AfCFTA and 44 have deposited their instruments of ratification. Already the Pan-African Payment and Settlement System (PAPSS), led by the Africa Export-Import Bank in partnership with the AfCFTA Secretariat and launched on January 13, 2022 after a successful trial in six West African countries, is a step in the right direction. PAPSS enables African importers and exporters to settle intra-area trade obligations in their respective national currencies. Policymakers now need to focus on accelerating implementation, supporting trade facilitation, and strengthening regional connectivity, particularly in the key corridors.

FIG.3 AFCFTA RATIFICATION

Trading under the African Continental Free Trade Area (AfCFTA) commenced on 1 January 2021 for the countries that have submitted their instruments of ratification. However, 11 countries have yet to deposit their instruments of ratification, thereby limiting the coverage of the AfCFTA.



Source: Tralac. 2022.

Invest in Developing Africa's Forward-Looking Mineral Repositories

Several African countries have huge deposits of resources and minerals such as cobalt, lithium, copper, manganese, and nickel which will be key to achieving green transitions. As this transition takes hold globally, the increase in demand will present opportunities for African producers to capture market share and accelerate development. Also, the market for these minerals will likely be different than those for oil and gas. Three issues merit the attention of policymakers. First, is supply management: Leaders and policymakers need to define clear, credible strategies and plans for developing these resources and maintaining investments into the sector. Second, is a strategy for value addition. To use these resources as a springboard for economic transformation, a plan for local value addition, technology and knowledge transfer, and employment generation is needed. This will require difficult negotiations with often very sophisticated multinational corporations, where individual countries may be at a disadvantage. This is an area where regional coordination and cooperation, especially considering AfCFTA, can be helpful. Third, is revenue management: Investing the proceeds from these minerals wisely by putting in place effective mechanisms and frameworks to channel revenues to clearly defined and well-designed investments. African countries are facing multiple global headwinds while their economies are still bearing the scars of a once-in-a century pandemic. Alone, each of these crises would normally present daunting challenges. But their combined impacts could be catastrophic. We believe that Africans can turn this moment of adversity into an opportunity: To accelerate development by drawing on the internal strengths of their respective nations. Managing the crises will demand a great deal from African policymakers. It will require political will and determination, as well as sound, well-informed judgement. It will also require a willingness to learn and to adapt, patience, and the ability to balance short- and long-term goals.

FIG.4 **SHOCK TO FOOD, FUEL AND FINANCE: HIGH COMMODITY PRICES COUPLED WITH RISING INTEREST RATES POSE A UNIQUE CHALLENGE FOR AFRICA**

The last time food and oil prices spiked the way they did in 2022 was during the aftermath of the Great Recession. Back then, the federal funds rate, a proxy for global liquidity, was less than one-quarter of 1 percent. Africa, therefore, could weather the high cost of commodities by borrowing at reasonable rates. But now, with the federal funds target range reaching 4 percent, Africa may not be able to rely on debt to finance costly commodities, or cope with elevated debt costs.

Source: IMF. 2022. World Economic Outlook database, October 2022. International Monetary Fund. St. Louis Federal Reserve. 2022. FRED Economic Data. Board of Governors of the Federal Reserve System (US).

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Reference

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