Recent Economic Trends in Africa and Prospects for 2006

1.1 Introduction

In 2005, African economies recorded another strong performance, continuing the momentum of strong growth achieved in 2004.[1] The continent benefited from rising global demand for primary commodities, including oil, which resulted in high export earnings for resource-rich countries. In addition, African economies continued to reap the benefits from macroeconomic reform, which translated into consolidation of macroeconomic balances with low inflation rates, declining budget deficits, stabilization of exchange rates and improvements in current account balances.

> *Africa needs more external funding to increase growth rates and achieve poverty reduction*

The continent also benefited from substantial inflows of external financing in the form of official development assistance (ODA), including debt relief, and foreign direct investment (FDI), which should boost economic growth in the coming years. The Multilateral Debt Relief Initiative (MDRI) announced at the G8 Summit in Gleneagles in 2005 provided much needed relief for 13 sub-Saharan African (SSA) countries. However, it is clear that this debt relief package is not enough and that more external funding will be needed to help African countries increase growth rates and achieve meaningful reduction in poverty.

Indeed, while the recent consecutive high growth rates represent a major turnaround, the levels of growth recorded are still not enough to achieve the Millennium Development Goal (MDG) of halving poverty by 2015. In 2005, only ten countries realized growth rates of 7 per cent or higher: Angola (19.1%), Burkina Faso (7.5%), the Republic of Congo (7.7%), Equatorial Guinea (9.3%), Ethiopia (8.9%), Liberia (8%), Libya (8.5%), Mozambique (7.5%), Sierra Leone (7.3%), and Sudan (8%). Of the ten countries that recorded high growth in 2005, only three maintained an average growth rate of 7 per cent in the medium term (over the 1998-2005 period): Angola, Equatorial Guinea and Mozambique. It is clear that while high growth rates are recorded in several countries, very few are able to sustain high performance for an extended period. Thus, the volatility of growth remains an obstacle to the goal of accelerating poverty reduction.

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1 The data used for recent macroeconomic performance in this chapter are mainly from the International Monetary Fund (IMF) and the Economist Intelligence Unit (EIU). Data on social and human development are from various sources, including the World Bank's *World Development Indicators* 2005 and United Nations Development Programme's (UNDP) *Human Development Report* 2005.

A major weakness of the recent growth performance in Africa is that it is mainly driven by extractive industries, especially oil and minerals. This exposes resource-rich economies to the adverse effects of fluctuations in international commodity prices, in addition to the negative effects of exchange rate appreciation on export competitiveness. The future of resource-led growth remains uncertain given the vagaries of international commodity markets. Moreover, given the weak employment gains from resource-based economic expansion, the recent patterns of growth are not likely to generate meaningful increases in living standards for the majority of the population.

"Volatility of growth is an obstacle to poverty reduction"

A major challenge for African countries is the ability to sustain reasonable levels of Gross Domestic Product (GDP) growth over an extended period. With erratic growth rates, African countries will not be able to generate enough decent employment opportunities to increase per capita income and reduce poverty.

The objective of this chapter is to provide an overview of the recent performance as well as future growth prospects for African economies at the continental and subregional levels. The chapter discusses the main factors behind the recent performance and factors that are likely to influence the medium-term growth prospects. It also identifies key challenges in the area of social development and suggests policy responses.

1.2 The global economy was largely favourable in 2005

Although the world economy slowed down in 2005 relative to 2004 (from 5% to 4.3%), it displayed resilience in the face of the increase in energy prices. The strong performance was driven by rising domestic demand in the United States, Canada, China and India. This partly helped to offset weaker growth in Japan (2.8%) due to slow inventory accumulation, the Euro zone (1.2%) due to weak household spending, and in the United Kingdom (1.75%), which experienced a deceleration of private and government consumption. Growth in Latin America slowed in 2005 relative to 2004 (from 5.8% to 4.2%), due to lower import demand from China and industrialized economies. Growth also decelerated relative to 2004 in transition economies (from 6.7% to 5.3%) and in Asia (from 7% to 6.5%).

The strong overall global growth performance has fuelled large increases in oil and commodity prices. However, the high oil prices have not spilled over into higher wage demands and long-term inflation expectations appear well anchored. As a result, contagion of oil price hikes to non-oil prices has remained minimal. Indeed, core inflation has remained stable in the United States (around 2%) and has trended down in the Euro zone.

Many developments witnessed in 2005 in the world economy have important implications for African economies in the short to medium term. The sustained rise in

oil prices will continue to put pressure on energy costs for all the countries and on the import bill for oil-importing ones. The rising short-term interest rates driven by monetary policy tightening, especially in the United States, imply higher costs of debt servicing, especially for countries with high proportions of short-term debt in total foreign liabilities. While the widening US trade deficit will contribute to weakening the dollar, this may be offset by the effects of rising interest rates and strong recovery, which will cause the dollar to appreciate, resulting in higher import costs and a worsened debt service burden for African countries.

"Strategies are needed for enhancing the efficiency of aid utilization"

Another major concern is the current account imbalances which are predicted to widen over the next two years (OECD 2005; UN 2006). The US external deficit is set to rise to 7 per cent of GDP in 2007, while Japan and China will register very high surpluses. These imbalances raise the risks of disorderly adjustments, with risks of large exchange rate fluctuations, asset price collapse, and interest rate hikes. These risks put into question the sustainability of current world growth rates.

The year 2005 was marked by a substantial increase in ODA, with aid from the Development Assistance Community (DAC) of the Organization for Economic Cooperation Development (OECD) rising by 31.4% to a record high of $106 billion. This increase reflected debt relief, including large sums to Iraq (about $14 billion) and Nigeria ($5 billion) as well as aid to countries affected by the tsunami in 2004 (about $2.2 billion).

The year 2005 was also marked by a number of positive developments in the international community with regard to commitment to support national and regional development efforts in Africa. Noteworthy developments include: the global review of MDGs by the United Nations General Assembly, the report of the Commission for Africa led by the Prime Minister of the United Kingdom, Tony Blair, and the focus of last year's G8 meeting on development financing for Africa. These efforts to increase growth need to be supported by strategies for enhancing the efficiency of aid utilization and better targeting of poverty reduction in national development agendas.

1.3 Overall growth performance in Africa remained strong

Many countries registered better performance in 2005 than in 2004

In 2005, African economies recorded another strong performance (5.4%), exceeding the record growth achieved in 2004 (5.2%), and more than a percentage point above that of 2003 (4%). See figure 1.1.[2] Comparatively, Africa's growth was the same as

2 The data used in this document are updated to September 2006.

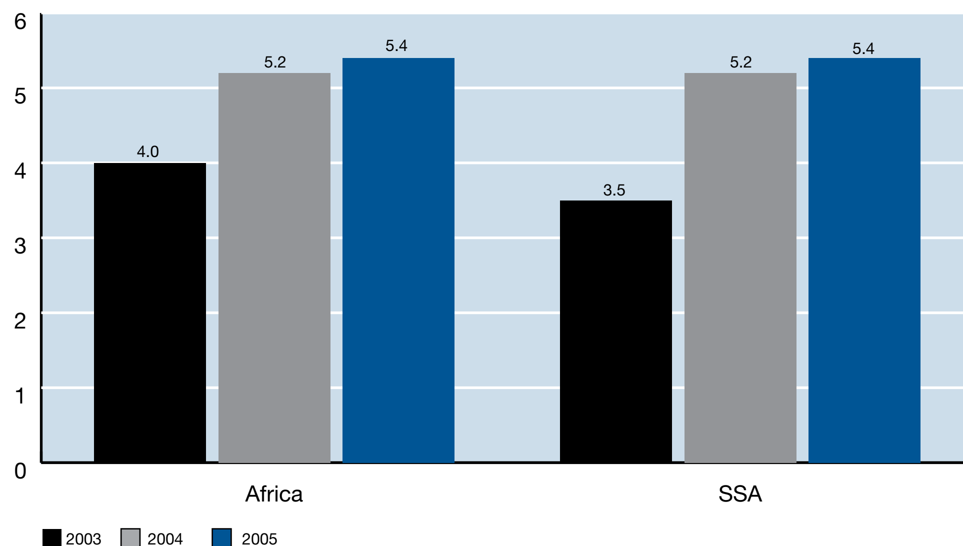
that of transition economies, higher than that of Latin America (4.3%) and lower than that of Asia (6.5%, excluding Japan). On a disaggregated level, as many as 25 African countries recorded improvements in growth rates in 2005 relative to 2004.

> *Improvements in macroeconomic management have resulted in lower inflation rates and consolidation of fiscal balances*

The strong growth performance achieved in 2005, as in recent years, represents a major turnaround from decades of economic decline and stagnation. A key driver of this recovery is the improvement in macroeconomic management in many African countries, which resulted in lower inflation rates and consolidation of fiscal balances. Another favourable factor is the increase in international prices of key export commodities for Africa, especially crude oil, due to strong growth in global demand.

The total commodity price index increased by an average of about 30 per cent in 2005 relative to 2004, led by crude oil prices, which rose by more than 40 per cent compared to 13 per cent for non-energy commodity prices. Among non-energy commodities, the prices of metals and minerals increased by 25.4 per cent while those of agricultural products, raw materials and fertilizers rose by 7.6, 7.1 and 6.6 per cent respectively. In contrast, export prices of cotton, tea, and cocoa continued to decline, mainly due to global excess supply.

Figure 1.1
Real GDP growth rate in Africa, 2003-2005



Source: *Economist Intelligence Unit (EIU), September 2006.*

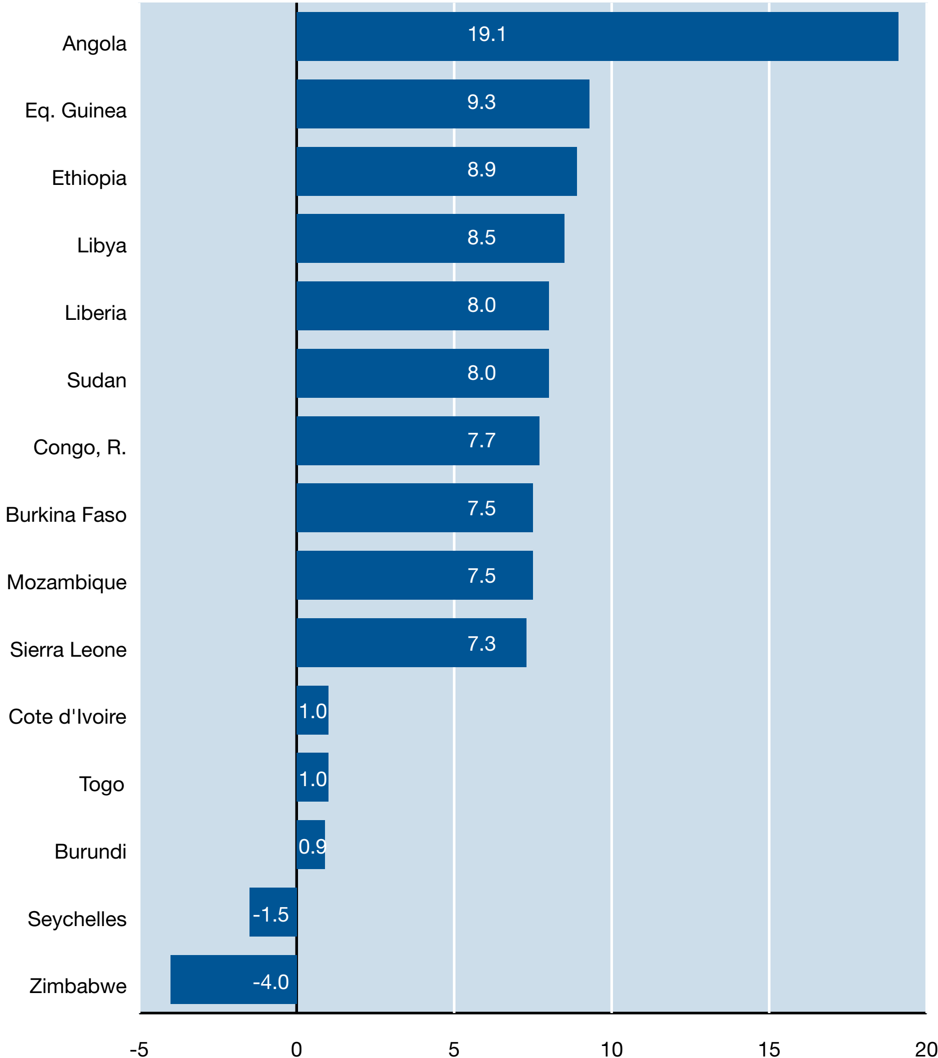
In 2005, the top 10 growth performers achieved the 7 per cent growth rate threshold needed to achieve the MDGs (figure 1.2). One half of the high performers are oil-exporting economies, reflecting the impact on export revenues of high oil prices and production. However, it is notable that the other half are non-oil economies: Burkina Faso, Ethiopia, Liberia, Mozambique, and Sierra Leone. High growth in these coun-

tries was mainly due to strong performance in the agricultural sector (Burkina Faso, Ethiopia, Mozambique, and Sierra Leone), the service sector (Sierra Leone and Mozambique), and recovery in the mining sector (Sierra Leone).

Zimbabwe and Seychelles exhibited the weakest performances in 2005 as in 2004, as a result of continuing instability in Zimbabwe and the adverse effects of the tsunami and weak performance in tourism and in tuna exports in Seychelles. Slow growth in Togo was attributable to political crisis and a decline in phosphate and cotton production. Political instability adversely affected overall growth performance in Côte d'Ivoire.

Figure 1.2

Top 10 and bottom 5 performers in Africa in 2005 (% real GDP growth)



Source: *Computed from EIU data, September 2006.*

The gains from Africa's oil boom are still limited

Oil production is playing an important role in Africa's overall growth performance

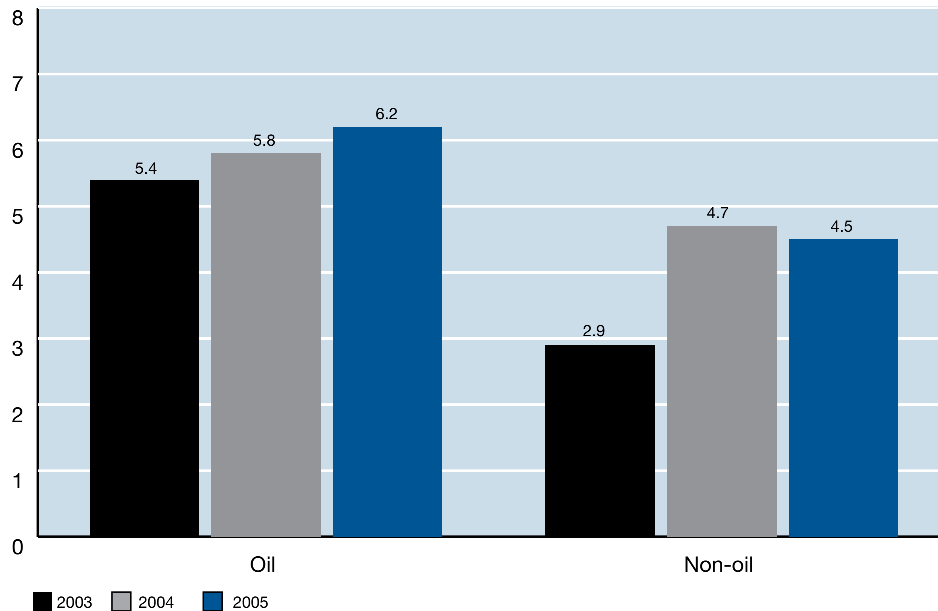
Over the last few years, Africa has been in the midst of an oil boom, resulting both from large increases in oil prices and the substantial influx of investments in petroleum exploration and production (US Department of Energy, 1999). This new oil boom spread across the continent, with all subregions coming out as net crude oil exporters, with the exception of East Africa. The dominant producers and net oil exporters are (in descending order of shares in total production) Nigeria, Libya, Algeria, Egypt, and Angola. Gabon, Congo, and Cameroon are also net oil exporters. Oil production also started recently in Mauritania.

African oil has been the subject of substantial interest from major oil consumers, especially the US and the fast-growing Asian economies led by China and India. Oil exploration in Africa is expanding faster than in any other region of the world and African oil producers enjoy large gaps between potential reserves and current output. The continent is therefore seen as a viable alternative to traditional sources such as the Middle East. The world's largest consumer of oil, USA is deriving 15 per cent of its oil imports from Africa. China, the second largest consumer of oil, buys 28 per cent of its oil from African countries, especially Angola, Nigeria and Sudan. In 2004, China's investments in Africa – mostly in oil exploration and production – represented $900 million out of the continent's total of $15 billion.

The massive export revenues and FDI in the oil sector explain the high growth rates recorded by oil-producing African economies. In 2005, as a continuation of the recent trend, African oil economies as a group grew at 6.2 per cent compared to 4.5 per cent for non-oil economies (figure 1.3). The oil producers as a group contributed 53.4 per cent of the continent's 5.3 per cent growth rate. Therefore, it is fair to say that oil production is playing an important role in the continent's overall growth performance.

Figure 1.3

Growth of real GDP in African oil- vs. non-oil economies, 2003-2005



Source: *EIU, September 2006.*

However, despite the high growth rates generated by the oil boom, several questions remain, especially the sustainability of these growth rates and the overall impact on economic development. For high oil prices to translate into higher growth rates – even in the short run – it is necessary that the revenues be spent to boost overall economic activity and production capacity in a wide range of sectors. If the higher revenues are stored in idle foreign exchange reserves at the central bank or spent on unproductive imports, then the effects on growth will be minimal. The bigger challenges are:

- How to translate oil revenues into sustainable growth; and
- How to convert the oil boom into higher living standards for the majority of the population.

"Africa's oil boom needs to be translated into poverty reduction"

To translate the oil boom into sustained high growth rates, the oil revenues need to be used to finance domestic investment, including infrastructure, and to diversify economic activity by financing new investments in non-oil activities. Moreover, the sustainability of oil-driven growth requires efficient management of oil revenues to hedge against the adverse effects of price fluctuations.

The biggest challenge is to translate the oil boom into poverty reduction. Even the largest oil-producing countries in Africa still face abject poverty despite the massive oil revenues collected over the years. In Angola, 70 per cent of the population lives below the poverty line. In Gabon, with one of the highest per capita incomes on the

continent, high income inequality has kept half of the population in poverty. The development of *rentier economies* has prevented the expansion of employment-generating activities, thus keeping the majority of the population on the sidelines of the oil-led prosperity.

Oil revenues should promote economic diversification

An important issue for oil-rich economies is the efficiency of the management of oil revenues. In some of these countries, lack of transparency and accountability on the part of both governments and oil companies has perpetuated embezzlement and misuse of oil revenues. Overall, while oil resources are a potent source for economic prosperity for the continent, specific measures are needed to ensure that the induced growth is sustained over an extended period, that the high oil revenues are invested to promote diversification of economic activity, and that the gains are broadly shared among all segments of the population.

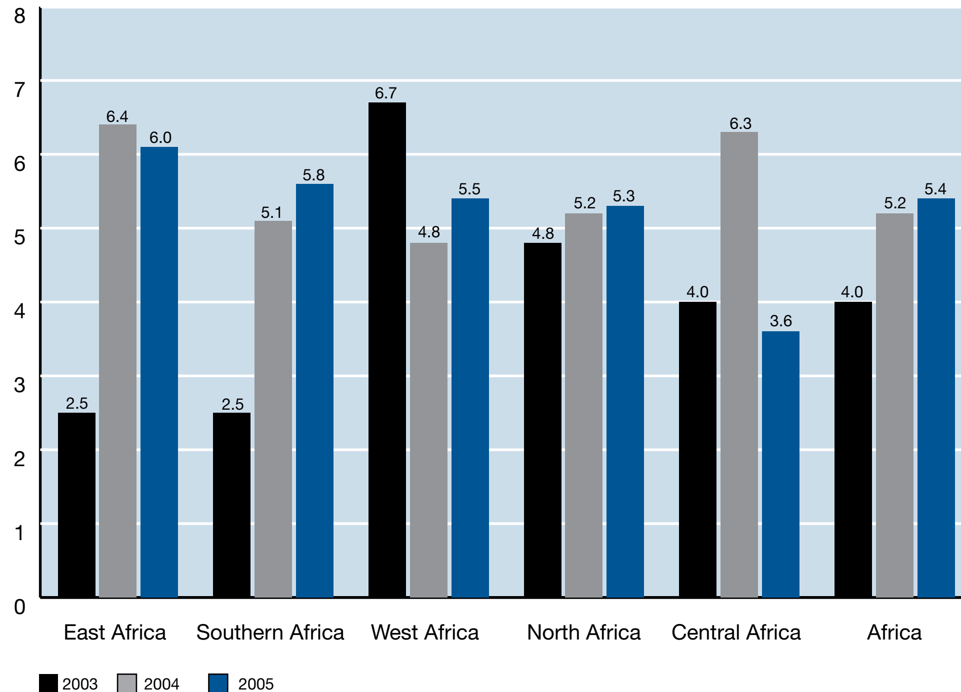
Subregional growth performance remains uneven

Aggregate economic performance exhibits substantial variations across subregions. East Africa led subregional growth performance for the second consecutive year with real GDP growth at 6 per cent in 2005, down from 6.4 per cent in 2004 (figure 1.4). In 2005, one half of the twelve countries of the subregion (with adequate data)[3] showed improved growth over that of 2004. The top performers were Ethiopia (8.9%), Tanzania (6.8%), the Democratic Republic of Congo (DRC) (6.5%), Kenya (5.2%), and Uganda (5.5%). Growth was driven by agricultural production, both in traditional cash crops such as coffee in Ethiopia, Rwanda and Uganda and in other products such as horticulture in Kenya.

Other factors of strong performance include high mineral production (DRC), and gains from improved political stability (Burundi and DRC). In Comoros, growth was sustained by donor support while growth in Djibouti was boosted by public and private investments in new port facilities. Eritrea's economic growth was low partly because of droughts that adversely affected agricultural production.

3 Excluding Somalia for which there are no adequate data.

Figure 1.4
Growth by sub-region, 2003-2005



Source: *EIU, September 2006.*

Growth in North Africa remained strong in 2005, improving slightly from 5.2 per cent to 5.3 per cent relative to 2004. Growth in the subregion was driven mainly by the strong performance of the oil sector in Algeria, Egypt, and Sudan. North Africa suffered from unfavourable weather conditions (especially in Mauritania, Morocco, and Tunisia). Furthermore, the end of the Multifibre Agreement on Textile and Clothing ended in January 2005. Morocco, the only non-oil producer in the subregion, experienced considerable slowdown in real GDP growth from 4.2 per cent in 2004 to 1.5 per cent in 2005 due to sharp contraction in agricultural output. Egypt and Sudan were the least affected by bad weather conditions. Weak export growth of textiles impacted negatively on GDP growth in Tunisia, which declined from 6 per cent in 2004 to 4.2 per cent in 2005. However, the subregion exhibited strong performance in the service sector, especially in Mauritania, Morocco, and Tunisia.

Central Africa was the worse performing subregion in 2005, with growth declining from 6.3 per cent in 2004 to 3.6 per cent in 2005. Growth decelerated in four countries: Cameroon (the largest economy that accounts for more than 50 per cent of the subregion's output), Chad, Equatorial Guinea, and São Tomé and Príncipe. The Central African Republic, the Republic of Congo, and Gabon recorded improvements (from 1.3% to 2.2%, 3.6% to 7.7%, and 1.4% to 2.9%, respectively). The

modest gains in performance in the Central African Republic are partly attributable to improvement in political stability. Growth in the Republic of Congo was driven by the oil sector. Gabon benefited from good performance in the tertiary sector (telecommunications) and timber exports (UNECA, SRO-CA, 2006). Chad and Equatorial Guinea both experienced marked slowdowns, from 29.7 per cent to 5.9 per cent and from 32.9 per cent to 9.3 per cent, respectively, due to the completion of major investment projects in the oil sector.

Growth in Southern Africa picked up from 5.1 per cent in 2004 to 5.8 per cent in 2005 owing mainly to higher growth in Angola, Mozambique, South Africa, and Zambia. At 19.1 per cent, Angola was the fastest-growing economy in Africa in 2005, thanks to higher oil revenues. South Africa's higher growth was due to higher domestic demand and exports as well as better performance in tourism. Growth in Zambia improved relative to 2004 (from 5.4% to 5.8%) as the adverse effects of droughts in the agricultural sector were offset by positive outcomes in other sectors such as increased copper production. Zimbabwe's economy continued to contract (-4%), bringing the real GDP level to 38 per cent below that of 1999.

Growth in West Africa improved in 2005 from 4.8% to 5.5%, marked by a predominance of the tertiary sector (UNECA, SRO-WA, 2006). At a disaggregated level, substantial increases in growth were registered in a number of countries: Burkina Faso (4.6% to 7.5%), Cape Verde (4.4% to 6.8%), Liberia (from 2.4% to 8%), Mali (from 2.2% to 6%), and Niger (from 0% to 4.5%). High GDP growth rates were also recorded in Senegal (6.1%), Sierra Leone (7.3%), Nigeria (6.5%), and Gambia (5.0%). Two countries experienced notable declines in growth rates: Côte d'Ivoire (from 1.6% to 1%) and Guinea Bissau (4.3% to 2.3%). Social and political tensions in Togo, Côte d'Ivoire, and Guinea Bissau were partly responsible for the poor economic performance.

"Post-conflict countries have moved from recovery to genuine growth"

Some countries have maintained high growth over the medium term

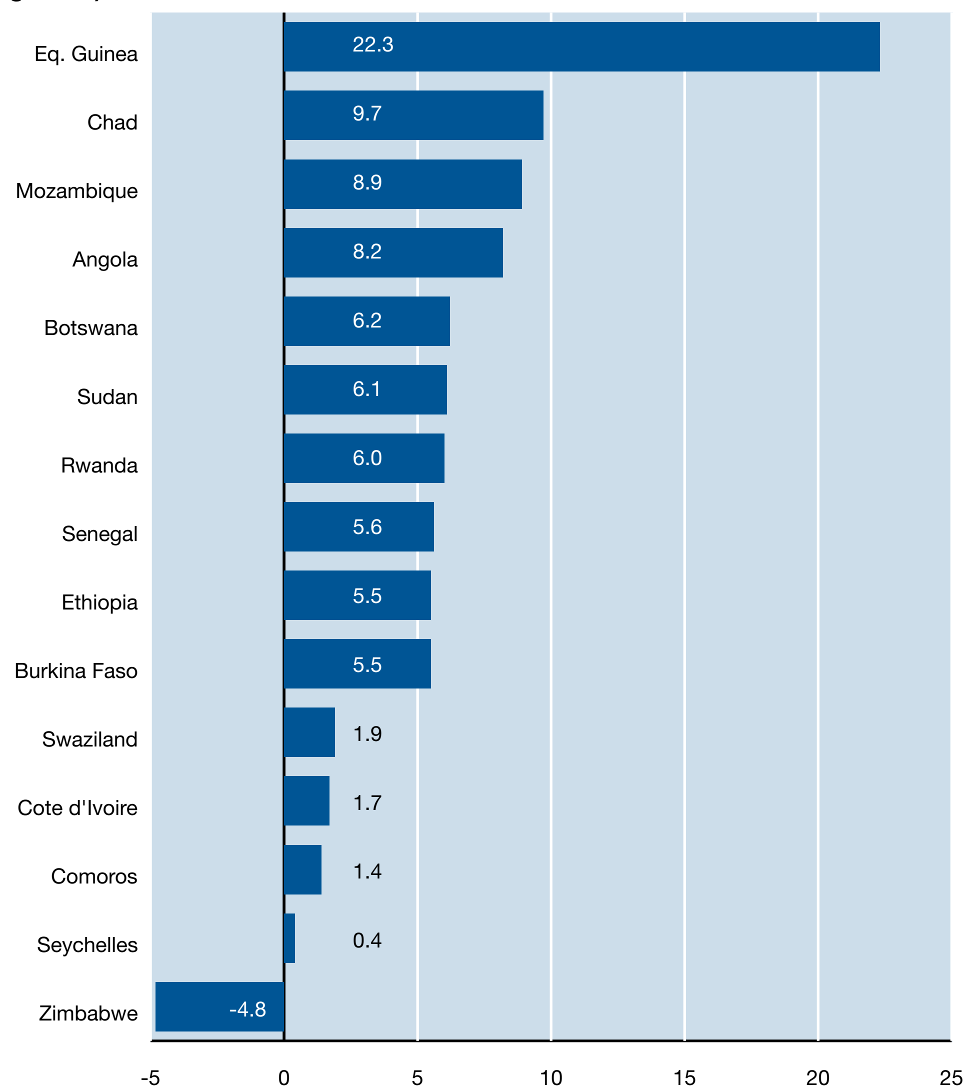
Figure 1.5 presents average growth rates over the 1998-2005 period.[4] Six of the top ten performers in 2005 are also among the top ten performers over the past eight years: Angola, Burkina Faso, Equatorial Guinea, Ethiopia, Mozambique, and Sudan. Côte d'Ivoire, Seychelles and Zimbabwe are among the weakest performers in 2005 and over the past eight years. The medium-term evidence also indicates that high growth is not restricted to oil-rich countries. Six out of the top ten performers are non-oil exporters: Botswana, Burkina Faso, Ethiopia, Mozambique, Rwanda, and Senegal. Growth in these countries was driven by the effects of comprehensive and sustained economic reforms as well as political stability in post-conflict countries such as Mozambique and Rwanda. These post-conflict countries have moved from recovery to genuine growth as a result of these reforms.

4 The choice of this period is governed by data consistency.

The group of least developed countries (LDCs)[5] in Africa has performed particularly well, recording an average growth rate of 5.3 per cent during the 1998-2005 period, higher than the SSA average (3.7%) and the average for the continent (4%) (UNECA 2006a). At a disaggregated level, oil-producing African LDCs outperformed non-oil producers (7.5% and 4.3%, respectively) while landlocked African LDCs performed worse in terms of growth (3.8%).

Figure 1.5

Top 10 and bottom 5 performers in Africa, 1998-2005 (% average annual growth)



Source: *EIU, September 2006.*

5 34 of the 53 African countries are LDCs.

1.4 Macroeconomic balances continue to improve

Fiscal balance has improved

Fiscal consolidation must remain high on Africa's economic reform agenda

One of the positive features of recent economic growth in Africa is improvement in the fiscal balance in many countries. The average fiscal position on the continent improved from a deficit of one per cent of GDP in 2004 to a surplus of 0.6 per cent in 2005. The number of countries with fiscal surpluses increased from 9 in 2004 to 12 in 2005 (table 1.1). The continent's improvement in fiscal position was mainly driven by the sizeable fiscal surpluses recorded by oil producers: Libya (20.6% of GDP), Equatorial Guinea (13.6%), the Republic of Congo (13.7%), Algeria (13.8%), Gabon (8.3%), Cameroon (3.4%) and Nigeria (0.3%). However, five non-oil economies also recorded fiscal surpluses: São Tomé and Príncipe (44.8%), Seychelles (8.0%), Botswana (2.6%), Lesotho (2.0%), and Kenya (0.3%).

Nevertheless, fiscal imbalances remain a critical problem in a large number of African countries. As many as 28 countries recorded fiscal deficits in 2005 compared to 31 in 2004. Moreover, many countries still depend heavily on ODA to finance their budgets, which raises concerns with regard to the sustainability of their development programmes. Therefore, fiscal consolidation, including strategies for increasing domestic revenue mobilization, must remain high on the agenda for economic reforms on the continent.

Table 1.1

Distribution of fiscal deficits in Africa, 2004 and 2005 (number of countries)

	2004	2005
Countries with surpluses	9	12
Less than 5 per cent	4	6
5 per cent to 10 per cent	3	2
More than 10 per cent	2	5
Countries with deficits	31	28
Less than 5 per cent	22	17
5 per cent to 10 per cent	8	11
More than 10 per cent	1	0
Total number of countries	40	40

Source: *EIU, June 2006.*

Single-digit inflation was contained in most countries

In 2005, the inflation outlook remained satisfactory with a majority of countries recording single-digit inflation rates (table 1.2). After declining from 10.8 per cent to 8.1 per cent between 2003 and 2004, the mean inflation for the continent increased slightly to 8.5 per cent in 2005. Inflation results were driven by pressures from oil prices, effects of weather shocks on agricultural production, and high domestic demand. Inflationary pressures were contained by the effects of macroeconomic policies aimed at containing public expenditures and money growth. These policies helped to contain the effects of the surge in oil revenues and development assistance inflows.

Inflation pressures mitigated by macroeconomic policies

In 2005, 16 countries experienced inflation above 10 per cent, compared to 17 in 2004. Nonetheless, inflation increased in 33 out of 51 countries, including eight of the 13 oil-producing countries: Cameroon, Chad, Côte d'Ivoire, Egypt, Equatorial Guinea, Libya, Nigeria, and Sudan. Inflation remained high in Angola at 23 per cent, but this represented a major improvement from 2004 (43.6%) and a major achievement from the triple-digit inflation rates experienced until 2002. Guinea and DRC experienced spikes in inflation (from 17.5% to 31.4% and from 4.0% to 21.4%, respectively) due to, among other factors, continued depreciation of the Guinea franc and international oil prices, and supply-side bottlenecks, a legacy of the civil war in DRC.

Table 1.2

Distribution of inflation rates in Africa, 2003-2005 (number of countries)

Range	2003	2004	2005
Less than 5 per cent	25	30	21
Between 5 and 10 per cent (10% excluded)	14	6	14
Between 10 and 20 per cent (20% excluded)	7	12	12
20 per cent and higher	5	3	4
Total number of countries	51	51	51

Source: *IMF, 2006.* ***World Economic Outlook Database****, September 2006.*

Developments in the balance of payments are positive

The continent's trade surplus (goods and services combined) has increased since 2003, mainly because of rising international oil prices coupled with expansion in crude oil production. Africa's trade surplus increased to $31.6 billion in 2005 from $13.0 billion in 2004 as a result of a 49.2 per cent increase in the region's oil trade surplus (IMF 2005). Strong performance in merchandise trade and net current transfers resulted in a current account surplus for the continent for the second consecutive year.

Overall performance at the continental level shows substantial variations across countries. Non-oil economies in particular continue to experience current account deficits, which are accentuated by rising oil prices. Indeed, out of the 37 non-oil economies with adequate data, only 11 experienced an improvement in current account balance from 2004 to 2005. It is clear that the aggregate trade surplus at the continental level is largely driven by oil revenues, which raises concerns about the sustainability of such a surplus.

"Debt service obligations are a major drain on social services, such as education and health"

External debt remains high

Africa's total external debt stock stood at $282 billion in 2005, down from $305.8 billion in 2004 (IMF 2006). Debt service obligations are on the rise since 2002 and stood at $34.6 billion, following a decline from $32.8 billion in 1997 to $21.3 billion in 2002. However, in relative terms, the average debt burden for the continent has been declining since the early 1990s. From a peak of 31 per cent in 1992, the debt service/exports ratio declined to 11.2 per cent in 2005. The debt/GDP ratio declined from 74 per cent in 1994 to 35 per cent in 2005.

These aggregate measures mask wide cross-country variations and are influenced by movements of debt and exports among large countries, especially oil exporters such as Algeria and Nigeria. At the disaggregated level, debt service obligations continue to represent a major drain on national resources, with many African countries spending more on debt service than on social services such as education and health. Thus, debt is still very much a critical constraint to development of the continent.

To alleviate the debt burden, the G8, at its Summit in Gleneagles in 2005, committed to cancellation of the debt of 14 African countries that had already reached the Highly Indebted Poor Countries (HIPC) completion points. These were Benin, Burkina Faso, Ethiopia, Ghana, Madagascar, Mali, Mauritania, Mozambique, Niger, Rwanda, Senegal, Tanzania, Uganda and Zambia. These countries were expected to start benefiting from complete debt cancellation beginning by early 2006, which should improve their debt position in the coming years. However, while these measures are a step in the right direction, they are insufficient to meet the development financing needs of African countries. Many low- and middle-income countries are not beneficiaries of the MDRI. The debt owed by SSA countries that qualify for debt write offs under the MDRI represents only 25 per cent of the continent's debt stock.

Addressing Africa's debt problems requires a comprehensive strategy. Such an integrated approach would enhance growth, increase exports, and raise domestic savings. It would thus reduce the need of African countries for more aid or borrowing in the future. The strategy should include:

- Extending debt relief to all poor countries (especially those recovering from conflict);

- Increasing new development aid so that debt relief is additional to, not a substitute for conventional development aid (Ndikumana 2004);
- Strict mechanisms that guarantee that the resources released by debt relief are invested in directly productive activities (especially infrastructure and social services); and
- Increasing access of African exports to Western markets, including preferential treatment arrangements and, most importantly, the removal of trade barriers in Western countries (e.g., removal of farm product subsidies).

"Africa needs to increase domestic revenue to prevent excessive dependence on aid"

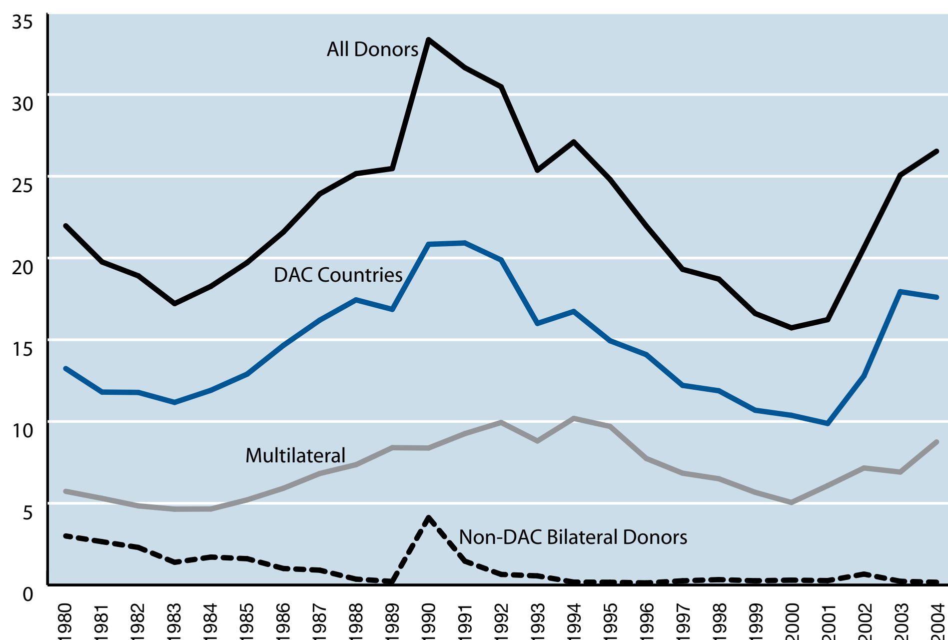
Official development assistance is rising but more is still needed

Total ODA to Africa continues its recovery from the long decline experienced between 1990 and 2001 (figure 1.6). ODA from all development partners stood at $26.5 billion in 2004 compared to $15.7 billion in 2000 (in constant 2000 dollars). The increase in aid since 2001 came from DAC and other multilateral donors. However, the rise in aid from 2003 to 2004 derived mostly from multilateral organizations, notably the World Bank, the African Development Bank and UN Agencies, including World Food Programme (WFP), United Nations Children's Fund (UNICEF) and United Nations High Commission for Refugees (UNHCR). This group contributed $2.2 billion (in nominal value) to the 2003-2004 aid increase. DAC donors disbursed a meagre $146.1 million while non-DAC bilateral donors have actually reduced aid to Africa for three consecutive years.

While ODA has increased recently in nominal terms, the resources received excluding emergency aid and debt relief increased only marginally from the past decade (UN 2006). Moreover, in real terms, aid inflows are still below the 1990 level of $33.3 billion. Aid to SSA has declined both as a percentage of Gross National Income (GNI) and as a percentage of Gross Capital Formation (GCF) since the early 1990s. From 6.5% in 1990-1994, the aid/GNI ratio declined to 5.3% in 2000-2003. The aid/GCF ratio declined from 40.7% to 27% during the same period (McKinley 2005).

To achieve and sustain higher levels of GDP growth rates and to accelerate poverty reduction, African countries will need higher volumes of aid in the coming years. With improvements in macroeconomic policies and institutions, and strong commitment by governments to target growth and poverty activities in the allocation of aid, it is possible for African countries to absorb higher levels of aid and reap more benefits from aid (see Commission for Africa, 2005; Millennium Project, 2005). Therefore, scaling up aid is not only necessary to achieve development targets but it is also feasible with regard to absorption capacity in receiving countries. New aid, however, should be in the form of grants to prevent a new round of external payment crisis. To prevent excessive dependence on aid, African countries also need to boost efforts to increase domestic revenue mobilization.

Figure 1.6
Official development assistance to Africa (constant 2003 $billion)



***Source**: OECD. 2005. International Development Statistics online databases*

Foreign direct investment remains low and concentrated

"Appropriate regulation is needed to address the detrimental impact of extractive industries on the economy and the environment"

During 2002-2004, Africa received a little over 2 per cent of FDI inflows in the world and less than 10 per cent of flows to developing economies (see chapter 2). FDI to Africa amounted to $30 billion, up from $18.1 billion in 2004. The distribution of FDI flows was uneven across subregions, with North Africa receiving about 30 per cent of the total compared to 10 per cent for East Africa. East Africa saw the largest increase in FDI (54.1%), while Southern Africa recorded more than 31.5 per cent decline in FDI from 2003 to 2004. Natural resource-rich countries continued to dominate in FDI inflows, with oil exporters capturing over 65 per cent of the annual FDI inflows to Africa between 2002 and 2004.

The heavy concentration of FDI in extractive industries raises concerns with regard to the impact on employment and poverty reduction as well as potential adverse effects on the environment. Given that production technology in these sectors is highly capital intensive, investment is generally accompanied by little job creation. Moreover, production in these sectors carries insufficient spillover effects on the rest of the economy as output is exported with little value added. Investments in extractive industries, especially oil, also tend to create environmental hazards with detrimental effects on the well being of local populations. These adverse effects to the economy, the environment and society need to be addressed by appropriate regulation.

Exchange rates remained stable in 2005

Most African currencies remained stable in 2005. In particular, the CFA franc was stable in 2005, with an appreciation of only 0.2 per cent against the US dollar. Only three currencies experienced an appreciation of more than 5 per cent: the Egyptian pound (6.8%), the Sudanese dinar (5.5%), and the Zambian kwacha (6.6%). The appreciation of the Egyptian pound was due to strong foreign exchange inflows and major improvements in the policy framework that boosted confidence in the national currency (SRO-NA, 2006). The Zambian kwacha appreciated because of high copper exports, and growing investor confidence, especially following the country's qualification for debt relief. The Sudanese dinar appreciated because of liberalization of the exchange rate regime, oil export revenue, and substantial capital inflows in the form of FDI and remittances.

"High interest rates, lack of access to credit and the cost of doing business discourage domestic investment and FDI"

The stability of exchange rates is an important achievement given the number of appreciation risks faced by many countries. In particular, the surge in oil revenues and the high inflows of aid put pressure on national currencies, causing them to appreciate. The observed results are partly attributable to efforts by monetary authorities to sterilize the inflows through appropriate market interventions.

1.5 Despite high growth performance, important development challenges remain

Saving and investment rates remain low

Among the factors explaining the inability to achieve and sustain high growth rates in many African countries is low domestic investment. Average gross domestic fixed investment for the continent was only 20 per cent in the 2000-2003 period. Domestic investment has not recovered from the decline in the early 1980s and has not responded to economic reforms aimed at macroeconomic stabilization. Out of 46 countries with adequate data, only nine achieved high investment rates, that is, at least 25 per cent of GDP during 2000-2003 (figure 1.7).

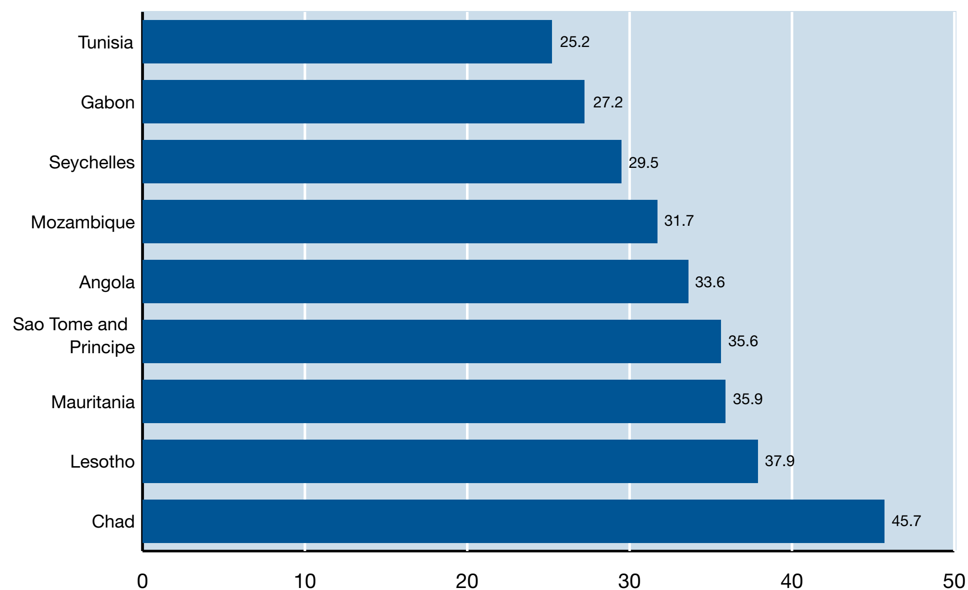
Major constraints to investment are high interest rates and general lack of access to credit, especially for medium and small enterprises (MSEs). The cost of doing business in African economies is also generally perceived as being much higher than in other regions, thus discouraging both domestic investment and FDI (UNECA 2005).

Saving rates are also low in most African countries, mostly due to low incomes and inefficiencies in savings mobilization by financial systems. Only seven countries recorded an average saving rate of 25 per cent or higher during 2000-2003. However, low saving rates provide only a partial explanation for the low levels of investment.

While saving rates have increased since the mid-1990s, this has not been accompanied by substantial recovery in investment (figure 1.8). In addition to the cost of doing business, another cause of the weak linkage between saving and investment in Africa is that financial systems are inefficient and fail to allocate capital optimally in the economy (Senbet and Otchere 2005).

Figure 1.7

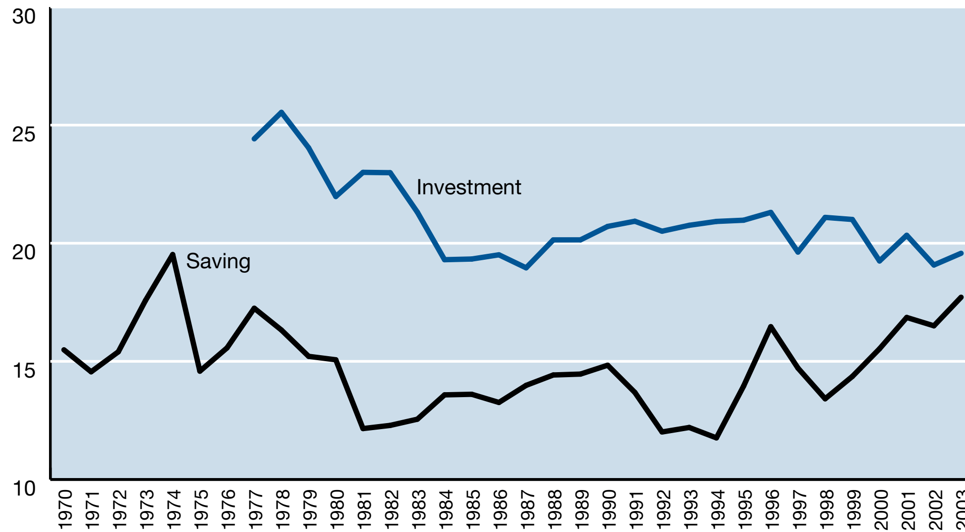
African countries with at least 25% investment-GDP ratio, 2000-2003



***Source**: World Development Indicators 2005.*

Figure 1.8

Gross domestic fixed investment and saving (% of GDP) in Africa, 1975-2003



***Source**: World Development Indicators 2005.*

***Note**: This figure includes 26 African countries with adequate data on savings and fixed investment over 1975-2003.*

Job creation remains a challenge

Another disappointing feature of the recent growth record in Africa is that growth has not been accompanied by substantial gains in job creation, which raises serious concerns about the continent's ability to achieve meaningful poverty reduction (UNECA 2006b). The first cause of the low employment performance on the continent is the inability to sustain high growth over an extended period. High volatility of GDP growth reduces incentives for job creation in the private sector due to the uncertainty of future profitability.

> *"Africa's economic growth has not been accompanied by substantial gains in job creation"*

The second cause is that growth rates have not been high enough in many countries to generate enough demand for labour. In addition, in many countries, GDP growth has not kept pace with growth of the labour force. Indeed, the strong average performance at the continental level masks wide disparity across countries, with many countries stuck in a low-growth equilibria.

The third cause of poor employment performance is the shift of economic activity away from agriculture into capital-intensive sectors such as mining and oil production. From 1994 to 2003, 35 out of 51 countries (with adequate data) experienced a decline in the share of agriculture in GDP (World Bank 2005). This shift of economic activity away from agriculture has been accompanied by little or no increase in productivity in the agricultural sector and very low absorption of labour into the non-agricultural sector, resulting in high under-unemployment in the rural/agricultural sector.

The human development record is still low

While the developing world in general has made significant progress towards achieving the MDGs over the past decade, most African countries are still lagging behind in both investments and outcomes in key areas of social and economic development (UNECA 2005a). SSA is the only region of the developing world where the poverty headcount has increased since 1980 (UNECA 2005b). SSA also has the highest number of people lacking access to clean drinking water (269 million) and sanitation (407 million), (UNDP 2006). In the 2005 *Human Development Report*, 30 of the 32 countries classified in the "low human development" category based on the Human Development Index (HDI)[6] are from SSA (UNDP 2005). The level of human development in SSA is not only lower than in other parts of the world, but it is also progressing at a slower pace since the mid-1980s.

Despite recent strong growth, there are concerns about its impact on social development and its sustainability in the medium term. While African countries have achieved higher growth rates than in previous decades, these rates still fall short of the threshold required to accelerate poverty alleviation and achieve the MDGs. On a medium-term basis, only four countries met the seven per cent growth threshold (figure 1.5): Equatorial Guinea, Chad, Angola, and Mozambique. Overall, very few African countries have been able to sustain sufficiently high economic growth rates, which largely explains the slow progress in social development.

Africa's growth rates still fall short of the MDG threshold

An important cause of the slow progress in human development is the fact that growth has not been accompanied by significant job creation. The concentration of growth in capital-intensive sectors such as oil and mining and the shift away from agriculture without absorption of the displaced labour, have contributed to job losses and the worsening of living standards.

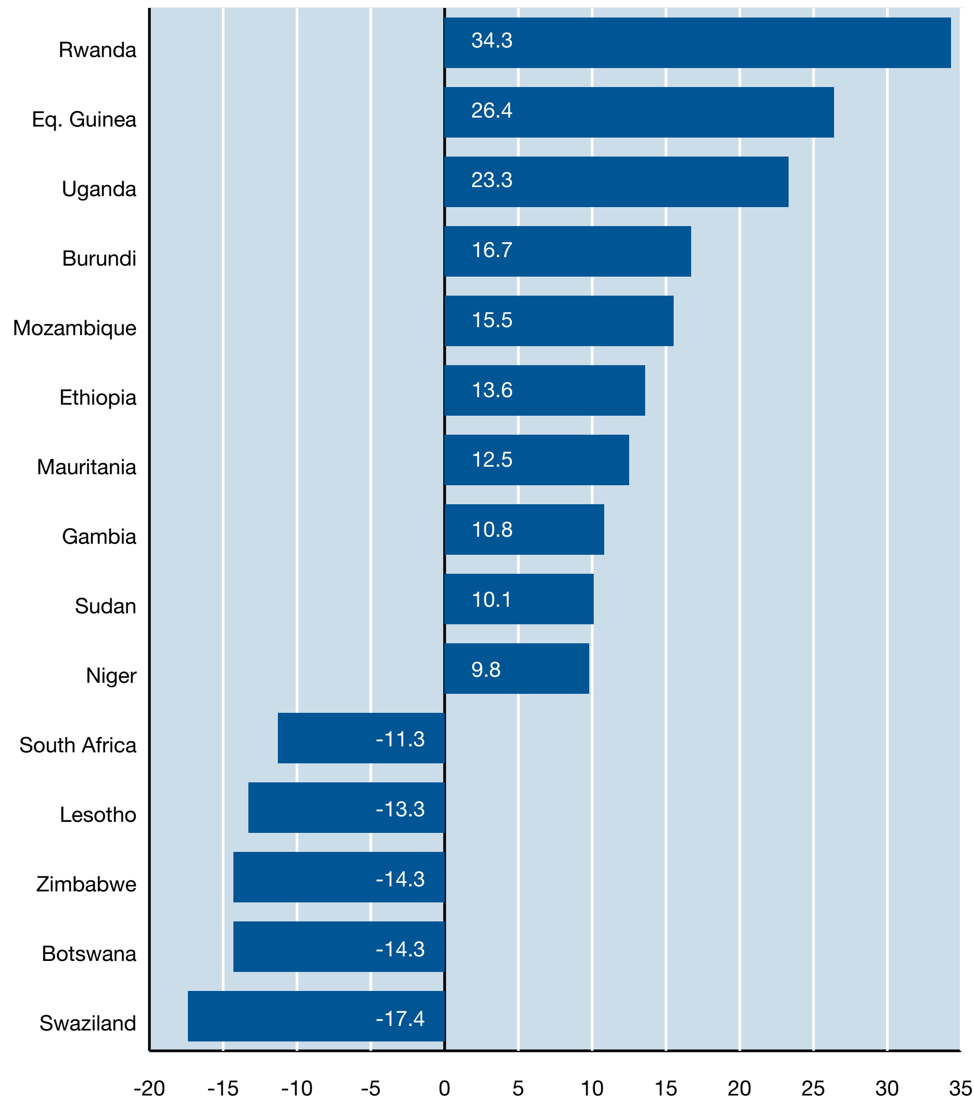
Nevertheless, there are large variations in performance in human development across the continent. Many African countries registered substantial increases in HDI over the past years, while others experienced deterioration in living standards (see figure 1.9). Note that six of the top performers in human development also rank among the top performers in medium-term growth as indicated in figure 1.5 (Equatorial Guinea, Ethiopia, Mozambique, Rwanda, Sudan, and Uganda). Top performers in human development include post-conflict countries, such as Rwanda, Uganda, and Mozambique, which also posted high growth rates in the past few years. The decline in HDI in Southern African countries as shown in figure 1.9 can be attributed to the worsening health situation due to HIV/AIDS.[7]

6 HDI measures a country's achievements in three aspects of human development: longevity, knowledge, and a decent standard of living. Longevity is measured by life expectancy at birth; knowledge is measured by a combination of the adult literacy rate and the combined gross primary, secondary, and tertiary enrolment ratio; and standard of living, as measured by GDP per capita.

7 In 2003, southern African countries exhibiting high HIV/AIDS prevalence rates were: Botswana (37.3%), Lesotho (28.9%), South Africa (21.5%), and Swaziland (38.8%).

Figure 1.9

Top 10 and bottom 5 performers in human development, % change in HDI between 1995 and 2003



***Source**: UNDP, Human Development Report 2005*

While many African countries are experiencing worsening social conditions, several have made progress toward meeting the MDGs, as measured by gains in various dimensions of social development, such as higher access to clean water and sanitation, increase in literacy, reduction in maternal and child mortality, and overall improvement in life expectancy (UNECA 2005). For example, out of the 51 countries with adequate data, child mortality declined in 34, stagnated in 9, and increased

in 8 countries (table 1.3).[8] Progress in social development is hampered by inequality, with poorer families experiencing slower progress than rich households. For example, about 38 per cent of children from the poorest 20 per cent of African households do not go to school, compared to 12 per cent for the richest 20 per cent of the households (UN 2005). Similar disparities are observed in the area of immunization and access to basic social services (UNDP 2005). The evidence suggests that while progress has been made in some countries, all African countries still need to increase efforts to accelerate progress towards achieving the MDGs.

"Progress in social development is hampered by inequality"

Table 1.3

Progress in achieving the MDGs in Africa

Goals	Countries that are likely to achieve the targets
Goal 1: Eradicate extreme poverty and hunger	Poverty: Botswana, Burkina Faso, Cameroon, Ghana, Lesotho, Mauritius, South Africa, Uganda and North African countries except Mauritania and Sudan. Child malnutrition: Botswana, Chad, Egypt, Gambia, and Tunisia. Overall undernourishment: Angola, Ghana, Malawi, Mauritius and North African countries except Sudan.
Goal 2: Achieve universal primary education	Net enrolment and completion rates: Algeria, Botswana, Cape Verde, Egypt, Gabon, Mauritius, Namibia, Swaziland, Rwanda, São Tomé and Principe, Seychelles, South Africa, Togo, Tunisia, and Zimbabwe
Goal 3: Promote gender equality	Primary level education: Botswana, Lesotho, Mauritius, Namibia, Rwanda, Swaziland, South Africa, Malawi, Zambia and Zimbabwe. Secondary level: Algeria, Botswana, Lesotho, Libya, Namibia, Zimbabwe, Mauritius, Swaziland, South Africa, Rwanda and Tunisia
Goal 4: Reduce child mortality	Cape Verde, Mauritius, Malawi, Seychelles and North African countries except Mauritania and Sudan.
Goal 5: Reduce maternal mortality	Botswana, Cape Verde, Gambia, Mauritius and North African countries except Mauritania and Sudan.
Goal 6: Combat HIV/AIDS, malaria and other diseases	HIV/AIDS: Botswana, Uganda and Zimbabwe. Malaria: Benin, Cameroon, Central African Republic, Comoros, Gambia, Guinea-Bissau, Kenya and Rwanda. Tuberculosis: Angola, Gabon, Gambia, Madagascar, South Africa, Swaziland, Zambia and North African countries except Mauritania and Sudan in all the three cases (HIV/AIDS, Malaria, and Tuberculosis)

8 Note that the progress report in table 1.3 is based on performance over 1990-2000 and does not take into account progress and setbacks thereafter. For example, Mauritania and Sudan experienced regression in child health status due to the effects of political instability.

Goals	Countries that are likely to achieve the targets
Goal 7: Ensure environmental sustainability	Sustainable development (forest area): Cape Verde, Gambia, Swaziland and North African countries except Mauritania and Sudan. Access to safe drinking water (rural): Algeria, Botswana, Burundi, Central African Republic, Egypt, Gambia, Ghana, Mauritius, Malawi, Sudan, Tanzania, and Namibia. Access to sanitation (urban): Algeria, Benin, Cameroon, Egypt, Ghana, Libya, Malawi, Mauritius, Morocco, South Africa and Tunisia.

***Source**: UNECA, 2005. **Survey of Economic and Social Conditions in Africa 2004-2005**. Addis Ababa, Ethiopia.*

Inequality remains high and hampers progress in poverty reduction

Another important challenge that limits progress in poverty reduction is the high levels of inequality in many African countries. Inequality manifests itself in various forms: income inequality, asset inequality, and inequality in access to education, health services, and labour markets. Moreover, in addition to vertical inequality, evidence continues to show substantial horizontal inequality across the continent. Empirical evidence suggests that high inequality substantially reduces the rate at which growth is transformed into poverty reduction (Fosu 2006). Therefore, in addition to strengthening strategies for accelerating growth, achievement of broad-based development must remain one of the priorities in debates over national economic policy.

"Accelerating growth and broad-based development must remain a priority"

Progress in closing the gender gap is still not enough

African countries continue to exhibit pervasive gender inequality in basic rights, access to productive resources and economic opportunities, and lack of political voice. The international development community has come to the realization that the issue of gender inequality can no longer be relegated to the domain of advocacy, but must occupy the centre stage in the economic development policy discourse (World Bank 2001). The focus on gender inequality is illustrated by the large and growing number of national and international declarations and conventions on the issue. However, actual implementation of these declarations remains weak, perhaps because of the lack of effective institutional backing.

There are important reasons why African policymakers should pay attention to gender inequality and seek ways to eliminate it. One overriding reason is that while gender inequality harms women primarily, it also imposes heavy costs on society as a whole. Inequalities in basic rights and access to schooling, credit and jobs affect not only women and girls but the entire society.

Inequalities in basic rights and access to schooling, credit and jobs affect not only women and girls but the entire society

It is encouraging that throughout the continent, there are visible gains in closing the gender gap, especially in education. Girl enrolment rates in elementary and secondary schools have increased substantially, and often faster than those of boys (table 1.4). Consequently, the ratios of female to male enrolment and primary school completion rates have increased in many countries.

It is also clear that some countries still exhibit large gender gaps in education regardless of the progress achieved over the past years. Women are especially lagging behind in higher education, with only a few countries reaching gender parity in recent years (figure 1.10).

Table 1.4

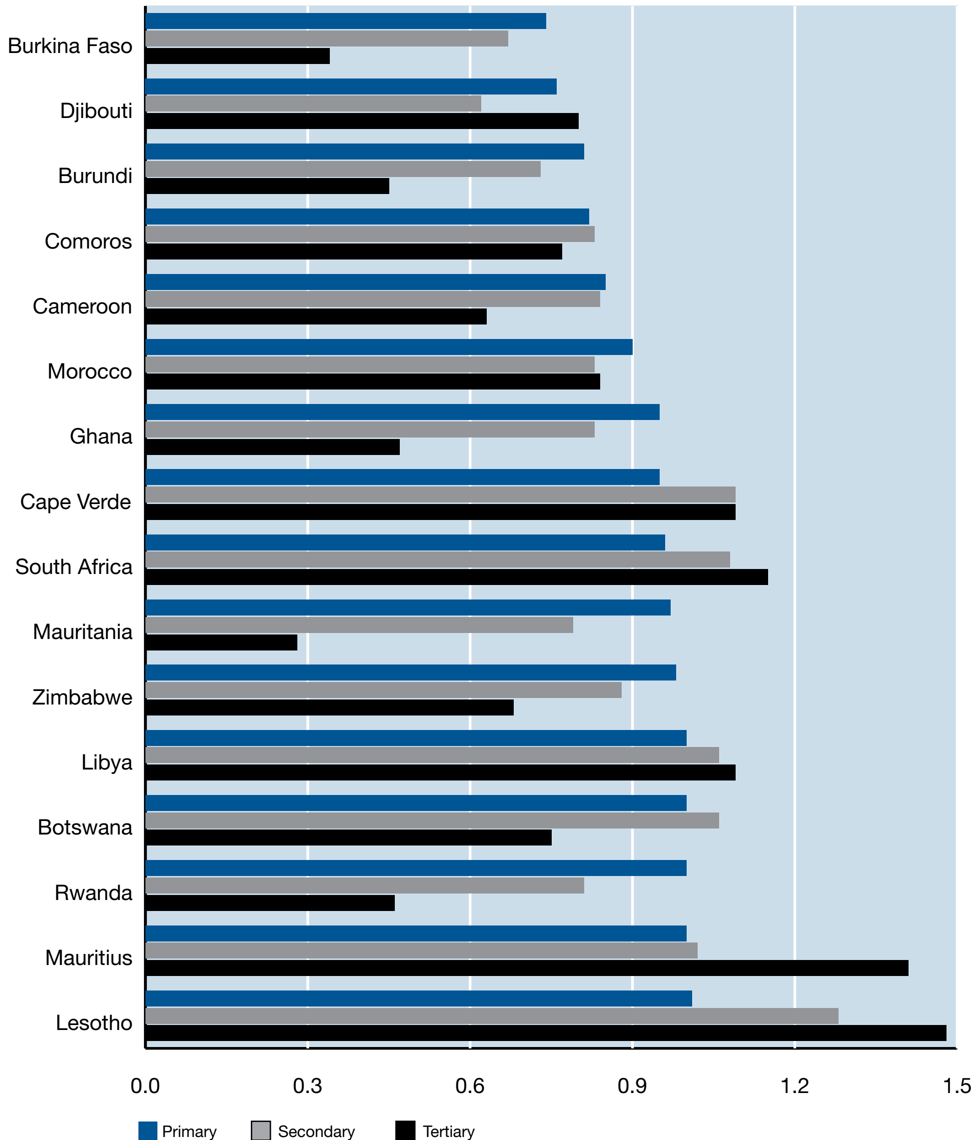
Gender gap in education, 1990-2002

	Ratio of girls to boys in primary school		Ratio of young literate females to males (% of age 14-25)		Ratio of female to male primary completion rate	
	2002	% change 1990-2002	2002	% change 1990-2002	2002	% change 1990-2002
Algeria	98.6	18.3	91.1	15.1	0.99	16.3
Burundi	79.4	-2.9	96.9	26.3	0.72	-16.0
Chad	58.8	41.9	84.4	30.7	0.47	108.4
Comoros	82.2	15.7	79.5	2.2	0.89	n.a.
Djibouti	71.2	1.7	91.2	16.7	0.84	n.a.
Ethiopia	n.a.	n.a.	82.1	24.3	0.54	n.a.
Ghana	91.0	18.5	95.7	11.9	1.05	38.7
Madagascar	n.a.	n.a.	92.5	8.1	1.03	-0.4
Malawi	92.5	14.7	76.7	13.5	0.96	23.6
Mali	71.3	22.5	n.a.	n.a.	0.64	-0.7
Mauritania	93.8	38.9	72.7	12.0	0.90	38.1
Morocco	87.8	25.2	79.2	28.2	0.89	30.8
Mozambique	79.0	8.2	64.3	34.2	0.67	3.0
Niger	69.0	24.0	44.4	18.8	0.71	25.3
Rwanda	94.8	-1.6	96.9	12.1	0.95	-5.3
Senegal	87.1	27.2	72.5	20.1	0.81	n.a.
South Africa	100.4	-2.7	100.0	0.2	1.06	n.a.
Sudan	85.8	10.9	88.5	23.7	0.85	4.5
Swaziland	94.4	-2.1	101.8	0.9	1.05	-3.3
Uganda	96.3	24.7	85.7	13.1	0.86	n.a.
Zimbabwe	95.4	-0.7	97.3	2.9	0.94	0.0

***Source**: World Bank, **World Bank African Database** 2005 CD ROM and **World Development Indicators** 2005 CD ROM*

Figure 1.10

Gender gap in enrolment (female/male ratio) in 2002.



Source**: World Bank, **World Development Indicators 2005.

***Note**: The figure includes only countries with adequate data.*

The case of conflict and post-conflict countries

Post-conflict countries face particular challenges arising from the effects of war and the immense financial needs associated with reconstruction. These countries are faced with the challenge of making myriad policy priorities, from infrastructure and energy

to social service delivery and from macroeconomic stabilization to micro-level and regulatory reforms. Nonetheless, many post-conflict countries have recorded high growth rates in recent years, due primarily to the restoration of peace, but also to government efforts to invest in reconstruction often with generous support from the donor community.[9] Countries such as Mozambique, Rwanda, and Uganda are good examples of economies achieving strong performance in their post-conflict era.

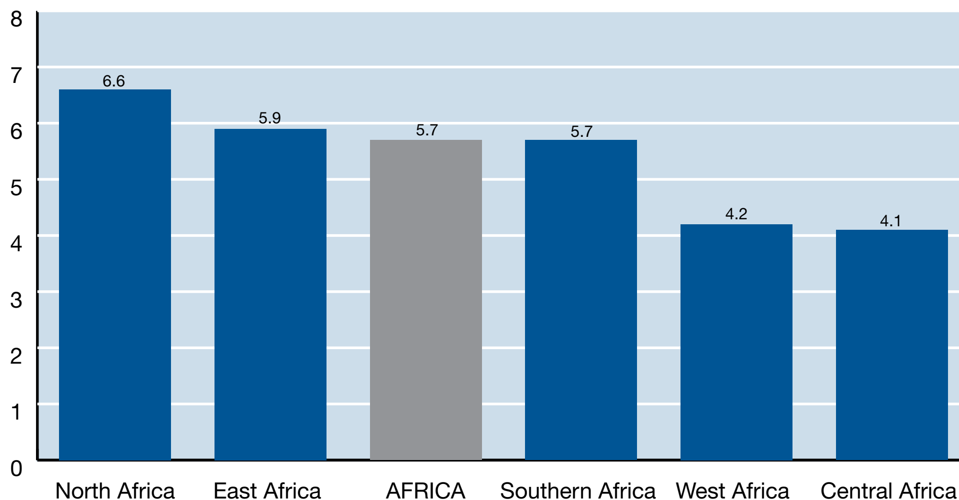
"Peaceful settlements of conflicts must be initiated and sustained for meaningful development and poverty reduction"

Countries that are still in conflict face even bigger challenges with regard to development, employment creation and poverty reduction. Insecurity in these countries also threatens economic activity and political stability in neighbouring countries and beyond. Efforts at the national, regional, and international level must be initiated and sustained to achieve peaceful settlement of conflicts and also to establish institutional mechanisms of democratic governance as a way of preventing future conflicts (Fosu 2005).

1.6 Growth prospects for 2006 are positive

Africa is expected to continue with the strong growth performance posted over the past two years. The growth rate is projected at 5.7 per cent in 2006, with North Africa leading all the subregions with a growth rate of 6.6 per cent (figure 1.11). As many as 31 countries are anticipated to post higher growth than in 2005. Growth performance will be driven by several factors, which are discussed below.

Figure 1.11
Projected real GDP growth rates by subregion, 2006 (%)



Source: *EIU, September 2006.*

9 A.K. Fosu, and P. Collier, eds. (2005). *Post-Conflict Economies in Africa*. New York: Palgrave Macmillan.

Favourable factors for growth

Oil export revenues are expected to remain high

Oil-rich countries are expected to benefit from continued strong performance in exports thanks to high international oil prices. However, the gains from the oil boom accruing to oil economies will be counterbalanced by the adverse effects of higher energy costs on growth among non-oil economies.

Global demand will support higher exports

Global demand for African products – especially oil, minerals and agricultural – is expected to remain upbeat due to economic recovery in major industrial countries. Tourism will also benefit from strong growth in industrialized countries. While growth in the Euro area is expected to be moderate, the United States and emerging Asian economies – led by China – are likely to experience substantial growth in the coming two years (Board of Governors of the Federal Reserve System, 2006).

Delivery of promised new aid and debt relief will boost domestic expenditure

Delivery of the promised aid and debt relief will allow African countries to boost expenditures in key sectors including infrastructure and social services. Higher investments in public infrastructure will contribute to lowering private production costs, which will improve the investment climate. This will boost private investment and lead to higher economic growth rates.

Better macroeconomic fundamentals will serve to contain long-term inflation expectations

Success in consolidating macroeconomic management will help not only in containing inflation in the short run, but also in containing long-term inflation expectations. This will in turn help in maintaining low long-term interest rates, thus reducing the cost of long-term borrowing for the government and the private sector. Containing long-term inflation expectations is also necessary to minimize the lasting effects of short-term shocks to the price level, such as energy price hikes.

Improved political stability

Some countries such as Burundi, the DRC, Liberia and Sierra Leone, are expected to benefit from improvements in political stability. Consolidation of political stability will necessitate support from the international community both financially and

politically. The dividends from such support are high in terms of economic recovery and peace building, both at the country and regional levels.

Constraints to medium-term growth

The rise in world interest rates will increase the cost of debt servicing

To contain inflationary pressures, the United States and other major industrial countries will likely pursue their "prudent" tightening of monetary policy by raising short-term interest rates (FRB 2005). Higher world interest rates will raise the cost of external debt service for African countries, which will dampen growth.

Droughts remain a threat to agricultural production

Agricultural production is expected to be severely affected by climatic shocks, including droughts, floods, and desertification in the Sahel.

The HIV/AIDS pandemic remains a threat to labour supply and labour productivity

Economic growth in many countries will be compromised by the increasing spread of the HIV/AIDS pandemic, which undermines labour supply and labour productivity.

Insufficient economic diversification remains an important source of vulnerability to shocks

Lack of diversification of production and exports constitutes an important source of potential instability and vulnerability to shocks. Oil economies are particularly vulnerable to swings in international prices. Competitive pressure from emerging economies, such as China and India, is a challenge to manufacturing sector growth.

Inefficient and inadequate public infrastructure remains a constraint to private sector growth and economic diversification

Lack of efficient public infrastructure and unreliable energy supply undermine productivity and international competitiveness, which ultimately slows down economic growth.

1.7 Conclusion and policy recommendations

The evidence surveyed in this chapter calls for a number of policy recommendations, including the following:

Consolidating macroeconomic management

At the macroeconomic policy level, African countries need to continue to pursue fiscal discipline and prudent monetary policy to consolidate macroeconomic stability. Efficient macroeconomic management will, among other gains, reduce inflation expectations, which will minimize long-term effects of supply shocks such as oil price increases.

Promoting economic diversification

The concentration of growth in natural resource sectors exposes African countries to terms-of-trade shocks. Efforts must be enhanced to promote new investments in manufacturing and service sectors to reduce vulnerability to these types of shocks and dependency on commodity exports.

Alleviating energy and public infrastructure bottlenecks

The provision of public infrastructure and reliable energy sources is essential for unlocking the potential of the private sector and increasing access to social services and markets for the poor; it is an important element of the poverty eradication agenda. Improvement of the stock of infrastructure and creation of reliable energy supply sources must then rise to the level of national priority to increase economic growth in the medium term.

Achieving greater gender equity

Efforts to increase gender equity in basic rights, access to productive resources and economic opportunities, and political voice must be supported and intensified at the national, regional and international levels.

Intensifying efforts at regional integration

Efforts at regional integration need to be intensified as a means of expanding trade opportunities and increasing the continent's leverage in world trade negotiations.

Addressing climate shocks

African countries need to invest in strategies for managing climate risk in order to increase their preparedness in handling climate shocks.

Curbing the spread of the HIV/AIDS pandemic

Public investments in preventive and educational programmes to fight the spread of HIV/AIDS will help to curb the upward trend of the epidemic while at the same time creating jobs for those who will be employed in those programmes.

Emphasizing job creation as a means of accelerating poverty eradication

In addition to raising the overall rates of economic growth, African countries need to design strategies for increasing the employment gains from growth. This will require both higher public investments in labour-intensive infrastructure and service-delivery programmes as well as providing incentives to the private sector to increase the overall labour intensity of production.

In addition, policymakers must integrate job creation in national macroeconomic frameworks. This will require, among other things, systematic tracking of the effects of monetary and fiscal policy on employment at the economy-wide level and at the sectoral level.

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