Sub-Saharan Africa
Economic Policy and Outlook for Growth

In recent years, improved policies in many sub-Saharan African countries have led to better economic performance. As policy-makers in the region work to sustain high growth rates and reduce poverty, how can they most effectively meet the challenge of globalization and create a favorable environment for domestic and foreign private investment?

Ernesto Hernández-Catá

AFTER a long period of weak performance, the economic situation in sub-Saharan Africa has improved significantly in the last few years. According to the latest available data, for the region as a whole:

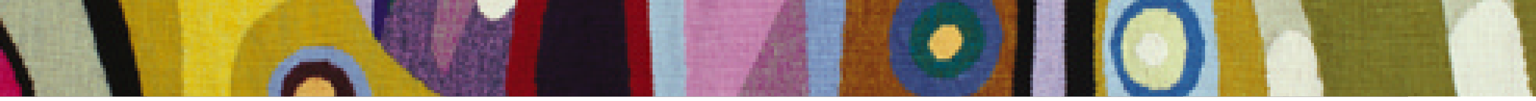
• Real GDP growth averaged 4¼ percent a year during 1995–98, up from less than 1½ percent during 1990–94. Per capita output rose at an average annual rate of 1 percent during 1995–98, compared with an average *decline* of 2¼ percent a year during the first half of the 1990s.

• After peaking at 47 percent in 1994, annual inflation dropped to 10 percent in 1998.

• The overall fiscal deficit (excluding grants) fell from almost 9 percent of GDP in 1992 to less than 5 percent in 1998.

These improvements in economic performance are encouraging because they resulted mainly from improved policies in a number of sub-Saharan African countries and not from favorable external developments. In fact, the region's aggregate performance in 1994–98 was substantially weakened by developments in 1998 that were entirely beyond the control of the national authorities, including falls in the world prices of several commodities (notably, oil), the impact of El Niño, and—for South Africa—the adverse effects of the international financial crisis. Armed conflicts in some sub-Saharan countries, in particular the Democratic Republic of Congo, also seriously affected economic activity in 1998.

The regional averages conceal large differences in performance among countries. For example, if Nigeria and South Africa (two countries that account for approximately one-half of the region's GDP) are excluded, it becomes clear that there has been a significantly stronger improvement in the rest of sub-Saharan Africa, where per capita GDP grew by 2 percent annually during 1995–98, following a 2½ percent annual drop during



1990–95. Moreover, a group of countries (including Ethiopia, Mauritius, Mozambique, Rwanda, and Uganda) experienced annual per capita GDP growth averaging well above 4 percent during 1995–98. By contrast, several countries experienced *falls* in their real per capita incomes, in some cases because of armed conflicts and the attendant economic disruptions, during 1995–98.

During the 1990s, many African countries have moved to implement important structural reforms: price controls have been abolished or liberalized; some inefficient public sector monopolies have been dismantled and many state enterprises privatized; nontariff barriers have been eliminated and import duties lowered; exchange rates have been freed and unified; and direct controls on bank credit have been eliminated and market-determined interest rates established.

Progress has now been made toward achieving macroeconomic stability. Control over government spending has improved, as reflected in a fall in the ratio of government expenditure to GDP, from a peak of 29 percent in 1992 to less than 27 percent in 1998. Moreover, the ratio of total government revenue (excluding grants) to GDP rose from an average of 20½ percent during the first half of the 1990s to 22 percent in 1998. Fiscal deficits have therefore been reduced, allowing money growth rates and inflation to decline significantly. Another important policy action was the overdue devaluation of the CFA franc in 1994, which sharply improved the badly damaged competitive position of the 13 countries then in the franc zone. Since the devaluation, those countries have experienced a strong increase in exports and a significantly better than average investment and growth performance. After a surge in prices associated with the devaluation, inflation in the zone was reduced to less than 3 percent in 1998.

The international financial crisis of 1998 will require difficult adjustments for a number of countries in the region, particularly in the oil-exporting countries, where government revenues have fallen sharply and per capita income growth dropped to zero last year and is expected to be negative in 1999. In South Africa, economic activity will take some time to recover from the high interest rates that resulted from speculative pressure on the rand in 1998. In the rest of the region, however, the drop in oil prices has had a favorable impact, broadly offsetting the effects of declines in the prices of exported commodities; growth in this subgroup of sub-Saharan countries has remained strong and is expected to strengthen further in 1999, barring an intensification of the war in central Africa.

Even if the current slowdown should prove to be transitory, the economic situation of sub-Saharan Africa will remain difficult: per capita incomes are still low; poverty is deep and widespread; and external imbalances are very large in many countries, reflecting their heavy dependence on foreign assistance. Moreover, the ratio of investment to GDP has failed to increase significantly during the 1990s and remains very low compared with other developing regions.

Has a turning point been reached?

Looking ahead, two important questions need to be asked. First, has the external environment facing policymakers in sub-Saharan Africa changed in a fundamental way? Second, can the region's relatively favorable performance of the past four years be sustained?

The answer to the first question is that the external environment has indeed changed, for at least two reasons: first, because official development assistance, on which most countries in the region have depended, is shrinking and, second, because globalization is proceeding inexorably and sub-Saharan Africa must decide how to live in a more complex and more competitive world.

Flows of official development assistance to sub-Saharan Africa have been declining, reflecting both disappointment with foreign aid programs and budgetary pressures in the donor countries. This trend is likely to continue and will require difficult adjustments in many African countries. At the same time, the decline in official development assistance will make it clear that, in the future, higher living standards will have to be achieved through efforts to attract higher private investment, domestic and foreign, and to increase the productivity of both capital and labor.

Globalization is another major challenge. Africa has little to lose from globalization (capital already flows *out* despite controls) and much to gain, provided it is accompanied by policy changes in several areas. First, transaction costs, which are very high in Africa, need to be reduced. In particular, transportation is expensive because of monopolistic, cartelized, and/or subsidized sea, air, and rail links. Globalization coupled with a reduction in transaction costs could shift comparative advantage toward manufacturing and raise output while helping to diversify the region's economy. Second, fiscal policy will have to shift toward the provision of infrastructure and education to prevent local capital from being moved to other countries where the quality of physical and human capital is higher. Third, a further reduction in barriers to foreign trade, which are still high in most sub-Saharan countries, would improve resource allocation and increase competition. Given the dependence of many governments on revenue from import duties, however, trade liberalization will have to be accompanied by the development of alternative revenue sources, including through the elimination of exemptions. Finally, more African countries will have to deal with episodes of large and potentially reversible inflows of foreign capital (a problem that has already been confronted by South Africa and a few other countries in the region). This will require strong fiscal policies and prudent debt management, tough bank supervision, and flexible monetary policies.

Sustaining high growth rates

The recent improvement in growth in sub-Saharan Africa reflects, in part, increased utilization of existing capacity. Sustaining high growth, however, will require higher investment rates and a steady rise in total factor productivity, or both.

It is encouraging that the ratio of investment to GDP has increased substantially since 1995, both among the countries with high growth rates that were mentioned earlier and in the CFA franc zone. For sub-Saharan Africa as a whole, however, the ratio of total investment to GDP has shown little improvement; in 1998 it was about 17 percent, compared with 29 percent in the developing economies of Asia and 22 percent in those of the Western Hemisphere. Moreover, the ratio of private investment to total investment in sub-Saharan Africa is significantly lower than in the newly industrialized economies of Asia and in Latin America, and much lower than in the advanced economies.

Ernesto Hernández-Catá is the Associate Director of the IMF's African Department.

Capital formation in sub-Saharan African countries has been hindered by perceptions of high risks resulting in part from the absence of well-established institutional and legal infrastructures to support market transactions—including adequate protection of property rights—and by instances of economic and political instability. The experiences of other developing countries indicate that a stable financial and macroeconomic environment can go a long way toward reducing the degree of uncertainty investors face. But beyond the macroeconomic fundamentals, legal and institutional changes are necessary to ensure that both domestic and foreign investors are effectively protected against sudden and arbitrary changes in the economic environment and the rules of the game.

Investment in sub-Saharan countries is also constrained by a shortage of capital. During 1995–98, domestic saving rates in Africa averaged 16 percent, compared with 18 percent for the developing countries in the Western Hemisphere and 33 percent for the newly industrialized economies in Asia. Higher saving rates would support higher investment while helping to reduce many sub-Saharan countries' excessive reliance on foreign savings. These will not be easy to achieve, particularly in view of the low income levels in most sub-Saharan countries. Governments will need to improve their fiscal positions without squeezing spending on education, public health, and infrastructure. To encourage private saving, the focus will have to be on extending financial sector reforms, promoting free entry into the banking system, raising interest rates to market-clearing levels, and providing reasonable assurance that savings will not be confiscated or eroded by inflation or other taxes.

Stronger growth also will require improvements in total factor productivity—that is, in the technological, administrative, and economic factors that determine the rates of return on both capital and labor. As noted previously, sub-Saharan Africa's relative lack of openness reduces efficiency and productivity by distorting resource allocation and increasing transaction costs. Also, policies have often been biased against agriculture through measures that reduce incentives to produce agricultural goods (such as price controls, export taxes or quotas, and import subsidies) or protect nonagricultural production. There are now good prospects, however, for the liberalization of important sectors like cocoa, coffee, and cotton in several West African countries, which would have far-reaching beneficial effects on both economic efficiency and income distribution.

Other measures to raise productivity include the expansion of privatization, an area where sub-Saharan African countries still lag behind other developing countries—for example, those in Latin America; civil service reform to reduce the wage bill for budgetary reasons and rationalize the salary structure to provide adequate pay and reward merit; banking reform, including the strengthening of supervision and increasing domestic and foreign competition; and, in some countries, labor market reforms aimed at improving flexibility and competitiveness to reduce structural unemployment.

Conclusion

In the last four years, Africa's economic performance has improved. Growth has picked up as a number of countries have pursued policies conducive to macroeconomic stability and greater efficiency in production. In many countries, budget deficits have been reduced, inflation has been lowered, the process of privatization has intensified, and the financial sector has been liberalized. Moreover, a serious effort to liberalize external trade and agriculture is under way in several countries, and the need to improve the legal system is beginning to receive the attention it deserves. Because of globalization and the tendency for official development assistance to decline over time, sub-Saharan Africa is at a turning point. What countries in the region need to do now is pursue policies that will enable them to consolidate the gains they have made and achieve a lasting increase in the region's growth rate.

The achievement of sustained, high growth in Africa requires an increase in investment—in particular, in private investment. This will require both the maintenance of a stable macroeconomic environment and far-reaching improvements in governance to avoid capricious interference in private activity and to develop and maintain a transparent and stable legal and regulatory environment that reduces the risks that currently discourage private domestic and foreign investors. It will also require the end of armed conflicts that destroy human and physical wealth and divert resources from education, health, and infrastructure. F&D

This article is based on a previous paper by Stanley Fischer, Mohsin S. Khan, and Ernesto Hernández-Catá, 1998, "Africa: Is This the Turning Point?" IMF Paper on Policy Analysis and Assessment 98/6 (Washington).