OECD DEVELOPMENT CENTRE www.oecd.org/dev/insights

Policy Insights No. 6

African Economic Performance in 2004: A Promise of Things to Come?

by Nicolas Pinaud and Lucia Wegner

Policy Insights No. 6 is derived from the *African Economic Outlook 2004/2005*, a joint publication of the African Development Bank and the OECD Development Centre
www.oecd.org/dev/aeo

Against a backdrop of sustained global growth and high commodity prices, Africa has experienced its best economic performance in many years. While recent economic performance is not merely driven by favourable external factors, African economies still lack proper "shock-absorbers" to withstand internal (e.g. drought and floods, political instability, HIV-Aids, etc.) and external (e.g. volatility of commodity prices and exchange rates) shocks alike. They remain strongly vulnerable. In this context, creating the conditions for the development of indigenous drivers of economic activity (starting with a thriving local private sector) is a top priority.

Growth in Africa: Best Performance in Years

Africa is currently experiencing its best economic performance in many years. The continent's economies are benefiting from global expansion, notably through higher demand for commodities at higher prices; improved domestic macroeconomic management; and the easing of conflicts in many countries. While serious problems persist – including the humanitarian catastrophe in western Sudan, the political hardening in Zimbabwe, and conflicts in Côte d'Ivoire – prospects for much of Africa appear to remain more favourable than they have been for many years.

The aggregate eight-year high of 5.1 per cent growth in 2004 masks striking divergences at country levels. Surges in oil and metal prices, the dollar depreciation, record low cotton prices, and a locust plague in the Sahel region, affected individual countries differently.

The global economic recovery and the general rise in global commodity prices gave a positive impetus to African oil and metal exports. Some oil exporters also benefited from new oil fields in Southern and Central Africa (Angola, Chad and Equatorial Guinea). However, West African countries are facing losses from lower prices for cotton and cocoa. The sharp euro appreciation has adversely affected the Franc Zone countries, while the strengthening of the rand has affected the Southern African economies whose currencies are pegged to it.

Africa benefited from the rise in official aid in the last three years, although much of the increase was due to emergency assistance and debt relief. Good performers, such as Ethiopia, Mozambique and Tanzania, accounted for the bulk of aid; conversely, aid to Zimbabwe and the Central African Republic has decreased considerably, reflecting mounting governance problems. Despite rising aid levels, the Millennium Development Goals (MDGs) remain underfinanced (by more than $40 billion, overall) and progress on most of the eight goals set for 2015 remains limited (see table).

Favourable weather conditions in Eastern, Central, and Southern African translated in a rebound in agricultural production (mainly in Ethiopia, Malawi, Zambia and Rwanda). In contrast, agricultural output in West Africa suffered from locust infestation, although its impact was limited by early treatment of infested areas.

Prudent macroeconomic policies have helped economic recovery. Inflation has reached overall historical lows, despite increasing oil prices. Low world-wide inflation benefited countries with pegged exchange rates, such as CFA franc countries, while prudent monetary policy played a key role in an increasing number of floating-rate countries. The windfall gains from commodity prices have improved public finances in oil-exporting countries.

Progress Towards Achieving the Millennium Development Goals

		Goal 1	Goal 2		Goal 3		Goal 4	Goal 7	
		Eradicate extreme poverty and hunger	**Achieve universal primary education**		**Promote gender equality and empower women**		**Reduce child mortality**	**Ensure environmental sustainability target**	
Targets		Halve the % of people suffering from hunger	Ensure that all children can complete primary school		Eliminate gender disparity in all levels of education		Reduce by 2/3 under-5 infant mortality rates	Halve the % of people without access to safe water	Number of Goals on target to be achieved
Indicators		Undernourished people	Net primary enrolment ratio	Children reach grade 5	Female primary ratio as % of male ratio	Female secondary ratio as % of male ratio	Under five mortality rates (per 1000 lives)	Access to improved safe water	
HDI Rank		(as % of population)	(%)	(%)				(%)	
106	Algeria	Slipping back	On track	On track	On track	On track	Slipping back	Slipping back	**4 of 7**
161	Angola	Slightly off	On track	..	..	..	Slipping back	On track	**2 of 7**
158	Benin	on track	On track	..	Far behind	Far behind	Far behind	On track	**3 of 7**
126	Botswana	Slipping back	Achieved	On track	Achieved	Achieved	Slipping back	On track	**5 of 7**
169	Burkina Faso	on track	Slipping back	..	Far behind	..	Far behind	On track	**2 of 7**
171	Burundi	Slipping back	Slightly off	..	Far behind	..	Far behind	On track	**1 of 7**
135	Cameroon	Slightly off	Slightly off	..	..	..	Slipping back	On track	**1 of 7**
100	Cape Verde	..	On track	..	Achieved	Achieved	On track	On track	**5 of 7**
165	Central African Republic	Far behind	Far behind	..	..	..	Far behind	Achieved	**1 of 7**
166	Chad	on track	Far behind	Far behind	Far behind	Far behind	Far behind	On track	**2 of 7**
137	Comoros	Slipping back	Slightly off	..	..	On track	On track	Achieved	**3 of 7**
136	Congo	Slightly off	On track	..	On track	Far behind	Far behind	..	**2 of 7**
155	Congo, Dem. Rep.	Slipping back	..	..	On track	..	Far behind	..	**1 of 7**
156	Côte d'Ivoire	Slightly off	Slipping back	Far behind	Far behind	Far behind	Slipping back	On track	**1 of 7**
149	Djibouti	on track	Slipping back	Slipping back	Far behind	On track	Far behind	Achieved	**3 of 7**
115	Egypt	on track	On track	..	On track	On track	On track	Achieved	**6 of 7**
111	Equatorial Guinea	..	On track	..	..	..	On track	..	**2 of 7**
157	Eritrea	Far behind	Slightly off	..	..	..	On track	On track	**2 of 7**
168	Ethiopia	Slipping back	Far behind	..	Slipping back	Slipping back	Far behind	Slightly off	**0 of 7**
117	Gabon	Slipping back	Achieved	..	Achieved	..	Far behind	..	**2 of 7**
160	Gambia	Far behind	On track	..	On track	On track	Far behind	..	**3 of 7**
129	Ghana	Achieved	On track	..	On track	..	Slightly off	Achieved	**4 of 7**
159	Guinea	Slipping back	Far behind	..	On track	Far behind	On track	Far behind	**2 of 7**
167	Guinea Bissau	..	Far behind	..	..	..	..	..	**0 of 7**

134	Kenya	Far behind	Achieved	..	Achieved	On track	Slipping back	Slightly off	**3 of 7**
132	Lesotho	Slightly off	Achieved	..	Achieved	Achieved	Far behind	On track	**4 of 7**
999	Liberia	Slipping back	Slightly off	..	..	..	Far behind	..	**0 of 7**
64	Libya	Achieved	Achieved	..	..	..	On track	Far behind	**3 of 7**
147	Madagascar	Slipping back	Achieved	..	Achieved	Achieved	Far behind	Far behind	**3 of 7**
163	Malawi	on track	On track	..	Achieved	On track	Slightly off	Slightly off	**4 of 7**
164	Mali	Far behind	Far behind	On track	On track	Slipping back	Far behind	On track	**3 of 7**
152	Mauritania	on track	On track	Slipping back	On track	Far behind	Far behind	Far behind	**3 of 7**
67	Mauritius	on track	Achieved	On track	Achieved	Achieved	On track	Achieved	7 of 7
123	Morocco	Slipping back	On track	Far behind	On track	On track	On track	On track	**5 of 7**
170	Mozambique	Slightly off	Slipping back	..	Far behind	Far behind	Far behind	..	**0 of 7**
122	Namibia	Achieved	Achieved	..	Achieved	Achieved	Far behind	Achieved	**5 of 7**
172	Niger	Slightly off	Far behind	..	Far behind	..	Far behind	..	**0 of 7**
148	Nigeria	Achieved	Slightly off	..	Slightly off	..	Far behind	Slightly off	**1 of 7**
162	Rwanda	Far behind	Achieved	..	Achieved	..	Slipping back	..	**2 of 7**
119	São Tomé and Principe	..	On track	..	..	..	Far behind	..	**1 of 7**
154	Senegal	Slipping back	On track	On track	On track	Far behind	Far behind	On track	**4 of 7**
47	Seychelles	..	Achieved	On track	..	..	On track	..	**3 of 7**
173	Sierra Leone	Slipping back	..	..	On track	..	Far behind	..	**1 of 7**
999	Somalia	Slipping back	..	..	..	..	Far behind	..	**0 of 7**
107	South Africa	..	On track	..	On track	Achieved	Slipping back	On track	**4 of 7**
139	Sudan	on track	Slightly off	..	Slightly off	On track	Far behind	On track	**3 of 7**
125	Swaziland	Far behind	On track	Far behind	On track	On track	Slipping back	..	**3 of 7**
151	Tanzania	Slipping back	Achieved	Far behind	Achieved	On track	Far behind	Achieved	**4 of 7**
141	Togo	on track	On track	..	Far behind	Far behind	Far behind	Far behind	**2 of 7**
97	Tunisia	Achieved	Achieved	On track	Achieved	On track	On track	On track	**7 of 7**
150	Uganda	Slightly off	On track	..	On track	Far behind	Slightly off	Slightly off	**2 of 7**
153	Zambia	Slipping back	Slipping back	..	On track	..	Slipping back	On track	**2 of 7**
128	Zimbabwe	Far behind	On track	..	Achieved	Far behind	Slipping back	On track	**3 of 7**
	Achieved	**5**	**12**	**0**	**13**	**7**	**0**	**8**	
	On track	**10**	**19**	**7**	**16**	**12**	**11**	**19**	
	Slightly off	**8**	**7**	**0**	**2**	**0**	**3**	**5**	
	Far behind	**8**	**7**	**5**	**9**	**11**	**27**	**5**	
	Slipping back	**16**	**5**	**2**	**1**	**2**	**11**	**1**	
	No data	**6**	**3**	**39**	**12**	**21**	**1**	**15**	
	Total	**53**	**53**	**53**	**53**	**53**	**53**	**53**	
	Satisfactory Performance Ratio *(Achieved and On track)*	**28.3%**	**58.5%**	**13.2%**	**54.7%**	**35.8%**	**20.8%**	**50.9%**	

Source: African Development Bank and OECD Development Centre, *African Economic Outlook* (2004/2005), Table 5 in Overview.

Solid Growth in Sight, but There Are Risks

Solid growth is expected to continue in 2005 and 2006 – although at a slightly lower rate of 4.7 per cent in 2005 as the effect of new Central African oil fields ends. West Africa is expected to recover in 2005 and 2006, while the trend of positive growth in Eastern Africa and Southern Africa will continue over the next two years, reflecting rising oil production in Angola and improved performance in South Africa. This positive outlook is however highly dependent on the continuous expansion of the global economy, an overall easing of regional conflicts, and favourable weather conditions.

African economies are still likely to be confronted with external or internal, global or idiosyncratic shocks. Positive prospects might be derailed by:

- A slowdown of the global economy: imbalances at the global level are building up (starting with large US current account and fiscal deficits and China's near overheating) and macro-adjustments are therefore bound to occur. They would bring down commodity prices, cause a further slide of the US dollar and might raise global interest rates. As a result, African countries would suffer from a worsening of their terms of trade, diminished competitiveness (especially for countries pegged to the euro) and, for some at least, rising financing costs (e.g. South Africa).

- The spectre of regional conflicts. In Africa these remain the strongest threat to democracy and human rights on the continent, and menace economic performances and poverty alleviation alike. The Democratic Republic of Congo is in the midst of transition to peace and democracy, but new fighting in the east could threaten that progress. In Côte d'Ivoire and in Sudan's Darfur region, conflicts have lingered and their spilling-over onto neighbours can not be fully ruled out.

- Adverse weather conditions and parasites infestations have the potential to destroy crops on which some African countries are strongly reliant for growth, household income, rural poverty alleviation, exports and fiscal revenue.

This is thus a strong case for reducing the vulnerability of African countries. Policies are needed that facilitate the adjustment of African countries to the changing environment, such as swings in commodity prices (e.g. cotton) and changes in international trade arrangements (e.g. removal of textile quotas).

The capacity to absorb the expected higher donor assistance must be increased. This will require ambitious reforms, in particular if the MDGs are to be reached while macroeconomic stability is maintained.

Finally, economic diversification needs to be encouraged through structural reforms, an improved environment for the private sector, and enhanced governance.

Africa and its International Environment: Taking up the Challenges of Aid Quality and Competitiveness

Aid flows need to increase, but aid also needs to be more effective!

High expectations surround the G8 summit in July this year, where significant action is expected to be taken to provide further debt relief, underpin pro-poor trade liberalisation and generate more aid. Yet the aid system remains highly fragmented. Over the past two years, new initiatives to simplify procedures and practices, to focus on delivery of development results, and to adopt common arrangements for sector-wide approaches and budget support which allow for greater reliance on national systems and improved donor co-ordination have made uneven progress. Projects remain the dominant mode of delivering aid, often channelled through donor-managed parallel structures. Historical ties and strategic interests continue to determine aid allocation, turning some recipients into "donor darlings" or "donor orphans".

Aid flows should also be made more predictable and thus contribute to effectiveness. Only a minority of bilateral donors now provide future aid commitments. Volatility in aid flows deeply compromises the ability of African governments to plan future public expenditures – and to undertake the strategic incremental investments required to meet long-term development objectives.

In parallel, local ownership of the reform program needs to be fostered, taking into account recipient-country diversity, including their capacity to absorb aid, ability to raise internal or external resources, and special circumstances such as shocks or conflicts.

African competitiveness needs to be enhanced

The Doha round of multilateral trade talks started in 2001 with the promise of reducing agricultural subsidies in developed countries and tearing down the trade barriers that hinder market access for African goods. Progress so far has been very limited, especially on agricultural liberalisation. Despite the impressive efforts to reform the cotton sector undertaken by Benin, Burkina Faso, Chad and Mali the persistence of cotton subsidies elsewhere has depressed world prices and damaged their cotton industry.

From January-July 2004 a new agreed framework emerged, which calls for the elimination of export subsidies, in particular in the cotton sector, and the reduction of trade-distorting domestic support and substantial tariff reduction. A specific timetable for the implementation of these measures, however, has yet to be decided.

The lifting of quota restrictions on trade in textiles and clothing from the beginning of 2005 is likely to pose a problem for textile-exporting countries in Africa. These – North African countries, Mauritius, Madagascar and Lesotho – will face competition from Asian countries, in particular China. African exports are specifically vulnerable since they are concentrated in the US and EU markets and in formerly quota-restrained products where competition is set to intensify following the removal of textile quotas.

Preferential treatment of African textiles on US and EU markets might not make a big difference any more. The elimination of textile quotas on a global scale will make preferential treatment of African textiles by the US (AGOA, Africa Growth and Opportunity Act) and the EU (EBA, Everything but Arms) far less supportive of African competitiveness and the attractiveness of African countries for foreign direct investors in the textile sector should be dented as a result.

Increased competition from Asian countries in the textile sector is an illustration of the broader competitiveness challenge to be taken up by African countries if they are to gain manufacturing global market shares.

Macroeconomic "Shock-absorbers" for Africa

The need for further fiscal consolidation

Public finances in most African countries remain structurally weak. They are markedly reliant on external concessional financing, while facing absorption problems. Expenditures targeted at poverty reduction and capital outlays remain low by international standards. Above all and due to the modest diversification of local economies, African fiscal revenues are strongly susceptible to swings in commodity prices.

Despite this, some progress has been achieved in fiscal medium-term programming. This might pave the way for a future counter-cyclical use of resources, in oil-producing countries in particular. Recent efforts have included commitment to resource revenue transparency and the formulation of fiscal policy within a medium-term expenditure framework. This should avoid commitments that are not sustainable and the associated boom-bust cycles that have characterised the past (see box).

Upholding external competitiveness?

In a context of large exchange rate swings (US dollar against the CFA franc and the South African rand in particular) the upholding of external price competitiveness may be increasingly high on African policy makers' agenda, which implies increased exchange-rate flexibility. While this should not raise specific difficulties for African "managed floaters" (within the limits of inflation control/targeting), the issue of exchange-rate flexibility might surface again as a major headache for policy makers in the CFA franc area should the euro appreciate substantially.

African Reforms are essential to Boost Private-sector Development and Improve Governance

The capacity of smoothing shocks highly depends on the ability of African policy makers to diversify their economies. Boosting the private sector and improving economic and political governance are crucial.

Despite progress in macroeconomic management, little has been done to create an environment conducive to private sector development. The cost of doing business in Africa is still high as a result of policy uncertainty, inadequate physical infrastructure, poor access to investment capital and banking services, and cumbersome procedures and regulations governing the establishment and operation of businesses.

Small and medium-size enterprises (SMEs) must be strengthened

SMEs foster economic diversification; they are a source of wealth generation; and they produce the bulk of job opportunities for future generations of Africans. Yet, after decades of policies aiming to lift legal and financial constraints to capital accumulation, SMEs still constitute the "missing middle" of African economies (see Development Centre Policy Insight No. 7, *Financing SMEs in Africa*).

Access to finance represents the major constraint to SME development. Promoting access to finance for SMEs will require improving the business climate, strengthening SME's own capacity to cope with formal banking requirements, promoting financial-sector development and diversifying the sources of financing, notably by favouring intra-private sector linkages.

More effort should be made in the fight against corruption

Better economic and political governance is crucial to improve the business climate and to ensure the sustainability of the reform.

If democracy has improved overall, corruption continues in many countries. The focus on good governance has intensified. Democracy has started to take root in a number of countries in the last ten years, as testified to by the flourishing of political parties and by the easing of conflicts. The NEPAD and the African Union have played an important role in this. In particular the African Peer Review Mechanism launched in 2003 is expected to provide a candid assessment of the situation in African countries and foster progress in this area.

According to Transparency International, however, corruption levels have increased in Africa between 2000 and 2004, with oil rich countries including Angola, Chad, Libya, and Nigeria displaying the highest rates of corruption. The only notable exceptions are Botswana and Tunisia, rated as half-way towards a corruption free environment.

Checks and balances and external monitoring by civil society are needed to improve political accountability and the delivery of the government. The strengthening of public expenditure management systems could ensure not only a more a more efficient allocation of the resource but it represents also an important way of building trust with the donor community.

Improving Management of Oil Revenue during Periods of Price Booms

With more than 100 billion barrels, Africa had 9 per cent of the world's oil reserves by the end of 2003. Half are located in North Africa. In sub-Saharan Africa, the oil-producing countries can be divided into three categories: the old ones where production is in decline (Congo, Cameroon and Gabon); those where production is still on the increase (Angola, Nigeria); and the new members of the club (Equatorial Guinea, Chad and São Tomé and Principe). However, most of these countries have suffered from the "oil curse" finding themselves heavily indebted and impoverished. For this reason, with the help of the international community, some oil-producing countries are seeking to take advantage of the high prices prevailing since 2003 to make better use of surplus revenue and to improve transparency in the oil sector.

Regulations Concerning the Utilisation of Oil Revenue

Several countries have specific regulations for the use of oil revenue. In Nigeria and Congo, the budget is based on a very conservative estimate of the price of oil. Any surplus is then deposited in a special account with the central bank. In 2004, high oil prices enabled Nigeria to save a substantial amount of its oil revenue. The government of Congo used most of its 2004 budget surplus to make external debt repayments and regain the approval of the international community. In Algeria, the government's budget for 2005 calls for a significant reduction of the primary non-oil deficit in order to reduce the government's dependence on volatile oil income, thereby ending a pro-cyclical budgetary policy. Since 2001, priority has been given to investment, with adjustments being targeted at recurrent expenditure.

Transparency of the Oil Sector

The Extractive Industries Transparency Initiative (EITI) aims to encourage information sharing between governments and private companies. Several African oil-producing countries (namely, Nigeria in November 2003, Angola in June 2003, Chad in October 2004, Gabon in May 2004, Congo and São Tomé and Principe in June 2004) have expressed their intention of adhering to the EITI in order to improve the transparency surrounding their oil income. Thus, Congo regularly publishes detailed information concerning financial transactions in the oil sector on its official web site, especially about its contracts with oil companies including the controversial financial dealings with a particular oil company in 2003. At the same time, the government has ended advance payment for the proceeds of future oil exports. In Chad, the allocation of oil revenue is regulated by law – 10 per cent is saved and the remainder is allocated to priority sectors – and the publication of an independent external audit carried out by the Petroleum Revenue Oversight and Control Committee is compulsory. Nigeria also publishes information on the government's oil income on a monthly basis.

Source: African Development Bank and OECD Development Centre, *African Economic Outlook 2004/2005,* Box 4, Overview.

Development Centre *Policy Insights*
www.oecd.org/dev/insights

Development Centre *Policy Briefs*
www.oecd.org/dev/briefs

Development Centre *Working Papers*
www.oecd.org/dev/wp

OECD

OECD Development Centre "Le Seine St Germain"
12 boulevard des Iles
92130 Issy-les-Moulineaux, France
Tel: 33 (0)1 45.24.82.00
Fax: 33 (0)1 44.30.61.49

E-mail: cendev.contact@oecd.org