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››› With good politics, sub-Saharan Africa can make up more lost ground

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If you ask which region of developing countries has performed well recently, sub-Saharan Africa is not generally the reply you will receive. While it is true that poverty and major economic and political problems are even more widespread in this region than elsewhere, it is worth taking a closer look. Since 2000, sub-Saharan Africa has achieved a level of economic growth exceeded only by developing countries in Asia, and considerably higher than in Latin America, North Africa / the Middle East or even advanced economies. Some of this success is due to external factors, such as good prices for commodities exports and the influence of China. But better economic policy on the part of African countries has also paid dividends. However, there is still a great deal to be done. Sub-Saharan Africa will only succeed in further narrowing the development gap compared to other regions if determined efforts to improve framework conditions continue.

A region of many faces

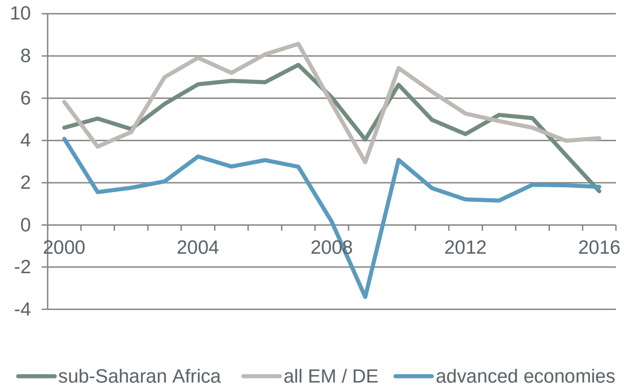
Sub-Saharan Africa is made up of 48 extremely diverse countries[1]. There are differences in the size of their economies (Nigeria and South Africa alone generate over 50 % of the region's total GDP), the level of development (26 low income, 20 middle income and even two high income countries[2]), dependency on exports of commodities and the effectiveness of state institutions and domestic political arrangements (there are many 'fragile states'), but also in terms of ethnicity and geographical factors (climate zone). As a rule, this paper will consider the region as a whole, in spite of this diversity, but will occasionally also look at sub-groups. This is because, despite all the differences between the individual countries, there are many basic conclusions that can be drawn about them all.

Impressive growth, but poverty still very widespread

During the period from 2000 to 2015, sub-Saharan Africa achieved average real-terms GDP growth of 5.3 % p.a. The region therefore consistently grew more strongly than advanced economies. At times, economic growth even exceeded the average for all Emerging Market and Developing Economies (EM / DE, see Figure 1), with sub-Saharan Africa outstripping Latin America and North Africa/the Middle East, and being beaten only by DCs/ECs in Asia. It is particularly encouraging that, since 2008, the poorest countries in sub-Saharan Africa (low income countries) grew considerably more rapidly on average (6.1 % p.a.) than the middle income countries (4.5 %). Even so, the pace of growth in sub-Saharan Africa has slowed significantly since 2013 (5.2 %) and is only likely to reach 1.6 % in 2016, after which the IMF forecasts it will again rise to 3.3 % in 2017.

Figure 1: Real-terms GDP growth

Percentages



2016: IMF forecast

Source: IMF

Sub-Saharan Africa has therefore caught up considerably from an economic point of view, although it still remains the region with the greatest development problems. This is due, among other things, to the low economic starting point and high population growth. In 2000, per capita income in sub-Saharan Africa averaged 502 US dollars, making it the most economically underdeveloped region in the world, along with South Asia. At that time, 58 % of the population of Africa lived below the poverty line. In subsequent years sub-Saharan Africa's poverty rate fell but, at 43 %, was still substantially higher than in every other EM / DE region in 2012 (latest available figures). This meant that sub-Saharan Africa missed the central Millennium Development Goal (MDG) of "halving the poverty rate between 1990 and 2015" by some margin. One of the reasons why moves to fight poverty had relatively limited success is that the economic growth recorded since 2000 has been offset by huge population growth, amounting to 50 % overall (equivalent to 2.7 % p.a.). Finally, the highly unequal distribution of income is a further problem area for human development.[3] Sub-Saharan Africa has the second highest Gini coefficient of EM / DE regions (second only to Latin America) and income inequality is particularly pronounced in African middle income countries, as well as oil-exporting countries such as South Africa and Angola.

Favourable external factors, in particular, are behind the many years of growth

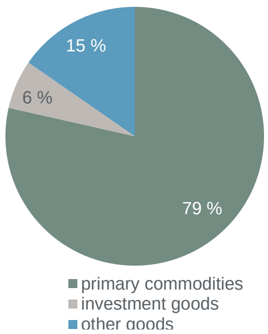
During the period considered here – from 2000 onwards – the following external determinants have been particularly noteworthy: commodity prices, the influence of China and rising inflows of capital. These determinants have long been important economic drivers for sub-Saharan Africa, but the wind has changed in recent times.

a) Commodity prices

The economies of sub-Saharan Africa are characterised to a very large extent by agriculture – 15 % of GDP is generated in this sector (cf. Latin America where the figure is just 5 %, and the OECD at 2 %). In addition to agriculture, we must also consider the very important area of oil, gas and metal extraction (iron ore, copper etc.) in quite a number of African countries. For statistical purposes, this is classified not as agriculture, but as mining (in the industrial sector). These commodities do not just dominate sub-Saharan Africa's production, but also make up 80 % of its exports (Figure 2).

Figure 2: Composition of sub-Saharan Africa's goods exports

2012–2014 average

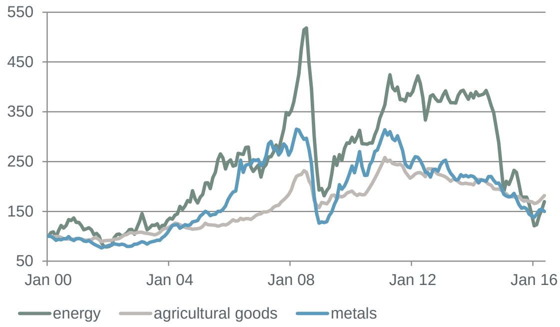


Source: UNCTAD, KfW's own calculations

For a long time, this one-sided export structure was, on balance, not a curse for sub-Saharan Africa, but a blessing. As Figure 3 shows, global market prices for these commodities may have plunged during the worldwide financial crisis, but they subsequently recovered again and continued to rise sharply overall until the start of 2011 (agricultural goods, metals) and the middle of 2014 (energy), respectively.

Figure 3: Nominal global commodity prices in USD

Index: 2000=100



Source: World Bank Commodity Price Data, KfW's own calculations

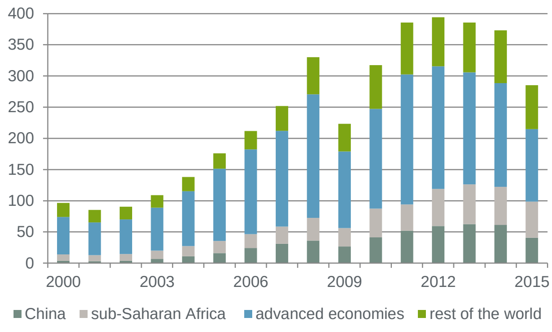
Accordingly, the reversal of the trend in 2011 / 2014 was bad for sub-Saharan Africa overall. However, it is important to make a distinction between the effects of different factors when considering the impact of price changes. For example, most countries in sub-Saharan Africa – with the exception of a small number of oil-producing countries (Nigeria, Angola, Gabon etc.) – are of course importers of crude oil, and as such have benefited from the fall in oil prices since 2014. At the same time, however, declines in the price of other commodities hurt the exports of countries that import oil. The World Bank has calculated the expected overall effect of changes in commodity prices during 2016, and arrived at a net terms of trade loss of 16 % for sub-Saharan Africa.[4] We should also remember that many African currencies have fallen in value. In domestic currency terms, a devaluation reduces the benefit to a country of cheaper oil imports (in dollars), but also decreases the 'damage' it suffers when exporting other commodities. Finally, the huge dependence on agriculture has meant that countries in eastern and southern Africa have been very hard hit by recent droughts.

b) China

As time has gone by, China has become sub-Saharan Africa's most important trading partner. China has enjoyed an economic boom for many years, but the boom itself is not the only factor behind the huge increase in Chinese demand for African commodities, especially energy and metals. The fact that the boom was driven to a large extent by investment has also played an important role. Africa's exports to China grew from 4 bn US dollars in 2000 to a peak of 63 bn in 2013, and the proportion of exports destined for China increased from 4 to 16 % over the same period (Figure 4). During this time, China had a significant influence not only on the quantity of African exports, but also on prices. However, two issues should be considered here. First, sub-Saharan Africa has plainly felt the effects of the slow-down in China's economy in recent years (African exports fell from 61 bn USD in 2014 to only 41 bn USD in 2015). Second, the diversity within sub-Saharan Africa referred to at the start of this paper becomes particularly evident in this area: Chinese demand does not benefit every country by any means; around 80 % of African exports to China come from just five countries, namely Angola, Equatorial Guinea, the Republic of the Congo, the Democratic Republic of the Congo and South Africa.

Figure 4: Regional composition of sub-Saharan African goods exports

USD bn

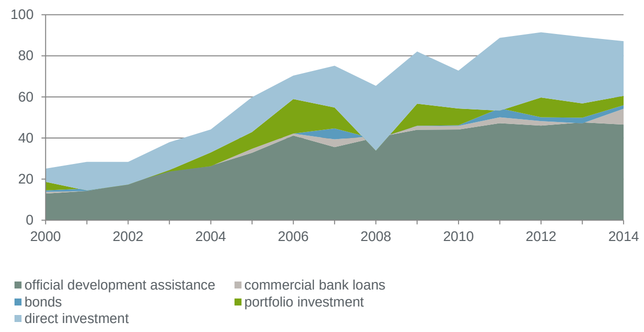


Source: IMF, KfW's own calculations

c) Capital inflows
Finally, capital inflows also play a major role in sub-Saharan Africa. First of all, it is striking (see Figure 5) that the structure of these inflows has remained largely unchanged since 2000. Official development assistance (ODA) continues to account for more than half of all capital inflows, and around a third comes from foreign direct investment. Between 12 and 25 % of capital inflows come from bank loans, bonds and portfolio investments. However, what is more important than the observation that the structure has remained largely constant is the absolute increase in inflows – from 25 bn USD in 2000 to more than 90 bn USD in 2012 (since which time there has been a slight decline, see Figure 5) – and in particular the growth of commercial financing. Sub-Saharan Africa's creditworthiness is low. Of the 48 countries that make up the region, only 22 have a rating from the international rating agencies at all, and of these just four countries are deemed investment grade (South Africa, Mauritius, Botswana and Namibia). Even so, 14 countries currently have government bonds in issue on the international capital markets,[5] meaning that, in a great many cases, a rating as 'speculative grade' has not put investors off. The picture is similar for international commercial banks which, for example, granted as much as 7.7 bn USD of (net) loans in 2014, and for portfolio investors (2014: inflow of 4.5 bn USD, 2012: a much higher 9.6 bn USD).[6] These considerable inflows of commercial capital in recent years may to some extent be due to a more positive assessment on the part of investors of the risk associated with the African countries involved. However, the fact that there is a great deal of liquidity in search of returns in advanced economies – as a result of extremely expansionary monetary policy – may be playing a major role here, as it increases investors' appetite for risk.

Figure 5: Net capital inflows [a)] to sub-Saharan Africa

USD bn, nominal



a) Disbursements less repayments.

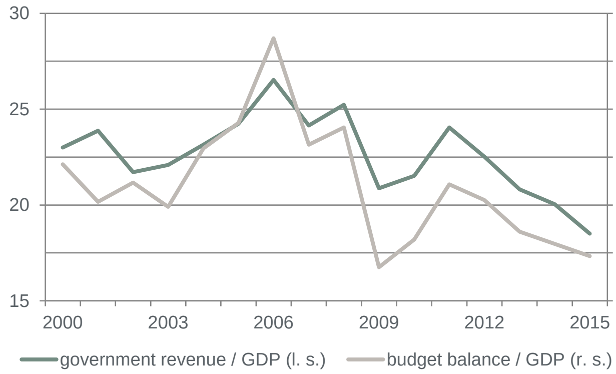
Source: World Bank: International Debt Statistics, KfW's own calculations.

Internal economic conditions have also improved, but are still very far from ideal[7]

The economic upturn in sub-Saharan Africa that has been outlined so far has not only been supported by external factors, but is also the result of internal reforms in economic policy. Even so, a great deal more effort could and should be made in order to help African economies make further progress. This is covered in more detail below, under the categories of fiscal policy, foreign trade and business climate.

a) Fiscal policy
Until the middle of the 2000s, and again after the global financial crisis of 2009, sub-Saharan African countries succeeded in increasing government revenue, not just in absolute terms, but also as a proportion of their (considerably higher) GDP (Figure 6). In many countries there was also an upwards trend in tax revenues, which make up around two thirds of government income. This is encouraging, as government spending, for example to build up economic and social infrastructure, is enormous, and requires the corresponding level of funds.[8] While governments' income was rising, government budget balances in the region also improved on average (Figure 6).

Figure 6: Fiscal indicators in sub-Saharan Africa

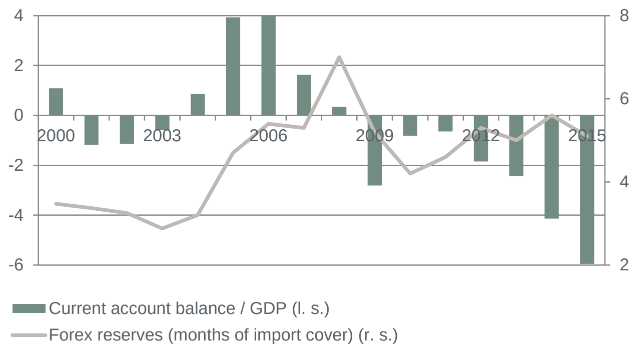


Source: IMF

However, since 2011 a new, challenging trend has emerged: Government revenues are falling, while budget deficits are growing. The background to this is that the budgets of many African states are heavily dependent on international commodity markets and, as mentioned above, the trend here has not been favourable to producers. In addition, structural weaknesses continue to exist, meaning, for example, that the state loses substantial amounts of income as a result of weak tax administration. The need for fiscal reform therefore remains high.

b) Foreign trade
Since 2000, a policy of flexible exchange rates has been more widely adopted in sub-Saharan Africa and distortions in the allocation of public funds caused by over-valued currencies have declined. Until 2008, forex reserves – an important buffer to avoid payment problems with foreign trade – were increased significantly, and then again in the period between 2010 and 2014 (Figure 7). In the middle of the 1990s, sub-Saharan Africa still suffered from a crushing burden of debt; foreign debt (both governmental and private) had risen as high as 80 % of economic output. Up until 2008 this indicator improved continually, finally falling below 25 % on average, where it has since remained. The striking rise in goods exports has already been set out.

Figure 7: Foreign trade indicators in sub-Saharan Africa



Source: IWF, World Bank

But the positive news in this area is subject to some serious qualifications. Despite the greater flexibility in exchange rates, the average real effective exchange rate[9] for sub-Saharan Africa has risen in value by around 25 % since 2000, according to the IMF's calculations. In effect, this equates to a loss of price competitiveness. Increasingly unbalanced foreign trade also has a similar effect. Although the current account balance rose as a proportion of GDP between 2001 and 2006 to reach a surplus of 4 %, and then improved again in 2010/2011, since as early as 2009 the region has had a current account deficit, on average, which has risen sharply to around 6 % / GDP (Figure 7). After each of the aforementioned growth phases, forex reserves fell again and, on average across sub-Saharan Africa, are now only sufficient to cover approximately five months of imports (Figure 7, in 17 countries they have fallen as low as less than three months of cover). In view of countries' high dependency on volatile commodity exports, their currency reserves should be considered as insufficient. The fact that foreign debt levels have eased is only partially thanks to countries' own efforts – the majority of the improvement comes from the cancellation of debt. After the 1970s, many poor developing countries found themselves faced with a huge debt crisis, as a result of taking on a great deal of borrowing, but more recently bi-lateral and multi-lateral creditors have written off a substantial proportion of the debt. Since then a certain recklessness with regard to borrowing has emerged again. The World Bank and the IMF, which produce comprehensive analyses of the sustainability of debt, are currently warning of a serious level of risk associated with the debt of six African countries[10], with two countries (Zimbabwe, Sudan) even in default. In this context it should also be noted that the global financing environment will not be as favourable in the longer term as it is now, when (as already stated) abundant liquidity is still available at the lowest possible interest rates.

c) Business climate

It is essential to a country's development that private companies have the opportunity to flourish economically within the framework of government regulation. The World Bank's 'Doing Business Index' provides a particularly useful international comparison of these economic and political conditions.[11] Each year since 2003, it has measured the investment climate and the degree to which contractual and ownership rights are guaranteed. It would be interesting to consider how the business climate in African countries has changed over time. However, it is not meaningful simply to track countries' rankings in the Doing Business Index over time, because the World Bank has made many modifications to the Index since it was first published (in 2003 there were only five indicators for 133 countries, compared with eleven indicators and 189 countries now). Even so, the World Bank now also includes in the Doing Business Index an indication of how specific results for individual countries have changed in relation to the 'Best Performer' since 2010 ('Distance to Frontier' measurement).

Roughly speaking, the following can be said of the 47 sub-Saharan African countries included in the Doing Business Index over the period from 2010 to 2016: Eight countries have improved steadily and 27 countries have shown a general trend of improvement, though for nine countries this has reversed again in the last two years. Only for a minority of 12 countries has the situation tended to worsen (i.e. an increase in the 'Distance to Frontier'). All in all, this means that the business climate in sub-Saharan Africa can be said to have improved in the majority of cases. But 'better' is still a long way from 'good'. While improvements have been made, sub-Saharan Africa still performs rather badly in international terms. Just six African countries feature among the top 100 in the Doing Business Index. By way of contrast, 25 countries in sub-Saharan Africa are ranked among the lowest positions (between 150 and 189), and as many as eight come in among the worst-performing ten. Conclusion: The direction of travel is right, but there is still a long way to go before the business climate can be considered good.

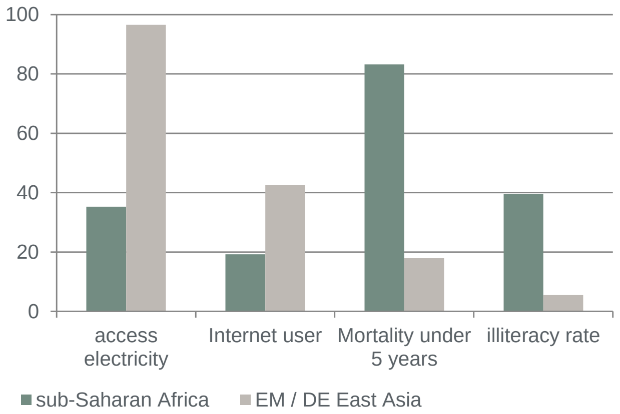
Additional key determinants for the future of sub-Saharan Africa

The region faces other major challenges in addition to the economic and political issues already outlined. These are in no way specific to Africa – they are also true of most other EM / DE – but the need for progress is particularly urgent in sub-Saharan Africa.

a) Inadequate economic and social infrastructure

The economic and social infrastructure in sub-Saharan Africa (transport, energy, health, education etc.) is inadequate, both quantitatively (facilities) and qualitatively (service). Figure 8 illustrates this in comparison with EM / DEs in South Asia. As previously stated, the problem of financing shortfalls in sub-Saharan African public budgets has decreased somewhat, but still remains an issue. This explains why state investment is weak. Without question, private investors could also potentially get involved in infrastructure investments, for example in the power sector and telecommunications, but also hospitals. However, private investors' involvement in such areas is low in sub-Saharan Africa, due to unprofitable tariffs, legal uncertainty and other adverse conditions (business climate, see above).

Figure 8: Figures illustrating the state of economic and social infrastructure; comparison between sub-Saharan Africa and EM / DEs in East Asia [a)]



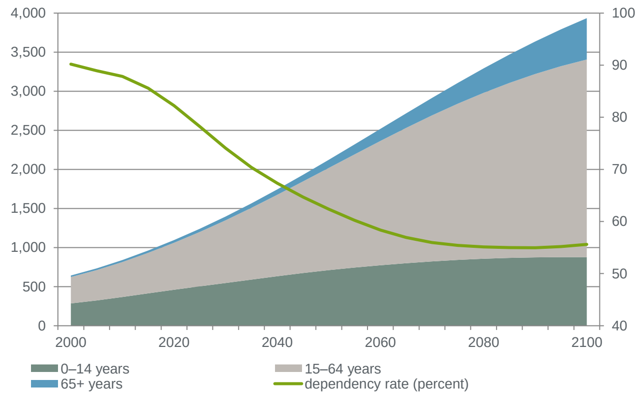
a) Latest available figures for each region. Proportion of the population with access to an electricity supply (per cent); proportion of the population with internet access (per cent); mortality rate for under-fives (per 1,000 live births); illiteracy rate among adults (ages 15 and over, per cent).

Source: World Bank, KfW's own calculations

b) Demographic change brings opportunities, but is currently more of a time bomb

Population changes are a crucial factor for the future development of sub-Saharan Africa. The historical high level of population growth has already been referred to above. The United Nations forecasts demographic change on a global scale up to the end of the century. Three observations can be made about sub-Saharan Africa (see Figure 9). First of all, the substantial rise in total population will continue unabated, as a result of increasing life expectancy and a birth rate which, while falling, is still high. Second, the number of both young people (aged up to 14) and senior citizens (65+) will grow only moderately. In contrast, and thirdly, the working population (aged 15–64) will increase sharply.

Figure 9: Population in sub-Saharan Africa between 2000 and 2100 (millions, on the left) and dependency rate (per cent, on the right)



Source: United Nations, Population Division

All in all, the result of this is a dependency rate (defined as the cumulative percentage share of young and old people in relation to the working-age population) that is falling sharply, from 85 % today to 56 % at the end of the century. A falling dependency rate is referred to as a 'demographic bonus', because a relatively large number of working people are available to produce goods to meet current needs, but also to save and invest, thereby increasing production and consumption opportunities for subsequent generations. This is the case in sub-Saharan Africa. However, this bonus can only be converted into a 'demographic dividend' if the working-age population is also actually employed in a productive way. Herein lies the greatest challenge for sub-Saharan Africa. Unemployment and underemployment are a key problem in the region. This can only change if both external and internal conditions are right.[12]

c) The general political framework is not conducive to progress

In order for economic development to occur, the right political conditions are crucial. It is not just the former Eastern Bloc that has enjoyed rising levels of democracy and personal freedom in the years since 1989 – the changes that happened there have also reached sub-Saharan Africa. Since 2000, however, this encouraging process of change has largely come to a standstill. The international non-governmental organisation Freedom House examines the progress of freedom and democracy in 195 countries every year. Its work focuses not on a concept of democracy that African governments can label as 'western' and hence not applicable to their countries, but on the Universal Declaration of Human Rights, to which African states are signatories. Freedom House currently classifies only nine countries in sub-Saharan Africa as free, 20 as partly free and 20 as not free.[13] Along with North Africa / the Middle East, sub-Saharan Africa is therefore the region with the world's highest deficit when it comes to political freedom, civil liberties and democracy. Similarly, many African countries are also classified as 'fragile' – state actors there are either unwilling or unable to fulfil their basic duties in terms of security, the rule of law, provision of basic social services and legitimacy. The World Bank and IMF currently consider 19 states in sub-Saharan Africa to be fragile – roughly 40 % of all countries in the region (with a quarter of the total population).

Conclusion

From an economic perspective, Sub-Saharan Africa has caught up considerably since 2000. Although conditions in the 48 individual countries vary widely, overall the region has both benefited from favourable external factors and carried out its own reforms. The recent reversal of this trend in terms of external factors has shown how precarious the position in sub-Saharan Africa is. Accordingly, internal economic and political reform is urgently needed so that countries can put their own house in order and hence achieve more involvement from the private sector, create jobs and diversify their economies. If governments show the determination to continue on the path they have already embarked on, the region has a chance of making significant economic progress. This would then provide a good basis for improving the political situation and reducing internal and external conflicts. ■

[1] The average macroeconomic figures in this paper are predominantly based on IMF statistics. However, for sub-Saharan Africa, these only include data from 45 countries; Mauritania, Somalia and Sudan are not included, presumably because of the limited availability of data. This paper evaluates both macroeconomic and development policy indicators, generally derived from the World Bank's database. Although the World Bank considers all 48 countries in sub-Saharan Africa, it aggregates individual figures into a regional average using an exchange rate concept that is somewhat different from the one used by the IMF. However, the 'data error' that arises from differences of this sort is minor and, all told, is insignificant as far as the conclusions drawn in this paper are concerned.

[2] Classification by per capita income is based on the World Bank's 'Atlas' method. Under this method, Equatorial Guinea and the Seychelles are included as high income countries.

[3] See also the section devoted to this topic in: IMF, Regional Economic Outlook October 2015, p. 55 et seq.

[4] World Bank: Africa's Pulse, Washington D.C. April 2016, p. 25.

[5] Angola, Cameroon, Côte d'Ivoire, Ethiopia, Gabon, Ghana, Kenya, Mozambique, Namibia, Nigeria, Senegal, South Africa, Tanzania, Zambia

[6] At this point we need to consider the region's diversity once again – in 2014 only ten countries received bank loans and, of these, Nigeria was by far the largest borrower, accounting for 57 % of the total.

[7] Improvements in internal conditions and the current strengths and weaknesses of economic policy in sub-Saharan Africa are often the subject of analysis, particularly in regular reports from the IMF (Regional Economic Outlook), the World Bank (regional chapter in the standard 'Global Economic Prospects' study and in the 'Africa's Pulse' series of publications) and the OECD/African Development Bank (African Economic Outlook). See also Radelet, S.: Africa's Rise – interrupted?, in: Finance and Development, June 2016, p.6 et seq. and United Nations Conference on Trade and Development (UNCTAD): Economic Development in Africa Report 2016: Debt Dynamics and Development Finance in Africa, New York/Geneva 2016.

[8] At 20-25 %, the ratio of government revenue to GDP in sub-Saharan Africa remains very far behind that for advanced economies (average 35 %, Germany 45 %). One reason why the gap is so great is the limited progress made in developing social security. The discussion in advanced economies as to whether, from the point of view of the economy and the population, the tax burden is too high, or even overwhelming, takes on a completely different perspective in developing countries.

[9] The effective exchange rate measures the value of a country's currency against those of all other countries, weighted for the share of foreign trade. By applying a correction to the effective exchange rate so as to take account of the differences in inflation between the various countries with which a given country trades, we arrive at the real effective exchange rate, which is used as a measure of the competitiveness of the country in question.

[10] Burundi, Cameroon, Central African Republic, Chad, Ghana, Mauritania

[11] http://www.doingbusiness.org/. Additional reliable indicators evaluating economic and political conditions can be found, for example, in the Bertelsmann Transformations Index (http://www.bti-project.org/de/index/) and the World Economic Forum's Global Competitiveness Index (http://www3.weforum.org/docs/gcr/2015-2016/Global_Competitiveness_Report_2015-2016.pdf). The key aspect of corruption is dealt with by Transparency International in its Corruption Perception Index (http://www.transparency.org/cpi2015). For reasons of space, this paper only presents information from the Doing Business Index; the assessments of the other indices are broadly similar.

[12] Filmer, D. and L. Fox: Youth Employment in Sub-Saharan Africa, The World Bank, Washington D.C. 2014

[13] The nine free countries are Benin, Botswana, Cape Verde, Ghana, Mauritius, Namibia, Sao Tomé and Principe, Senegal and South Africa; see https://freedomhouse.org/sites/default/files/FH_FITW_Report_2016.pdf.