"Near-term prospects for the region's economies are encouraging when one considers the enormous shocks of the recent crisis and the depth of the global downturn."

African Economies' New Resilience

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Governments & Markets

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The economic repercussions of the global financial crisis that began in 2007 have steadily swept through the regions of the world. In the early stages of the crisis, there was some hope that Africa would escape the turbulence that afflicted the US and European financial sectors, because most African countries have been marginal to these markets. But this expectation proved misplaced, as the general slump in the international economy was quickly transmitted to Africa through the mechanisms of trade, investment, and financial shocks.

What had been a promising, extended episode of regional growth thus ended abruptly, and many African countries once again faced, at least in the short term, the prospect of economic decline and deepening poverty. The continent's economic growth slowed to just over 1 percent in 2009. Lagging economies and reduced capital flows have meant diminished employment and incomes, strained coping mechanisms, and stressed public finances.

Not surprisingly, some commentators have detected in today's circumstances echoes of the protracted stagnation and decline that African economies experienced in the 1980s and 1990s. And, to be sure, recent dislocations in the commodity and financial markets have set Africa back.

But current troubles should not be interpreted simply as a reprise of the 1980s, inevitably to be followed by another era of crisis and malaise. The recent downturn is substantially different from the economic predicament that the region experienced in earlier decades; and responses to the downturn, both by Africans and by external actors, have been substantially different as well.

Indeed, the continent's present economic condition highlights the marked changes that have been made in the governance of African economies—particularly when it comes to macroeconomic management and to political systems' reactions to adversity. African governments throughout the current crisis have largely sustained their central policy orientations of the past decade, and there has been little evidence of strong populist or protectionist reactions.

Most governments in the region have acted pragmatically to mitigate the effects of damaging external shocks, and improvements in external conditions have begun to aid in the recovery from the downturn. The course of the crisis suggests, too, that African countries are now situated differently within the global economy, and may draw on a greater array of capital and investment flows than were previously available.

In Africa there are signs not just of economic buoyancy, but also of political resilience. The prevalence of elected governments, and societies' broader scope for civic action, have provided outlets for popular grievances and demands. While most African governments have limited fiscal space for remedial stimulus programs or social safety nets, popular reactions to the economic downturn have not broadly unsettled the region's regimes. Many countries have experienced political turbulence in hard times—from South Africa and Kenya to Ghana and Senegal—yet African publics have largely worked within prevailing systems to press their claims.

That said, it must be noted that the recent crisis has also accentuated long-standing problems in the region's postcolonial experience. Africa's dependence on commodity exports, its wide-

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spread poverty, and its weak institutions pose continuing challenges for economic revitalization. Although a forgiving external environment is now fostering recovery from the economic slump, major challenges involving structural change, institutional renovation, and governance still face African states seeking to reach more stable trajectories of development.

THE UNFOLDING CRISIS

The evolution of the international downturn is by now well known. In early 2007, America's housing bubble began to deflate and its subprime mortgage market fell into distress. This initial failure affected the banking industry, along with securities and equity markets. The collapse of the US financial services firm Lehman Brothers in September 2008 accelerated the breakdown of financial markets in the world's leading economies. In subsequent months the financial shambles created a widening international recession as investment and lending plummeted, growth slowed, and unemployment expanded in most upper-income countries. The effects of declining international trade and capital flows rippled outward as the crisis deepened. Major emerging economies, including China and India, were adversely affected. Poor countries were soon exposed to these negative shocks.

In the initial stages of the crisis, some analysts of African economies sounded a note of cautious optimism, suggesting that the region might not be seriously affected by the turmoil in the richer economies. Africa accounts for only about 2 percent of global trade and 3 percent of foreign direct investment, and is largely decoupled from global financial markets due to its comparatively small banking sector, stock exchanges, and securities markets.

Moreover, except for pockets in a few countries such as South Africa, Nigeria, and Ghana, the continent's real estate has not been a site of speculation linked to financial markets. Paradoxically, Africa's global economic marginality, long cited as an impediment to development, had the potential to protect the region from the contagion at the center of the world economy.

These expectations were not borne out, as global trends soon buffeted Africa. In contrast to the advanced economies, where the crisis was transmitted through financial markets, most African countries began to suffer on account of drops in trade, investment, and other capital flows. Global trade volumes contracted by an estimated 12 percent from the latter part of 2008 through the early months of 2009, causing a decline in both the price and the quantity of most of Africa's key commodity exports.

In early 2009, oil prices plunged by two-thirds from their apex levels of 2008, while copper and aluminum prices dropped by more than half. Agricultural commodities, though not as sharply affected, followed the general trend. Palm oil prices were halved, tea and cocoa prices were down by a fifth, and maize and cotton prices slumped by about a third. Recent estimates by the World Bank show that Africa's 2009 exports shrank by 5.2 percent from the previous year, paralleled by an equal decline in imports.

AVENUES TO DISTRESS

Trade has long been the critical channel of transmission for Africa's commodity-based economies, but other mechanisms are also significant: External investment flows, foreign remittances, and development aid represent important sources of financing and growth for many African economies. As the global crisis unfolded, all of these channels contributed to distress.

Foreign direct investment, after several years of rapid growth, declined by at least a fifth across the region. While much of the slowdown in foreign investment was concentrated in the petroleum and mining sectors, economies not as dependent on these sectors faced adversity as well. Meanwhile, two significant sources of capital in the region, China and South Africa, have faced domestic economic challenges that may continue to hamper the pace of their investment.

Flows of portfolio investment, though modest for most African economies other than South Africa, also subsided as stock markets and other exchanges buckled. In 2006, Africa had received an unprecedented net inflow of about $19 billion in portfolio investment; two years later it experienced a net outflow of nearly $17 billion. Last year the region attracted only a trickle of inward investment. The Nigerian stock market crashed in early 2009, losing two-thirds of its value compared to its peak of the previous year, while the South African index fell 45 percent over the same period.

Remittances from Africans living overseas are a large source of financial flows to the region, providing at least $20 billion across sub-Saharan Africa in 2007 (compared with about $29 billion in foreign direct investment and $35 billion in foreign aid). As the recession deepened in the United States, Europe, and the Middle East, Africans abroad reduced their transfers home, lowering Africa's remittance income by 6 to 8 percent in 2009, according to the World Bank. This probably underestimates the long-term reduction, since an unknown number of migrants have returned from abroad with their savings. Such a transfer of outside assets can momentarily slow the decline in financial flows, but a diminishing pool of external migrants can cause future remittances to slacken.

Remittance income furnishes an essential coping mechanism for tens of millions of Africans, and curtailed flows will mean increased hardship across much of the region, especially in smaller countries such as Lesotho and Cape Verde; among major sources of migrants such as Nigeria, Ghana, Senegal, Mali, and the Democratic Republic of Congo; and in southern African nations where intra-regional migration is an important feature of livelihoods.

Foreign assistance, essential for many African countries, faces uncertain prospects. The general expectation is that development aid may be trimmed as economically distressed wealthy countries place greater priority on domestic needs. Current statistics are lacking, but recent aid commitments at donor meetings have lagged behind targets set at a 2005 Group of Eight summit hosted by Britain. There are indications that transfers to Africa have fallen from their historical peak in 2008. All this raises questions about the medium-term trend of development assistance if economic sluggishness persists in major donor countries.

The region's performance has been more than just an artifact of commodity markets.

Multilateral financial institutions (the International Monetary Fund, the World Bank, and the African Development Bank), traditionally the lenders of last resort, have faced mounting demands for short-term compensatory finance during the global economic crisis. This has given rise to concerns that their reserves might be insufficient to meet commitments. But in fact, the IMF has substantially bolstered its reserves and accelerated its lending to Africa, from $1.1 billion in 2008 to more than $3 billion last year. The World Bank in 2009 boosted lending by nearly half. While the effects of such transfers are controversial, it is clear that the availability of multilateral resources has not diminished.

UNEVEN TERRAIN

The tumult in the global economy has affected African countries in different ways. Overall, economic growth on the continent has declined substantially. Last year, sub-Saharan aggregate growth slowed to just 1.1 percent, while for the first time in a decade per capita growth turned negative (minus 0.6 percent). The region's growth prospects have recently improved, however, and current World Bank projections anticipate a 3.8 percent expansion this year, and 4.6 percent in 2011.

Still, this represents an abrupt break from the impressive growth that the region had experienced in recent years, which averaged more than 6 percent annually from 2003 to 2008. And the relatively anemic pace of the projected recovery will offer limited space for increases in incomes or reductions in poverty. The downturn has already returned several million Africans to poverty, jeopardizing a fragile trend toward better livelihoods in many parts of the region. Many Africans, affected by unemployment, the loss of remittance income, lower returns on agriculture, reduced demand in some markets, and strains on already weak government services, are experiencing additional stresses on their frail subsistence and coping mechanisms.

But the effects of the downturn are not playing out uniformly across the region. According to IMF data, Africa's oil-exporting economies (including Nigeria, Angola, Cameroon, and the Republic of Congo), which are concentrated around a single source of earnings, have experienced some of the largest revenue shocks. At the same time, they retain a measure of fiscal capacity to weather the turbulence in global markets. A substantial recovery in oil prices has improved these countries' position and will likely provide stability in the near term.

A distinct set of middle-income countries (including South Africa, Botswana, Mauritius, and Namibia) reflects greater economic diversity, though several of these rely heavily on solid mineral exports. Economic growth in this group has also slowed, variously affected by sagging mineral prices (South Africa, Botswana, and Namibia), lower tourism receipts (Seychelles), and troubled textile markets (Mauritius). South Africa, with a large banking industry and more extensive financial markets than other African countries, is more exposed to international financial dislocation. Although these countries face uncertain prospects for growth, they also have significant fiscal and societal resources that can provide a measure of buoyancy.

Africa's low-income countries (including Benin, Ghana, Mali, Ethiopia, Kenya, Tanzania, Malawi, Mozambique, Rwanda, and several others) have performed relatively well in recent years, and appear to be experiencing a shallower downturn than their higher-income or oil-rich neighbors. After a five-year run of growth averaging over 7 percent annually, these economies slowed to 4.5 percent growth in 2009, and may approach 5 percent this year. Most of these countries rely on agricultural exports that have experienced less volatility than other commodities, and they are largely detached from global financial markets. Governments in these nations, many of which are dependent on donor-provided budget support, have limited fiscal maneuverability in any case.

Prospects are more muted for a set of post-conflict and unstable states (including Liberia, Sierra Leone, Togo, Ivory Coast, the Democratic Republic of Congo, Burundi, and Zimbabwe) that are designated as "fragile" economies by the IMF. Not surprisingly, these countries have grown more slowly than others in Africa, averaging about 3.5 percent a year during the continent's recent run of relatively strong growth. These economies, weakly integrated into global markets and highly aid-dependent, have seen modest downturns and face tepid prospects for growth.

Another way to look at the economic landscape is to consider effects by sector. Commodity prices, for example, have recovered from last year's trough, and prices for certain things (including copper, gold, aluminum, coffee, tea, cocoa, and cotton) have even surpassed their pre-crisis levels. Some economic sectors such as telecommunications and infrastructure activities are likely to resume growth as investment recovers. Tourism, meanwhile, which was expected to be seriously depressed by the downturn, has proved more resilient than anticipated. Growth in tourist entries to South Africa slowed as a result of the global recession, but will likely rebound with the soccer World Cup this year. Kenya, still struggling to recover from its political violence of 2008, saw tourist volume increase last year by nearly a third. In short, many sectors and activities across the continent have rebounded to a considerable degree from the depths they reached in early 2009.

Not the 1980s

Although the downturn has produced dislocation and hardship, the current circumstances are notably better than those that prevailed during Africa's protracted crisis of the 1980s, which involved a steep economic decline followed by more than a decade of stagnation, political upheaval, and worsening poverty.

In the early 1980s, a combination of price shocks, rising debt, and global recession sparked widespread economic distress in sub-Saharan Africa. The downturn was aggravated by fiscal crises, unworkable policies, and lagging economic and governmental reforms. The region's economies contracted by 0.5 percent on average from 1980 to 1987, while per capita incomes declined by 3.7 percent. Donor-induced austerity and adjustment programs were slow to arrest regional decline, and Africa did not show signs of increased growth until the late 1990s.

Capable state authorities are a requisite for structuring and managing market economies.

In recent years, the international economy has again conveyed powerful, temporary shocks to Africa, but as the economist Harry G. Broadman and some others have noted, most countries in the region are better positioned to manage these challenges than was formerly the case. The differences are evident along four dimensions: macroeconomic performance, a new external context, domestic policy responses, and the changing context of governance.

Africa's current macroeconomic position is dramatically stronger than in the early 1980s. Since the late 1990s, most countries in the region have experienced accelerating growth, with average growth rates, as noted, exceeding 6 percent from 2003 until the global downturn began. Among all categories of countries, fiscal balances have improved, and a majority of countries managed to achieve budget surpluses during the three years preceding the crisis. Over that same period, most African economies maintained moderate-to-low inflation and stable exchange rates.

Further, the region's debt burden has significantly eased due to relief initiatives undertaken by the IMF, the World Bank, and the African Development Fund, which have retired large volumes of bilateral and multilateral debt. Average indebtedness in 1982 was a third of gross domestic product and a staggering 135 percent of exports; five years later these figures had actually increased to half of GDP and twice the value of exports. By contrast, African debt in 2008 totaled about 10 percent of regional GDP and 40 percent of exports. Debt service in 2007 averaged about 14 percent of export earnings. Debt overhang, which in the 1980s stifled prospects for many countries, has not been a factor in the recent financial turbulence.

Several African states in the years before the crisis accumulated substantial foreign exchange reserves that could offset some of the shocks of the global turmoil. Nigeria, for example, increased its external reserves from about $3 billion in 2000 to more than $60 billion in 2008. Other oil exporters also accumulated reserves, as did mineral-rich economies such as South Africa and Botswana. For a select group of countries, including the largest economies in sub-Saharan Africa (South Africa and Nigeria), reserves offered a cushion that allowed them to reduce the volatility of currencies and sustain public spending in the face of revenue losses. Nigeria burned through a third of its reserves in just a few months early last year, but was able to stave off some of the dislocation caused by a precipitous decline in oil prices.

During much of the past decade, important trends in the international economy have benefited sub-Saharan Africa. Global commodity prices have increased sharply; recent years have seen the longest and steepest price boom since the early twentieth century. While petroleum has led the way, minerals and agricultural commodities have also advanced. Unquestionably, the commodity boom has driven a substantial portion of African growth in recent years, since most countries rely heavily on a narrow range of commodity exports for revenues and livelihoods.

There are indications, however, that the region's performance has been more than just an artifact of commodity markets. During the boom period, according to an IMF analysis, even as oil revenues surged, non-oil GDP grew faster than the rate for overall GDP (including oil).

An important additional element of the improved external context has been a rapid rise in private capital flows to the region. Foreign direct investment in sub-Saharan Africa increased nearly five-fold in less than 10 years, peaking at over $35 billion in 2008. Moreover, Africa in the past decade began to attract significant amounts of portfolio investment as stock markets proliferated and capital controls were eased.

The entry of new actors into African markets has been a crucial development. An array of investors has brought new resources to economies in the region, significantly diversifying the pattern of investment seen in earlier decades. The leading actor in this regard is China, with its assertive push to expand economic engagement on the continent. China, through direct government links and the activities of numerous firms, has dramatically increased trade with the region while boosting aid and lending to dozens of countries. Chinese companies have undertaken large investments in the energy and mineral sectors, and have also made diverse forays into infrastructure, manufacturing, and other activities.

Another important source of investment comes from within the region, as South African investment has expanded throughout the continent since the end of apartheid. South African firms have ventured well beyond their traditional mining activities; their investments now encompass telecommunications, hotels, retail, agriculture, and other areas. Indian firms have also increased their involvement in Africa, while Malaysia has invested in the petroleum sector.

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THE REFORM EFFECT

But other trends beyond debt levels, commodity prices, and the like have mitigated the impact of the global downturn and increased African nations' economic buoyancy. Domestic efforts toward economic policy reform, extending more than a decade in many countries, have better positioned African economies to take advantage of external developments. Despite continuing controversies over the appropriate scope of economic reform, a number of observers have pointed out the emergence of stabler macroeconomic policies and a more pragmatic approach to state management of economies.

Balanced budgets, limited inflation, realistic exchange rates, higher returns for agricultural producers, and more competitive trade and investment frameworks have enabled African countries to attract investment and improve management of their resources. Most African governments over the past 15 years have taken steps to limit public sector payrolls and profligate spending, reduce state ownership and administrative control, and open important sectors such as finance to wider flows and investment.

In ongoing debates over donor-induced economic liberalization in Africa, critics have emphasized the liabilities of receding public services, lagging investments in infrastructure, widespread market failure, regulatory shortcomings, and corruption. Indeed, despite Africa's improving record of growth, there has been limited evidence of poverty reduction or improved equity in the region's highly skewed economies. A syndrome of "growth without prosperity" is apparent in many countries, especially those reliant on oil or mineral enclaves for much of their revenue.

Compelling evidence, however, argues for the idea that better macroeconomic management and more flexible approaches to market factors—of the sort encouraged by international donors—have helped foster the increasing pace of growth since the mid-1990s. An improved policy framework is necessary, though it is often insufficient, for economic transformation.

Improved governance has been the other salient component of economic performance. The protracted economic crisis of the 1980s was identified with entrenched authoritarian rule throughout the continent. An array of single-party and military regimes maintained state-dominated economic systems that were managed through the discretion of personal rulers. These governments often followed dissolute fiscal practices, pursued insular policies, and fostered weak institutions. Economic crisis, followed by donor-induced austerity, limited regimes' ability to sustain patronage networks and populist largesse. The resulting political tensions toppled dozens of regimes, opening the way to a wave of political reform and democratization in the 1990s.

Political change has produced uneven effects across Africa, from the liberal democratic trends seen in Ghana and Benin, to dominant party rule in Zambia and Namibia, to electoral forms of authoritarian rule in Ethiopia and Uganda. Nonetheless, common elements of improved governance in the economic domain have emerged in many countries in the region. Governments have increasingly delegated some authority to technocratic managers in the economic sphere, introducing a level of prudent management into the economic policy process. Many regimes have conceded space to independent media, civil society groups, or opposition elements that seek accountability and improved economic performance from government.

A measure of institutional development has also emerged, after the hollowing out of the 1980s and the retrenchment of the early 1990s. Many governments have taken steps to develop regulatory structures, renovate legal codes, bolster oversight capabilities in areas such as banking and telecommunications, and develop capacity in budgeting or service delivery. Of course, the limitations of such reforms are also clear, since Africa's institutional capabilities and policy frameworks still compare unfavorably with those of other developing regions of the world.

CONTINUING CHALLENGES

Near-term prospects for the region's economies are encouraging when one considers the enormous shocks of the recent crisis and the depth of the global downturn. Africa is likely to rebound nicely. However, while the crisis has highlighted the region's new resilience, it has also underscored continuing challenges to growth and economic change.

Economic performance in sub-Saharan Africa reflects long-standing structural problems and skewed linkages with the global economy that hamper growth, diversification, and the improvement of livelihoods. African countries continue to rely for essential revenues on a narrow range of primary commodity exports, leaving them vulnerable to price fluctuations and other sources of volatility in external markets. Many countries rode the commodity boom of the past decade and may recover after the price dips of the past year. But their prospects further down the road will continue to depend on uncertain prices and demand in export markets.

The growth of the past decade has not been accompanied by diversification from traditional exports or the expansion of other sectors, such as manufacturing and value-added services. Indeed, many countries, ranging from Nigeria and South Africa to Lesotho and Zambia, have experienced additional stresses on their manufacturing sectors as Asian exports have overshadowed domestically made goods, and as the region's exports continue to be constrained by receding demand. The global crisis has accentuated the continuing challenge of diversifying African economies to achieve greater competitiveness and wider employment. The inertia of agriculture is another significant problem, as widespread reliance on small-holder, rain-fed production has not yielded increases in productivity or incomes.

External capital flows remain a driving element in most African economies. At least a dozen low-income countries depend on budget support from the donor community for their fiscal viability, and the volume of lending and aid will for nations throughout the region be critical for recovery from the current downturn. But apart from donor resources, longer-term private capital flows will shape productive capabilities for countries at all levels of development. Investments in infrastructure, manufacturing, agriculture, finance, and other service activities are integral to the transformation of these economies.

In order to attract and utilize such flows, African countries must develop their institutional and policy frameworks to improve conditions for production and exchange. Enhanced conditions for private capital—which will also entail greater government capacity and improved provision of public services—are necessary for sustained growth and diversification.

This leads directly back to the issue of governance. Capable state authorities are a requisite for structuring and managing market economies. Accountable regimes are the basis for furnishing public goods and responding to popular needs. Political reform and incipient democratization have gained ground throughout much of Africa, yet too many states are encumbered by entrenched presidents, dominant parties, and insular political elites. Many countries display persistent syndromes of corruption, rent-seeking alliances with business cronies, and pervasive political influence throughout the economy. The longer-term challenges of economic development in Africa will turn on the process of political reform and the emergence of governments that provide a supportive foundation for growth and welfare. ■