More Resilient Than Meets the Eye

AFRICA AND THE GLOBAL ECONOMIC CRISIS

Harry G. Broadman

As we reflect on the evolution of the recent global financial crisis, the consistent underestimation of emerging markets to withstand the economic instability engendered by the advanced countries of the world stands out with glaring clarity. Indeed, against dire predictions in early 2008 of the imminent onset of a global depression with the potential to devastate emerging market economies, not only were most macroeconomic forecasts for many of those markets constantly upgraded over the course of 2009, but capital, bond and equity markets in these countries were booming by the last quarter of 2009 and the first quarter of 2010. While there certainly remain significant downside risks, any observers rooting for this crisis to mark the end of the 'Era of Globalization' surely must be disappointed.

Without question, China and India are the most widely reported emerging market countries to have unexpectedly withstood the full brunt of the global crisis, with both suffering only a modest slowing of GDP growth rather than predicted negative growth. Also well known is the relatively robust performance of Brazil and some of the Asian "tigers" which, after a brief slump, rebounded quickly and sharply. Of course, the emerging markets are a very heterogeneous group and not all have fared well during the crisis. In this regard, much attention has been devoted to the chronic and strong negative economic growth of former Soviet Union

Harry Broadman is Managing Director of Albright Stonebridge Group, a global consultancy, and Chief Economist of Albright Capital Management, an emerging markets investment advisory firm. For over 28 years in a variety of positions, Dr. Broadman has worked on emerging markets, including as an official of the World Bank; as Assistant United States Trade Representative; Chief of Staff of the President's Council of Economic Advisers; Chief Economist of the U.S. Senate Committee on Governmental Affairs; on the faculties of Harvard and Johns Hopkins Universities; Resources for the Future, Inc.; the Brookings Institution; and the Rand Corporation. Dr. Broadman has published widely, his most recent book being Africa's Silk Road: China and India's New Economic Frontier (2007).

and Eastern European countries as well as of Mexico. What has escaped the notice of most observers, however, is Sub-Saharan Africa's resilient economic performance which, on the whole, has proven to be far more robust than virtually anyone – from African policy makers to senior officials in the international financial and donor community – thought possible. To be sure, the crisis has and will continue to exact a toll, worsening poverty in some already very poor places. But, for the continent overall, the impacts have been far more muted and greatly differentiated than expected. In fact, it is arguable that from the perspective of deviations from macroeconomic "initial conditions" just prior to the onset of the global crisis, Sub-Saharan Africa has proven to be the most resilient region in the world, including the advanced countries. Understanding why this is yields significant insights into the economic dynamics that have been fundamentally transforming the continent over the past 15 years.

What has escaped the notice of most observers, however, is Sub-Saharan Africa's resilient economic performance which, on the whole, has proven to be far more robust than virtually anyone thought possible

COUPLED OR DE-COUPLED? THE CRISIS IN ADVANCED COUNTRIES COMPARED TO EMERGING MARKETS

Despite thefact that most experts' calamitous predictions have failed to materialize for many emerging markets, there is no escaping the reality that the economic fortunes of the emerging markets have come under significant stress for more than a year. But this is, of course, the case globally as indicated by the fact that the economy of the world, for the first time in 60 years, will actually have contracted in 2009. The most recent data from the International Monetary Fund (the source of all data cited herein unless otherwise noted) indicates that global GDP in 2009 will have declined by 1.1%.

An initial key to understanding how the economies of Sub-Saharan Africa have fared under this stress is to recognize the differences in how the global crisis has affected economic growth in advanced countries compared to emerging market countries overall. With few exceptions, in the aggregate, the advanced countries

suffered almost uniform negative economic growth, with average country GDP contracting by 3.4% in 2009. Japan and Germany have had particularly deep recessions. In contrast, average GDP for all emerging market countries is expected to have grown by 1.7% in 2009. And, unlike the almost uniform negative growth witnessed in advanced countries, the pattern of GDP growth in emerging markets has been quite diverse and fairly positive. On the lesser end of the spectrum, China's GDP grew at 9% in 2008 but is expected to have registered a relatively modest slowdown by 8.5% for 2009. Similarly, in the same period, India's 2008 GDP growth of 7.3% is expected to have declined to 5.4%. At the opposite end of the spectrum, in 2008, Russia's GDP grew at 5.5%, but in 2009 it is likely to have shrunk by -6.7%. Mexico, which barely grew at 1.3% in 2008, is expected to have registered negative GDP growth of -7.3% in 2009.

...unlike the almost uniform negative growth witnessed in advanced countries, the pattern of GDP growth in emerging markets has been quite diverse and fairly positive

Just prior to the onset of the global crisis, Sub-Saharan Africa's average growth rate was high and rising, largely in tandem with the rest of the world. In 2007, for the Sub-Saharan continent as a whole, average GDP grew at 6.9%. In 2008, GDP growth slowed to 5.5% and, in 2009, it is expected to have slowed further to 1.3%. As of this writing, however, for 2010, the sub-continent's GDP is projected to rebound relatively sharply and grow at 4.1%. While this is a far cry from the almost 7% seen in 2007, it is far better than what many other emerging markets, not to mention advanced countries, are experiencing and expecting.

THE IMPACT ON AFRICA

When the economic crisis evolved beyond a pure financial disturbance and began to affect the real sector, it shifted geographically outside the advanced countries. While many emerging markets were quickly affected, including South Africa and Nigeria which are fairly integrated into international capital markets, much of Africa was the last to feel the strain.

Not surprisingly given the heterogeneity of the region, there

are significant differences in how various countries on the Sub-Saharan continent have been affected by the crisis. As the table below indicates, while Middle Income Countries (MICs) – and to a lesser extent, oil-exporting countries – experienced sharp declines in growth, Low Income Countries (LICs) and post-conflict countries fared much better. While these data may seem non-intuitive to many observers, they underscore just how much the fundamental economic landscape of much of Sub-Saharan Africa has changed over the past decade-and-a-half. Indeed, contrary to the widely held perception that the only real African economic success stories – the type presumed to best weather a global crisis – are oil exporting countries and MICs, it is the non-resource dependent countries (home to 40% of the African population) that have produced the most sustained high economic growth rates in recent years. From 1998 to 2008, annual average real GDP among these countries grew at a rate of 5.6% and, throughout much of the current global economic crisis, many of these economies have been the most resilient on the continent.

DIFFERENTIAL IMPACTS OF THE GLOBAL ECONOMIC CRISIS ON GROWTH IN SUB-SAHARAN AFRICAN COUNTRIES

Average Annual GDP Growth Rates in Real Terms

Country Groups*	2008	2009
Oil Exporters	6.9%	1.4%
Middle Income Countries (MICs)	3.1%	-0.8%
MICs (less South Africa)	2.9%	-5.8%
Low Income Countries	6.9%	4.5%
Fragile/Post-Conflict Countries	3.7%	3.1%

*Country groupings are defined by the IMF. Data from the IMF; 2009 data are estimates.

Beyond its impact on GDP growth, the crisis in the advanced countries has been exerting downward pressure on Sub-Saharan African economies through several other channels. Perhaps the two most obvious are a decline in trade flows and a fall in commodity prices – primarily oil and minerals – both due to a drop in advanced country demand. (Food prices, on the other hand, shot upwards prior to the crisis and began to decline only later.)

In many respects the decline in global trade flows has been one of the hallmarks of this crisis. Indeed, it is expected that for all

of 2009 the dollar-value of global trade in goods and services will have contracted by about 12%. This marks the first actual decline in world trade flows since 1982 and the largest fall in global trade volume since the mid-1940s.

Similar to the inter-regional pattern of decreases in GDP over the crisis, the decline in trade flows during 2009 has been experienced more severely in advanced countries than in emerging markets. For the advanced countries, the volume of exports and imports of both goods and services is expected to have decreased by about 13.5% over 2009. In contrast, among the emerging market economies, the volume of exports will likely have fallen 7.2% and the volume of imports is anticipated to have declined by 9.5%. For Sub-Saharan Africa, it is estimated that, for 2009, exports will have declined by 8.5% and imports will have decreased by 6.5%.

This marks the first actual decline in world trade flows since 1982 and the largest fall in global trade volume since the mid-1940s

That the contraction in global trade flows is affecting not only trade in goods but also trade in services is critical for the economic prospects of Sub-Saharan Africa. This is because international trade in services – notably tourism, back-office administration and mobile money – are *the* new growth sectors for an increasing number of these economies.

Another channel through which the crisis has been exacting a toll on Sub-Saharan Africa (as well as other emerging market economies) has been the reduction in financial flows. This has occurred either though less foreign direct investment (FDI) or foreign portfolio investment or both. Inflows of FDI to Sub-Saharan Africa reached US$33 billion in 2008 but are expected to have decreased by about 25% over 2009. The flow of workers' remittances back to the Sub-Saharan continent has also been affected by the contractions in advanced country economies. To most observers, these resource flows are surprisingly large: in 2008 they were US$20 billion, roughly 2/3 of total FDI inflows. Over the course of 2009 the flow of workers' remittances back to Sub-Saharan Africa is likely to have declined by about 4.5%.

ROOTS OF RESILIENCE

As is clear and to be expected, African economies have by no means been immune to the negative effects of the global economic crisis. But there is no escaping the fact that growth on the continent has not come to a standstill. Not by a long shot.

Why is Sub-Saharan Africa more resilient than meets the eye? It certainly isn't by luck. Rather, over the last 15 years, a solid foundation for good economic performance has been built by deftly skilled macroeconomic policy makers who are willing to confront difficult choices. Several types of policies in particular have proven to be immensely beneficial, including: (1) the reduction of wasteful spending and public finance reforms, (2) the prioritization of sound investments in secondary education and health delivery systems, (3) the reform of infrastructure and utility services, especially concerning competitive access to transport facilities and the reliability of electricity generation and distribution, (4) the privatization of state-owned enterprises and measures to enhance competition among businesses within domestic markets, (5) the liberalization of trade policies, including WTO membership, and (6) the introduction of flexibility into interest rates and exchange rates. Of course, the reform record among African countries is far from uniform. The countries are, after all, quite diverse, with wide variations in prosperity, population, geographic size and position (e.g. landlocked vs. coastal), degree of urbanization, language and culture, etc.

Why is Sub-Saharan Africa more resilient than meets the eye? It certainly isn't by luck

HARD-WON REFORMS AT RISK?

How resilient Sub-Saharan Africa proves to be is, in part, dependent on the fundamental flexibility (or inflexibility) of the continent's markets and related institutions and the actions of businesses, workers and consumers. But it also depends on how economic policy makers react to the multifaceted dimensions of the crisis itself. In many countries, the declines in export revenues and workers' remittances have threatened to unravel hard-won discipline on fiscal and current account balances. Between 2005 and 2007, Sub-Saharan Africa as a whole ran a fiscal surplus. For 2009, the continent is expected to have registered a deficit of 4.4% of GDP. Among other things, these deficits limit the size of already

tenuous social safety nets, and in some cases will either reverse previous gains made in poverty reduction or worsen conditions for those who were never made better off. These problems are exacerbated by the rising food prices that serve to threaten food security. In turn, economic strains could fuel political tensions and unrest – indeed it already has in some countries – undermining progress made over the past two decades in opening up the political process on the continent.

In terms of domestic policy responses, the choices are often extraordinarily limited and the decisions politically difficult. Surprising many observers worldwide, however, is that it is in just such situations that Sub-Saharan Africa's most talented and experienced economic officials can shine – and in fact already have shone. Those who have performed the best in minimizing the types of problems described above have largely stayed with the same type of sound over-arching policy making principles they followed during less turbulent times: (1) the design of macroeconomic and microeconomic policies to help induce flexibility into the economy (in product, labour and capital markets), (2) levelling the playing fields for competition to take hold, and (3) the creation of a robust system of checks and balances for good governance.

At the outset of the crisis, protectionist and populist policies were irresistible and not just in Sub-Saharan Africa but also in numerous OECD and larger developing economies – who were perhaps even guiltier than African nations. Significantly, a number of African policy makers exercised notable restraint on this front, understanding that import quotas, export taxes and/or rationing schemes for food, fuel and other commodities had the potential to leave the public worse off and more vulnerable to the next crisis – ironically the poorest segment of society in particular. Instead, they chose a path that allowed certain relative prices to adjust while at the same time designing targeted social safety net programmes to protect the most vulnerable. The most successful policy responses in Sub-Saharan Africa have been those that engaged civil society, workers and businesses in an open and transparent dialogue about the causes and consequences of the crisis, educating stakeholders about the steps the government will take to help ameliorate the effects and explaining the limits of what government action can achieve.

Unfortunately, domestic policy responses alone have proven to be

insufficient for a continent as geographically fragmented as Sub-Saharan Africa. Recognizing this, certain African policy makers have pushed for more action at the regional level, since the absence of bona fide regional integration creates a real bottleneck to solving crisis-induced problems at the national level. This is especially true for landlocked states that require greater transport access options in order to engage with potentially new trading partners. A central problem to be addressed is the fact that the functions and jurisdictions of many existing regional entities overlap with one another and thus add to, rather than reducing, the complexity of creating integrated trade channels.

CAN THE INTERNATIONAL DONOR COMMUNITY HELP?

Sub-Saharan Africa is home to 300 million of the world's poorest people and is the planet's most formidable development challenge. The current crisis makes addressing the challenge more imperative and much of the international donor community – the multilateral financial institutions, bilateral aid entities, foundations and NGOs – have stepped up to the plate in varying degrees. While they have made a difference in a number of areas, unfortunately, the underlying incentive structure and implementation of foreign assistance to Sub-Saharan Africa are flawed and, while beginning to undergo reform years before the crisis, at present there is still a long way to go.

Unfortunately, domestic policy responses alone have proven to be insufficient for a continent as geographically fragmented as Sub-Saharan Africa

In this context, some of the most critical issues highlighted by the crisis as important for the international donor community to focus on in their reform agenda include: (1) ensuring that the recipient country is in the driver's seat in the foreign aid policy dialogue, (2) harmonizing disparate bilateral aid flows, (3) eliminating tied-aid, (4) reducing the proliferation of 'stove-piped' or 'vertical' sectoral funds, (5) halting the rise of trade protectionism – not just North-South, but also South-South, and (6) reforming the governance structure and programmatic focus of the multilateral development banks.

A CONTINENT OF ECONOMIC MISPERCEPTIONS

Surprisingly, there is scant recognition among even the most sophisticated international businesses and investors of the unanticipated – and unprecedented – changes in much of Sub-Saharan Africa's underlying economic condition. To be sure, some investors have caught on that the track record of economic performance means that the continent presents significantly profitable opportunities for investment. Important to the North is that an increasing number of multinational corporations from countries in the South, not only those from China and India, but also from Brazil, the Middle East and Russia, have been far quicker to appreciate and to capitalize on these changes. Such investment flows epitomize the acceleration of South-South commerce – trade and investment between emerging markets – that has been underway and increasing as a proportion of global commerce over the past three decades.

...the Chinese and Indian multinationals operating in Sub-Saharan Africa tend to be state-of-the-art integrated businesses with numerous "off the shelf" advantages

Significantly, many of these South-South investments, particularly those made by Chinese and Indian firms, are beginning to take place outside the oil and mineral sectors, arenas traditionally targeted by foreign investors. Indeed, contrary to the newspaper headlines, the newest plays by the Chinese and Indians in Sub-Saharan Africa are quite diversified and include investments in telecommunications, financial services, water purification and distribution, waste disposal and sanitation, transport, construction, tourism and a variety of manufacturing activities.

Moreover, the Chinese and Indian multinationals operating in Sub-Saharan Africa tend to be state-of-the-art integrated businesses with numerous "off the shelf" advantages. For example, their operations often create new value-added on the continent by climbing the production chain in their African facilities, such as processing raw materials into finished products prior to exporting. This allows African countries to participate in global trade networks that before have been difficult to access by domestic firms themselves or in which Northern investors had less interest to engage. By dint of their inherent integrated corporate structures,

these firms also increase the ability of African countries to engage in cross-border multi-plant economies of scale, thus fostering true regional integration.

These investments are all occurring despite the fact that there is a deeply held perception that Africa is a highly risky, if not a dangerous, place to do business. Sub-Saharan Africa is a difficult place to do business. But so are many countries in the former Soviet Union, Latin America and Asia. Indeed, there are several countries in Sub-Saharan Africa where the risks of doing business are arguably much lower than in comparable parts of the world. To wit, it is a fundamental misnomer to even refer to 'Africa' as a unit of analysis. Sub-Saharan Africa is not a single monolithic country, but a heterogeneous continent of 48 very different countries.

Of course not only is there a lack of knowledge about the fact that there has been robust and continuous growth on the African continent, but that this economic performance is, in some significant part, the result of the hard-won economic reforms implemented by African policy makers. Indeed, investments of the type and scale now taking place would not have been consummated if real economic policy, institutional and political reforms had not taken root.

Even if the investment risks in Africa are high, so too are the rewards. Indeed, unlike virtually any other region of the world, Sub-Saharan Africa is the one location where true investment 'first mover advantages' can still be found – and they exist across a surprising number of different sectors and in varying locales. The simple fact is that for much of the North, Sub-Saharan Africa is a "continent of economic misperceptions" and potential investors from the North would be wise to correct their concept of the continent before first mover advantages become the permanent domain of investors from the South.