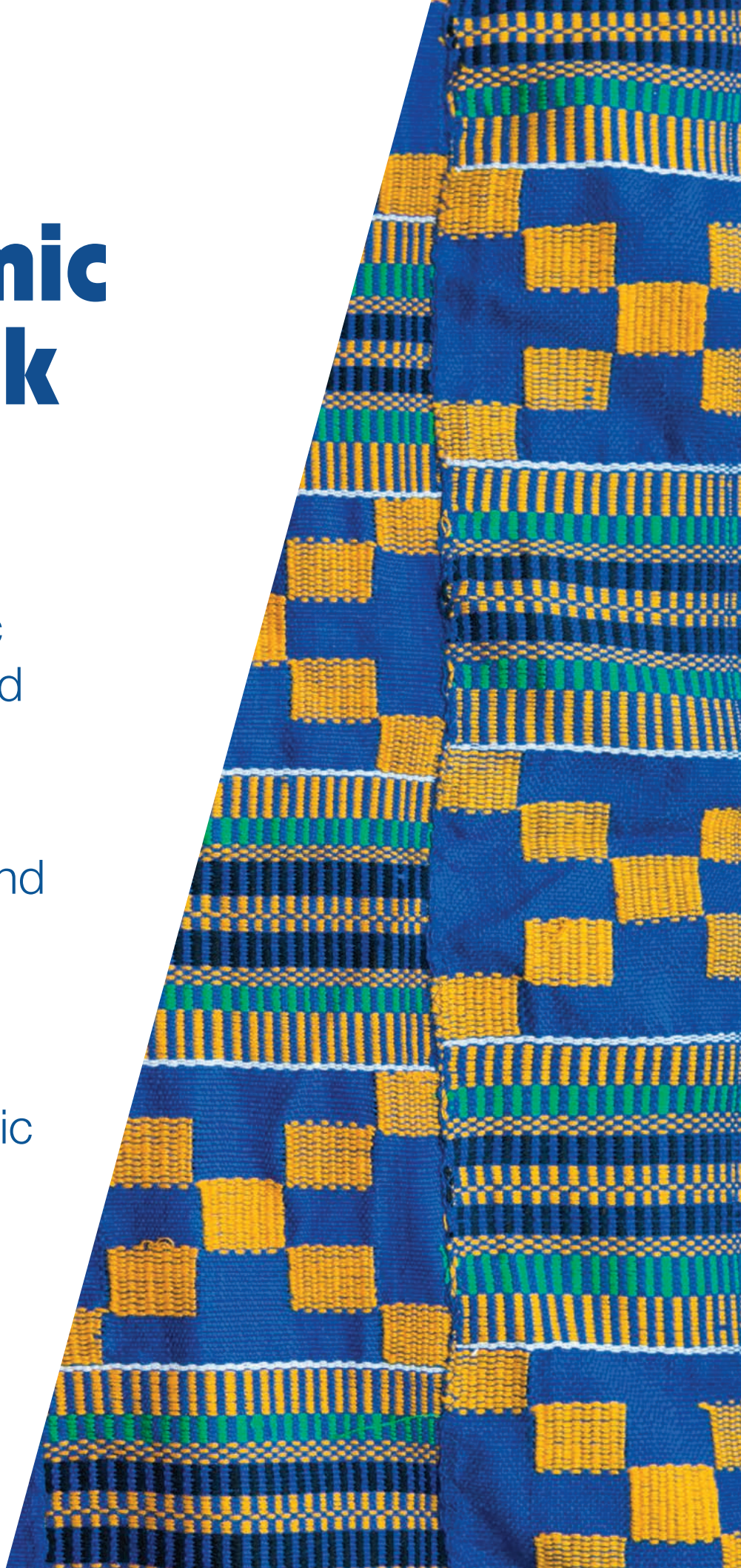
African Economic Outlook 2019

Macroeconomic performance and prospects

Jobs, growth, and firm dynamism

Integration for Africa's economic prosperity



AFRICAN DEVELOPMENT BANK GROUP

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FOREWORD

The state of the continent is good. Africa's general economic performance continues to improve, with gross domestic product growth reaching an estimated 3.5 percent in 2018, about the same as in 2017 and up 1.4 percentage points from the 2.1 percent in 2016.

Looking forward, African economic growth is projected to accelerate to 4 percent in 2019 and 4.1 percent in 2020. While higher than that of other emerging and developing countries, it remains insufficient to address the structural challenges of persistent current and fiscal deficits and debt vulnerability. The challenge is thus twofold: to raise the current growth path and to increase the efficiency of growth in generating employment.

The 2019 African Economic Outlook highlights that macroeconomic stabilization and employment outcomes are better when industry leads growth, suggesting that industrialization is a robust path to rapid job creation. However, African economies have deindustrialized. Although structural change is occurring, it has been through the rise of the services sector, which has been largely dominated by informality, low productivity, and an inability to create quality jobs. To avoid the informality trap and chronic unemployment, Africa needs to industrialize and add value to its abundant agricultural, mineral, and other natural resources.

Perhaps the most significant decision by African political leaders last year was their collective willingness to move forward with Africa's economic integration. A borderless Africa is not just a political ideal. It would lay the foundation for a competitive continental market to accelerate growth and allow Africa to be more competitive in global trade and value chains. It would also allow industries to develop across borders, creating economies of scale for investors as they look at wider integrated markets. And it would foster inter-firm competition, raise intrafirm productivity, and support growth of small and medium enterprises and large African conglomerates. It would help eliminate monopoly positions while enhancing cross-border spillovers between coastal and landlocked countries. At a deeper level, regional integration can improve regional security, since the expansion of international trade often correlates with a reduced incidence of conflict.

The 2019 Outlook shows that countries do not benefit equally from regional integration, so the incentives and commitments vary by country circumstances. But all African countries would fare better with more integration than without it.

The great news is that things are moving in the right direction. The recently issued 3rd edition of the Africa Visa Openness Index Report 2018, also published by the African Development Bank with the Africa Union Commission, shows that African countries are on average becoming more open to each other. But the fact that Africans still require visas to travel to just over half of other African countries shows that more progress is needed to realize free movement of people continent-wide.

This year's Outlook offers new and timely analytics to show how African economies are integrating, how regional public goods are moving integration beyond the purely economic domain, and how the Continental Free Trade Agreement can generate substantial gains for all African countries.

African countries should work even more closely together and move toward a common future of collective wealth and prosperity.

Dr. Akinwumi A. Adesina, President
African Development Bank Group

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THEMATIC COVERAGE OF PREVIOUS EDITIONS

Edition	Thematic title
2003	Privatization
2004	Energy Supply and Demand
2005	Financing of Small and Medium-sized Enterprise (SME) Development
2006	Promoting and Financing Transport Infrastructure
2007	Access to Drinking Water and Sanitation in Africa
2008	Technical and Vocational Training
2009	Information and Communication Technology across Africa
2010	Public Resource Mobilization and Aid
2011	Africa and Its Emerging Partners
2012	Promoting Youth Employment
2013	Structural Transformation and Natural Resources
2014	Global Value Chains and Africa's Industrialization
2015	Regional Development and Spatial Inclusion
2016	Sustainable Cities and Structural Transformation
2017	Entrepreneurship and Industrial Development
2018	Infrastructure and Its Financing

HIGHLIGHTS

This year's African Economic Outlook examines recent macroeconomic developments and the outlook in Africa, focusing on the implications of external imbalances for growth and the financial and monetary challenges of integration (chapter 1). It next discusses employment creation through the analysis of firm dynamism (chapter 2). It then explores the economics of regional integration in Africa and the policies that can make it deliver economic prosperity (chapter 3).

AFRICA'S MACROECONOMIC PERFORMANCE AND PROSPECTS

Africa's economic growth continues to strengthen, reaching an estimated 3.5 percent in 2018, about the same as in 2017 and up 1.4 percentage points from the 2.1 percent in 2016. East Africa led with GDP growth estimated at 5.7 percent in 2018, followed by North Africa at 4.9 percent, West Africa at 3.3 percent, Central Africa at 2.2 percent, and Southern Africa at 1.2 percent.

In the medium term, growth is projected to accelerate to 4 percent in 2019 and 4.1 percent in 2020. And though lower than China's and India's growth, Africa's is projected to be higher than that of other emerging and developing countries. But it is insufficient to make a dent in unemployment and poverty. Of Africa's projected 4 percent growth in 2019, North Africa is expected to account for 1.6 percentage points, or 40 percent. But average GDP growth in North Africa is erratic because of Libya's rapidly changing economic circumstances.

East Africa, the fastest growing region, is projected to achieve growth of 5.9 percent in 2019 and 6.1 percent in 2020. Between 2010 and 2018, growth averaged almost 6 percent, with Djibouti, Ethiopia, Rwanda, and Tanzania recording above-average rates. But in several countries, notably Burundi and Comoros, growth remains weak due to political uncertainty.

Growth in Central Africa is gradually recovering but remains below the average for Africa as a whole. It is supported by recovering commodity prices and higher agricultural output.

Growth in Southern Africa is expected to remain moderate in 2019 and 2020 after a modest recovery in 2017 and 2018. Southern Africa's subdued growth is due mainly to South Africa's weak development, which affects neighboring countries.

The drivers of economic growth are gradually rebalancing

The drivers of Africa's economic growth have been gradually rebalancing in recent years. Consumption's contribution to real GDP growth declined from 55 percent in 2015 to 48 percent in 2018, while investment's contribution increased from 14 percent to 48 percent. Net exports, historically a drag on economic growth, have had a positive contribution since 2014.

But despite the rebalancing trend, most of the top-growing countries still rely primarily on consumption as an engine of growth.

Inflationary pressures have eased. Africa's average inflation fell from 12.6 percent in 2017 to 10.9 percent in 2018 and is projected to further decline to 8.1 percent in 2020. Double-digit inflation occurs mostly in conflict-affected countries and countries that are not members of a currency union. Inflation is highest in South Sudan, at 188 percent, due to the lingering economic crisis. Inflation is lowest, at 2 percent or less, in members of the Central African Economic and Monetary Community and the West African Economic and Monetary Union and particularly in members of the CFA zone because of its link to the euro.

While debt vulnerabilities have increased in some African countries, the continent as a whole is not exposed to a systemic risk of debt crisis

Fiscal positions are gradually improving

Between 2016 and 2018, several countries achieved fiscal consolidation by increasing tax revenue and, at times, lowering expenditures. Revenue increases were due partly to higher commodity prices and increased growth, but several countries also implemented tax reforms. Domestic resource mobilization has improved but falls short of the continent's developmental needs.

Although current account deficits have been deteriorating, total external financial inflows to Africa increased from $170.8 billion in 2016 to $193.7 billion in 2017, which represents a 0.7 percentage point increase in net financial inflows as a ratio of GDP (from 7.8 percent in 2016 to 8.5 percent in 2017).

Remittances continue to gain momentum and dominate the other components of capital flows, at $69 billion in 2017, almost double the size of portfolio investments. Meanwhile, FDI inflows have shrunk from the 2008 peak of $58.1 billion to a 10-year low of $41.8 billion in 2017. Underlying factors include the global financial crisis and the recent rebalancing of portfolios due to rising interest rates among advanced economies.

Official development assistance (ODA) to Africa peaked in 2013 at $52 billion and has since declined to $45 billion in 2017, with fragile states receiving more ODA as a percentage of GDP than nonfragile states. All regions saw ODA increase between 2005–10 and 2011–16; East Africa and West Africa remain the highest recipients.

Africa's debt is rising, but there is no systemic risk of a debt crisis

By the end of 2017, the gross government debt-to-GDP ratio reached 53 percent in Africa, but with significant heterogeneity across countries. Of 52 countries with data, 16 countries—among them Algeria, Botswana, Burkina Faso, and Mali—have a debt-to-GDP ratio below 40 percent; while 6 countries—Cabo Verde, Congo, Egypt, Eritrea, Mozambique, and Sudan—have a debt-to-GDP ratio above 100 percent. The traditional approach to estimating debt sustainability classifies 16 countries in Africa at high risk of debt distress or in debt distress. Debt situations in some countries have thus become untenable, requiring urgent actions whose range and modalities depend on the precise diagnosis of the source of debt distress. Even so, while debt vulnerabilities have increased in some African countries, the continent as a whole is not exposed to a systemic risk of debt crisis.

External imbalances have implications for long-term growth

Africa's external imbalances have worsened, measured by both the current account and the trade balance. The weighted average current account deficit was 4 percent of GDP at the end of 2017 (the median was 6.7 percent) and, despite recent improvement, has been deteriorating since the end of the 2000s. This could threaten external sustainability and require sharp adjustments in the future.

Based on the balance-of-payments constraint theory (that external financing gaps must turn into surpluses in the long run to avoid external default or sharp consumption adjustments), Africa's current external deficits may be justified if they sow the seeds for future surpluses. This will be the case as long as higher imports are consistently associated with rising capital formation, followed by an increased share of manufacturing and tradable industries in value added, an improved position in global value chains, and a gradual repayment of external liabilities.

Risks to the outlook

Clouding the macroeconomic forecasts for Africa are several risks.

First, further escalation of trade tensions between the United States and its main trading partners would reduce world economic growth, with repercussions for Africa. These tensions, together with the strengthening of the US dollar, have increased the volatility of some commodity prices and pressured the currencies of emerging countries. If global demand slows, commodity prices could drop, reducing GDP growth and adversely affecting trade and fiscal balances for Africa's commodity exporters.

Second, costs of external financing could further increase if interest rates in advanced countries rise faster than assumed.

Third, if African countries are again affected by extreme weather conditions due to climate change, as they have been in recent years, agricultural production and GDP growth could be lower than projected.

Fourth, political instability and security problems in some areas could weaken economies. Countries that have improved their fiscal and external positions and that have low or moderate debt will probably be resilient to new external shocks. But those that have not rebuilt their fiscal buffers are unprepared for significant downside risks.

Monetary integration is always challenging

As noted in last year's Outlook, countries engage in monetary unions with the hope of macroeconomic and structural benefits. The benefits include a stable exchange rate and macroeconomic environment, less external vulnerability, greater intraregional trade, more financial integration, lower transaction costs (as currency conversion costs fall)—and thus faster growth and more convergence among member countries. But there also are costs. By definition, monetary unions limit the flexibility of member countries to use monetary instruments to adjust to external shocks.

The immediate gains from African monetary integration, one of the aspirations of regional and continental integration, may be much more elusive—and the macroeconomic challenges much greater—than conventional analysis predicts. The standard framework that many economists use (the optimal currency area) can be difficult to validate for countries with too little accurate data on key macroeconomic variables. It is unlikely that differences in labor markets will disappear rapidly over time. It is also unlikely that shocks will hit only one member and not be generalized to many or all of them. So it is unlikely that an African supranational authority will have the resources to come to aid of countries facing severe economic difficulties.

For countries in a monetary union, well-functioning, cross-country fiscal institutions and rules are needed to help members respond to asymmetric shocks. The free movement of labor, capital, and goods should be a reality—not just a goal. Debt and deficit policies should be consistent across the union and carefully monitored by a credible central authority. And the financial and banking sector should be under careful supervision by a unionwide independent institution capable of enforcing strict prudential rules. Each of these four requirements is a tall order. Together, they present enormous macroeconomic challenges.

Policy implications

The recovery of Africa's GDP growth from the trough of 2016 suggests resilience as well as vulnerability to regional and global shocks. The projected growth of 4 percent in 2019 and 4.1 percent in 2020 is welcome progress. But dependency on a few export commodities to spur growth and vulnerability to volatility in commodity prices has impeded most African economies from sustaining high growth. Commodity dependence has also reduced macroeconomic levers, creating tensions and tradeoffs between growth-enhancing and stabilization policies. As a result—and as often advocated—Africa needs deep structural reforms to successfully diversify its economy, both vertically and horizontally.

Diversifying and undertaking deep structural change require considerable development finance. Apart from revenue from extractive sectors and taxes, most African countries receive remittances that now exceed ODA and FDI—not including remittances transferred through informal channels,

The projected growth of 4 percent in 2019 and 4.1 percent in 2020 is welcome progress

which could equal half of remittances through formal channels. Policies to lower the cost to transfer money and to improve platforms for diaspora investment and other incentives can increase the availability of critical resources for financing development. Intra-Africa remittances flow largely through informal channels because of high transfer costs and limited interbank services within Africa, which stymie formal remittance flows.

Widespread illicit financial outflows are hurting most African countries, limiting the financial resources available for investing in infrastructure, power, and other long-term projects. (Illicit financial flows account for 5.5 percent of GDP in Sub-Saharan Africa and have cost $1–$1.8 trillion over the past 50 years.) And continuous monitoring of the debt situation in the most fiscally fragile African economies is required to develop early-warning systems and feedback mechanisms to avoid debt distress. In addition, there is a need to raise awareness of debt sustainability at the highest political level, lay the foundation for efficient use of existing resources to limit recourse to additional debt, strengthen countries' capability to manage their public debt, support efficient and productive use of debt, and build fiscal capacity.

As interest rates gradually normalize in advanced economies and rates of return in Africa fall, policy adjustments are needed that continue to attract investors to the region through strong performance in macroeconomic fundamentals, such as high GDP growth, stable and low inflation, and security of lives and property. One way to achieve export-led growth is to accumulate physical capital and expand the economy's productive capacity.

Policy interventions focused on increasing the share of intermediate and capital goods in imports could help countries benefit from scale and scope economies and exploit knowledge transfers from more advanced production processes.

- Higher private investment is associated with future improvement in the trade balance. Countries may thus sustain current large external deficits, as long as tax incentives, institutional frameworks, and basic infrastructure are in place to channel capital investment toward the sectors most likely to drive a trade balance reversal.
- Emphasizing urbanization and a reallocation of the most productive resources toward export-intensive areas that are well integrated into global value chains appears to be key to aggregate productivity growth.
- Among African success stories of export diversification, improving the external tariff structure to avoid an undue burden on intermediate and capital goods is also a relevant policy intervention to level the playing field and foster a structural shift in the import mix from consumer to capital goods.
- Ensuring integration into global value chains by upholding technical and labor standards and reinforcing regional integration enables countries to move up the ladder of specialization and reverse external imbalances.
- Reinvesting surpluses from commodity price windfalls toward sectors with higher productivity growth and more potential for integration into global value chains is crucial to make trade an inclusive part of structural change in Africa.

Africa has achieved one of the fastest and most sustained growth spurts in the past two decades, yet growth has not been pro-employment

JOBS, GROWTH, AND FIRM DYNAMISM

Creating jobs in higher productivity sectors

Africa's working-age population is projected to increase from 705 million in 2018 to almost 1.0 billion by 2030. As millions of young people join the labor market, the pressure to provide decent jobs will intensify. At the current rate of labor force growth, Africa needs to create about 12 million new jobs every year to prevent unemployment from rising. Strong and sustained economic growth is necessary for generating employment, but that alone is not enough. The source and nature of growth also matter.

Africa has achieved one of the fastest and most sustained growth spurts in the past two decades, yet growth has not been pro-employment. A 1 percent increase in GDP growth over 2000–14 was associated with only 0.41 percent growth in employment, meaning that employment was expanding at a rate of less than 1.8 percent a year, or far below the nearly 3 percent annual growth in the labor force. If this trend continues, 100 million

people will join the ranks of the unemployed in Africa by 2030. Without meaningful structural change, most of the jobs generated are likely to be in the informal sector, where productivity and wages are low and work is insecure, making the eradication of extreme poverty by 2030 a difficult task.

One of the most salient features of labor markets in Africa is the high prevalence of informal employment, the default option for a large majority of the growing labor force. On average, developing countries have higher shares of informal employment than developed countries. While data on informal employment are sketchy, it is clear that Africa has the highest rate of estimated informality in the world, at 72 percent of nonagriculture employment—and as high as 90 percent in some countries. Furthermore, there is no evidence that informality is declining in Africa.

While evidence from other developing countries shows a fairly competitive labor market structure, Africa has a more segmented labor market. Segmented labor markets tend to improve with economic policies that facilitate labor mobility, a competitive environment for private sector operations, and better skill development programs.

Growth accelerations and job growth

Growth accelerations, or economic take-offs, are often underpinned by structural change, which is the result of changes in growth fundamentals. In Africa, long-term economic performance is closely related to these growth episodes. Sectoral labor reallocations that capture structural change patterns are important aspects of these growth dynamics.

In Africa, most growth acceleration episodes were associated with a reallocation of labor to services (18 of the 20 episodes) and to industry (16 of the 20 episodes). Of nine industry-driven growth acceleration episodes, seven were characterized by a higher growth in employment shares in industry than in services. Growth acceleration episodes are also associated with a rise of employment in the mining sector (10 of 20 episodes), confirming the specific role of the extractive sector in Africa. The overall picture is consistent with the notion that growth accelerations are associated with structural change.

Industry-driven growth acceleration episodes increased total employment growth considerably and had stronger effects on employment elasticities, boosting employment's elasticity by about 0.017 percentage point (or by 3 percent)—three times higher than the effects of service-driven episodes. Moreover, industry-driven growth acceleration episodes have larger cross-sector effects—0.034 percentage point higher growth elasticities of employment for industry, 0.038 for services, 0.022 for agriculture, and 0.053 for mining. In addition, mining-driven growth acceleration episodes had a similarly robust effect as industry-driven episodes. This could be explained by the simultaneity of the two types of growth acceleration episodes in a large number of cases: of the eight mining-driven growth acceleration episodes, six were also industry-driven.

Overall, industry-driven growth acceleration episodes led to positive structural change, with potentially stronger dynamic effects in the long run. The implications of such a strong association between industry-driven growth episodes and jobs is that industrialization is the key to the employment conundrum in Africa.

Large firms are more productive and pay higher wages than small firms. For instance, a 1 percent increase in firm size is associated with a 0.09 percent increase in labor productivity. The return to firm size is even higher in Africa than in other developing regions, with a 0.15 percent increase in labor productivity for a 1 percent increase in size. The size effect is even stronger for manufacturing firms in Africa, with 1 percent increase in size associated with a 0.20 percent increase in labor productivity—well above the 0.12 percent increase for firms in the services sector.

Wages are also much higher in medium and large enterprises than in small firms—and in manufacturing than in services. Wages are twice as high in large manufacturing firms as in large service firms and 37 percent higher in small manufacturing firms than in small service firms. Differentials in productivity and wages by firm size are partly due to the fact that large firms tend to have more educated and skilled workers and to be more capital intensive in production than smaller firms, commanding higher output per worker.

Segmented labor markets tend to improve with economic policies that facilitate labor mobility, a competitive environment for private sector operations, and better skill development programs

Overall, there is little firm dynamism in Africa, particularly for small firms' chances of transitioning into medium and large firms. The implication is that the dominance of small firms drives down aggregate productivity, particularly in the manufacturing sector, and prevents firms from creating enough high-quality jobs for Africa's growing labor force. More needs to be done to encourage large companies to set up businesses in Africa and to help small firms grow by removing constraints such as poor infrastructure, political instability, and corruption. Identifying and building the necessary clusters at the right scale also might help firm growth. This implies a concerted industrialization effort that builds on countries' comparative advantage in Africa's manufacturing sector.

Creating better jobs and enabling sustainable development require diversifying at the product level by developing a strong manufacturing sector

Creating better jobs and enabling sustainable development require diversifying at the product level by developing a strong manufacturing sector. This is all the more the case in Africa, where growth acceleration episodes driven by industry have generated more employment than acceleration episodes driven by services or agriculture and where premature deindustrialization points to more challenges ahead. Fostering industrialization in Africa to promote decent jobs and sustained growth requires that firms be allowed to grow and thrive relatively unfettered. Thus, industrial policy and how countries industrialize matter.

Business obstacles and lost jobs

Business obstacles also have an impact on job creation, largely through lower firm survival rates and staff cutbacks. When obstacles are too severe, firms may decide to shut down, resulting in a loss of job opportunities. Firms that survive despite severe obstacles might decide to optimize profits or minimize losses by hiring fewer workers or by laying some off. In Africa, the biggest impact on jobs is through firm survival; the employment effects are less severe among surviving firms.

Firms that survive seem to cope reasonably well with business obstacles, though firms still report them as a detriment to their operations. Each obstacle to doing business reduces annual employment growth among surviving firms, controlling for age, by 0.1–0.34 percentage point. This translates into a 1.5–5.2 percent loss in annual employment growth.

On rough estimates, the continent loses an average of 176,000 private sector jobs every year because of each of the business obstacles examined, for a total of 1.2–3.3 million jobs lost every year. The number of estimated jobs lost ranges from 74,000 due to customs and trade regulations to 264,000 due to licensing and permitting. These rough estimates are indicative only, and actual and potential job losses could be much higher. They do, however, indicate how detrimental the obstacles are to both creating new jobs and maintaining existing high-quality jobs in the formal sector. Licensing and permitting, courts, political instability, and corruption are associated with the highest numbers of private sector jobs lost in Africa. Related to governance, these obstacles are thus amenable to reform.

Firm productivity, and thus firm growth, are shaped by four interrelated factors, often determined by policy choices. The first, and perhaps most frequently mentioned, is getting the basics right. These include adequate infrastructure (utilities, transport, communications, and the like), human capital (skills), and functioning institutions. The second is identifying the type of market firms target to sell their products. A wealth of research in Africa and other developing regions has identified manufactured exports as an important source of productivity growth. Third is forming industrial clusters, and fourth is attracting foreign direct investment.

One way to relieve the infrastructure constraints for firm entry and survival is to set up industrial zones. African firms that engage in exporting, operate in proximity to other firms, and attract foreign direct investment tend to be more competitive and therefore to thrive. With many African countries dependent on extractive industries, building economic complexity is challenging. The capabilities and productive knowledge in extractive industries have little overlap with those needed to produce more complex manufactured products. Policymakers should identify the frontier products that countries can diversify into, as well as the capabilities needed. And they should alleviate unnecessary constraints to doing business, especially those that firms have identified as primary obstacles and that are within government's ability to deal with quickly.

Industrial strategies should be developed in collaboration with stakeholders, particularly the private sector, and focus on identifying priority issues and creating a strong competitive environment. Countries need to clear their own paths to sustainable economic transformation. Finally, to avoid redundancy and increase synergies between neighboring countries, regional industrial zones could be established to reap the benefits of externalities and agglomerations and to build a critical mass of skilled labor.

INTEGRATION FOR AFRICA'S ECONOMIC PROSPERITY

A borderless Africa is the foundation of a competitive continental market that could serve as a global business center. It would allow agricultural and industrial production across national boundaries and therefore offer economies of scale to investors, while creating much bigger markets and providing new opportunities for small firms and large. It would help eliminate monopoly positions while enhancing cross-border spillovers between coastal and landlocked countries. At a deeper level, regional integration can improve regional security, since the expansion of international trade often correlates with a reduced incidence of conflict.

Reducing tariffs and nontariff barriers

The first expected outcome of an effective preferential trade agreement is an increase in trade among members—through three channels. The first is reducing tariffs between members. The second is reducing nontariff barriers that arise from policies and from non-policy-induced rent extraction. The third, and hardest to achieve, is through the two components of trade facilitation: a "hard" component, related to tangible infrastructure such as ports, roads, highways, and telecommunications, and a "soft" component, related to transparency, customs management, the business environment, and other intangible institutional aspects that affect the ease of trading. The first two are the outcomes of measures taken under shallow integration, and the third is associated with deep integration.

Increasing labor mobility

Migration is happening in Africa even if not all free movement of persons protocols are ratified and implemented. Fully implementing all of them might increase flows among African countries. That makes it important to focus on what prevents countries from implementing the protocols. The Africa Union Passport, launched in July 2016 at the African Union Summit in Kigali, encourages the free movement of people in general and labor mobility in particular. And the first objective of the African Continental Free Trade Area is to "create a single continental market for goods and services, with free movement of business persons and investments, and thus pave the way for accelerating the establishment of the Continental Customs Union and the African customs union."

For these initiatives to be successful and effective, it is useful to proceed by first improving the effectiveness of the policies within each regional economic community (REC) before scaling up efforts to the continent. And because integration should happen not only in the goods market but also in factors of production, the discussions should attend more to the free movement of persons.

Integrating financial markets

Despite progress, financial markets in Africa are still weakly integrated. Measures of institutional restrictions to financial flows suggest that a lot more needs to be done from a governance perspective. The correlations between domestic savings and investment rates are still strong, even though they should have been weakening in the absence of barriers to capital movements. Interest rate spreads on retail banking are still wide but have stabilized in the past few years. And African stock markets are more sensitive to global benchmarks than to the South African benchmark. Bold reforms, especially at the institutional level, are needed to synchronize financial governance frameworks across the region and to remove any remaining legal restrictions to cross-border financial flows and transactions. It is important to pursue stronger technological advances in the harmonization of payment systems across the continent, as this would facilitate actual movement of funds across borders.

A borderless Africa is the foundation of a competitive continental market that could serve as a global business center

As an extension of regional integration, monetary unions in Africa are seen as a way to achieve prosperity and better governance, sparked to some extent by the example of European monetary integration. But African monetary unions have underperformed, failing to bring about economic prosperity and poverty reduction. In many cases, even the weaker requirements of free trade areas and customs unions have not been met. Yet African political leaders have consistently chosen to forge ahead without first taking the bold institutional and economic coordination measures that would enable monetary unions to strengthen integration in Africa. In the absence of true fiscal and economic coordination, the opportunity cost of maintaining a single currency can be high.

While the treaty creating the African Union envisions a single currency for Africa, and many RECs have plans to create regional currencies, these plans are in most cases more aspirational than concrete guides to national policy. Countries need to implement the institutional building needed to make a monetary union successful, such as close coordination of banking supervision, a willingness to come to the assistance of countries in economic crisis, and political federation to coordinate fiscal policies and control deficits.

Collective action by governments requires regional governance by a regional body with real authority over member states to deliver regional public goods

Enhancing cooperation for regional public goods

Regional integration has always been about more than market access. Regional cooperation has always been important, if only because of the need for rail, roads, and other means of communication, and it is now attracting more attention on several fronts. Beyond the eight RECs and seven other regional organizations aiming at deepening intraregional trade, the majority of regional organizations deal with regional public goods: 5 deal with energy, 15 with the management of rivers and lakes, 3 with peace and security, and 1 with the environment.

Collective action by governments in the region should create positive spillovers across the region that are greater than the spillovers that individual governments acting alone could generate. This requires regional governance by a regional body with real authority over member states to deliver regional public goods. States must be willing to cede a significant amount of authority to the body, something that has so far occurred only in the European Union. That is why most regional cooperation is intergovernmental. Each state retains veto power, and the regional organization is a secretariat to coordinate and harmonize policies, set standards, and provide services—but with no authority.

Hard infrastructure

Roads, ports, railways, pipelines, and telecommunications have always been important for African integration. And recently, China and the African Union Commission signed a far-reaching agreement within the framework of the African Union's Agenda 2063 to link all African capitals by road, rail, and air transport.

By reducing trade costs, new roads, railways, and ports are intended to improve connections across cities, accelerate urbanization, and encourage regional integration. A virtuous cycle leads from investments in hard infrastructure to increased trade that in turn makes further investments profitable. By contrast, poorly functioning logistics markets lead to a vicious circle of low trade volume and high trade costs. The quality and quantity of hard infrastructure are key determinants of trade costs.

Soft infrastructure

Good logistics are necessary to operate the close-to-seamless transport corridors necessary for successful regional integration. Efficient services, including trucking, freight-forwarding and handling, and smooth terminal operation, are all necessary. Logistics markets operate more efficiently when freight forwarding and handling services and terminal operations are opened up to competition regionally and goods are submitted and cleared through customs expeditiously. Trade costs due to poorly functioning logistics markets may be a greater barrier to trade than tariffs and nontariff barriers. Lack of well-functioning corridors impedes the development of regional value chains, where goods often cross borders several times during production.

Barriers to trade from border impediments have fallen over the past 20 years. These patterns suggest three conclusions. First, although borders

are still "thick," they have become progressively thinner, easing concerns expressed in some studies on regional integration in Africa that concentration of activity has increased. Second, membership in a regional trade agreement does not seem to affect agglomeration. Third, trade facilitation projects—an integral component of current and planned integration efforts—can alleviate the fears of unbalanced development across the continent by leading to the development of peripheral areas.

Reducing trade costs to increase participation in trade supply chains

An immediate objective of the Continental Free Trade Agreement is to increase participation in cross-border supply chains by reducing trade costs through regional integration. African countries have participated little in global trade supply chains except in upstream activities as providers of unprocessed goods and raw materials. But experience in textiles and apparel, supermarkets, and automotives show that African countries are getting progressively more involved in trade in tasks through regional value chains. Key to this is a reduction in trade costs as goods cross borders multiple times. To develop cross-border supply chains, improving customs management and adopting simple and transparent rules of origin are essential.

Rapidly implementing the WTO's Trade Facilitation Agreement would introduce a first set of cost-reducing measures that African WTO members could carry out. The WTO estimates that reducing time delays at customs could lower trade costs by about 15 percent for developing countries. Further estimates at the country level prepared for this report confirm the gains from improving transparency and reducing red tape at customs.

In a world of spreading preferential trade agreements and greater trade in tasks, rules of origin stand in the way. One of the challenges of "multilateralizing regionalism" is to prevent rules of origin from working at cross-purposes with the rise in global and regional value chains. Nowhere is this challenge greater than across African RECs. While rules of origin are necessary to prevent transshipment, if too restrictive they will undo any trade-creating effects of preferences since product-specific rules of origin are then tailored to producers' demand for protection.

Taking advantage of the World Trade Organization's Trade Facilitation Agreement

Reducing the supply chain barriers to trade could increase global GDP up to six times more than removing tariffs. If all countries could bring border administration, together with transport and communications infrastructure, up to just half the level of global best practice, global GDP would grow by $2.6 trillion (4.7 percent), and total exports would increase by $1.6 trillion (14.5 percent).

Clearly, global value chains are now the dominant framework for trade. And as seen, African countries such as Rwanda (and Ethiopia and Morocco) are already taking advantage of this paradigm shift. Rather than waste time in unproductive policy discussions over tariffs, they are redirecting their strategies to focus on trade facilitation.

The reduction in fixed trade costs related to time in customs and the associated monetary costs should encourage greater diversification of trade to other markets and in other products to the same market. It should also lead to greater participation in supply chain trade at both the regional and global levels, where goods have to cross borders multiple times.

Harmonizing rules of origin

Because duties and import restrictions may depend on the origin of imports, criteria are needed to determine the country of origin of a product. These are referred to as rules or origin, and they are an integral part of all trade agreements. Preferential rules of origin are used to enforce preferential schemes by establishing which products can benefit from preferential access.

As in other free trade agreements, the negotiations on rules of origin for the CFTA are likely to be dominated by strong industry lobbying. During the negotiations so far, West and Central Africa have preferred general rules of origin, which would probably resemble those in the East Asia and the Pacific region. On the other side, Egypt, Kenya, and South Africa have pushed for product-specific rules of origin, and South Africa has lobbied for adoption of the Southern African Development Community rules of origin on a sector- or product-specific basis.

To develop cross-border supply chains, improving customs management and adopting simple and transparent rules of origin are essential

Rules of origin will also have to deal with the regime-wide rules covering certification, verification, and cumulation. Because there are few differences in certification and verification methods across the African RECs, agreeing on them should be relatively easy—especially if, as recent evidence suggests, administrative costs are not as high as previously estimated. So, it might be easier to agree first on harmonizing rules governing certification and verification. In contrast, provisions on cumulation (treating of intermediates from other countries in the bloc or countries with special cumulation status) differ across RECs.

Do monitor progress in reducing bilateral tariffs and nontariff barriers, as the East African Community does with the Common Market Scorecard, tracking compliance in the free movement of capital, services, and goods

Dos and don'ts for integration policymakers

All African countries would fare better with well-designed integration than without it. What, then, are the policy responses to maximize the benefits of regional integration and to mitigate the potential risks?

Here, first, are some things integration policymakers should not do.

- Do not worry overly about ceding national sovereignty to supranational authority because that facilitates harmonizing regulatory policies, building trust, and checking the political pressure to erect nontariff barriers.
- Do not neglect the soft infrastructure (logistics and the like) that's essential to reap the gains from investments in hard infrastructure (roads, rails, bridges, ports).
- Do not believe that integration will necessarily concentrate even more economic activity in big countries because trade facilitation has spread economic activity all along the corridors.
- Do not underestimate how poor households are hit most by high-tariff sensitive lists for, say, rice and sugar, as the common external tariffs do in the Economic Community of West African States and (less) in the East African Community.
- Do not impose sector-specific or product-specific rules of origin. Word in policy circles, however, has it that African trade negotiators already have identified 800 products for specific treatment.

Now turn to the dos for trade.

- Monitor progress in reducing bilateral tariffs and nontariff barriers, as the East African Community does with the Common Market Scorecard, tracking compliance in the free movement of capital, services, and goods.
- Eliminate all of today's applied bilateral tariffs in Africa and keep rules of origin simple, flexible, and transparent. That could increase intra-Africa trade by up to 15 percent, for a gain of $2.8 billion, small but welcome in these times of rising protectionist stances in the global economy and the China–United States and Britain–mainland Europe divides.
- Remove all nontariff barriers on goods and services trade on a most favored nation basis, since they apply overwhelmingly to all partners for trade across Africa. When added to eliminating tariffs, this would increase trade and boost the cumulative income gains to $37 billion—and the continent's tariff revenues by up to $15 billion, which is more than small change.
- Implement in addition the WTO's Trade Facilitation Agreement to reduce the time it takes to cross borders and the transaction costs tied to nontariff measures. When added to the removal of tariffs and nontariff barriers, that could yield a cumulative income gain of 3.5 percent of the continent's GDP, bringing the gains to just over $100 billion.
- Consider the effect of other developing countries reducing by half their tariffs and nontariff barriers on a most favored nation basis. That could bring Africa's gains to 4.5 percent of its GDP, for an additional $31 billion, bringing the total gains to $134 billion.
- Also consider a 0.2 percent tariff on imports from high-income countries. That could bring in $850 million a year to finance trade facilitation projects.

Then, put much more emphasis on regional public goods, a no-brainer because every country benefits, but especially the low-income countries.

- Synchronize financial governance frameworks across the region and tighten prudential frameworks for supervising financial flows, while removing any remaining ill-founded legal

restrictions to cross-border financial flows and transactions.

- Pool power to tap the enormous potential of cross-border trade in electricity. And as the Nord Power Pool in northern Europe shows, start with a small number of countries, rely on external finance to increase capacity, combine generation with transmission, and have enough transmission capacity to stabilize supply and promote competition.
- Open your skies to competition, as with Mozambique, which recently opened to foreign carriers. The African Union's Single African Air Transport Market, launched in January 2019, has so far been signed by 22 countries with 75 percent of intra-African air transport. Morocco's open skies policy shows how lowering airfares and opening new routes can increase the seats offered by half (against 10 percent in Tunisia) and boost the share of low-cost airlines from 3 percent in 2006 to 36 percent in 2010 (from 7 to only 10 percent in Tunisia).
- Open your borders to free movements of people—say, by ratifying and implementing the African Union Passport, launched in 2016 and expected to be fully rolled out by 2020.

Do synchronize financial governance frameworks across the region and tighten prudential frameworks for supervising financial flows

BOX 1. Customizing regional integration strategies and policies

Here are some specific items for the integration agendas for Africa's diverse economies.

For landlocked economies—Botswana, Burkina Faso, Burundi, Central African Republic, Chad, Ethiopia, Lesotho, Malawi, Mali, Niger, South Sudan, eSwatini, Rwanda, Uganda, Zambia, and Zimbabwe.

- Advance efforts for delegating regional public goods.
- Continue to develop national multimodal rail, road, air, and pipeline networks.
- Strengthen regional transport corridors. Under the Northern Corridor Transit and Transport Agreement, long-distance transport prices in 2011–15, despite large increases in traffic, came down 70 percent from Mombasa to Kampala and 30 percent from Mombasa to Kigali. By contrast, they rose along the Central Corridor by almost 80 percent from Dar to Kampala and by 36 percent from Dar to Kigali. The main difference was the better improvement of logistics in the Northern Corridor.
- Revamp the transport regulatory frameworks. Landlocked countries in Africa, many of them low income, tend to engage more in intra-Africa trade than coastal or middle income countries. But an estimated 77 percent of their export value consists of transport costs, a high barrier to regional and international trade.
- Push for improving the conventions and instruments that facilitate transit trade (beyond the stalled multilateral negotiations).

For coastal economies—Algeria, Angola, Benin, Cabo Verde, Cameroon, Comoros, Congo, Democratic Republic of Congo, Côte d'Ivoire, Djibouti, Egypt, Equatorial Guinea, Eritrea, Gabon, Gambia, Ghana, Guinea-Bissau, Kenya, Liberia, Libya, Madagascar, Mauritania, Mauritius, Morocco, Mozambique, Namibia, Nigeria, São Tomé and Príncipe, Senegal, Sierra Leone, Somalia, South Africa, Sudan, Tanzania, Togo, and Tunisia.

- Expand port facilities, including storage and customs administration, and increase the efficiency of handling vessel traffic and loading and unloading containers. The cost of African port facilities is estimated to be 40 percent above the global norm, and they have long container dwell times, delays in vessel traffic clearance, lengthy documentation processing, and low containers per crane hour (except South Africa). Ultimately, over 70 percent of delays in cargo delivery come from extra time in ports.
- Increase the speed and reliability of rail and road networks by reducing congestion and delays at checkpoints, and diversions of trucks and rolling stock for maintenance.
- Push for improving conventions and instruments beyond the stalled multilateral negotiations to facilitate transit trade.

For larger economies—Egypt, Morocco, Nigeria, and South Africa

- Lead the move toward a customs union by accepting greater delegation of decisionmaking to supranational authorities and resisting internal pressures to protect domestic producers and limit competition.

For resource-rich economies—Botswana, Democratic Republic of Congo, Ghana, Guinea, Mozambique, Namibia, Niger, South Africa, Tanzania, and Zambia

- Apply the core principles of the National Resource Charter.
- Cooperate to harmonize taxation of oil, gas, and minerals to avoid races to the bottom and the associated overexploitation.

1

AFRICA'S MACROECONOMIC PERFORMANCE AND PROSPECTS

KEY MESSAGES

- **Africa's economic growth continues to strengthen, reaching an estimated 3.5 percent in 2018.** This is about the same rate achieved in 2017 and up 1.4 percentage points from the 2.1 percent in 2016. In the medium term, growth is projected to accelerate to 4 percent in 2019 and 4.1 percent in 2020. And though lower than China's and India's growth, Africa's growth is projected to be higher than that of other emerging and developing countries.
- **Improved economic growth across Africa has been broad, with variation across economies and regions.** Non-resource-rich countries—supported by higher agricultural production, increasing consumer demand, and rising public investment—are growing fastest (Senegal, 7 percent; Rwanda, 7.2 percent; Côte d'Ivoire, 7.4 percent). Major commodity-exporting countries saw a mild uptick or a decline (Angola, –0.7 percent), while Nigeria and South Africa, the two largest countries, are pulling down Africa's average growth.
- **The positive growth outlook is clouded by downside risks.** Externally, risks from uncertainty in escalating global trade tensions, normalization of interest rates in advanced economies, and uncertainty in global commodity prices could dampen growth. Domestically, risks from increasing vulnerability to debt distress in some countries, security and migration concerns, and uncertainties associated with elections and political transition could weigh on growth.
- **Growth remains insufficient to address the structural challenges of persistent current and fiscal deficits and debt vulnerability.** One way to accelerate growth in the medium to long term and overcome the structural challenges is to shift imports to intermediate and capital goods and away from nondurable consumption goods. For African countries, a 10 percentage point increase in the share of capital goods in total imports could, five years later, reduce the share of primary goods by 4 percentage points, amplifying the effectiveness of diversification rooted in transferring technology and accumulating capital.
- **Vigorous public finance policy interventions are needed in tax mobilization, tax reform, and expenditure consolidation to ensure debt sustainability.** Policymakers need to adopt countercyclical policy measures to stabilize inflation and reduce growth volatility. Macroprudential policies should be used to reduce vulnerability to capital flow reversal and shift inflows toward more-productive sectors. For a sample of African countries, a 1 percent increase in public savings (by reducing the budget deficit) is correlated with a 0.7 percent improvement in the current account balance.
- **For countries in a monetary union, well-functioning, cross-country fiscal institutions and rules are needed to help members respond to asymmetric shocks.** Debt and deficit policies should be consistent across the union and carefully monitored by a credible central authority. And the financial and banking sector should be under careful supervision by a unionwide independent institution.

After tepid real GDP growth of only 2.1 percent in 2016, Africa's economy recovered with 3.6 percent growth in 2017 and 3.5 percent growth in 2018. Growth is projected to accelerate to 4 percent in 2019 and 4.1 percent in 2020, higher than in other emerging and developing economies as a whole but lower than in China and India. In 2019, 40 percent of African countries are projected to see growth of at least 5 percent. The challenge is to achieve a higher growth path that is inclusive and pro-employment.

Economic fundamentals in most African countries have improved, and inflationary pressures are low or have subsided in countries with stable exchange rates. But where exchange rates have depreciated, inflationary pressures remain high, and central banks have tightened monetary policy. Many countries have pursued fiscal consolidation to contain deficits, but there have been slippages in some, threatening debt sustainability and aggravating current account deficits. The average current account deficit is projected to decline from 5.4 percent in 2016 to 3 percent in 2020, and the average fiscal deficit is projected to decline from 7 percent to 3.7 percent. Attention has to be paid to the quality of fiscal consolidation to mitigate the impact on long-term growth.

Economic fundamentals in most African countries have improved, and inflationary pressures are low or have subsided in countries with stable exchange rates

The long-term trend in the structure and composition of current account balances suggests that countries that tended to allocate a higher share of their export earnings to import intermediate and capital goods grew faster, sustained better external trade balances, and mobilized domestic savings. This organic link among exports, productive imports, and growth provides an important pathway for structural change to accelerate growth.

This chapter is organized as follows. The first section describes African economies' growth performance and prospects and identifies growth drivers. The second section assesses progress and challenges for macroeconomic stability. And the final section discusses external imbalances and trade deficits, emphasizing a long-term perspective taking into account present external deficits, the composition of exports and imports, and the direction of domestic investment in the assessment of the long-term sustainability of current account deficits.

GROWTH PERFORMANCE AND OUTLOOK

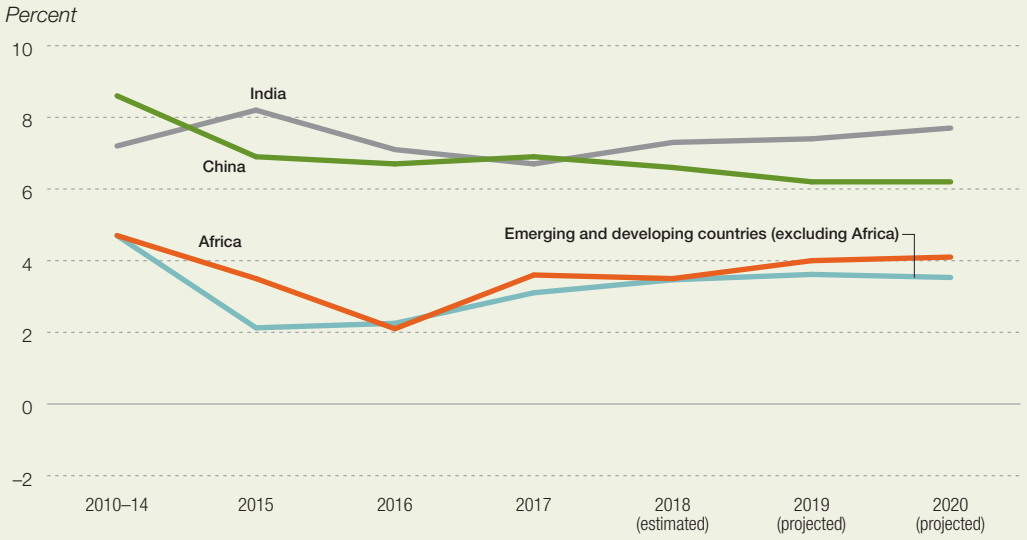
Economic recovery continues

After peaking at 4.7 percent in 2010–14, Africa's real GDP growth slowed to 3.5 percent in 2015 and 2.1 percent in 2016 (2.2 percent excluding Libya), due partly to the drastic drop in oil prices and other regional shocks such as drought in East Africa and Southern Africa (figure 1.1 and table 1.1; see also table A1.1 in annex 1.1). A gradual recovery followed, with growth picking up to 3.6 percent in 2017 (3.0 percent excluding Libya) and an estimated 3.5 percent in 2018.[1] Growth is projected to accelerate to 4 percent in 2019 and 4.1 percent in 2020. About 40 percent of African countries are projected to see growth of at least 5 percent in 2019, while about 25 percent are projected to see growth of less than 3 percent.

While the recovery from the 2016 trough is good news for Africa, the projected medium-term growth of 4 percent is insufficient to make a dent in unemployment and poverty. Population growth of more than 2 percent implies that GDP per capita will increase less than 2 percent,[2] leaving convergence with middle- and high-income economies slow to materialize. And the growth path is insufficient to create enough jobs for the growing labor force. The working-age population is projected to increase an average of 2.75 percent a year between 2016 and 2030.[3] Assuming average employment-to-GDP elasticity of 0.4,[4] economic growth of 6.9 percent a year is required just to absorb new entrants to the labor force, far above the highest growth rate attained in this decade. Even with employment-to-GDP elasticity of 0.6, growth would need to exceed 4.6 percent a year to stabilize the unemployment rate (figure 1.2). The challenge is thus twofold: to raise the current growth path and to increase the efficiency of growth in generating employment.

Africa's low elasticity of employment with respect to growth reflects an economic structure that depends heavily on primary commodities and the extractive sector, with little progress in labor-intensive manufacturing. This is a major concern given the substantial positive effect of manufacturing-driven growth acceleration on employment's responsiveness to economic growth (see chapter 2).

FIGURE 1.1 Real GDP growth in Africa, 2010–20



Source: African Development Bank statistics and International Monetary Fund.

TABLE 1.1 Real GDP growth in Africa, 2010–20

Indicator and country group	2010–14	2015	2016	2017	2018 (estimated)	2019 (projected)	2020 (projected)
Central Africa	5.0	3.3	0.2	1.1	2.2	3.6	3.5
East Africa	5.9	6.5	5.1	5.9	5.7	5.9	6.1
North Africa	3.7	3.7	3.2	4.9	4.3	4.4	4.3
Including Sudan	3.6	3.7	3.2	4.8	4.3	4.4	4.3
Southern Africa	3.8	1.6	0.7	1.6	1.2	2.2	2.8
West Africa	6.2	3.2	0.5	2.7	3.3	3.6	3.6
Africa	*4.7*	*3.5*	*2.1*	*3.6*	*3.5*	*4.0*	*4.1*
Excluding Libya	4.4	3.6	2.2	3.0	3.5	3.9	4.1
Sub-Saharan Africa	5.2	3.4	1.5	2.9	3.1	3.7	3.9
Excluding South Africa	5.9	3.9	1.8	3.3	3.6	4.2	4.3
Oil-exporting countries	4.7	3.3	1.5	3.2	3.4	3.8	3.7
Oil-importing countries	4.6	3.7	3.1	4.2	3.8	4.3	4.5

Source: African Development Bank statistics and staff calculations.

While the recovery from the 2016 trough is good news for Africa, the projected medium-term growth of 4 percent is insufficient to make a dent in unemployment and poverty

The recent commodity price rebound supported the recovery of commodity-exporting countries

The recovery in growth since 2016 among Africa's commodity exporters has been driven by the rebound in commodity prices (box 1.1). Over the past two years the price of Brent crude oil has risen about 177 percent (from a 10-year low of $27.45 in February 2016 to $74.34 in October 2018). This has helped oil exporters (notably Algeria, Angola, Chad, Congo, Gabon, Libya, and Nigeria) recover but also pushed up inflation in oil-importing countries. Both supply factors (the agreed production restrictions between the

FIGURE 1.2 Real GDP growth in Africa and GDP growth needed to absorb the growing labor force, 2010–20

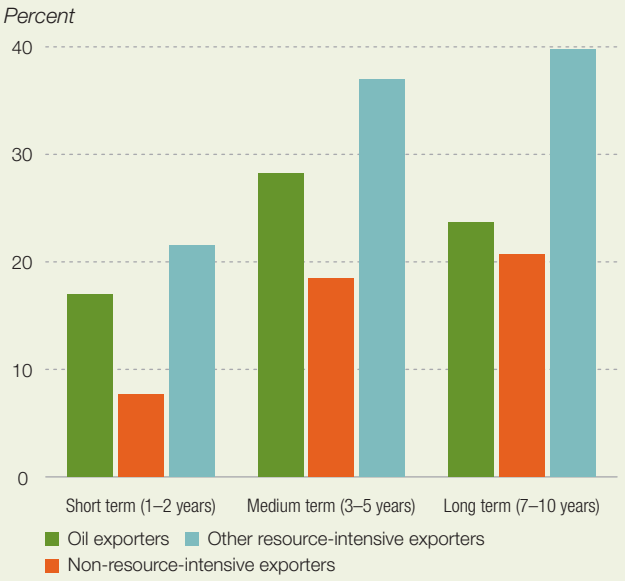
Source: African Development Bank statistics.

BOX 1.1 Commodity price fluctuations and GDP uncertainty in Africa

A global vector autoregression model is used to quantify the short-, medium-, and long-term sensitivity of Africa's GDP to a one standard deviation shock in commodity prices, which is roughly equivalent to a $30 increase in the price of crude oil (that is, from the current $50 to about $80). In the short term, commodity price fluctuations explain 7–21 percent of GDP instability (box figure 1). The impact of commodity price volatility on GDP is smallest in non-resource-intensive countries, 8 percent, and largest in mineral- and metal-exporting economies, 22 percent. In the medium to long term, commodity price fluctuations explain a larger share of GDP instability, up to 28 percent in oil-exporting countries and 37 percent in mineral- and metal-exporting countries.

These results point to the vulnerability and high exposure of many African countries to fluctuations in global commodity prices. Although commodity price fluctuations explain a smaller proportion of GDP instability in the short term, which could be the result of countercyclical monetary and fiscal policies applied to stabilize the economy, in the medium term, commodity prices have a stronger influence on fluctuations in GDP.

BOX FIGURE 1. Proportion of GDP instability in Africa explained by commodity price fluctuations in the short, medium, and long term



Source: African Development Bank staff calculations.

Organization of the Petroleum Exporting Countries and Russia, the reimposition of sanctions on Iran, and the sociopolitical crisis in Venezuela) and robust global demand are driving the current price rebound. The outlook for oil prices remains unclear, given the uncertainty of global geopolitical risks, coordinated production restrictions, and industrial demand changes. Growth projections for 2019 and 2020 assume that oil prices stabilize at $70. Because oil prices are so volatile, oil-exporting economies are better off building reserves and sovereign wealth funds during periods of recovery to ensure sufficient buffers against future shocks and maintain fiscal sustainability.

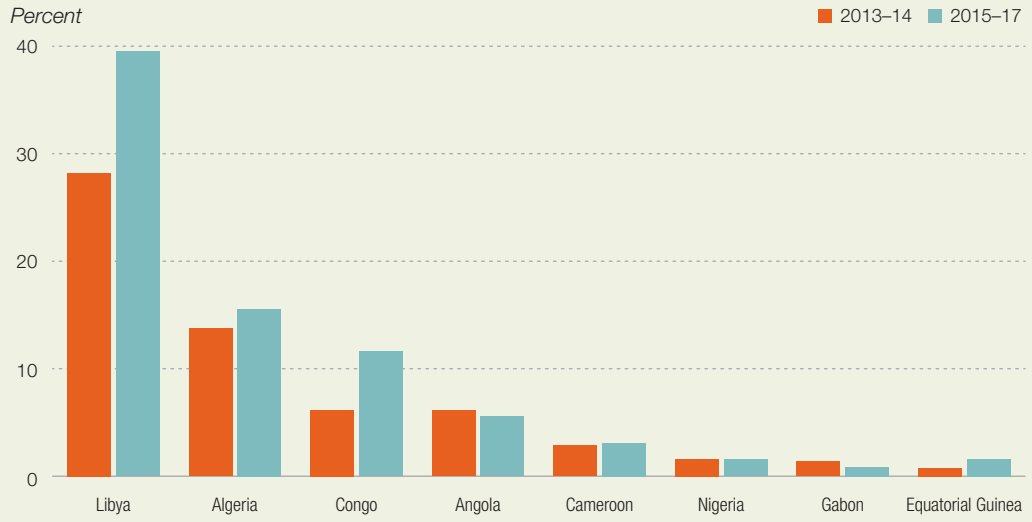
Energy subsidies in many African countries constitute a considerable fiscal burden. Despite the drop in global oil prices, energy subsidies as a share of GDP have remained mostly unchanged.[5] Among oil-exporting economies, Angola, Cameroon, and Nigeria had a similar share in the pre-peak period (2013 and 2014) and the post-peak period (2015–17), but in Libya, Algeria, and Congo, the share increased (figure 1.3). Most oil importers saw small changes, though some countries (including Egypt, Tunisia, Morocco, Benin, and Togo) reduced subsidies as a share of GDP, and a few (including South Africa, Zambia, Mozambique, and Ghana) increased them (figure 1.4). Subsidy reforms must be geared toward more-efficient and better targeted social safety nets for the most vulnerable. This could improve public finance management, create more fiscal space for much-needed public investments in infrastructure, and improve the debt situation.

North Africa leads the growth recovery, but East Africa remains the most dynamic region

Of Africa's projected 4 percent growth in 2019, North Africa is expected to account for 1.6 percentage points, or 40 percent (figure 1.5). But average GDP growth in North Africa is erratic because of Libya's unstable development. After declining for three years, Libya's GDP increased in 2017 and 2018 because of higher oil production. Despite this, the country's GDP remains roughly 15 percent below its pre-revolution level. But the political and humanitarian crisis continues, and the highly uncertain outlook depends on achieving political stability. Tunisia's economy is gradually recovering after near stagnation in 2015 and 2016 because of security problems and social conflicts.

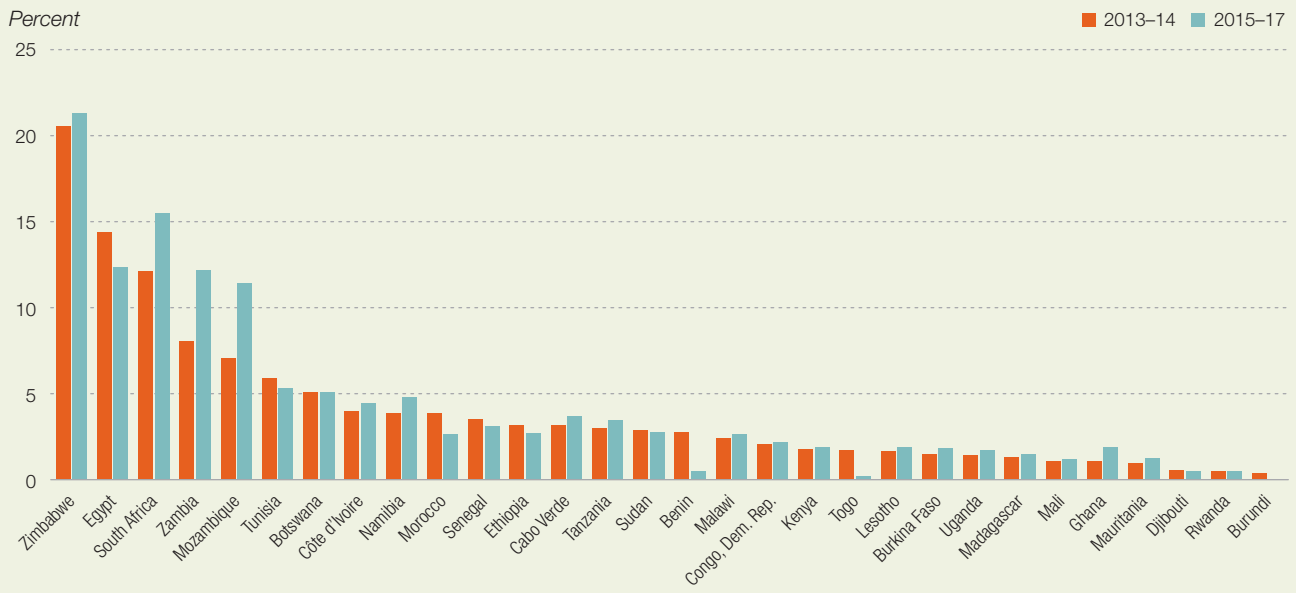
Subsidy reforms must be geared toward more-efficient and better targeted social safety nets for the most vulnerable

FIGURE 1.3 Energy subsidies as a share of nominal GDP, African oil exporters, 2013–14 and 2015–17



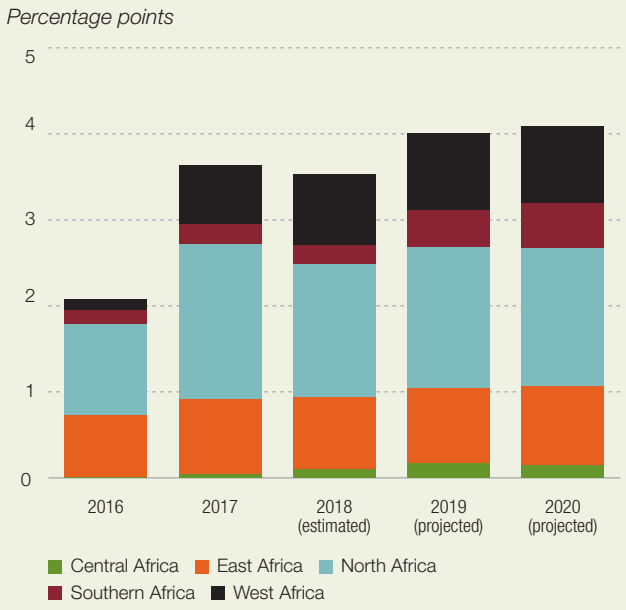
Source: International Monetary Fund.

FIGURE 1.4 Energy subsidies as a share of GDP, African oil importers, 2013–14 and 2015–17



Source: International Monetary Fund.

FIGURE 1.5 Contribution to GDP growth in Africa, by region, 2016–20



Source: African Development Bank staff calculations.

Note: Calculated as average growth rate of regions weighted by the regions' share of Africa's total GDP.

Growth is driven by improved tourism and manufacturing production and a more expansive fiscal policy. Unlike other main commodity exporters, Algeria weathered the commodity price shock in 2015 and 2016 through expansionary fiscal policies; growth is expected to weaken in 2019 and 2020. Morocco's growth has been boosted by agricultural production and extractive industries and supported by accommodative monetary policy, as inflation remains low. Egypt's growth remains positive, and its stabilization program is now paying off. Growth is driven by the return of investor confidence, private consumption, and higher exports, which have benefited from adjustments in the real exchange rate.

East Africa, the fastest growing region, is projected to achieve growth of 5.9 percent in 2019 and 6.1 percent in 2020 (table 1.2). Between 2010 and 2018, growth averaged almost 6 percent, with Djibouti, Ethiopia, Rwanda, and Tanzania recording above-average rates. But in several countries, notably Burundi and Comoros, growth remains weak due to political uncertainty. In South Sudan, GDP continues to fall due to political and military conflicts and because the 2015 peace agreement has not been implemented.

West Africa saw high growth until 2014, but an economic slowdown followed due to the sharp drop in commodity prices and the Ebola crisis. Nigeria, Africa's largest economy and largest oil exporter, fell into recession in 2016. Its gradual recovery in 2017 and 2018, helped by the rebound of oil prices, is restoring growth in the region. Other countries—including Benin, Burkina Faso, Côte d'Ivoire, Ghana, Guinea, and Senegal—have seen growth of at least 5 percent in the past two years and are projected to maintain it in 2019 and 2020.

Growth in Central Africa is gradually recovering but remains below the average for Africa as a whole. It is supported by recovering commodity prices and higher agricultural output. Several countries have reduced public spending, including on investment, to restore debt sustainability. After rapid growth, Equatorial Guinea's economy has been shrinking since 2013 as oil production declines and the nonoil sector has been too weak to compensate. In 2018, its real GDP was about a third below its level six years ago.

Growth in Southern Africa is expected to remain moderate in 2019 and 2020 after a modest recovery in 2017 and 2018. Southern Africa's subdued growth is due mainly to South Africa's weak performance, which affects neighboring countries. Low public and private investment and risks of lower sovereign credit ratings are weighing on growth in the region. In Botswana, growth accelerated due to improved diamond trade, services and investment, the recovery of agriculture after the drought, and the expansionary fiscal policy and accommodative monetary policy resulting from moderate inflation. Mauritius also continues its steady growth, driven mainly by strong consumption and higher exports, including tourism.

At the country level, slow growth in Nigeria and South Africa is dampening Africa's average growth. They account for a large share of Africa's GDP but only 0.2–0.4 percentage point of Africa's GDP growth (figures 1.6 and 1.7). Ethiopia, continuing on a high growth path, accounts for about 0.2 percentage point more than South Africa, despite accounting for a smaller share of Africa's GDP. Egypt, the third largest African economy, accounts for more than 1 percentage point of Africa's growth.

TABLE 1.2 Real GDP growth in Africa, by region, 2010–20

Percent

Region	2010–14	2015	2016	2017	2018 (estimated)	2019 (projected)	2020 (projected)
Central Africa	5.0	3.3	0.2	1.1	2.2	3.6	3.5
East Africa	5.9	6.5	5.1	5.9	5.7	5.9	6.1
North Africa	3.7	3.7	3.2	4.9	4.3	4.4	4.3
Southern Africa	3.8	1.6	0.7	1.6	1.2	2.2	2.8
West Africa	6.2	3.2	0.5	2.7	3.3	3.6	3.6
Oil-exporting countries	4.7	3.3	1.5	3.2	3.4	3.8	3.7
Oil-importing countries	4.6	3.7	3.1	4.2	3.8	4.3	4.5
Africa	4.7	3.5	2.1	3.6	3.5	4.0	4.1
Excluding Libya	4.4	3.6	2.2	3.0	3.5	3.9	4.1
GDP per capita	2.1	0.9	–0.4	1.1	1.1	1.5	1.6

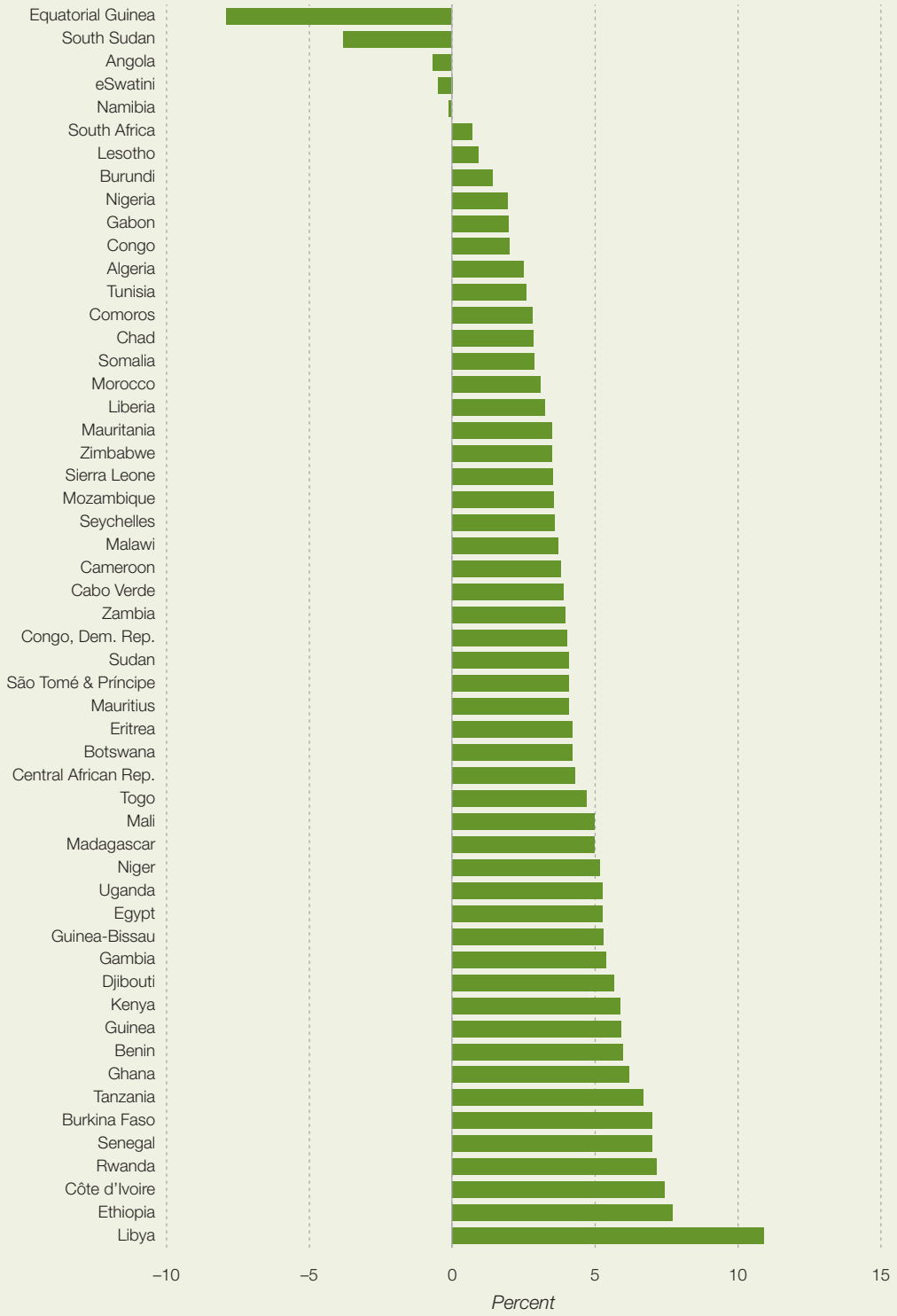
Source: African Development Bank statistics.

The drivers of economic growth are gradually rebalancing

Consumption has historically been the main source of demand in Africa, hovering around 80 percent of GDP, while investment, the second largest contributor, has remained around or below 25 percent of GDP since the early 2000s. However, consumption as a share of GDP has declined since 2016 while investment and net exports have picked up (figures 1.8–1.10). Though fiscal consolidation measures to reduce deficits have constrained public consumption and investment in some countries, Benin, Botswana, Burkina Faso, Côte d`Ivoire, Djibouti, Ethiopia, Senegal, Tanzania, and Uganda have all increased public investment. On the other hand, conditions for the private sector have improved in Egypt, Ethiopia, and Seychelles, subsequently increasing FDI.

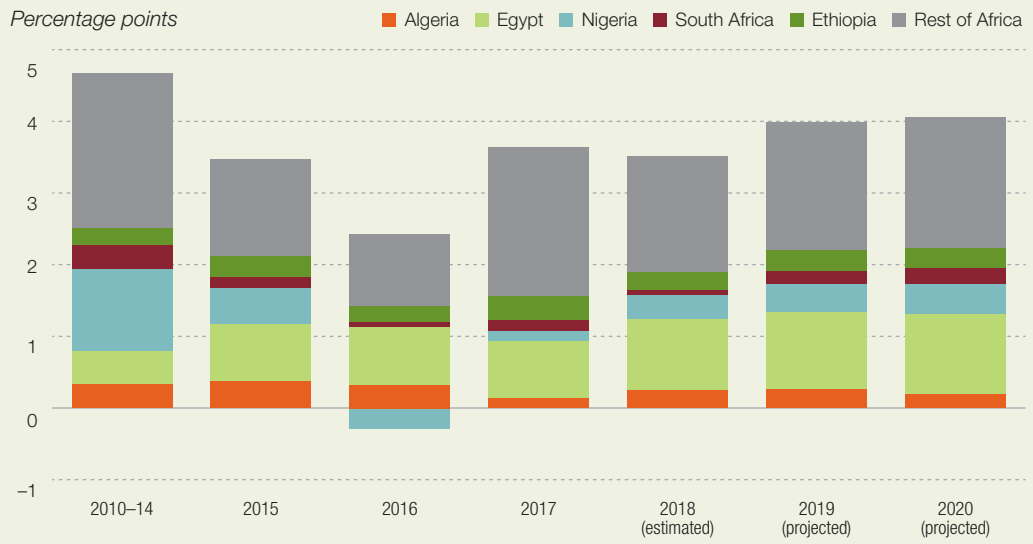
The drivers of Africa's economic growth have been gradually rebalancing in recent years. Consumption's contribution to real GDP growth declined from 55 percent in 2015 to 48 percent in 2018, while investment's contribution increased from 14 percent to 48 percent. Net exports, historically a drag on economic growth, have had a positive contribution since 2014 (figure 1.11). But despite the rebalancing trend, most of the top-growing countries still rely primarily on consumption as an engine of growth.

FIGURE 1.6 Real GDP growth, by country, 2018



Source: African Development Bank statistics.

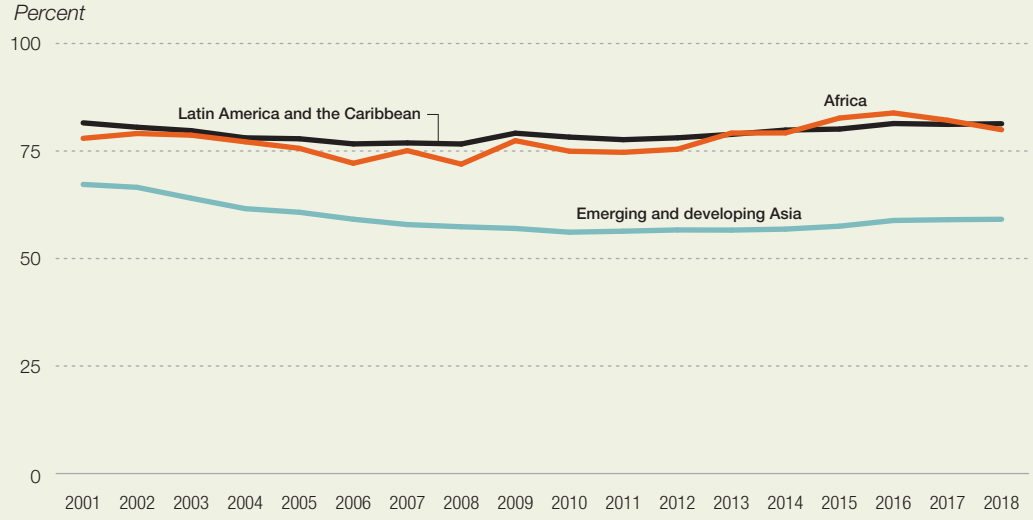
FIGURE 1.7 Contribution to GDP growth in Africa, by country, 2010–20



Source: African Development Bank statistics and staff calculations.

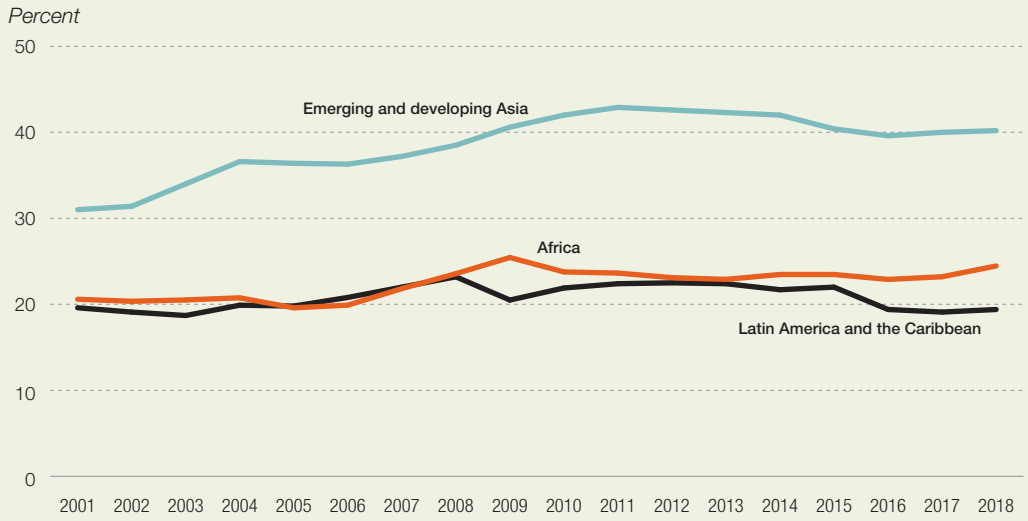
Note: Calculated as the average growth rate of countries weighted by the countries' share of Africa's total GDP.

FIGURE 1.8 Consumption as proportion of GDP in Africa, emerging and developing Asia, and Latin America and the Caribbean, 2001–18



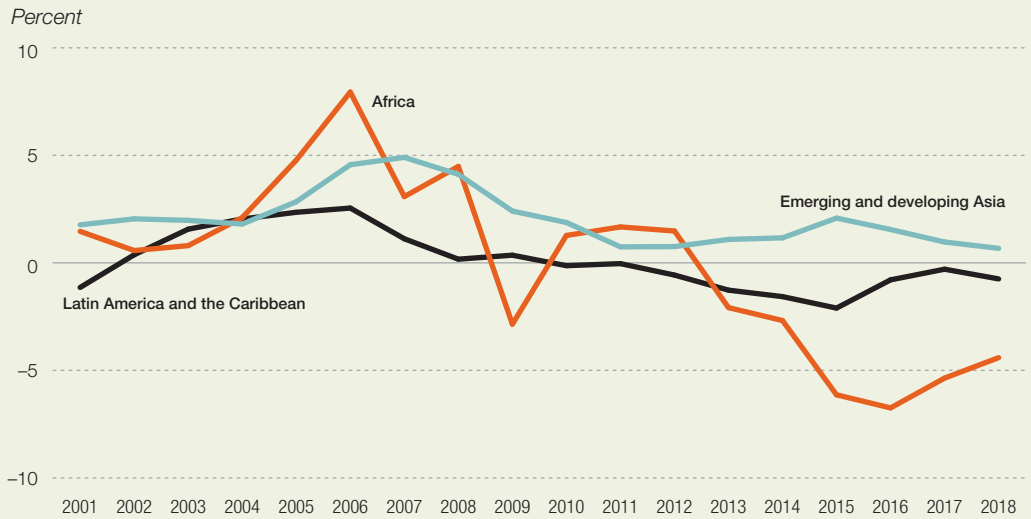
Source: African Development Bank statistics and International Monetary Fund.

FIGURE 1.9 Investment as a proportion of GDP in Africa, emerging and developing Asia, and Latin America and the Caribbean, 2001–18



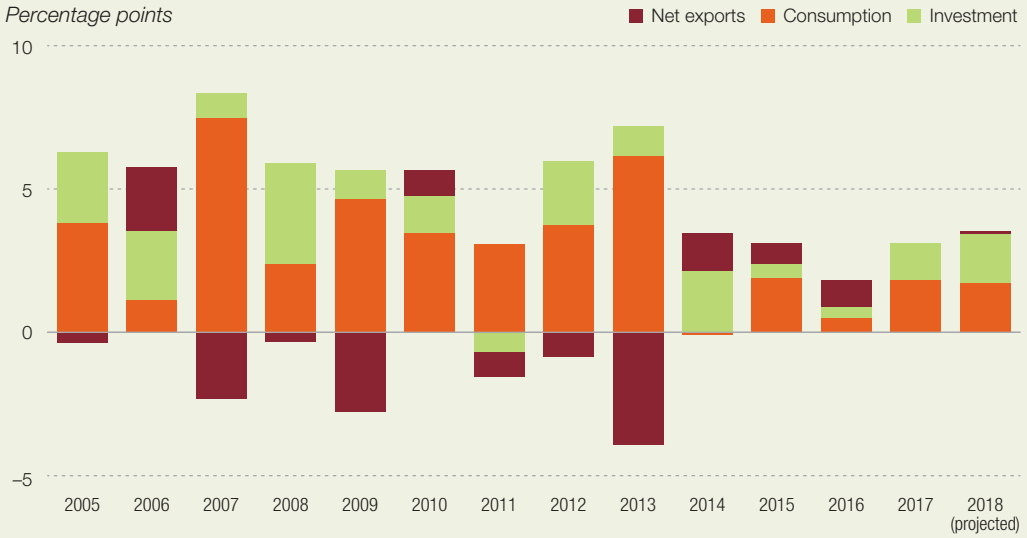
Source: African Development Bank statistics and International Monetary Fund.

FIGURE 1.10 Net exports as a proportion of GDP in Africa, emerging and developing Asia, and Latin America and the Caribbean, 2001–18



Source: African Development Bank statistics and International Monetary Fund.

FIGURE 1.11 Contributions of demand components to GDP growth in Africa, 2005–18



Source: African Development Bank statistics.

Risks to the outlook

The macroeconomic forecast for Africa described above is clouded by several risks. First, a further escalation of trade tensions between the United States and its main trading partners would reduce world economic growth, with repercussions for Africa (box 1.2). These tensions, together with the strengthening of the US dollar, have increased the volatility of some commodity prices and pressured the currencies of emerging countries. If global demand slows, commodity prices could drop, reducing GDP growth and adversely affecting trade and fiscal balances for Africa's commodity exporters.

Second, costs of external financing could further increase if interest rates in advanced countries rise faster than assumed. Third, if African countries are again affected by extreme weather conditions due to climate change, as they have been in recent years, agricultural production and GDP growth could be lower than projected. Finally, political instability and security problems in some areas could weaken economies.

Countries that have improved their fiscal and external positions and that have low or moderate debt will probably be resilient to new external shocks. But those that have not rebuilt their fiscal buffer are unprepared for significant downside risks.

Countries that have improved their fiscal and external positions and that have low or moderate debt will probably be resilient to new external shocks

MACROECONOMIC STABILITY: SOME PROGRESS, BUT CHALLENGES REMAIN

Inflationary pressures have eased

Africa's average inflation fell from 12.6 percent in 2017 to 10.9 percent in 2018 and is projected to further decline to 8.1 percent in 2020. Double-digit inflation occurs mostly in conflict-affected countries and countries that are not members of a currency union (figure 1.12). Inflation is highest in South Sudan, at 188 percent, due to the lingering economic crisis. Inflation is lowest, at 2 percent or less, in members of the Central African Economic and Monetary Community and the West African Economic and Monetary Union and particularly in members of the CFA zone because of its link to the euro.

Where inflationary pressures have abated and exchange rates have stabilized—Ghana, Morocco, South Africa, Tanzania, and Uganda—central banks have gradually eased monetary policy. But in several countries—Egypt and

BOX 1.2 Potential impacts of escalating trade tensions: Modest contraction but opportunities for deeper intraregional integration in Africa

As the trade tensions between the United States and its major trading partners escalate, the World Trade Organization estimates that growth in global trade volume could decline from 4.4 percent to 3.9 percent in 2018 and to 3.7 percent in 2019.[1]

Impulse response multipliers from an orthogonalized 1 percentage point (contraction) shock in global trade volume in a parsimoniously specified global vector autoregression model help provide estimates of how these tensions could affect African countries, depending on the nature and intensity of their main exports.

In the short term (within one year), the impact of the trade tensions on Africa's GDP is about ±0.07 percent of GDP (box figure 1). In the medium term (within three years), the negative impact of the contraction in global trade volumes grows larger. It is strongest for other resource-intensive exporters, at –2.5 percent, followed by oil exporters, at –1.9 percent, and weakest for non-resource-exporting economies, at –1.1 percent (box figure 2).

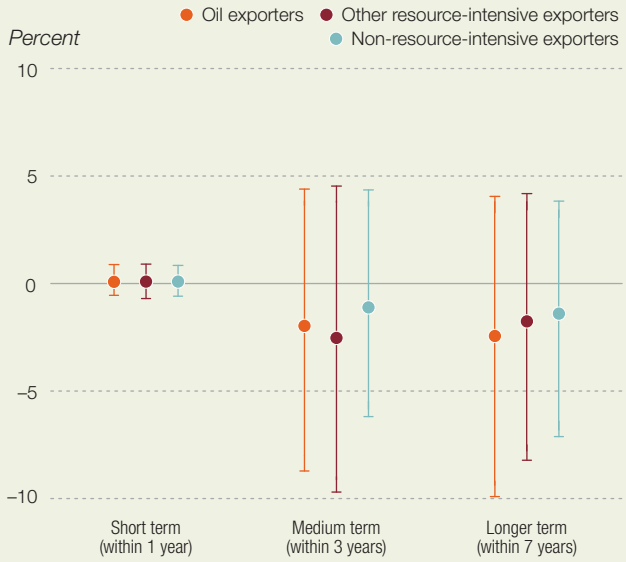
There are several possible explanations for this pattern. African countries' size, openness to, and trade intensity with the United States and China are significant—more than 60 percent of Africa's exports go to the United States, China, and Europe, and more than 70 percent of Africa's imports originate from these countries. So a decline in demand for Africa's exports due to a slowdown in the global economy prompted by tariffs is an important channel that could affect Africa.

But despite the modest negative effects, Africa could—with the right policy responses—turn the increasing trade tensions into an opportunity to improve competitiveness and deepen intraregional integration. One way is to take advantage of the dislocation and trade diversion caused by the tensions to become the new supplier of goods previously supplied, for example, by China to the United States. Capturing even a small portion of the dislocation from increasing trade protectionism could benefit Africa.

Note

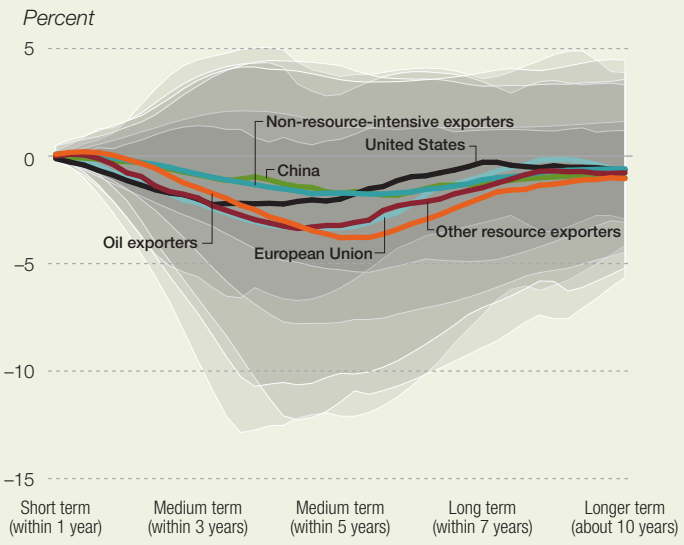
1. WTO 2018.

BOX FIGURE 1 Potential impacts of increasing trade tensions on GDP in Africa, by economic classification and time horizon



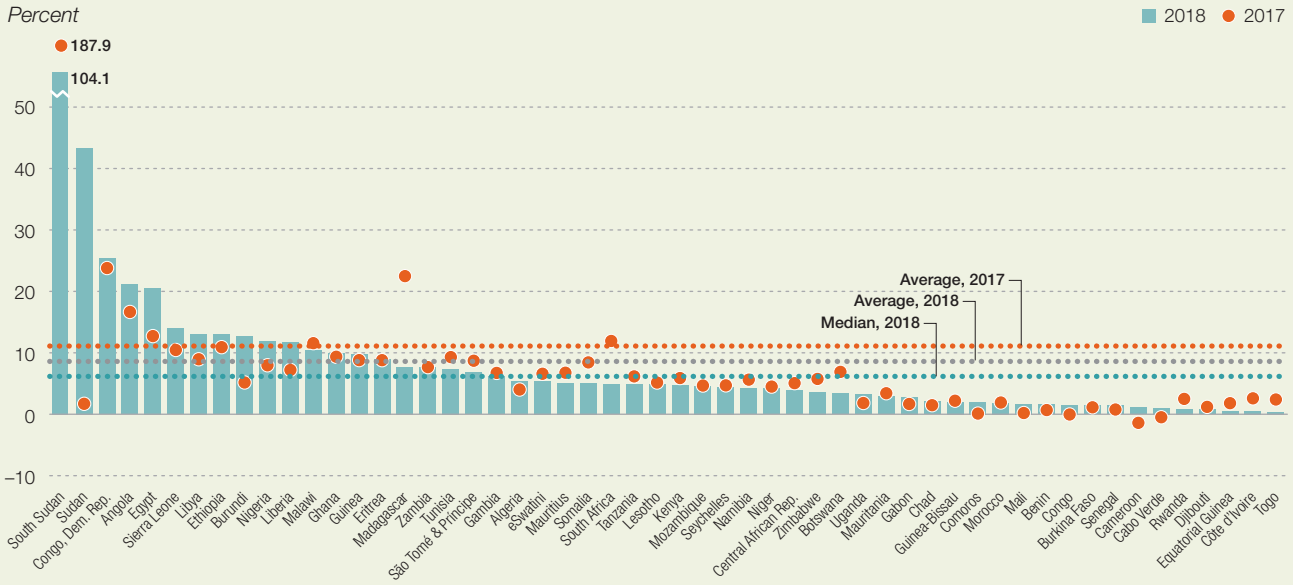
Source: African Development Bank staff calculations.

BOX FIGURE 2 Trajectories of GDP response to contraction in global trade



Source: African Development Bank staff calculations.

FIGURE 1.12 Consumer price inflation, by country, 2017 and 2018



Source: African Development Bank statistics.

Tunisia—monetary policy remains tight or has become more restrictive to contain inflation.

Fiscal positions are gradually improving

Some countries weathered the sharp drop in commodity prices in 2014 better than others. Mauritania, Mozambique, and Democratic Republic of Congo were moderately affected and moved from a stable growth path to a vulnerable or slower one. By contrast, Algeria and Nigeria, among the largest economies in Africa, saw weakening macroeconomic stability amid slow growth, making macroeconomic policy levers compete between growth and stabilization objectives. Côte d'Ivoire, Ethiopia, Rwanda, Tanzania, and Uganda maintained their stable growth path, suggesting that other drivers of growth, such as public investment, helped maintain growth momentum (figure 1.13). Oil- and mineral-exporting countries such as Congo, Equatorial Guinea, Liberia, Sierra Leone, and South Sudan had the largest fiscal deficits and the lowest real GDP growth. In response to narrower fiscal space, these commodity exporters reduced expenditures to improve their fiscal balances, despite lower growth rates, suggesting procyclical behavior. The fiscal behavior during this recent boom-bust confirms previous findings that African countries have heterogeneous policy responses to external shocks,[6] a more nuanced finding than what recent studies have reported.[7]

Africa's average fiscal deficit declined from 7 percent in 2015 and 2016 to an estimated 4.5 percent in 2018 and is projected to further decline to 4 percent in 2019 and 3.7 percent in 2020 (figure 1.14). In oil-exporting countries, the rebound of oil prices and fiscal consolidation measures reduced the average fiscal deficit from 8.7 percent of GDP in 2016 to an estimated 4.5 percent in 2018 and, assuming oil prices remain stable, should push it further down to 3.8 percent in 2019 and 3.5 percent in 2020. In oil-importing countries, the average fiscal deficit has remained lower than in oil-exporting countries and is projected to decline slightly, from an estimated 4.5 percent in 2018 to 4 percent in 2019 and 2020. Despite these improvements, fiscal buffers remain limited in many countries. Fiscal deficits are expected to remain at 10 percent of GDP or higher in Burundi, Djibouti, Eritrea, and Zimbabwe and at 5–10 percent in Comoros, Egypt, Mozambique, eSwatini, and Zambia.

FIGURE 1.13 Real GDP growth and primary fiscal balances, by country, 2014–16 and 2017–18

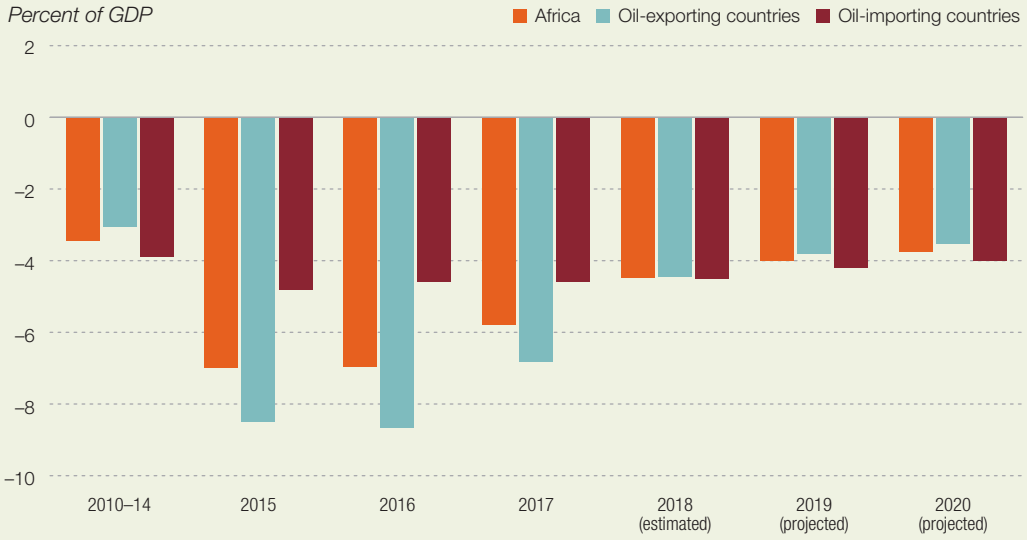
Source: Staff calculations and African Development Bank statistics.

Note: The fiscal balance score is the normalized value and lies between 0 and 1.

Several countries achieved fiscal consolidation by increasing tax revenue and, at times, lowering expenditures

Between 2016 and 2018, several countries achieved fiscal consolidation by increasing tax revenue and, at times, lowering expenditures. Revenue increases were due partly to higher commodity prices and increased growth, but several countries also implemented tax reforms. For example, Algeria and Egypt increased their value added tax, while Angola introduced one that will take effect in 2019. And several countries (Botswana, Kenya, Mauritania, Morocco, Rwanda, and Zambia) introduced an online platform to pay taxes. Domestic resource mobilization has improved but falls short of the continent's developmental needs. The average ratio was about 17 percent in 2017, below the 25 percent needed to finance development objectives such as the

FIGURE 1.14 Average fiscal balance, by country group, 2010–20



Source: African Development Bank statistics.

But limiting government spending should not affect growth-enhancing spending

Sustainable Development Goals. But there is wide variation across countries, from 2.8 percent in Nigeria to 31 percent in Seychelles and 36 percent in Lesotho.

On the expenditure side, lower oil revenue and nonoil tax revenue have led African governments to greatly reduce current and capital expenditures to contain public deficits. Capital expenditure fell from 9.4 percent of GDP in 2014 to 7.6 percent in 2018 (figure 1.15). Since 2015, consolidation has been more pronounced for current expenditure (figure 1.16). To contain rising debt, further fiscal consolidation will be necessary, particularly reducing recurrent expenditure. But limiting government spending should not affect growth-enhancing spending. Given the importance of public investment in catalyzing private investment, particularly in core infrastructure (such as energy and transport), public expenditure should be well targeted to ensure that poverty-reducing social sectors and key infrastructure investments are adequately protected.

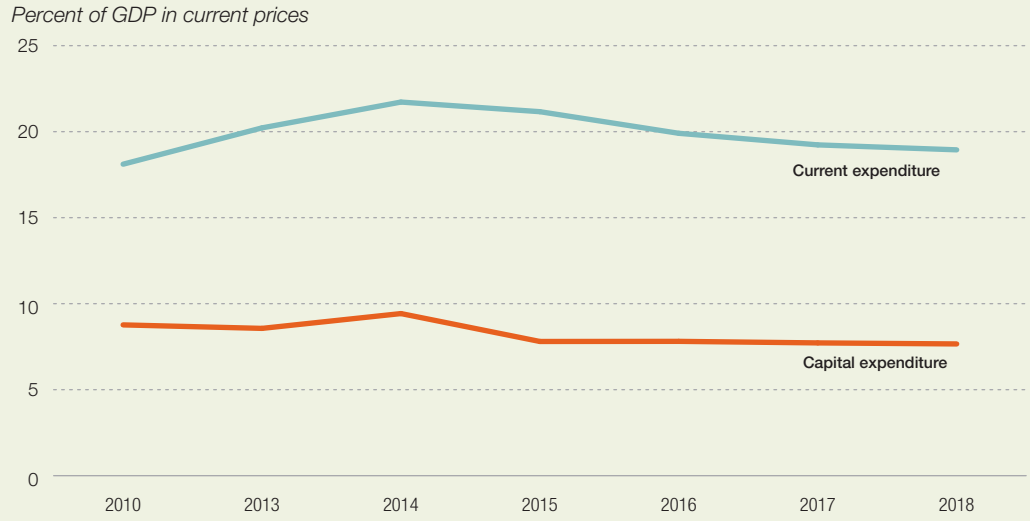
Financial flows reflect changing global and country conditions

Although current account deficits have been deteriorating (see the last section of this chapter), total external financial inflows to Africa increased from $170.8 billion in 2016 to $193.7 billion in 2017, which represents a 0.7 percentage point increase in net financial inflows as a ratio of GDP (from 7.8 percent in 2016 to 8.5 percent in 2017; figure 1.17).

Remittances continue to gain momentum and dominate the other components of capital flows, at $69 billion in 2017, almost double the size of portfolio investments. Meanwhile, FDI inflows shrank from the 2008 peak of $58.1 billion to a 10-year low of $41.8 billion in 2017. Underlying factors include the global financial crisis and the recent rebalancing of portfolios due to rising interest rates among advanced economies.

A closer look reveals marked differences in FDI inflows across African regions and countries between 2005–10 and 2011–17. North Africa, which attracted the most FDI among African regions in 2005–10, was the only region where FDI decreased between the two periods (figure 1.18). This was due mainly to political uncertainties and transitions. Egypt and Libya recorded a large decline, though Egypt recovered. West Africa attracted the most FDI among African regions in 2011–17 (FDI increased substantially in Ghana and to a lesser extent in

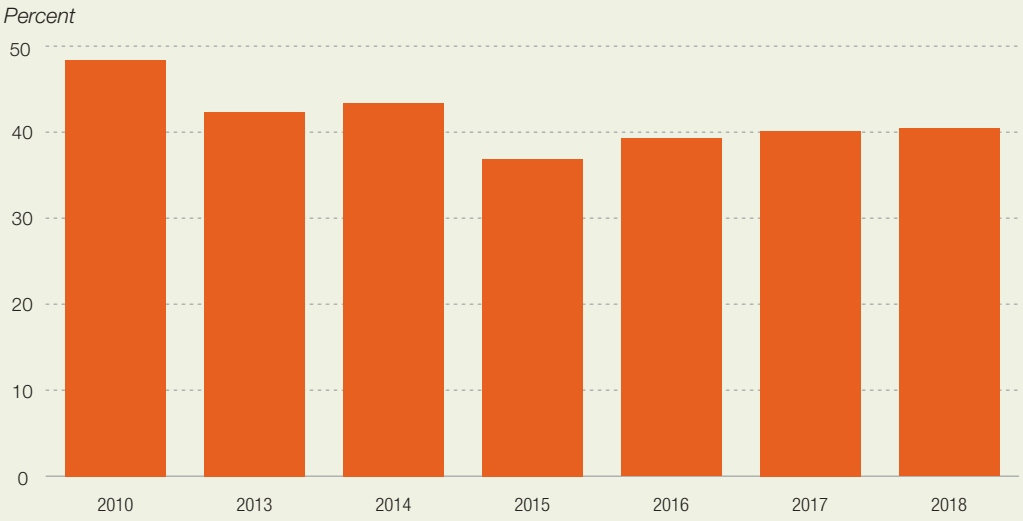
FIGURE 1.15 Current and capital expenditures in Africa, 2010–18



Source: International Monetary Fund International Financial Statistics database.

Remittances increased from $62 billion in 2016 to almost $70 billion in 2017, with Nigeria having the largest inflow

FIGURE 1.16 Ratio of capital expenditure to current expenditure, 2010–18

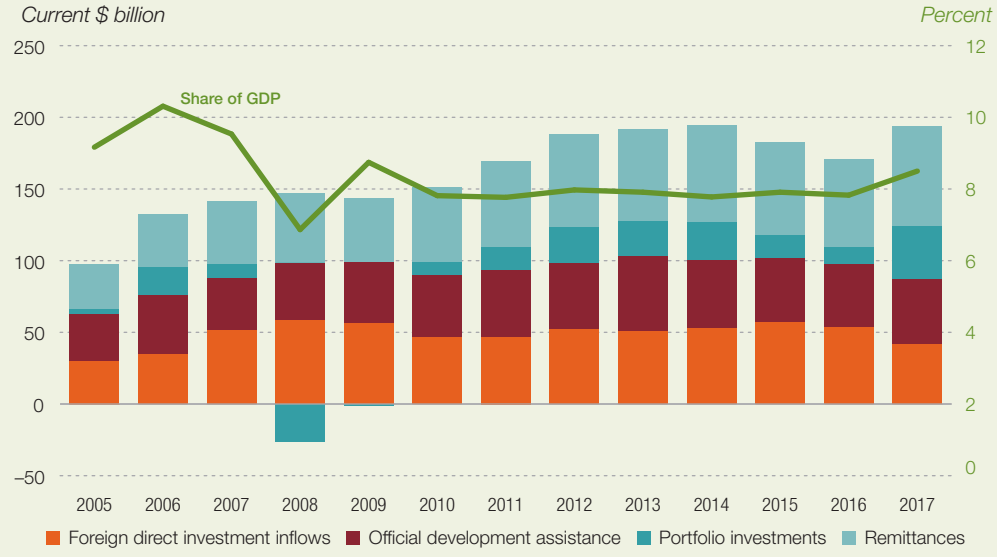


Source: Staff calculations and International Monetary Fund International Financial Statistics database.

several other countries but declined in Nigeria). East Africa benefited from the largest FDI growth among African regions during 2011–17 (with Ethiopia accounting for 60 percent of the increase after Chinese and Turkish firms announced additional FDI in manufacturing).

Remittances increased from $62 billion in 2016 to almost $70 billion in 2017. Nigeria has the largest inflow of remittances. Among smaller countries, remittances are particularly large in Senegal, Tunisia, and Uganda. In Senegal remittances amounted to about 10 percent of GDP in

FIGURE 1.17 Sources of external financing in Africa, 2005–17



Source: African Development Bank statistics.

FIGURE 1.18 Average annual foreign direct investment inflows to Africa, by region, 2005–10 and 2011–17

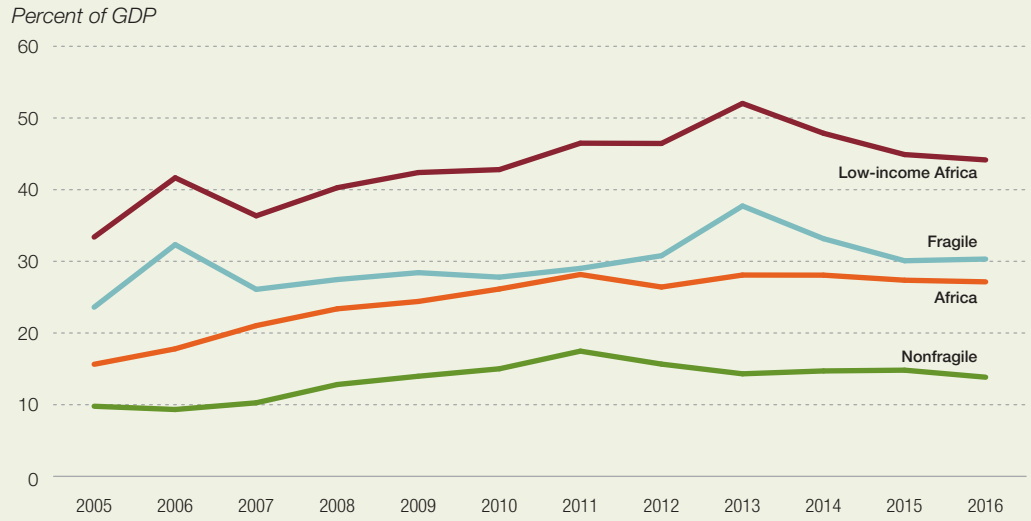
Source: African Development Bank statistics and staff calculations.

2017 and were roughly half as large as total tax revenue.

Official development assistance (ODA) to Africa peaked in 2013 at $52 billion and has since declined to $45 billion in 2017, with fragile states receiving more ODA as a percentage of GDP than nonfragile states (figure 1.19). All regions saw ODA increase between 2005–10 and 2011–16; East Africa and West Africa remain the highest recipients (figure 1.20).

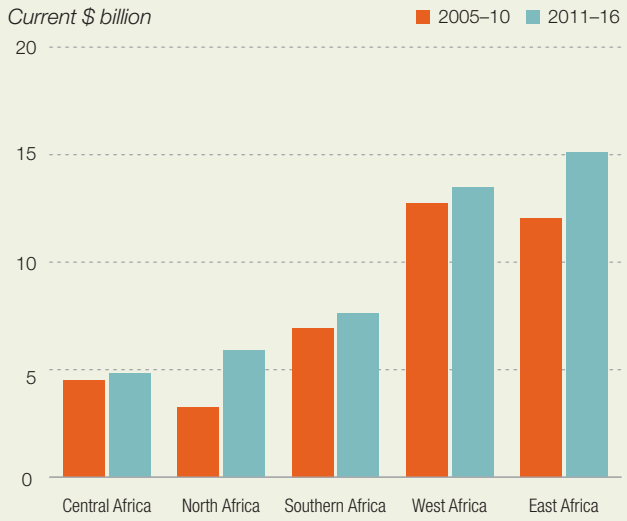
Official development assistance (ODA) to Africa peaked in 2013 at $52 billion and has since declined to $45 billion in 2017, with fragile states receiving more ODA as a percentage of GDP than nonfragile states

FIGURE 1.19 Net official development assistance to Africa from all donors, by country group, 2005–16



Source: African Development Bank statistics.

FIGURE 1.20 Average annual official development assistance to Africa, by region, 2005–10 and 2011–16



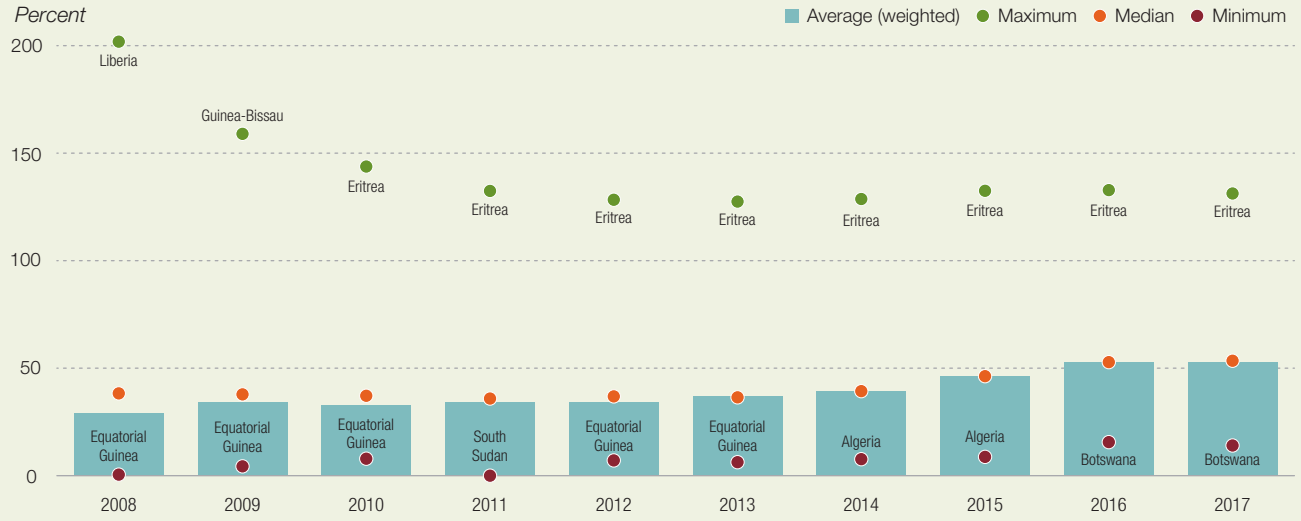
Source: African Development Bank statistics and staff calculations.

Debt levels are rising, but there is no systemic risk of debt crisis

In 2017, Africa's gross government debt–to-GDP ratio reached 53 percent, with considerable heterogeneity across countries (figure 1.21). Of 52 countries with data, 16 (including Algeria, Botswana, Burkina Faso, and Mali) have a debt-to-GDP ratio below 40 percent, and 6 (Cabo Verde, Congo, Egypt, Eritrea, Mozambique, and Sudan) have a ratio above 100 percent. The International Monetary Fund Debt Sustainability Approach classifies 16 countries as being at high risk of debt distress or in debt distress. While debt vulnerabilities have increased in some countries, the continent as a whole does not face the systemic risk of debt crisis.

The drivers of the recent rise in debt differ by country, but the 2014 commodity price decline is a leading source of deteriorating fiscal positions, especially among oil exporters. The average debt-to-GDP ratio among oil exporters increased from 19 percent to 43 percent between 2013 and 2017, compared with an increase from 52 percent to 62 percent among oil importers. Public investment has also risen, to build the necessary infrastructure in the transition to middle-income status, leading to large foreign and domestic borrowing. The continent's infrastructure needs are $130–$170 billion a year, with a financing gap of $68–$108 billion.[8] For some countries, the recent surge in terror-related security threats has also prompted a need to prop up security spending, pushing debt levels higher.

FIGURE 1.21 Gross government debt–to-GDP ratio in Africa, 2008–17



Source: International Monetary Fund.

Note: Data are not available for Libya and Somalia.

The composition of debt in Africa has shifted away from official and concessional foreign debt toward commercial debt, which has greater service costs. External debt service as a proportion of exports increased from 5 percent in 2013 to 10 percent in 2016 (the most recent year with data). The move toward international capital markets was encouraged by the speed of access to financing, keen interest from institutional investors for frontier markets, and the signaling value of access to commercial Eurobond borrowing. In 2017, bond issues from Côte d'Ivoire, Egypt, Nigeria, Senegal, South Africa, and Tunisia amounted to $19.3 billion, bringing the cumulative total since 2010 to $69.5 billion. Africa's credit landscape has also seen a shift from traditional bilateral lenders, in Europe and the United States, toward emerging creditors. For example, new loans from China to Africa increased from $2 billion in 2003 to $17 billion in 2013, before stabilizing around $13 billion in 2015.

Debt accumulation in Africa reflects debt's function in financing crucial infrastructure for development and export capacity and in buffering against short-term macroeconomic fluctuations. Efficiently investing funds mobilized through debt boosts the productive capacity of capital-scarce economies and generates growth that pays for itself in the longer run.

The recent rising debt levels across many countries in Africa and the concern it has raised indicate an opportune time to explore the role of debt accumulation in financing productive investments, in particular through intermediate and capital goods imports. The next section examines the dynamics of the trade balance and explores the conditions under which debt can be sustained in the future if the composition of imports tilts toward investment goods.

EXTERNAL IMBALANCES AND IMPLICATIONS FOR LONG-TERM GROWTH

Africa's external imbalances have worsened, measured by both the current account and the trade balance. The weighted average current account deficit was 4 percent of GDP at the end of 2017 (the median was 6.7 percent) and, despite recent improvement, has been deteriorating since the end of the 2000s. This could threaten external sustainability and require sharp adjustments in the future.

This section summarizes recent trends in the current account, identifies the components of the current account imbalance, and investigates the recent evolution of domestic savings and investment, emphasizing the role of decreased public revenue and rising public and private capital formation in expanding the savings–investment gap in many African economies.[9]

The average current account deficit has been deteriorating since the end of the 2000s and could threaten external sustainability and require sharp adjustments in the future

BOX 1.3 What defines external sustainability?

The traditional analyses of current account sustainability focus on aggregate dynamics of the current account to determine whether a country is more or less likely to meet its external solvency constraints in the medium and long term or whether it will require external adjustment (through default on external liabilities, import contraction, or exchange rate devaluation).[1] This has led to an emphasis on monitoring private and public external borrowing, the real exchange rate, the variation in public deficits, and aggregate capital formation, as well as short-run liquidity. In traditional definitions, a country is said to be externally solvent if the present discounted value of future trade surpluses is equal to current external indebtedness.[2] When this is not the case, a country is more likely to require a future "hard landing" in the form of a sharp adjustment of monetary, exchange rate, fiscal, and capital account policies, often brought forward by agent anticipations of such constraints in the future. However, a country can run very large current account deficits for an extended period and still meet the solvency condition as long as there are sufficient surpluses at some point, so the intertemporal external constraint imposes only mild restrictions on current account imbalances over time.[3]

Most traditional analyses of current account sustainability have focused on modeling aggregate dynamics of external imbalances, looking at the current account or trade balance as a whole. They relate their current level to a recommended "optimal" level of the current account (such as the one derived from a theoretical model of intertemporal consumption smoothing), or a "predicted" level drawing on fundamental economic drivers. These include external balance assessments[4] performed by international institutions such as the International Monetary Fund, which traditionally focus on the appropriate level of the real exchange rate required to bring the current account back to equilibrium, modeled on the basis of fundamental drivers, such as demographics, savings rates, fiscal constraints, natural resources wealth, and dependency ratios.

This chapter offers evidence that, among African countries, disaggregating the dynamics of the trade balance to focus on the role of imports of consumption, capital, and intermediate goods provides additional information about the degree of current account sustainability. Among African economies, many of which exhibit large current account deficits that have fostered worries among international investors and donors about external sustainability, current account deficits driven by capital and intermediate goods imports are more likely to lead to future industrialization and the generation of export capacity and trade surpluses, compared with current account deficits produced by large imports of consumption goods. Moreover, such capital and intermediate goods imports constitute a crucial link in structural transformation by allowing economies to rely less on volatile commodity and raw material exports, further improving the sustainability of the export mix and external solvency.

Notes

1. For an early reference, see Milesi-Ferretti and Razin (1996).
2. Milesi-Ferretti 1996, chapter 1.
3. Roubini and Wachtel 1998.
4. See, for example, Phillips et al. (2013).

The organizing framework relies on an intertemporal view of the current account, focusing on net exports of goods as a key indicator of future sustainability to study the link between the composition of imports, the potential growth of export-generating industries, and the structural transformation of African economies (box 1.3). Based on the balance-of-payments constraint theory (that external financing gaps must turn into surpluses in the long run to avoid external default or sharp consumption adjustments[10]), Africa's current external deficits may be justified if they sow the seeds for future surpluses. This will be the case as long as higher imports are consistently associated with rising capital formation, followed by an increased share of manufacturing and tradable industries in value added, an improved position in global value chains, and a gradual repayment of external liabilities.

Recent current account dynamics

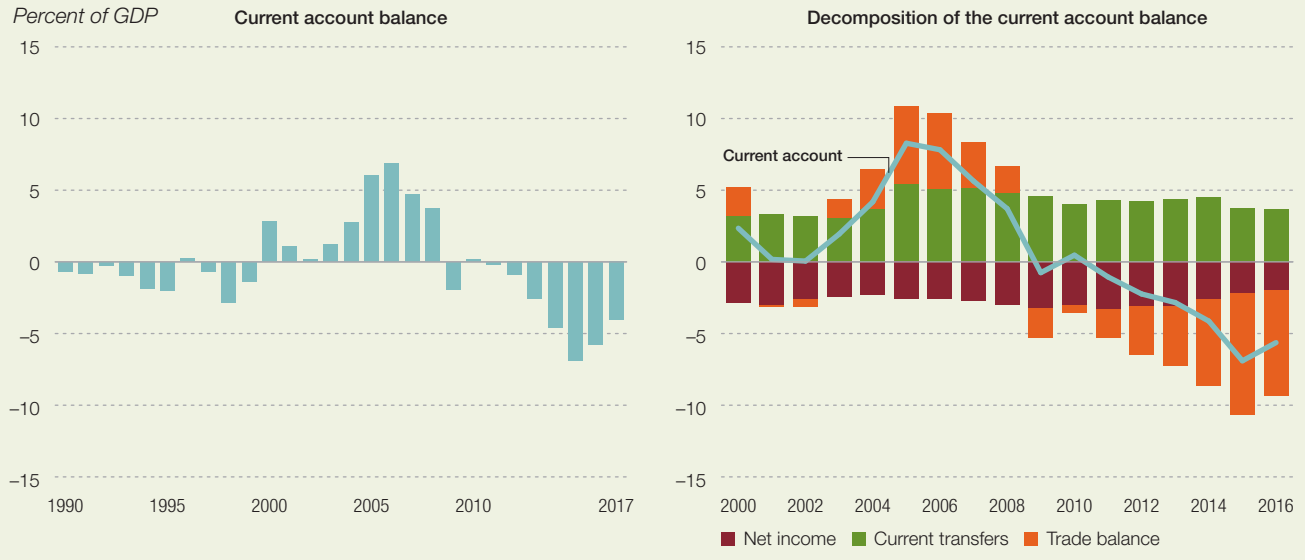
Despite rapid and generalized economic progress, Africa has been plagued with widespread external imbalances for the past 15 years. Part of the initial decline in the current account was driven by large capital income outflows, and trade balances remained positive until recently, dropping after 2010 when export prices of raw materials plummeted (figure 1.22).

Since the Great Recession, significant current transfer inflows (including aid) have reduced the size of external imbalances in Africa, but the main reason for the recent accumulation of external debt and rising current account deficits is the sharp deterioration of the net exports balance. Net income payments to foreign factors (in particular, investment income accruing to foreign corporations operating in the natural resources and manufacturing sectors) have also contributed to rising external deficits, representing a net aggregate outflow of nearly $40 billion a year for the continent.

While most African countries ran a current account deficit in 2017, with the largest in Djibouti, Guinea, and Liberia, a few countries had a surplus. The reason and qualitative interpretation behind the surpluses vary: they can be driven by diversification in exports, as in the success stories of Botswana and eSwatini,[11] but they are more often the result of a substantial drop in GDP and

Africa's current external deficits may be justified if they sow the seeds for future surpluses

FIGURE 1.22 Current account balance in Africa, 1990–2017, and decomposition of the current account balance in Africa, 2000–16



Source: African Development Bank statistics and International Monetary Fund World Economic Outlook and Balance of Payment Statistics database.

subsequent import contraction following reduced domestic consumption, as in Libya and Nigeria, and thus represent a sharp external adjustment after years of imbalances.

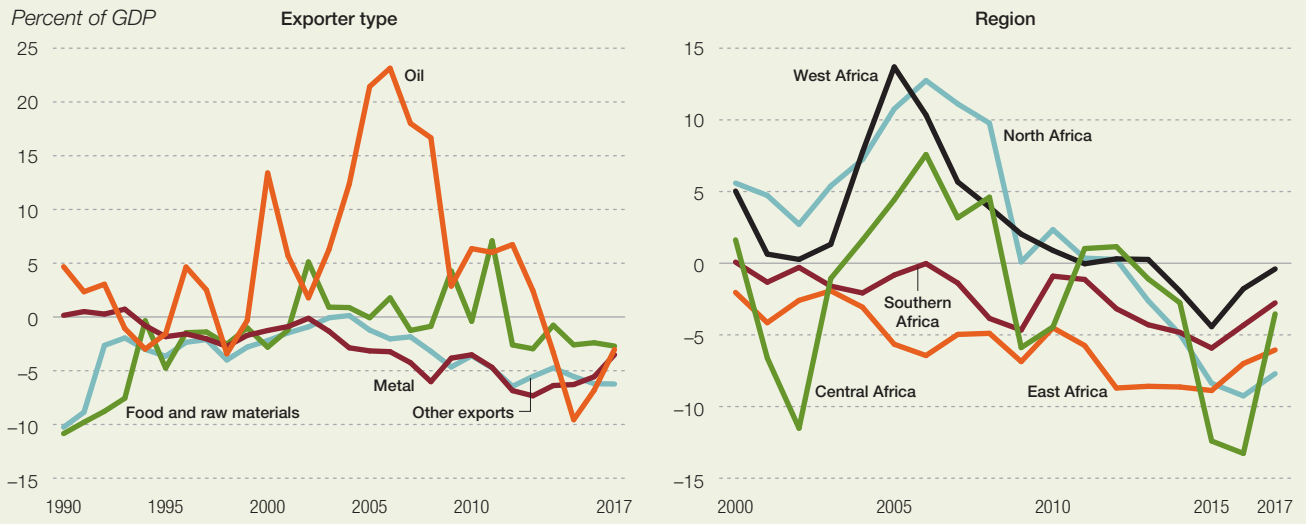
Oil exporters and Central Africa have seen large declines in current account balances, though since 2016, the external imbalances are gradually being addressed and external financing gaps have begun to close in several oil-producing countries. Raw material exporters have typically seen better current account balances than other countries throughout the 2000s, but they have also faced much more volatility and were hit particularly hard by the drop in commodity prices in 2013–16. While all regions have seen a decline in external balances since 2014, Central Africa and North Africa were most severely hit (figure 1.23). This is consistent with the role of oil and other commodities in Central Africa and the increasing security challenges posed by terror threats in both Central Africa and North Africa.

From 1990 to 2000, imports kept pace with exports in Africa, leading to a period of narrow trade deficits (figure 1.24). The commodity price supercycle that came into effect in early 2000 enabled exports to outpace imports, leading to a trade surplus at the continent level for much of the decade. This trend recently reversed as commodity prices collapsed, leading to lower export earnings while imports decline at a slower pace. As a result, the trade deficit has widened, implying rapid accumulation of foreign liabilities that are likely to weigh on the current account for several years.

Heterogeneity in export and import dynamics across African regions is key to understanding recent trends at the aggregate level. In particular, declining tourism revenue in North Africa (following rising security challenges) and falling raw material prices affecting Central Africa and West Africa are crucial to understanding the recent export dynamics across regions. In Central Africa, exports as a share of GDP declined by close to 15 percentage points from 2011 to 2016, following negative terms of trade shocks and limited real exchange rate depreciation due to high domestic inflation (figure 1.25). Exports as a share of GDP declined markedly after 2010 in most regions, though not as much in Southern Africa (where South Africa plays a prominent role and has less exposure to commodity price changes, thanks to a more diversified export mix). Imports as a share of GDP decreased in East Africa but remained high in Central Africa and North Africa, increasing divergence and the need for large external funding inflows.

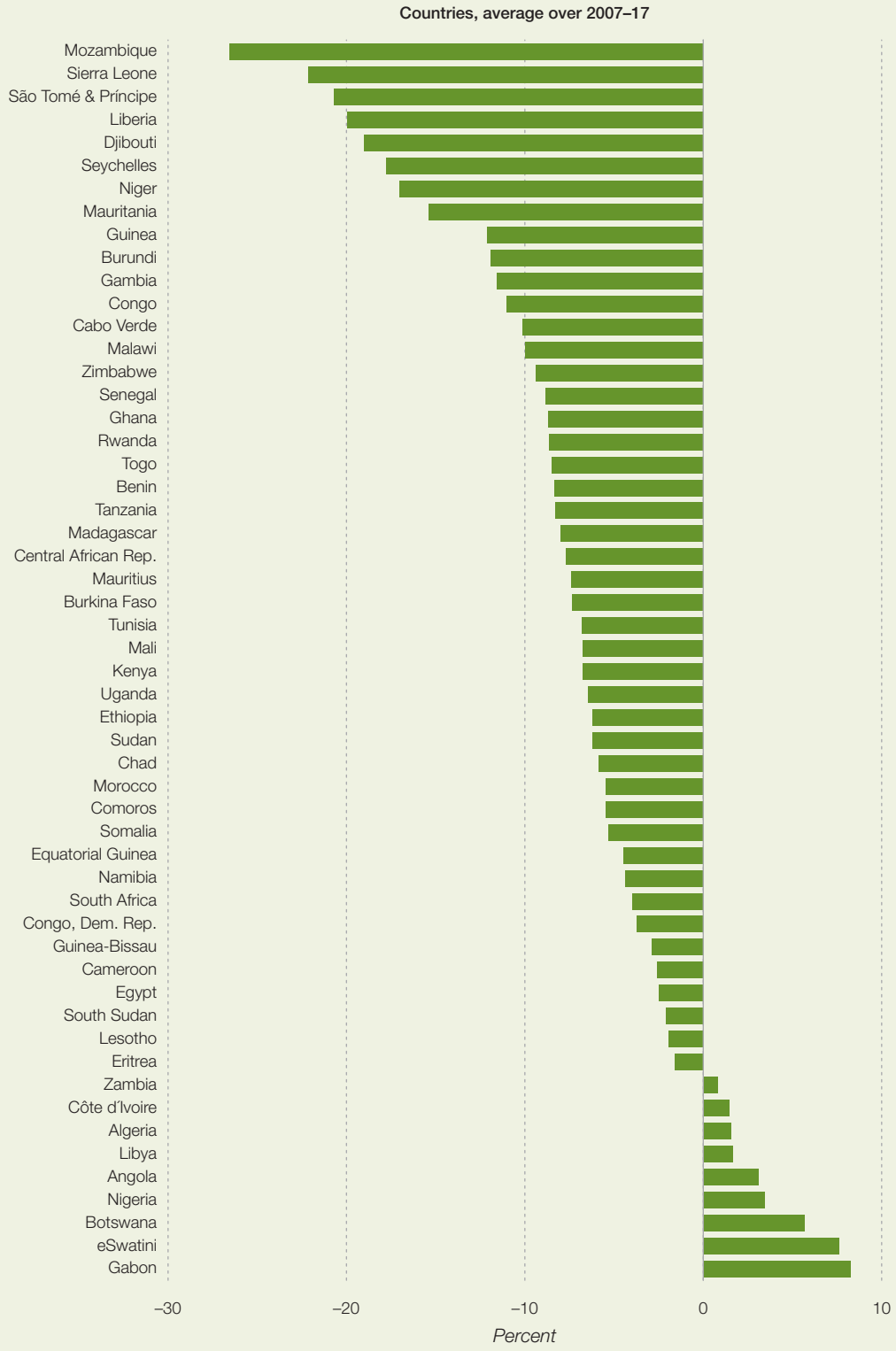
The rapid accumulation of foreign liabilities is likely to weigh on the current account for several years

FIGURE 1.23 Current account balances in Africa by exporter type, region, and country



(continued)

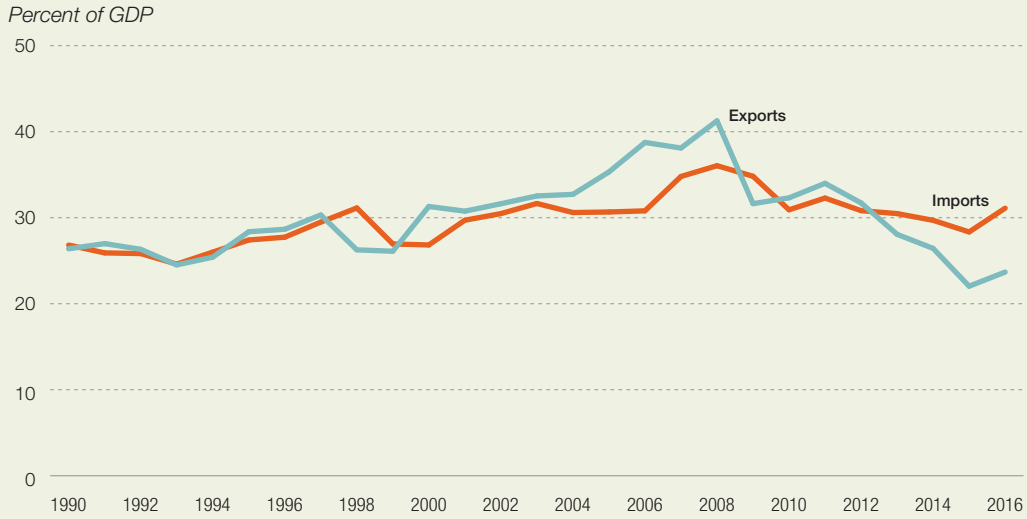
FIGURE 1.23 Current account balances in Africa by exporter type, region, and country *(continued)*



Source: African Development Bank statistics and International Monetary Fund World Economic Outlook and Balance of Payment Statistics database.

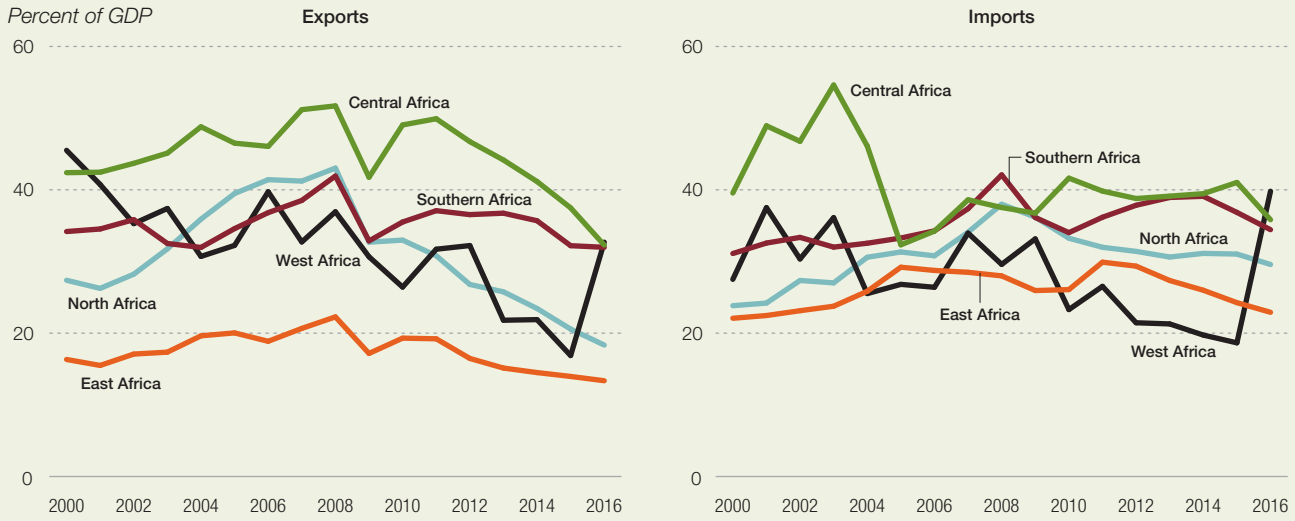
Exports as a share of GDP declined markedly after 2010 in most regions, though not as much in Southern Africa

FIGURE 1.24 Weighted average of African exports and imports, 1990–2016



Source: African Development Bank statistics and International Monetary Fund World Economic Outlook and Balance of Payment Statistics database.

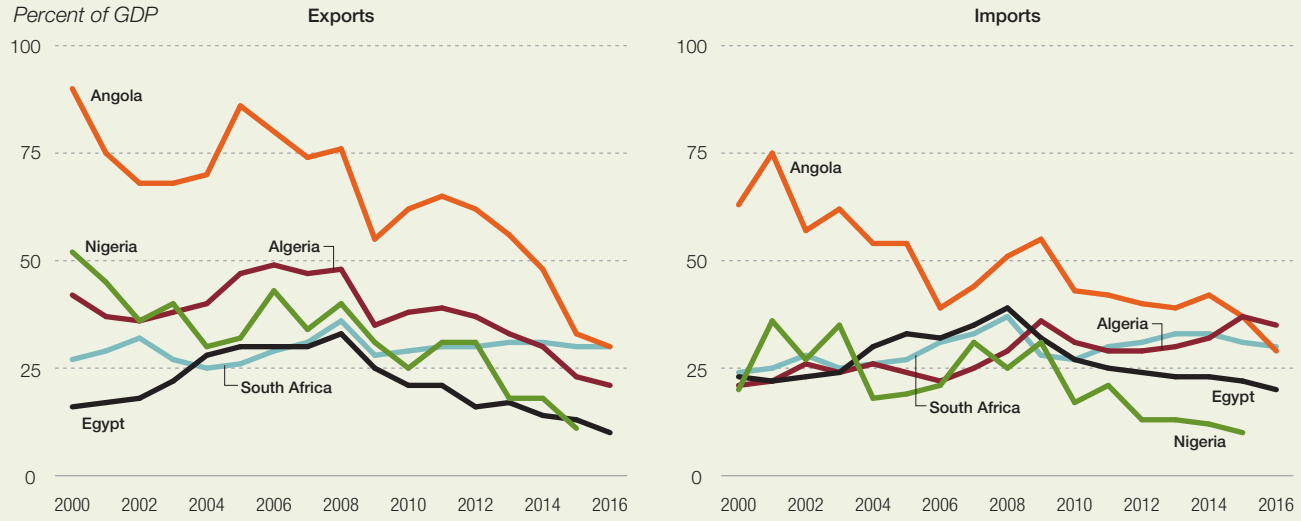
FIGURE 1.25 Weighted average exports and imports in Africa, by region, 2000–16



Source: African Development Bank statistics and International Monetary Fund World Economic Outlook.

Assessing the evolution of exports and imports in the five largest African economies—Nigeria, Angola, Algeria, Egypt, and South Africa—helps flesh out recent trade dynamics. The sharp reduction in exports in oil- and hydrocarbon-producing economies, notably Algeria and Angola, between 2000 and 2016 was not matched by a similar reduction in imports, leading to rising trade balance deficits (figure 1.26). Exports declined in all the economies except South Africa, which is more insulated from global commodity price shocks; imports rose in Algeria and South Africa.

FIGURE 1.26 Weighted average exports and imports in Africa's five largest economies, 2000–16



Source: African Development Bank statistics and International Monetary Fund World Economic Outlook.

BOX 1.4 The relationship among the current account, investment, and savings

Denoting B_t as net foreign assets at time t, the current account corresponds to the change in net foreign assets:

$$\Delta B_{t+1} = B_{t+1} - B_t = CA_t.$$

And by domestic budget constraints, the sum of public and private consumption and investment equals production plus net foreign income, plus the change in foreign assets:

$$C_t + I_t + G_t + \Delta B_{t+1} = Y_t + r_t B_t.$$

Domestic savings, defined as production minus public and private consumption, plus net foreign income, must equal:

$$S_t = Y_t + r_t B_t - C_t - G_t = \Delta B_{t+1} + I_t = CA_t + I_t.$$

Hence the current account is a savings–investment imbalance:

$$CA_t = S_t - I_t.$$

Finally, using the definition of the balance of trade as net exports of goods (produced goods minus goods consumed or invested):

$$TB_t = Y_t - (C_t + I_t + G_t).$$

So the current account can be expressed as the sum of net foreign factor income and the trade balance:

$$CA_t = r_t B_t + TB_t.$$

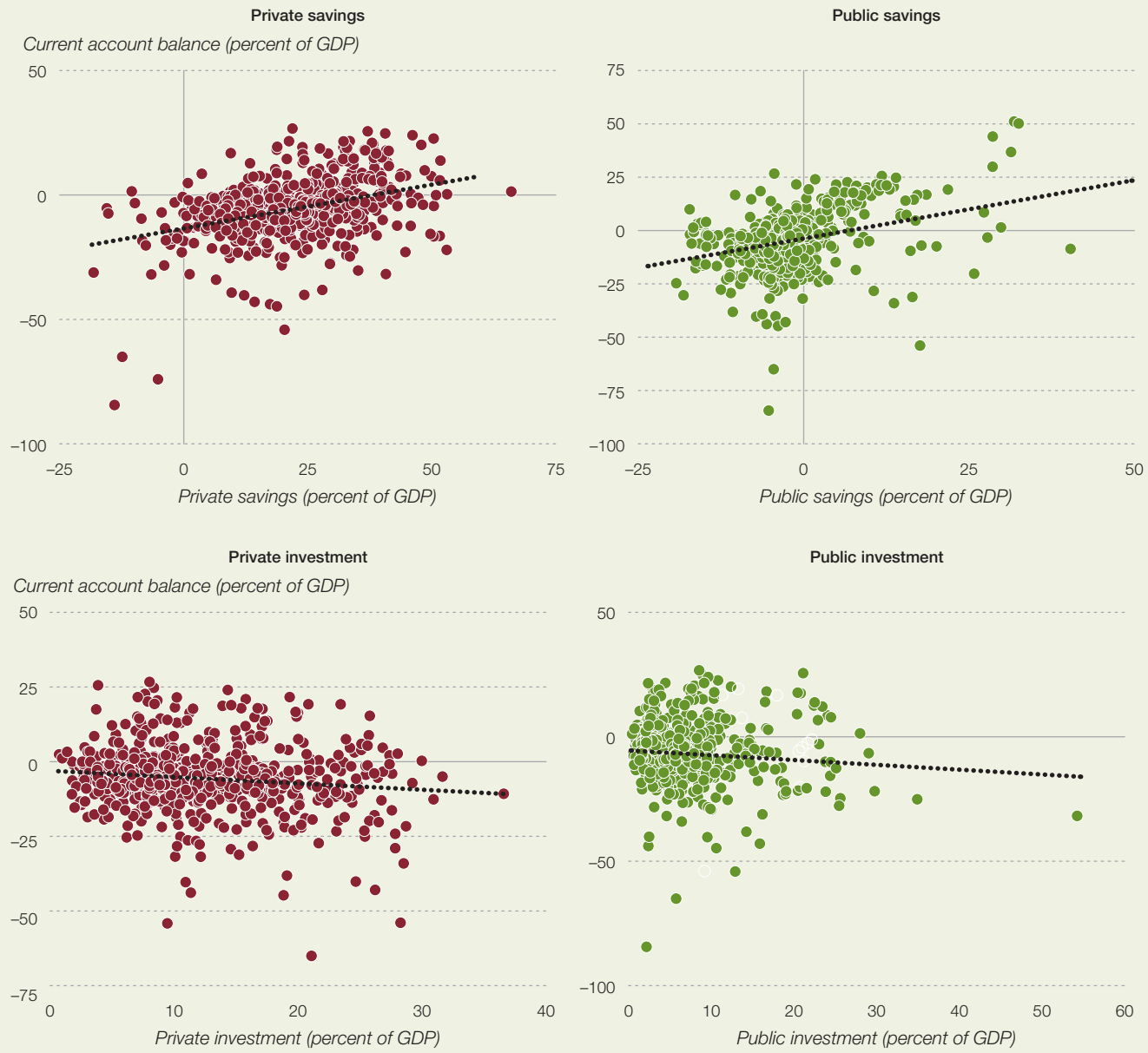
Determinants of current account imbalances

Domestic investment and savings dynamics are seen here as drivers of the need for external borrowing. Indeed, while the current account can be seen as the excess of domestic absorption over consumption, or the sum of net exports and net foreign factor payments, national accounting also implies that the current account mirrors the excess of domestic investment over savings (box 1.4).

Low domestic savings in Africa since 2000, driven in particular by rising public deficits, has

fostered a need for external borrowing in the form of loans and foreign portfolio and direct investment. Investment rates have remained high throughout the past decade, at 22 percent of GDP, and required sustained current account deficits because domestic absorption exceeded production. There is a close association between domestic savings and investment and current account deficits (figure 1.27). In particular, domestic public savings have been a key driver of current account imbalances in Africa. Rising fiscal deficits brought about by stagnating tax

FIGURE 1.27 The relationship between the current account balance and public and private savings and investment in Africa, 2000–17

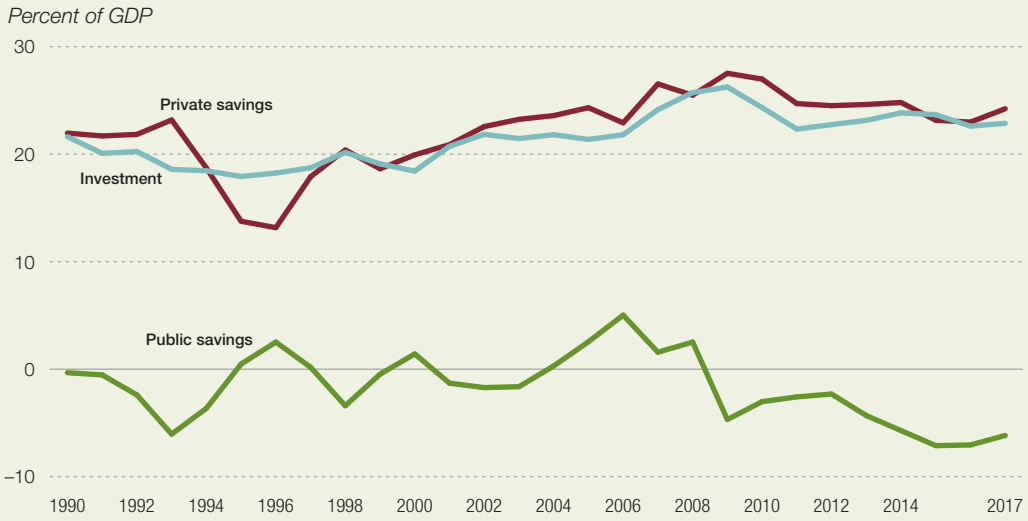


Source: African Development Bank statistics, World Bank World Development Indicators, and International Monetary Fund World Economic Outlook.

revenue, volatile nontax receipts, and increased spending on basic infrastructure and social needs are reflected in the accumulation of foreign liabilities.

Investment in Africa has increased, albeit slowly, but domestic savings have been highly volatile, losing ground in the 1990s, recovering in the 2000s, and crashing heavily recently (figure

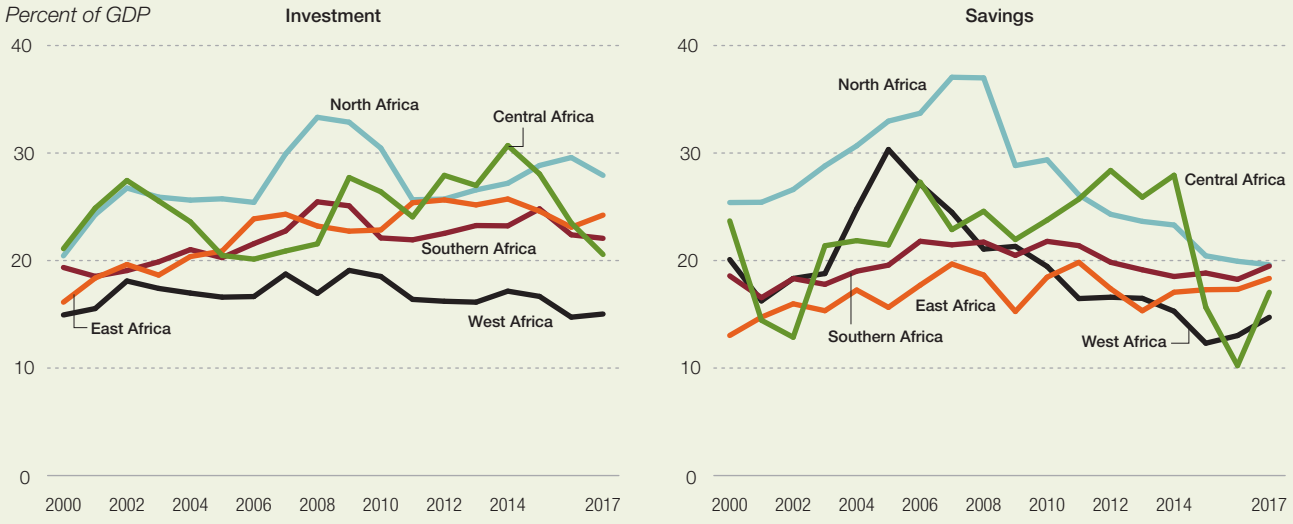
FIGURE 1.28 Weighted average investment and public and private savings in Africa, 1990–2017



Source: African Development Bank statistics, World Bank World Development Indicators, and International Monetary Fund World Economic Outlook.

Investment in Africa has increased, but domestic savings have been highly volatile

FIGURE 1.29 Investment and savings in Africa, by region, 2000–17



Source: African Development Bank statistics, World Bank World Development Indicators, and International Monetary Fund World Economic Outlook.

1.28). This trend hides substantial variation across regions and countries. Investment is highest in North Africa and East Africa, at 25–27 percent of GDP, and lowest in West Africa, at 15 percent of GDP (figures 1.29 and 1.30).

Savings have plummeted in most regions since 2015, particularly in West Africa and commodity-exporting countries,[12] due partly to rising fiscal deficits arising from the drop in oil prices (see figure 1.29). In East Africa, higher investment was not matched with a decline in savings, which points to one explanation for the region's relative overperformance: large external financing needs driven mostly by productive capital investment rather than a drop in public or private savings.

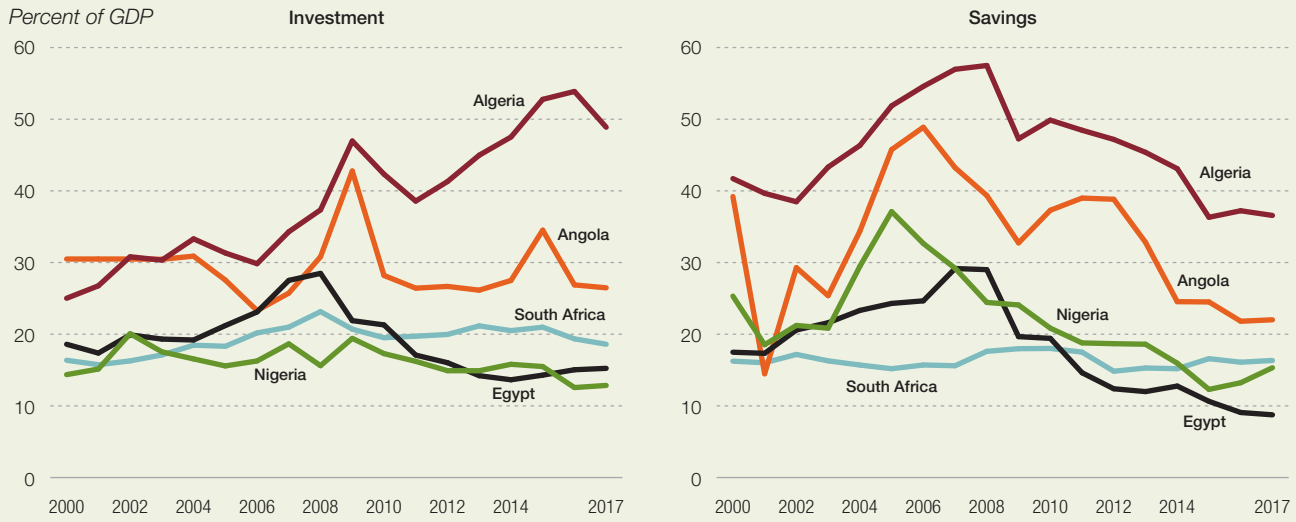
Savings have plummeted in most regions since 2015, particularly in West Africa and commodity-exporting countries

Analysis suggests strong persistence of trade surpluses and deficits. Industrialization plays a role in shifting from trade deficits to surpluses, even conditional on levels of development (proxied by GDP per capita and the share of services in value added). The share of industry in value added, the share of urban population in the largest city, and the urbanization rate all show a positive correlation with the current account balance, after country and year fixed effects are controlled for, suggesting a relationship between specializing in higher value added manufactured goods produced at larger scale and running a trade surplus (table 1.3). Countries with rising urbanization and industrialization rates include several export diversification success stories: from 2012 to 2016, Cabo Verde's urbanization rate went up 11 percentage points, to 66 percent, and Tanzania's went up 9. Some countries, however, witnessed an urbanization decline—for example, Zimbabwe (from 35 percent in 2002 to 32 percent in 2016).

Level of development also appears positively correlated with current account and trade balances, providing suggestive evidence for a growth path in which foreign capital inflows gradually lead to industrialization and reduced dependency on external funding. Public deficits (measured as overall government balance as a share of GDP) appear to drive down the current account, suggesting the existence of "twin deficits" on the continent. This has been documented elsewhere in the literature and points to the limited ability of domestic savings to cushion changes in government deficits and to the key role of government in generating and receiving most of the export revenues stemming from raw materials and the exploitation of natural resources.

Competitiveness is also a key driver of current account and external surpluses. A rise in the real

FIGURE 1.30 Investment and savings in Africa's five largest economies, 2000–17



Source: African Development Bank statistics, World Bank World Development Indicators, and International Monetary Fund World Economic Outlook.

exchange rate index leads to a deterioration of net exports, though the magnitude of the effect is limited. Industrialization is associated with an improved current account balance, while importing consumer goods and specializing in services are correlated with worse current account and trade balances. Higher domestic investment, both public and private, leads to larger deficits today, as domestic savings prove insufficient to finance government and private sector needs for productive infrastructure. This points to the key tradeoff for developing countries, between present deficits and export capacity–generating investment (see the next section). Higher public and private investment shares in GDP are indeed associated with larger trade balance deficits today, in line with the savings–investment gap interpretation of external imbalances, and suggesting that investment is a key driver of Africa's current account funding needs. In other words, investing today in Africa requires large foreign capital inflows and capital goods imports.

Digging deeper: import content and future growth

Not all trade deficits are created equal. Among African countries, disaggregating the dynamics of the trade balance, with a focus on imports of consumption, capital, and intermediate goods, provides further information on future current account sustainability. The recent literature on current accounts, export-led growth, and structural change also helps in assessing the viability of recent external imbalances in Africa using a disaggregated, sector-level analysis of import and export content rather than from an aggregate external position perspective.[13] The focus here is on two subdimensions of trade-induced structural change: imports of capital goods, which are subsequently used in production and allow a country to develop a strong domestic manufacturing and capital base, and imports of intermediate goods, which allow further integration into global value chains, a key determinant of growth in living standards for developing economies.[14] Disaggregated trade data at the broad industry level emphasize the degree to which African economies are shifting, or not, toward imports of capital goods and intellectual property–intensive products, which are likely to trigger growth in export-led industries.

TABLE 1.3 Trade balance regression

Factor	Coefficient
Lagged trade balance (% of GDP)	0.531*** (0.023)
Real GDP growth (annual %)	0.062* (0.036)
Industry value added (% of GDP)	0.447*** (0.038)
Population growth (%)	20.880 (21.884)
Overall government balance (% of GDP)	0.073*** (0.025)
Gross private capital formation (% of GDP)	–0.427*** (0.028)
Gross public capital formation (% of GDP)	–0.315*** (0.039)
Consumer price inflation (annual %)	0.008 (0.014)
Real exchange rate index (2000=100)	–0.001* (0.0004)
Log GDP per capita ($)	6.482** (2.703)
Log GDP per capita ($), squared	–0.216 (0.199)
Number of observations	945
R^2	0.678
Adjusted R^2	0.648
F-statistic	165.388*** (df = 11; 865)

* Significant at the 10 percent level; ** significant at the 5 percent level; *** significant at the 1 percent level.

Source: African Development Bank statistics, World Bank World Development Indicators and World Integrated Trade Statistics, and International Monetary Fund World Economic Outlook.

Note: Includes country and year fixed effects.

Africa remains heavily specialized in raw material exports with low jobs content and low complexity (notably fossil fuels). They account for about 40 percent of exports in the region, the most specialized in the world (figure 1.31). The lack of reallocation of employment away from labor-intensive, low-productivity raw materials (as well as nontradable services and light manufacturing) toward tradable industries with higher external economies of scale is one of the bottlenecks jeopardizing the continent's growth prospects. Moreover, this pattern of specialization is associated with several risks: volatile terms of trade, limited potential for

differentiation and market power, reduced ability to exploit scale and knowledge externalities, and dependency on external demand fluctuations.

In African countries, a higher share of capital goods in merchandise imports is associated with lower specialization in raw materials in the future. There is a strong correlation between a higher share of capital goods in imports in one year and a lower share of raw materials in exports five years later, after the current share of raw materials in exports, GDP per capita, and country and year fixed effects are accounted for (figure 1.32). Regression analyses emphasize the key role of intermediate and capital goods in reducing future reliance on raw materials exports and triggering self-perpetuating industrialization, urbanization, and structural change. The effect is strongest in North Africa, possibly because the region has a higher level of development and less reliance on raw material exports.

Future industrialization and greater export capacity and trade surpluses are more likely to follow current account deficits that are driven by capital and intermediate goods imports

Intermediate and capital goods imports

Future industrialization and greater export capacity and trade surpluses are more likely to follow current account deficits that are driven by capital and intermediate goods imports than current account deficits that stem from large imports of consumption goods. The share of capital goods in imports is largest in the fastest growing emerging regions, including East Asia and Pacific, and lower on the African continent, where it is closer to the share in Europe and Central Asia. Moreover, the share of capital goods in imports has declined in Africa, stagnating at about 25 percent, compared with the nearly 40 percent in Latin America and East Asia.

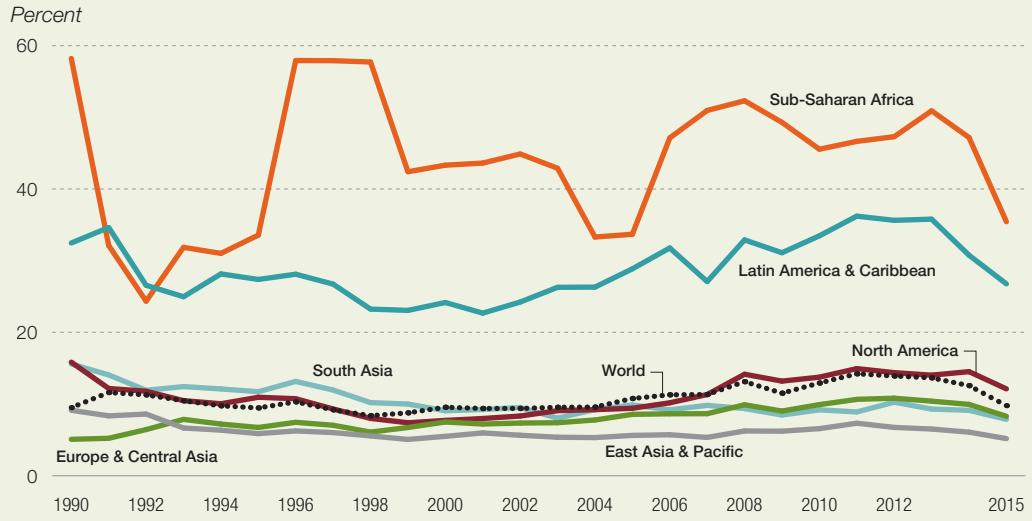
The share of intermediate and capital goods in imports in 2015 (the most recent year with disaggregated data) varies widely across African countries. It is highest among producers specializing in light manufacturing, tourism, and other services, including Madagascar, Tunisia, and Morocco, which are already well integrated into global value chains (figure 1.33). These countries have specialized in exports of textiles, integrated circuits, insulated wires, and small electronics[15] and supply traditional purchasers, notably those in the European Union, with low-cost light manufacturing. They have captured at least part of the value generated by the accumulation of tasks along global value chains. By contrast, capital equipment goods and machinery are imported mostly by large fuel producers and heavy industry exporters, including Niger, Algeria, Angola, and South Africa, which export mostly raw materials and hydrocarbons or heavy industry products (chemicals, metal products, cars, and coal and coal-derived products).

Capital goods imports play a virtuous role in structural change, growth in export-led industries, and subsequent reversals of external and current account imbalances. Long-term growth in income per capita appears correlated with a higher share of capital imports. Regression analyses show that countries where imports have focused on upstream, capital-intensive products and industries have been more likely to see accelerated growth, increased industrialization, an improved trade balance, and lower external debt following a rise in exports and import substitution[16] relative to countries in which initial imports were driven mostly by final consumption sectors. After country and year fixed effects and the initial share of industry and manufacturing in value added are accounted for, higher capital goods imports are likely to lead to a rise in industry's share of GDP (figure 1.34). The importance of capital goods imports is further supported by their strong correlation with future growth and poverty reduction. Growth in GDP per capita in five years is associated with the share of capital goods in total imports, even after various observables and country and year fixed effects are controlled for.

After the current share of exports in GDP, log GDP per capita, and country and year fixed effects are accounted for, higher current investment leads to future improvement in export performance and the trade balance 5 and 10 years later, with short-term improvement correlated more closely with private investment and long-term improvement correlated more closely with public investment.

African countries with the highest shares of manufacturing in value added also have higher levels of development. They follow the well-established path of industrialization, urbanization, and upward movement in the value added chain. Higher private capital formation has a strong impact on future export growth (figure 1.35). The impact is similar across African regions, though weaker in West Africa and

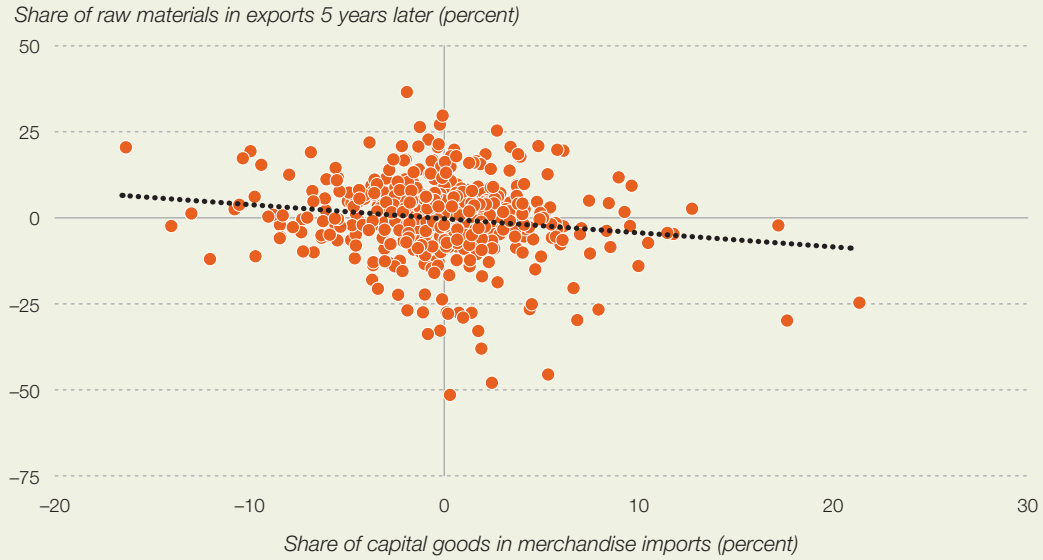
FIGURE 1.31 Share of raw materials in exports, by world region, 1990–2015



Source: African Development Bank statistics and World Bank World Development Indicators and World Integrated Trade Statistics.

African countries with the highest shares of manufacturing in value added also have higher levels of development

FIGURE 1.32 Relationship between share of capital goods in merchandise imports and share of raw materials in exports five years later in Africa



Source: African Development Bank statistics and World Bank World Development Indicators and World Integrated Trade Statistics.

Note: Covers 54 African countries with data for 2000–17. The regressions include country fixed effects to remove the effect of time-invariant country characteristics and year fixed effects to net out the effect of aggregate trends affecting the continent as a whole.

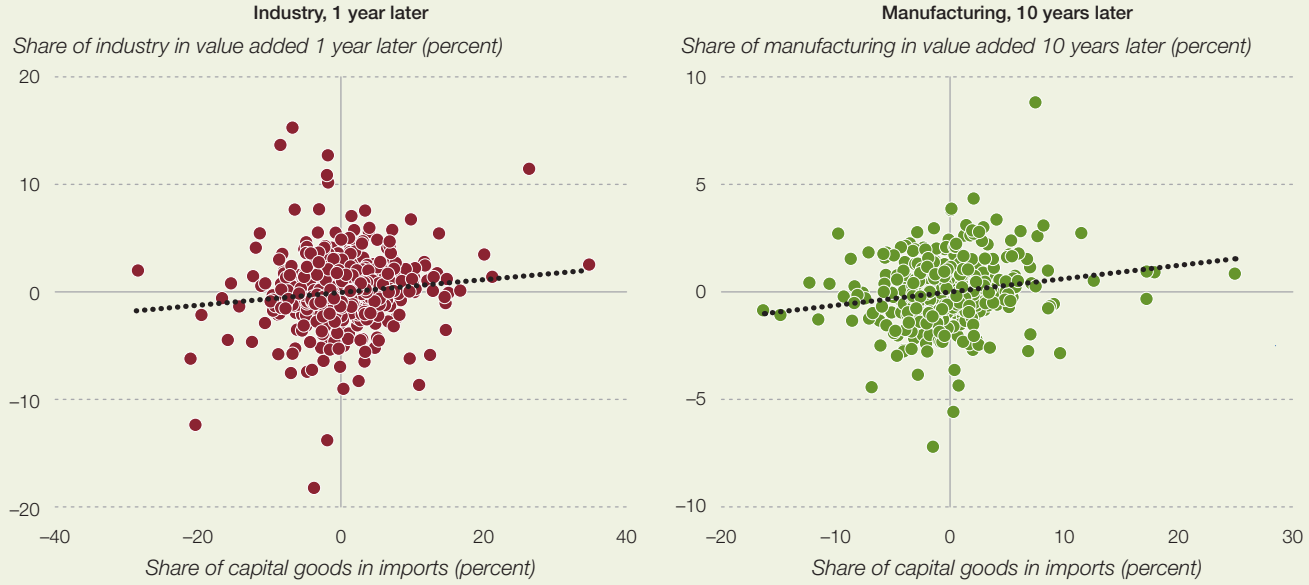
FIGURE 1.33 Share of intermediate goods and capital goods in imports in Africa, by country, 2015

Source: African Development Bank statistics and World Bank World Development Indicators and World Integrated Trade Statistics.

weaker and less robust in Central Africa, where capital investment has been targeted mostly toward hydrocarbon and raw material extraction and is thus less correlated with future export growth because the terms of trade associated with such specialization is highly volatile. Improved export performance following a large rise in private investment is driven by faster industrialization. Higher private investment is associated with a sharp rise in the share of industry in value added in five years.

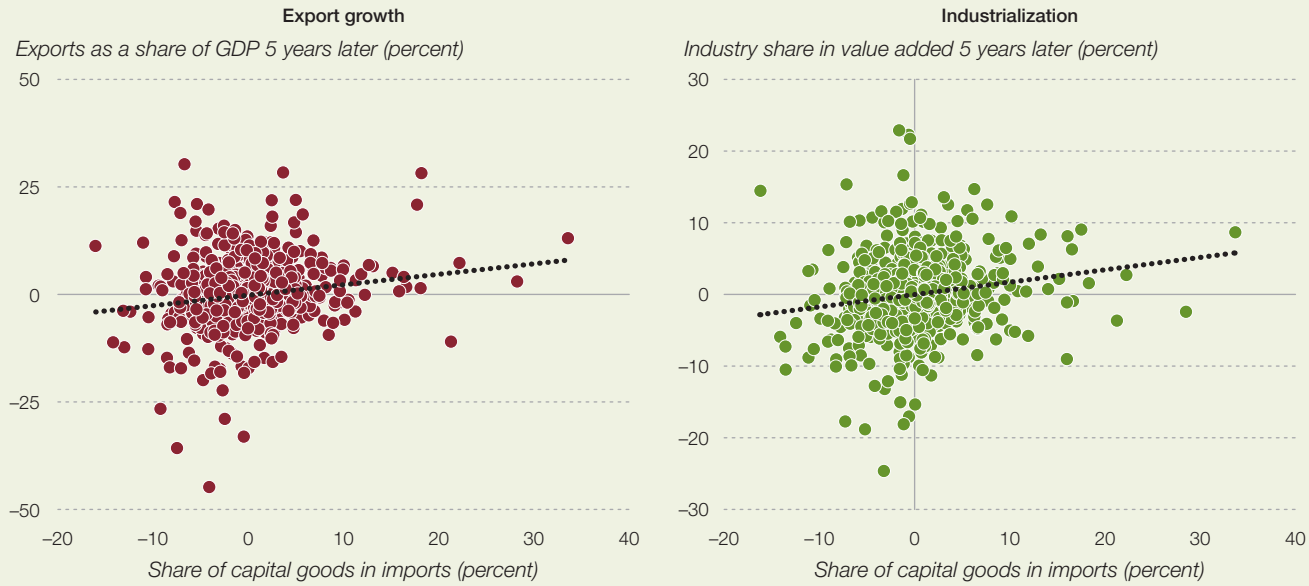
Beyond capital goods imports, integration into global value chains is a key factor for development

FIGURE 1.34 Relationship between share of capital goods in imports and future industry and manufacturing shares in value added in Africa



Source: African Development Bank statistics and World Bank World Development Indicators and World Integrated Trade Statistics.
Note: Covers 54 African countries with data for 2000–17. The regressions include country fixed effects to remove the effect of time-invariant country characteristics and year fixed effects to net out the effect of aggregate trends affecting the continent as a whole.

FIGURE 1.35 Relationship between gross private capital formation and future exports as a share of GDP and industry share in value added in Africa



Source: African Development Bank statistics and World Bank World Development Indicators and World Integrated Trade Statistics.
Note: Covers 54 African countries with data for 2000–17. The regressions include country fixed effects to remove the effect of time-invariant country characteristics and year fixed effects to net out the effect of aggregate trends affecting the continent as a whole.

and structural change in developing countries. It drives the convergence of living standards through several channels: technology transfers and know-how externalities, logistical support and additional export opportunities, and reduced volatility of trade and the cost to discover trade partners.[17] For Africa, a rise in intermediate goods imports is associated with a higher share of industry in value added in five years—a strong association that holds when country and year fixed effects, initial share of industry, and GDP per capita are controlled for (figure 1.36).

After country and year fixed effects, the shares of capital goods in imports, and the share of raw materials in exports are controlled for, a higher share of intermediate goods imports is also associated with a higher World Economic Forum Global Competitiveness Index score (figure 1.37). Some of Africa's success stories of global integration and export diversification also show high shares of intermediate goods in imports in recent years, with growing trends in Madagascar, Ethiopia, and Tunisia in recent years (figure 1.38).

Integration into global value chains is a key factor for development and structural change

Monetary and financial integration: Assessing the challenges

Africa is home to three monetary unions—the West African Economic and Monetary Union, the Central African Economic and Monetary Community, and the Common Monetary Area—and political leaders across the continent have been talking about creating new ones or expanding the existing three. A major rationale for these monetary unions is the expected political benefit of ultimately having a single currency for the continent, as a symbol of African unity. Another more technical rationale involves the costs and benefits of engaging in such unions, whether regional or continental.

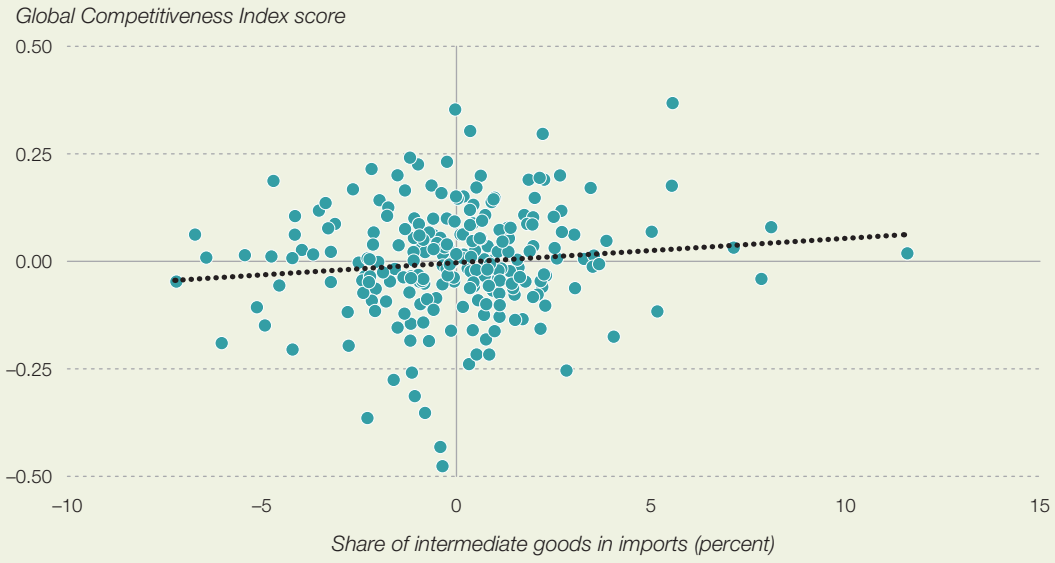
As noted in last year's *African Economic Outlook,* countries engage in monetary unions with the hope of macroeconomic and structural benefits.[18] The benefits include a stable exchange rate and macroeconomic environment, less external vulnerability, greater intraregional trade, more financial integration, lower transaction costs (as currency conversion costs fall)—and thus faster growth and more convergence among member

FIGURE 1.36 Relationship between intermediate goods imports and future industry share in value added in Africa

Source: African Development Bank statistics and World Bank World Development Indicators.

Note: Covers 54 African countries with available data for 2000–17. The regressions include country fixed effects to remove the effect of time-invariant country characteristics and year fixed effects to net out the effect of aggregate trends affecting the continent as a whole.

FIGURE 1.37 Relationship between intermediate goods imports and global competitiveness score in Africa

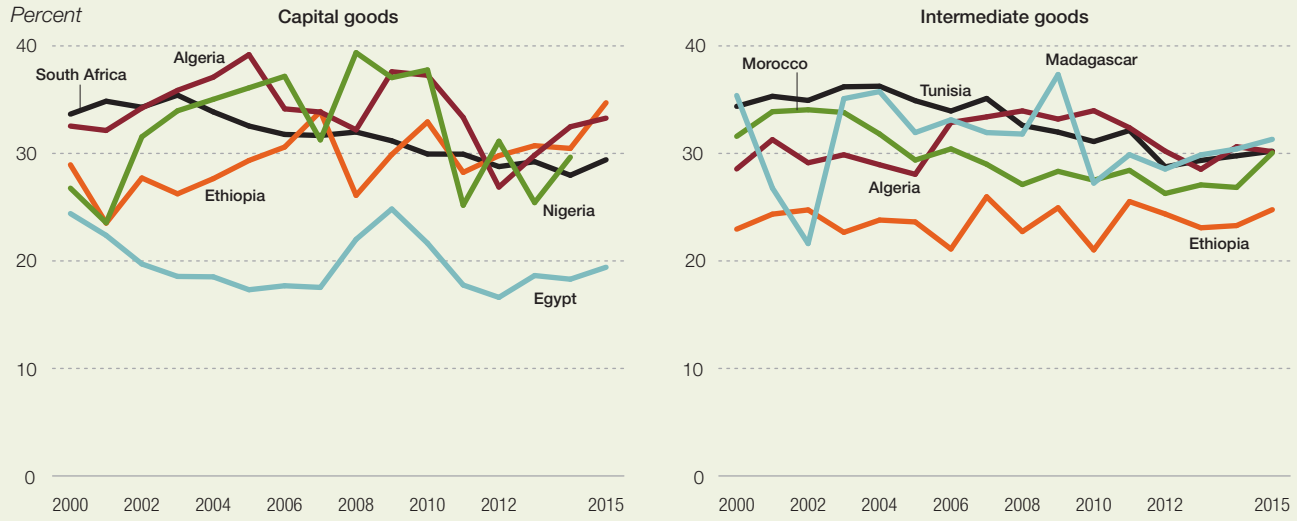


Source: African Development Bank statistics and World Bank World Development Indicators.

Note: Covers 54 African countries with available data for 2000–17. The regressions include country fixed effects to remove the effect of time-invariant country characteristics and year fixed effects to net out the effect of aggregate trends affecting the continent as a whole.

Some of Africa's success stories of global integration and export diversification also show high shares of intermediate goods in imports in recent years

FIGURE 1.38 Shares of capital and intermediate goods in imports in African economies, 2000–15



Source: African Development Bank statistics and World Bank World Development Indicators and World Integrated Trade Statistics.

countries. But there also are costs. By definition, monetary unions limit member countries' flexibility to use monetary instruments to adjust to external shocks.

The standard framework that many economists use to assess the viability of a monetary union and the scope for expanding one is the optimal currency area.[19] In theory, membership in a monetary union can be beneficial depending on the degree of openness and intraregional trade, the degree of labor and factor mobility, the symmetry of shocks across countries, and the system for sharing risk and providing financial support to countries facing severe economic difficulties.

Masson, Debrun, and Pattillo (2015) use that general framework to try to answer three questions. First, are the existing monetary unions in Africa economically viable? Second, should existing monetary unions be expanded, or should new ones be created? Third, what lessons come from the Eurozone? They conclude that African monetary unions are economically viable, with net economic gains from membership in the West African Economic and Monetary Union, though the benefits are not equal across member countries (table 1.4). Because currencies are pegged to the euro, countries benefit from greater monetary stability. But they are worse off since they cannot use exchange rate adjustments to cushion the effect of fiscal and external shocks. The results are similar for the Common Monetary Area, pegged to the South African rand.

By definition, monetary unions limit member countries' flexibility to use monetary instruments to adjust to external shocks

Should existing monetary unions be expanded? For example, should the West African Economic and Monetary Union include the Economic Community of West African States? When Gambia, Ghana, and Guinea are added to the West African Economic and Monetary Union, there are net gains (if reduced) for both current and new members (table 1.5). When Nigeria is added, current members would not benefit, although it could be welfare-enhancing for Nigeria, which would gain from a more stable currency. But without Nigeria, expanding the monetary union in West Africa erodes the net gains accruing to both current and new members.

On lessons from the eurozone, Masson, Debrun, and Pattillo (2015) indicate that, in addition to satisfying the macroeconomic convergence criteria, closer integration in other dimensions is needed to reap the gains from a monetary union. Specifically, they recommend close coordination of banking supervision and a lender-of-last-resort facility at the union level. They also suggest that member countries in currency unions should be willing to bail out others in extreme circumstances, among other noneconomic dimensions.

Such a generally positive assessment of African monetary unions has drawn skepticism from other researchers,[20] and several criticisms can be leveled against the optimal currency area theory (see box 3.3 in chapter 3). First, the theory can be difficult to test and validate empirically, especially in countries with insufficient or inaccurate data on

TABLE 1.4 Net welfare gain from membership in the West African Economic and Monetary Union *(% of GDP)*

	Net welfare gain	Monetary externality	Fiscal asymmetry	Shock asymmetry
Benin	0.87	1.44	–0.45	–0.13
Burkina Faso	1.28	1.44	–0.09	–0.07
Côte d'Ivoire	1.28	1.44	–0.06	–0.1
Mali	1.93	1.44	0.56	–0.05
Niger	0.77	1.44	–0.06	–0.61
Senegal	1.48	1.44	0.18	–0.14
Togo	0.93	1.44	–0.37	–0.15

Source: Masson, Debrun, and Pattillo 2015.

TABLE 1.5 Net welfare gain or loss from adding countries one by one to the West African Economic and Monetary Union *(% of GDP)*

For new members	Net welfare gain or loss	For current members						
		Benin	Burkina Faso	Côte d'Ivoire	Mali	Niger	Senegal	Togo
Gambia	–0.0015	0.0006	0.0006	0.0005	0.0005	0.0006	0.0006	0.0006
Ghana	0.0129	0.0037	0.0038	0.0043	0.004	0.0038	0.0037	0.004
Guinea	0.0024	0.0009	0.0008	0.0005	0.0007	0.001	0.0009	0.0006
Nigeria	0.0229	–0.0128	–0.0134	–0.0175	–0.016	–0.0133	–0.0114	–0.017

Source: Masson, Pattillo, and Debrun 2015.

key macroeconomic variables.[21] Second, differences in labor markets (institutional arrangements, union behavior) will not necessarily disappear over time as the monetary union takes hold. Third, differences in economic performance across countries in a monetary union may not be decisive. Indeed, a demand shock concentrated in only one country may be unlikely and would be offset by the importance and the structure of trade.[22]

Moreover, the dissimilarity in industry structures is often the end point of efficient monetary integration, not the starting point. Here's why. The interaction of higher returns and lower transport costs leads to uneven regional development, facilitating the clustering of firms in some places, creating core and peripheral regions. In such circumstances, reducing transport costs would facilitate locating production where it is cheapest but also concentrate production in one location to realize economies of scale. This new economics of space tends to localize industries in a monetary union's countries where the returns are higher and eventually to have countries specialize within the union —that is, a monetary union's members have a different economic structure only much later.

Considering such limits to the assessment criteria of optimal currency area proponents, two other issues must be analyzed: the lack of strong and credible mechanisms for fiscal coordination within African currency unions and the uncertainty about creating and distributing the revenues from printing money (seigniorage):

- *Lack of coordination.* Monetary unions, with their explicit coordination of monetary and exchange rate policies, require strong cooperation in the fiscal policies of all member states. Given the structural differences among the various areas of any given union, fiscal policies must be the stabilizers, with transfers offsetting a member's economic difficulties. But highly divergent fiscal policies could put unbearable strains on the union, especially if they lead to conflicting balance of payment movements. The "fiscal federalism" that helps Germany, the United States, and other federal currency areas succeed despite having economically diverse regions is absent in African monetary unions. Compounding the problem is that government revenue from taxing international trade and transactions varies greatly across African countries in the same monetary union. So, member countries do not have the same incentives for economic integration.
- *Loss of seigniorage.* The opportunity cost of relinquishing the use of seigniorage should be factored into estimates of the gains from monetary integration among African countries.[23] Government revenue from printing money can sometimes amount to fairly high proportions of GDP and to more than 10 percent of total revenue. It is a source of revenue because, simply by printing money to pay for its expenditures, a government generates inflation, thus lowering the real value of payments and taxing existing holders of money.

What, then, does a monetary union need if it is to be effective? It needs well-functioning, cross-country fiscal institutions and rules, which can

A monetary union needs well-functioning, cross-country fiscal institutions and rules, which can help members respond to asymmetric shocks

help members respond to asymmetric shocks. For instance, a central authority should be able to organize financial transfers to member countries suffering from a negative shock. The free movement of labor, capital, and goods should be a reality—not just a goal. Debt and deficit policies should be consistent across the union and carefully monitored by a credible central authority. And the financial and banking sector should be under careful supervision by a unionwide independent institution capable of enforcing strict prudential rules. Each of these four requirements is a tall order. Together, they present enormous macroeconomic challenges.

POLICY IMPLICATIONS

Policies to lower the cost to transfer money and to improve platforms for diaspora investment and other incentives can increase the availability of critical resources for financing development

The recovery of Africa's GDP growth from the trough of 2016 suggests resilience as well as vulnerability to regional and global shocks. The projected growth of 4 percent in 2019 and 4.1 percent in 2020 is welcome progress. But dependency on a few export commodities to spur growth and vulnerability to volatility in commodity prices has impeded most African economies from sustaining high growth. Commodity dependence has also reduced macroeconomic levers, creating tensions and tradeoffs between growth-enhancing and stabilization policies. As a result—and as often advocated—Africa needs deep structural reforms to successfully diversify its economy, both vertically and horizontally.

Diversifying and undertaking deep structural change require large development finance. Apart from revenue from extractive sectors and taxes, most African countries receive remittances that now exceed ODA and FDI—not including remittances transferred through informal channels, which could equal half of remittances through formal channels. Policies to lower the cost to transfer money and to improve platforms for diaspora investment and other incentives can increase the availability of critical resources for financing development. Intra-Africa remittances flow largely through informal channels because of high transfer costs and limited interbank services within Africa, which stymie formal remittance flows.

Widespread illicit financial outflows are hurting most African countries, reducing available resources for investing in infrastructure, power, and other long-term projects. (Illicit financial flows account for 5.5 percent of GDP in Sub-Saharan Africa and have cost $1–$1.8 trillion over the past 50 years.) And continuous monitoring of the debt situation in the most fiscally fragile African economies is required to develop early-warning systems and feedback mechanisms to avoid debt distress. In addition, there is a need to engage in policy dialogue to raise awareness of debt sustainability at the highest political level, lay the foundation for efficient use of existing resources to limit recourse to additional debt, strengthen countries' capability to manage their public debt, support efficient and productive use of debt, and build fiscal capacity.

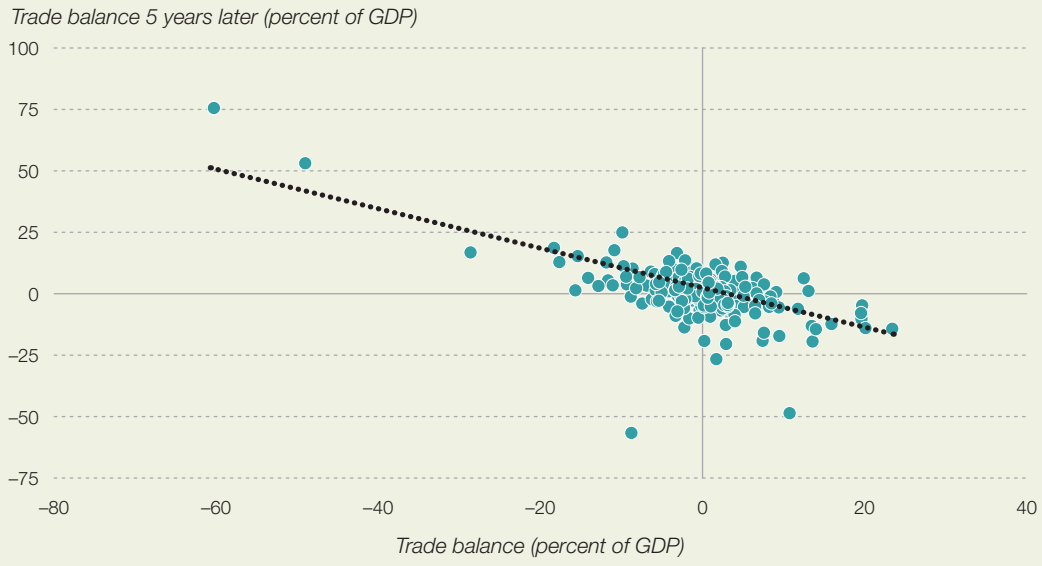
While improving tax collection is high on the policy agenda in many countries, a balance must be found among the fiscal objective (creating more revenue), the efficiency objective (preventing adverse effects on investment and economic growth), and the equity objective (that people consider it fair). But meeting these objectives remains challenging because of countries' low incomes, large informal sectors, and inefficient tax administration.

As interest rates normalize in advanced economies, policy adjustments are needed that continue to attract investors to the region through strong performance in macroeconomic fundamentals, such as high GDP growth, stable and low inflation, and security of lives and property. One way to achieve export-led growth is to accumulate physical capital and expand the economy's productive capacity.

A preceding section showed that capital and intermediate goods imports reduce the role of raw materials in Africa's revealed comparative advantage but that this pattern of specialization has some associated risks. The evidence suggests that trade balance convergence (the fact that current negative trade balances in one year are associated with improvements five years later; figure 1.39) is driven partly by the quality of the trade balance, measured as the share of capital and intermediate goods in imports.

These dynamics suggest a cautiously optimistic view of the sustainability of external imbalances in Africa. The increasing weight of export-generating industries in domestic investment and

FIGURE 1.39 **Relationship between the current trade balance and the future trade balance in Africa**



Source: African Development Bank statistics and World Bank World Development Indicators.

Note: Covers 54 African countries with available data for 2000–17. The regressions include country fixed effects to remove the effect of time-invariant country characteristics and year fixed effects to net out the effect of aggregate trends affecting the continent as a whole.

Policy interventions focused on increasing the share of intermediate and capital goods in imports could help countries benefit from scale and scope economies

the rising share of capital and intermediate goods relative to consumption goods in imports support the presumption that external debt tends to be used sensibly, to fund essential infrastructure and industrial investment likely to eventually reverse trade balance deficits.

Policy interventions focused on increasing the share of intermediate and capital goods in imports could help countries benefit from scale and scope economies and exploit knowledge transfers from more advanced production processes. First, higher private investment is associated with future improvement in the trade balance. Countries may thus sustain current large external deficits, as long as tax incentives, institutional frameworks, and basic infrastructure are in place to channel capital investment toward the sectors most likely to drive a trade balance reversal. Second, emphasizing urbanization and a reallocation of the most productive resources toward export-intensive areas that are well integrated into global value chains appears to be key to aggregate productivity growth. Third, among African success stories of export diversification, improving the external tariff structure to avoid an undue burden on intermediate and capital goods is also a relevant policy intervention to level the playing field and foster a structural shift in the import mix from consumer to capital goods. Fourth, ensuring integration into global value chains by upholding technical and labor standards and reinforcing regional integration enables countries to move up the ladder of specialization and reverse external imbalances. Fifth, reinvesting surpluses from commodity price windfalls toward sectors with higher productivity growth and more potential for integration into global value chains is crucial to make trade an inclusive part of structural change in Africa.

Finally, the immediate gains from African monetary integration, one of the aspirations of regional and continental integration, may be much more elusive—and the macroeconomic challenges much greater—than conventional analysis predicts. The standard framework that many

economists use (the optimal currency area) can be difficult to validate for countries with too little accurate data on key macroeconomic variables. It is unlikely that differences in labor markets will disappear rapidly over time. It is also unlikely that shocks will hit only one member and not be generalized to many or all of them. So it is unlikely that an African supranational authority will have the resources to come to the aid of countries facing severe economic difficulties.

For countries in a monetary union, well-functioning, cross-country fiscal institutions and rules are needed to help members respond to asymmetric shocks. The free movement of labor, capital, and goods should be a reality—not just a goal. Debt and deficit policies should be consistent across the union and carefully monitored by a credible central authority. And the financial and banking sector should be under careful supervision by a unionwide independent institution capable of enforcing strict prudential rules. Each of these four requirements is a tall order. Together, they present enormous macroeconomic challenges.

ANNEX 1.1

TABLE A1.1 Macroeconomic developments in Africa, 2010–20

Indicator and country group	2010–14	2015	2016	2017	2018 (estimated)	2019 (projected)	2020 (projected)
Real GDP growth (%)							
Central Africa	5.0	3.3	0.2	1.1	2.2	3.6	3.5
East Africa	5.9	6.5	5.1	5.9	5.7	5.9	6.1
North Africa	3.7	3.7	3.2	4.9	4.3	4.4	4.3
Including Sudan	3.6	3.7	3.2	4.8	4.3	4.4	4.3
Southern Africa	3.8	1.6	0.7	1.6	1.2	2.2	2.8
West Africa	6.2	3.2	0.5	2.7	3.3	3.6	3.6
Africa	*4.7*	*3.5*	*2.1*	*3.6*	*3.5*	*4.0*	*4.1*
Excluding Libya	4.4	3.6	2.2	3.0	3.5	3.9	4.1
Sub-Saharan Africa	5.2	3.4	1.5	2.9	3.1	3.7	3.9
Excluding South Africa	5.9	3.9	1.8	3.3	3.6	4.2	4.3
Oil-exporting countries	4.7	3.3	1.5	3.2	3.4	3.8	3.7
Oil-importing countries	4.6	3.7	3.1	4.2	3.8	4.3	4.5
Consumer price inflation (%)							
Central Africa	3.6	2.3	1.6	9.3	7.3	4.7	4.1
East Africa	13.8	10.1	12.7	14.0	14.5	12.5	11.4
North Africa	5.8	7.5	7.8	14.2	12.8	9.2	7.4
Including Sudan	7.3	8.2	8.5	15.4	14.6	10.6	8.8
Southern Africa	6.5	5.7	11.0	9.3	7.4	7.1	6.6
West Africa	9.2	8.2	12.7	13.0	9.5	9.7	9.1
Africa	*7.6*	*7.4*	*10.0*	*12.6*	*10.9*	*9.2*	*8.1*
Excluding Libya	7.7	7.4	9.9	12.5	10.9	9.1	8.1
Sub-Saharan Africa	9.2	7.3	11.3	11.7	9.8	9.1	8.5
Excluding South Africa	8.0	6.4	9.9	10.6	8.8	8.1	7.4
Oil-exporting countries	8.6	8.9	12.8	17.9	14.9	11.9	10.2
Oil-importing countries	6.1	5.2	6.1	5.4	5.4	5.3	5.2
Overall fiscal balance, including grants (% of GDP)							
Central Africa	–0.2	–4.7	–4.0	–3.0	–1.4	–1.0	–0.3
East Africa	–2.8	–4.5	–3.8	–3.8	–4.1	–3.7	–3.5
North Africa	–5.9	–14.0	–13.9	–9.6	–6.0	–4.8	–4.1
Including Sudan	–5.4	–12.4	–12.0	–8.2	–5.5	–4.4	–3.8
Southern Africa	–2.8	–4.4	–4.1	–4.5	–4.1	–4.2	–4.1
West Africa	–2.5	–3.8	–4.4	–5.0	–4.2	–3.9	–3.9
Africa	*–3.4*	*–7.0*	*–7.0*	*–5.8*	*–4.5*	*–4.0*	*–3.7*
Excluding Libya	–3.6	–6.1	–6.0	–5.3	–4.5	–4.1	–3.8
Sub-Saharan Africa	–2.5	–4.2	–4.1	–4.4	–3.9	–3.7	–3.6
Excluding South Africa	–1.9	–4.1	–4.2	–4.5	–3.9	–3.6	–3.4
Oil-exporting countries	–3.1	–8.5	–8.7	–6.8	–4.5	–3.8	–3.5
Oil-importing countries	–3.9	–4.8	–4.6	–4.6	–4.5	–4.2	–4.0

(continued)

TABLE A1.1 Macroeconomic developments in Africa, 2010–20 *(continued)*

Indicator and country group	2010–14	2015	2016	2017	2018 (estimated)	2019 (projected)	2020 (projected)
External current account, including grants (% of GDP)							
Central Africa	–2.0	–9.0	–9.3	–4.3	–2.0	–1.0	–1.3
East Africa	–6.7	–7.9	–5.9	–5.0	–4.9	–4.6	–4.6
North Africa	–0.8	–8.4	–9.4	–7.4	–5.7	–5.0	–5.0
Including Sudan	–1.3	–8.2	–8.7	–6.5	–5.3	–4.6	–4.6
Southern Africa	–2.6	–6.5	–3.4	–2.1	–2.9	–3.0	–3.3
West Africa	0.5	–4.1	–1.5	0.2	0.4	0.1	–0.2
Africa	*–1.7*	*–6.7*	*–5.4*	*–3.6*	*–3.0*	*–2.8*	*–3.0*
Excluding Libya	–1.9	–6.3	–5.2	–3.7	–3.1	–2.9	–2.9
Sub-Saharan Africa	–2.1	–6.1	–3.8	–2.2	–2.2	–2.1	–2.3
Excluding South Africa	–1.5	–6.4	–4.0	–2.2	–1.9	–1.9	–2.0
Oil-exporting countries	1.8	–6.7	–5.3	–2.8	–1.3	–0.8	–1.0
Oil-importing countries	–6.4	–6.6	–5.5	–4.5	–5.0	–5.0	–5.2

Source: African Development Bank statistics and staff calculations.

NOTES

1. In 2017, a substantial increase in oil production boosted Libya's growth rate to 64 percent, distorting the picture of the continent's recovery.
2. Real GDP per capita growth is estimated at 0.9 percent in 2018 and is projected to be 1.5 percent in 2019.
3. Based on the medium variant of UNDESA (2017).
4. African Development Bank 2018.
5. Recent International Monetary Fund staff calculations show zero pass-through for oil exporters and positive pass-through of about 47 percent for oil importers.
6. African Development Bank, OECD Development Centre, and UNDP 2014.
7. Carmignani 2010; Ilzetzki and Vegh 2008. The analysis of cyclical fiscal policy in Africa in African Development Bank, OECD Development Centre, and UNDP (2014) was based on Leibfritz and Rottmann (2013).
8. African Development Bank 2018.
9. See the methodology in Chinn and Prasad (2003) or more recently Phillips et al. (2013).
10. Barbosa-Filho 2004.
11. See Acemoglu, Johnson, and Robinson (2002).
12. While exports of raw materials correspond to increased public and private revenue from abroad, they should also be properly accounted for in any complete definition of genuine savings, which considers the depletion of natural capital. Indeed, adjusted net savings, which incorporate both net investment in human capital in the form of education and health spending and the negative effect from the deterioration of the natural environment, were negative over the period for several major natural resource exporters. See Bolt, Matete, and Clemens (2002) for a complete definition of adjusted net savings.
13. See Brunnermeier, Itskhoki, and Gourinchas (2018).
14. Przemyslaw et al. 2015.
15. See https://atlas.media.mit.edu/en/resources/data/ for a visualization of country-level export at the two- and four-digit level of the Harmonized System, using data from the United Nations Conference on Trade and Development Comtrade database.
16. Piyusha, Ravikumar, and Sposi 2014.
17. Brumm et al. 2016.
18. African Development Bank 2018.
19. Mundell 1961.
20. Building on the work by Devarajan and Rodrik (1992), Monga (1997, 2015) provides a different perspective.
21. Tchundjang Pouémi 1980.
22. de Grauwe 1992.
23. Monga 1997.

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2

JOBS, GROWTH, AND FIRM DYNAMISM

KEY MESSAGES

- **Africa's labor force is projected to be nearly 40 percent larger by 2030.** If current trends continue, only half of new labor force entrants will find employment, and most of the jobs will be in the informal sector. This implies that close to 100 million young people could be without jobs.
- **The rapid growth achieved in Africa in the past two decades has not been pro-employment.** Analysis of growth episodes reveals better employment outcomes when the growth episodes were led by manufacturing, suggesting that industrialization is a robust pathway to rapid job creation.
- **African economies have prematurely deindustrialized as the reallocation of labor has tilted toward services, limiting the growth potential of the manufacturing sector.** To dodge the informality trap and chronic unemployment, Africa needs to industrialize.
- **Key factors impeding industrialization, particularly manufacturing growth, are limited firm dynamism.** Firm growth and survival are held back by corruption, an unconducive regulatory environment, and inadequate infrastructure.
- **Estimates from Enterprise Surveys show that 1.3–3 million jobs are lost every year due to administrative hurdles, corruption, inadequate infrastructure, poor tax administration, and other red tape.** This figure is close to 20 percent of the new entrants to the labor force every year.
- **Small and medium firms have had very little chance of growing into large firms.** Such stunting, coupled with low firm survival rates, has stifled manufacturing activity in most African countries.
- **Reviving Africa's industrialization requires a commitment to improve the climate that supports firm growth.** Industrial policies could benefit from assessing production knowledge and identifying competitive products to inform the design of robust national and subnational industrial strategies.

THE CHALLENGE OF CREATING JOBS IN HIGHER PRODUCTIVITY SECTORS

Africa's working-age population is projected to increase from 705 million in 2018 to almost 1 billion by 2030.[1] As millions of young people join the labor market, the pressure to provide decent jobs will intensify. At the current rate of labor force growth, Africa needs to create about 12 million new jobs every year to prevent unemployment from rising. Strong and sustained economic growth is necessary for generating employment, but that alone is not enough. The source and nature of growth also matter.

A 1 percent increase in GDP growth over 2000–14 was associated with only 0.41 percent growth in employment

Evidence suggests that Africa has achieved one of the fastest and most sustained growth spurts in the past two decades, yet growth has not been pro-employment. A 1 percent increase in GDP growth over 2000–14 was associated with only 0.41 percent growth in employment,[2] meaning that employment was expanding at a rate of less than 1.8 percent a year, or far below the nearly 3 percent annual growth in the labor force. If this trend continues, 100 million people will join the ranks of the unemployed in Africa by 2030. Without meaningful structural change, most of the jobs generated are likely to be in the informal sector, where productivity and wages are low and work is insecure, making the eradication of extreme poverty by 2030 a difficult task.

This chapter examines the challenge of creating jobs in high-productivity sectors through the lenses of industrialization, private sector dynamism, and the obstacles to firm survival and growth. The first section looks at the informal sector, which has long been the primary source of employment in many African countries. Nearly 82 percent of African workers, a majority of them in the informal sector, are considered working poor, well above the world average of 39 percent.[3] Moreover, low-productivity employment in the informal economy is highly correlated with inequality.[4] To escape the informality trap and generate jobs in high-productivity sectors, Africa should learn from its recent past how to revive its nascent industry sector.

The second section investigates the job creation potential of specific sectors of the economy, examining their effectiveness in driving episodes of economic growth and employment growth in the long term. The third section looks at firm dynamics to better understand the opportunities for enhancing labor demand and eliminating the constraints that firms face in their everyday operations.

INFORMALITY IS THE DOMINANT SECTOR FOR EMPLOYMENT IN AFRICA

One of the most salient features of labor markets in Africa is the high prevalence of informal employment, the default for a large majority of the growing labor force. The vast majority of jobs created in Africa in the past three decades have been informal jobs, defined by the International Labour Organization as noncontracted jobs that are not regulated or protected and that confer no rights to social protection.[5] Informal jobs include noncontracted jobs in the formal sector, as well as all jobs in the informal sector, and account for more than half of all jobs worldwide. Typically, statistics on informal employment exclude agriculture; when agricultural jobs are included, the share of informal employment rises to almost 61 percent worldwide.[6]

Patterns and trends of informal employment in Africa

On average, developing countries have higher shares of informal employment than developed countries. While data on informal employment are sketchy, it is clear that Africa has the highest rate of informality in the world, estimated at 72 percent of nonagricultual employment (figure 2.1)—and as high as 90 percent in some countries. Furthermore, there is no evidence that informality is declining in Africa.

Informal employment also tends to be countercyclical. Economic downturns typically lead to a slowdown in economic activity and an increase in informality. Economies in recession are likely to experience a shift from tradable to nontradable sectors, where informality is higher.[7] In many developing countries, informal employment acts as a buffer during downturns for people who are laid off or looking for new jobs.[8] As finding jobs

in the high-productivity nonagriculture sectors becomes more difficult, the informal sector is a last resort.

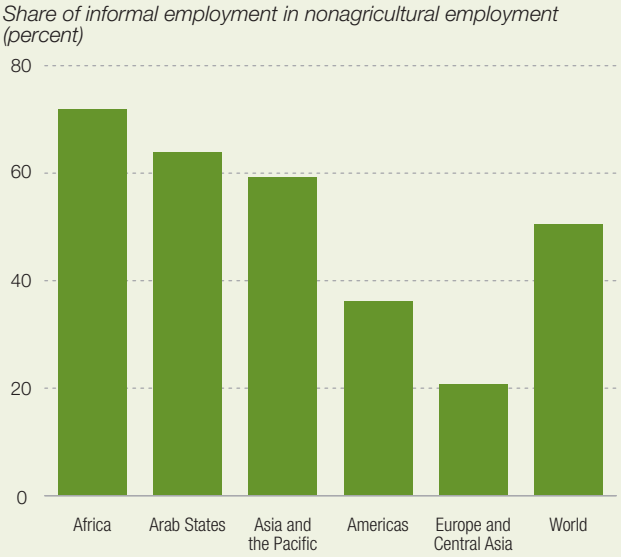
Informal employment rates also vary by gender and education. A higher proportion of women's employment (79 percent) than of men's (68 percent) in Africa is in the informal sector, except in Northern Africa, where this pattern is reversed (figure 2.2a). In all regions of the world, people with less education are more likely to be informally employed. Informality is highest among workers with no education (figure 2.2b). In Africa, 94 percent of workers with no education are informally employed.

Lower wages and living standards are also common in informal employment. Studies that have estimated the conditional wage gap between informal and formal employment have found that in South Africa, for example, nearly 37 percent of the observed wage penalty is due to differences in human capital and job characteristics. Moreover, accounting for taxes paid in the formal sector reveals that the informal sector wage gap in South Africa (as well as in Brazil and Mexico) is largest among the lowest paid workers. The informal wage penalty affects primarily young workers and is larger all along the age distribution in South Africa than in Brazil and Mexico.[9] Generally, living standards are lower in the informal sector, and both monetary and nonmonetary poverty are much higher than in the formal sector.[10]

In Africa, informality is highest in low-income countries, while middle-income countries tend to experience higher unemployment (figure 2.3).[11] These findings indicate that although growth has been robust over the past two decades, it has not been pro-employment. Thus, while formalization is necessary to create more decent jobs, it is not sufficient since it tends to follow rather than lead growth. Both growth and job creation require structural transformation, which shifts resources from low-productivity to high-productivity firms and sectors. In Africa, however, there has been a decline in the share of industry in the economy, which has led to premature deindustrialization (as discussed in the next section).

Finally, while evidence from other developing countries shows a fairly competitive labor market structure, Africa has a more segmented labor market. Segmented labor markets tend to improve with economic policies that facilitate labor mobility, with a competitive environment for private sector operations, and with better skill development programs.[12]

FIGURE 2.1 Africa has the highest share of informal employment in the world, various years

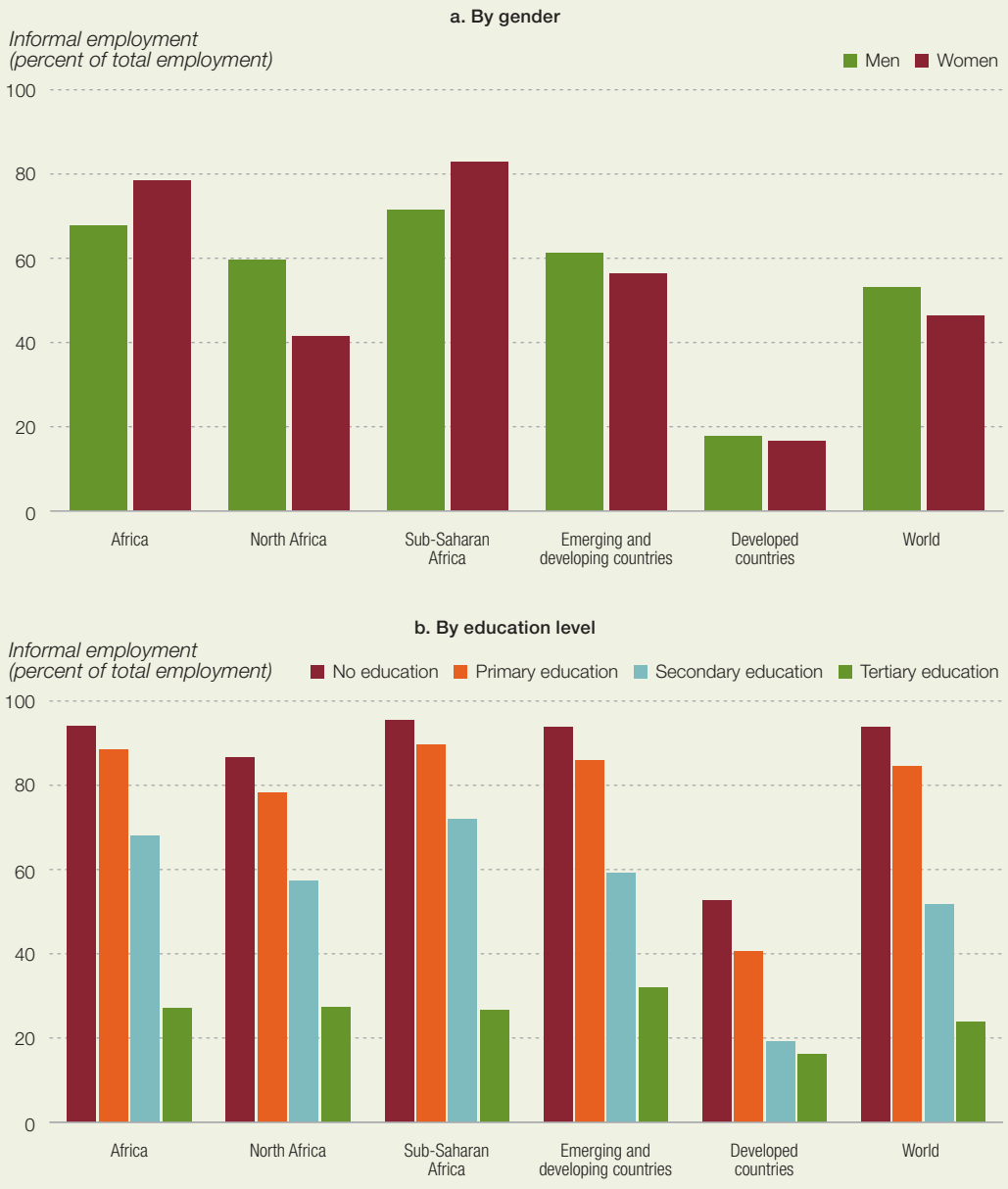


Source: Data from ILOSTAT (https://www.ilo.org/ilostat).

Understanding the barriers to formalization

Informal enterprises are, not surprisingly, more likely than formal enterprises to employ workers informally. Thus, reducing informality requires understanding the barriers to formalization, including labor regulations. Formality offers more opportunities, higher and more stable incomes, better quality jobs, and greater social protection. However, moving from informality to formality may not be enough to significantly reduce poverty and improve living conditions. A critical aspect of the development process is structural transformation, shifting capital and labor from low- to high-productivity sectors. The next section explores these issues within the context of episodes of pro-employment growth in Africa and quantifies the effects of the sectors driving those episodes.

FIGURE 2.2 Informal employment varies by gender and education, 2018



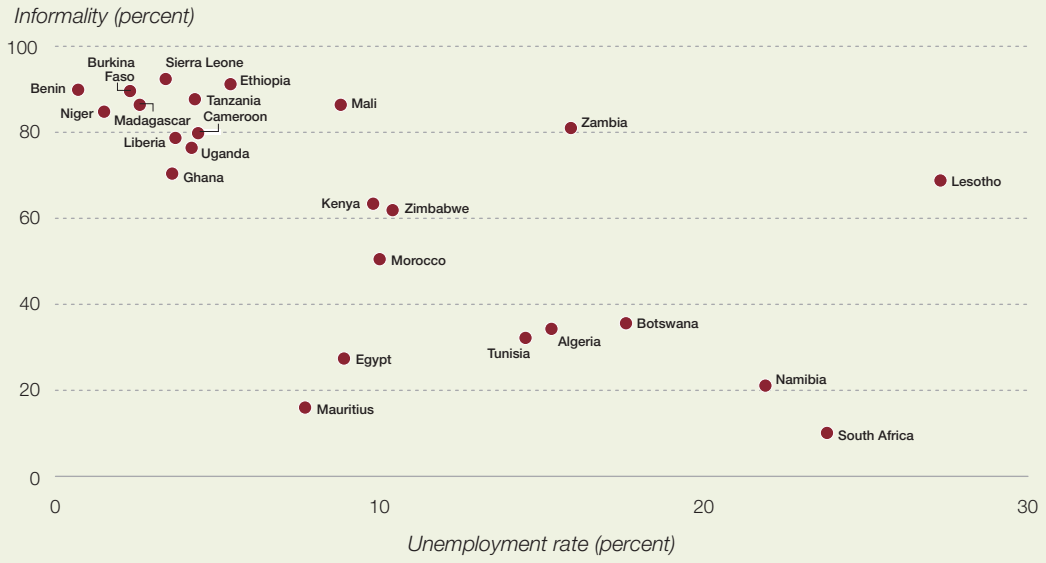
Source: Data from ILO (2018).

Moving from informality to formality may not be enough to significantly reduce poverty and improve living conditions

GROWTH ACCELERATION EPISODES AND JOB GROWTH

Growth acceleration, or economic take-off, is often underpinned by structural change,[13] which is the result of shifts in growth fundamentals. In Africa, long-term economic performance is closely related to these growth episodes.[14] Sectoral labor reallocations that capture structural change patterns are important aspects of these growth dynamics. Building on the growth acceleration analysis in chapter 2 of the 2018 *African Economic Outlook,*[15] this section explores Africa's growth acceleration episodes, looking at the roles of manufacturing, services, agriculture, and mining. The analysis explores the nexus between employment

FIGURE 2.3 Informality is highest in low-income countries, and unemployment in middle-income countries in Africa, 1999–2010



Source: Data from Page and Shimeles (2015).

and growth, with a focus on sector-driven episodes of growth acceleration to identify the sector most amenable to job creation in the long term.

Employment growth is higher during growth acceleration episodes

In developing countries, economic growth is generally uneven, alternating among periods of acceleration, stagnation, and decline. Such volatility affects the path of employment growth. Understanding the link between growth episodes and employment creation yields important policy insight.

Growth acceleration is defined as eight years with average annual growth in GDP per capita of at least 3.5 percent and a growth rate at least 2 percentage points higher than in the previous eight years. To rule out episodes of economic recovery, real GDP must also be higher in the last year of the acceleration period than in the years preceding it.[16] A further distinction is among failed take-off (growth acceleration followed by a crisis), recovery (growth acceleration following a crisis), and growth acceleration episodes (economic take-off).[17] The increase in GDP per capita observed during these episodes helps explain the dynamics of long-term improvements in living standards and job creation. Moreover, the analysis of growth acceleration episodes suggests that countries with at least one growth acceleration episode tend to grow more than countries without any.[18]

Growth acceleration episodes in Africa since the 1960s (which have occurred in 33 countries) have been driven by different sectors, revealing that the relationship between such episodes and structural change is not clear. For a sample of 20 African countries (see table A2.1 in annex 2.1), which account for about 80 percent of African GDP, most growth accelerations were driven by services, which are a mix of traditional and modern activities (table 2.1).[19] Other acceleration episodes were driven by agriculture and mining, and these are largely inconsistent with structural change; mining-driven acceleration episodes are due mainly to booms in natural resource prices and discoveries. Unless these primary commodity–driven growth acceleration episodes boost growth in other high-productive sectors, they cannot be associated with structural change.[20] Growth accelerations have not been associated with a rapid rise in value added in manufacturing. On average, higher average annual growth in value added was observed in the mining sector (6.86 percent) and the services sector

The increase in GDP per capita observed during growth acceleration episodes helps explain long-term improvements in living standards and job creation

TABLE 2.1 Twenty growth acceleration episodes in 10 African countries, by driving sector, 1958–2016

Manufacturing driven		Service driven		Agriculture driven		Mining driven	
Botswana	1967–79	Botswana	1967–79 1984–08	Burkina Faso	1994–05	Botswana	1967–79 1979–84
Egypt	1958–79 1979–88	Burkina Faso	1994–05	Egypt	1988–02	Egypt	1958–79 2002–16
Kenya	2004–16	Egypt	1958–79 1979–88 1988–02 2002–16	Mauritius	1969–79		
Mauritius	1969–79 1981–99			Morocco	2007–15	Ghana	2006–16
Morocco	1957–67					Kenya	2004–16
Namibia	2003–15	Ghana	2006–16			Morocco	2002–07
Uganda	2009–16	Mauritius	1981–99 2005–15			Uganda	2009–16
		Morocco	1981–97 2002–07 2007–15				
		Namibia	2003–15				
		South Africa	2001–16				
		Uganda	2009–16				

Source: Data from Penn World Tables 9.1 and the Expanded Africa Sector Database.

Note: A growth acceleration episode is classified as driven by a particular sector if the average annual growth rate of the value added in that sector is higher than the average annual growth of total value added. See table A2.2 in annex 2.1 for annual growth rates for each sector during growth acceleration episodes.

(6.33 percent) than in the manufacturing sector (5.79 percent; see table A2.2 in annex 2.1).

Growth accelerations are underpinned by the reallocation of labor toward modern sectors. In Africa, most growth acceleration episodes were associated with a reallocation of labor to services (18 of the 20 episodes) and to manufacturing (16 of the 20 episodes; see table A2.3 in annex 2.1). Of the nine manufacturing-driven growth acceleration episodes (see table 2.1), seven were characterized by a higher growth in employment shares in manufacturing than in services. Growth acceleration episodes are also associated with a rise of employment in the mining sector (10 of 20 episodes), confirming the specific role of the extractive sector in Africa. The overall picture is consistent with the notion that growth accelerations are associated with structural change.

Manufacturing-driven growth accelerations have the highest impact on jobs creation

In aggregate, the growth acceleration episodes pooled over the 20 sample African countries over 1958–2016 have had limited positive effects on the responsiveness of employment to growth (figure 2.4; see table A2.4 in annex 2.1 for the full estimation results). The growth acceleration episodes raised the employment intensity of growth by only 0.008 percentage point. The effect is strongest for employment in the services sector (0.014 percentage point) and weaker in manufacturing (0.006 percentage point). There is no significant effect on agricultural employment and a negative effect on mining employment.

Looking at growth accelerations by specific sector-driven episodes reveals important differences (see figure 2.4 and table A2.4 in annex 2.1). Manufacturing-driven growth acceleration episodes increased total employment growth considerably and had stronger effects on employment elasticities, boosting employment elasticity by about 0.017 percentage point (or by 3 percent)—three times higher than effects of services-driven episodes (0.005 percentage point). Moreover, manufacturing-driven growth acceleration episodes have larger cross-sector

FIGURE 2.4 Effects of growth acceleration episodes on the growth elasticity of employment vary by sector and by the driver of growth, 1958–2016

Source: Data from Penn World Tables 9.1 and the Expanded Africa Sector Database.

Note: The estimated growth elasticities are for 20 African countries, pooled over the period. Elasticities are estimated using ordinary least squares regressions and the following specification: $\ln(E_{i,j,t}) = \beta_1 \ln(GDP_{i,t}) + \beta_2 \ln(GDP_{i,t}) \times Growthspkes_{i,j,t} + \epsilon_{i,j,t}$, where $Growthspkes_{i,j,t}$ is a dummy variable indicating whether country *i* experienced at least one growth acceleration episode driven by sector *j*. The elasticities are given by the estimated coefficient β_1 (outside growth acceleration episodes) and $\beta_1 + \beta_2$ (during growth acceleration episodes).

effects—0.034 percentage point higher growth elasticities of employment for manufacturing, 0.038 for services, 0.022 for agriculture, and 0.053 for mining. In addition, mining-driven growth acceleration episodes had a similarly robust effect as manufacturing-driven episodes. This could be explained by the simultaneity of the two types of growth acceleration episodes in a large number of cases: of the eight mining-driven growth acceleration episodes, six were also manufacturing-driven.

Overall, manufacturing-driven growth acceleration episodes led to positive structural change, with potentially stronger dynamic effects in the long run. The implications of such a strong association between manufacturing-driven growth episodes and jobs is that industrialization is the key to the employment conundrum in Africa. Do these opportunities still exist in Africa, or are they fading away?

Africa's Achilles' heel: The looming premature deindustrialization

Industrial development has been called the "quintessential escalator for developing countries."[21] It has the potential to create decent jobs on a large scale, stimulate innovation, and enhance productivity across all sectors. Within industry, manufacturing exhibits unconditional labor productivity convergence and could be a powerful driver of aggregate income convergence.[22] However, even though the industry sector exhibits stronger effects than other sectors on the elasticity of employment to growth during growth acceleration episodes, there are indications that Africa is experiencing premature deindustrialization. That is a major concern for job creation potential in high-productivity sectors and for long-term prosperity. Despite lower initial shares of industry (manufacturing, construction, and utilities) in employment and the economy in Africa than in

Industrial development has the potential to create decent jobs on a large scale, stimulate innovation, and enhance productivity

other regions, industry's shares have been growing very slowly. The average share in total employment is around 15 percent and the average share in total value added is about 20 percent (figure 2.5). Since the mid-1980s, growth in value added has stalled at around 20 percent.

Figure A2.1 in annex 2.1 provides a disaggregated view of the pattern of industrialization that underscores considerable differences in experiences beyond the average depicted in figure 2.5. Some countries (Egypt and Ethiopia) have seen the share of employment and value added in industry increase over time, while others have seen only one increase or have seen a downward trend.

Manufacturing exhibits unconditional labor productivity convergence and could be a powerful driver of aggregate income convergence

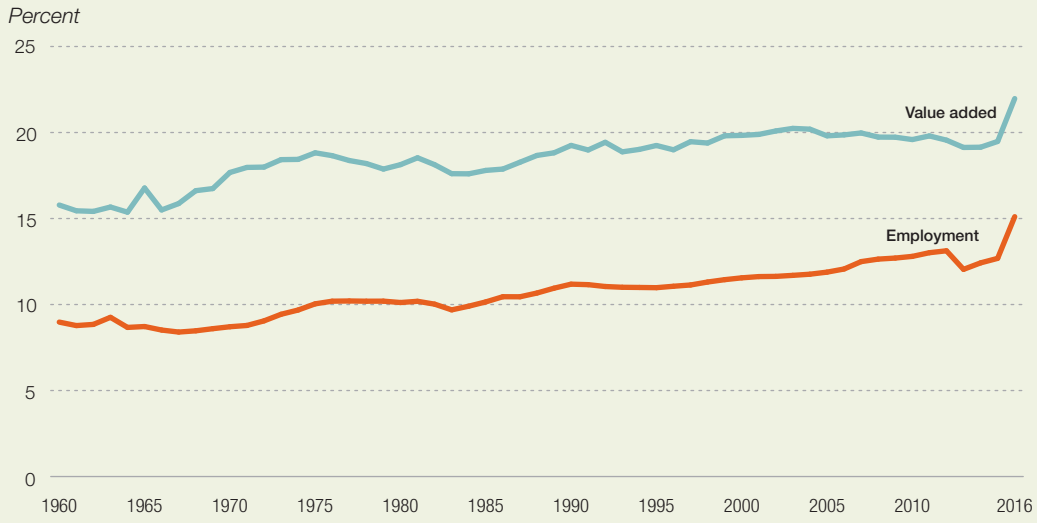
The dynamics of the industry sector typically follow a hump-shaped curve relationship for both employment and value added, and this is the case in African countries, despite lower initial industrialization. That implies that countries in Africa will run out of industrialization expansion opportunities sooner rather than later and at a much lower level of industrialization than early industrializers did.

An empirical analysis to assess whether there has been premature deindustrialization in Africa suggests a hump-shaped curve for industrial real value added but not for employment shares (figure 2.6).[23] The negative coefficients for employment shares in industry in recent decades indicate deindustrialization (see table A2.5 in annex 2.1).

The turning point (the top of the hump) in the estimate is a GDP per capita of $3,772 ($3,197 without Mauritius)—approximately Ghana's income level in 2013. This result is particularly striking in light of a global turning-point estimate of around $8,000 for employment share and a much higher level for value added.[24]

Thus, the pattern of industrialization is very different in Africa from patterns in other comparable regions, again revealing premature deindustrialization. The value added share of industry starts to decline at very low levels of income per capita. Low industrial productivity in Africa could be associated with the large proportion of small firms, which are generally less productive and pay lower wages than larger firms.

FIGURE 2.5 Industry employment and value added shares in Africa started low and have grown slowly, 1960–2016



Source: Data from Penn World Tables 9.1 and the Expanded Africa Sector Database.

Note: Covers 20 countries from 1958–2016 (see list of countries in table A2.1 in annex 2.1). These countries account for 80 percent of African GDP. The use of this database allows us to expand the number of countries and the time coverage considerably compared with other studies. Rodrik's (2016) seminal paper includes only 11 African countries.

FIGURE 2.6 Relationship between industry shares in employment and value added and GDP per capita, 1960–2016 and 2014

Source: Data from Penn World Tables 9.1 and the Expanded Africa Sector Database.

Size matters: Large firms are more productive and pay more but there are few of them

Studies have shown that large firms are more productive and pay higher wages than small firms (figure 2.7).[25] For instance, a 1 percent increase in firm size is associated with a 0.09 percent increase in labor productivity.[26] The return to firm size is even higher in Africa than in other developing regions, with a 0.15 percent increase in labor productivity for a 1 percent increase in size. The size effect is even stronger for manufacturing firms in Africa, with 1 percent increase in size associated with a 0.20 percent increase in labor

productivity—well above the 0.12 percent increase for firms in the services sector.

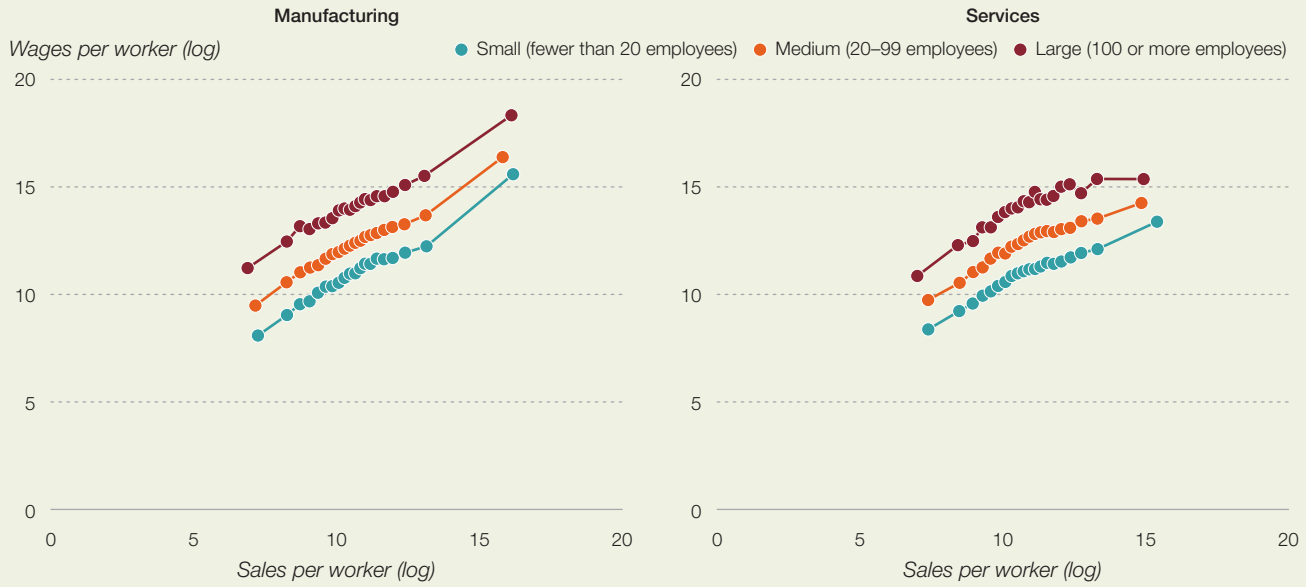
Wages are also much higher in medium and large enterprises than in small firms and in manufacturing than in services (see figure 2.7). Wages are twice as high in large manufacturing firms as in large service firms and 37 percent higher in small manufacturing firms than in small service firms. Differentials in productivity and wages by firm size are partly due to the fact that large firms tend to have more educated and skilled workers and to be more capital intensive in production than smaller firms, commanding higher output per worker.

The African enterprise landscape is dominated by small firms, with too few medium and large firms (the "missing middle" and "missing large"; figure 2.8). More than 40 percent of African firms have fewer than 10 employees, and more than 60 percent have fewer than 20. This preponderance of small firms is particularly concerning for reaping the gains of industrialization at an aggregate level in the sense that firms starting out small need to survive, evolve, and grow at a scale dictated by circumstances applicable to specific sectors, including the potential to enter global or regional value chains. Analysis of firm dynamics provides some clues on the state of firm growth in Africa, followed by impediments for survival and overall operations.

The African enterprise landscape is dominated by small firms, with too few medium and large firms

Table 2.2 provides probability estimates of firm dynamics over an average of six years based on enterprise survey data from selected African countries. Firms that started out small had a higher probability of staying small (77 percent) than medium (18 percent) or large firms (5 percent). For firms that started out large, the probability of scaling down to small or medium size was 33 percent. Firms that started out medium had a 31 percent chance of scaling down to small size. By contrast, firms that started out small had a 23 percent chance of growing into a medium or large firm, and firms that started out medium had a 13 percent chance of growing into a large firm. Overall, it seems much easier for African firms to shrink than to expand. Currently 55 percent of firms are small, 30 percent are medium, and 15 percent are large. Simulations show that on existing trends, in the long run, 49 percent of firms will be small,

FIGURE 2.7 Large firms are more productive and pay more than small firms, and the differences are greater in manufacturing than in services, most recent year available during 2006–17



Source: Data from World Bank Enterprise Survey harmonized data.
Note: Values are weighted.

31 percent will be medium, and 20 percent will be large in the long run. This is much closer to the distribution in developing countries, where 21 percent are small, 33 percent are medium, and 46 percent are large.[27] The question is what are the most important factors that drive firm growth?

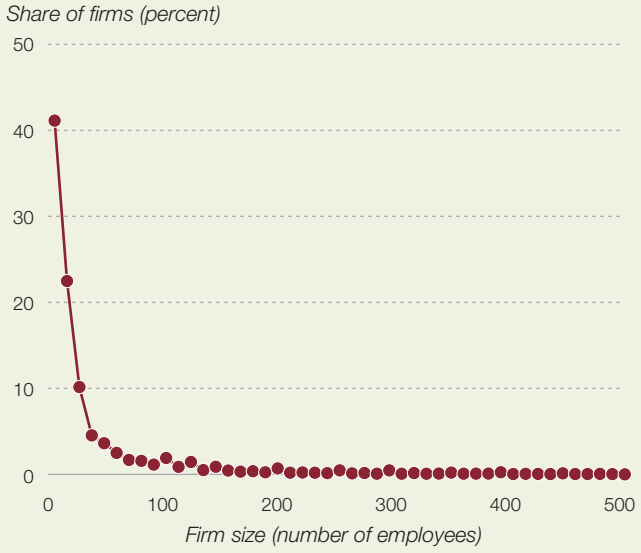
Firm dynamism depends largely on productivity. More productive firms tend to expand their workforce. The conditional probability[28] estimates of firm dynamism differentials (conditional on firm-level productivity) confirm that small firms in developing countries have lower chances of growing into medium or large firms (see table A2.6 in annex 2.1).

Overall, the analysis reveals little firm dynamism in Africa, particularly for small firms' chances of transitioning into medium and large firms. The implication is that the dominance of small firms drives down aggregate productivity, particularly in the manufacturing sector, and prevents firms from creating enough high-quality jobs for Africa's growing labor force. More needs to be done to encourage large companies to set up businesses in Africa and to help small firms grow by removing constraints such as poor infrastructure, political instability, and corruption. Identifying and building the necessary clusters at the right scale also might help firm growth. This implies a concerted industrialization effort that builds on countries' comparative advantage in Africa's manufacturing sector. The next section considers the potential for Africa's industrialization at the product level, looking at prospects from the perspectives of product complexity and product space in four African countries.

CONSTRAINTS TO FIRM DYNAMISM

In a natural process of creative destruction, some failing firms cease operation, paving the way for more productive or more capable firms to replace them. In well-functioning markets, such churning is positively associated with aggregate productivity and economic growth. However, firm dynamism, measured as firm survival and growth, can be impeded by external obstacles to business operations that result in the inefficient allocation of resources and limit firms' potential to create employment. These drags on firm dynamism are particularly concerning for Africa, where firms,

FIGURE 2.8 Africa has mostly small firms, most recent year available during 2006–17



Source: Data from World Bank Enterprise Surveys.

TABLE 2.2 Transition matrix for firm dynamism in Africa, most recent year available during 2003–17

Change over a six-year period (percent)

	Small (5–19 employees)	Medium (20–99 employees)	Large (100 or more employees)
Small (5–19 employees)	77	18	5
Medium (20–99)	31	56	13
Large (100 or more)	9	24	68

Source: World Bank Enterprise Survey panel data.

Note: Panel data for 12 African countries are used: Cameroon (7-year gap), Egypt (3-year gap), Ethiopia (4-year gap), Lesotho (7-year gap), Liberia (8-year gap), Malawi (5-year gap), Mali (6-year gap), Niger (8-year gap), Nigeria (5-year gap), Rwanda (5-year gap), Sierra Leone (8-year gap), and Zimbabwe (5-year gap). To account for different sample sizes and gaps between survey waves, the transition matrices were first calculated for each country and averaged by sample size and survey gap. Countries with longer survey gaps were given more weight. The average survey gap is 6 years.

small and large, face multiple obstacles to their operations.[29]

Globally, exiting firms in countries covered by the World Bank Enterprise Survey account for around 3–4 percent of private sector employment a year.[30] In Africa, about 6.1 percent of firms exit each year. Exit rates of firms vary across countries and by firm size (figure 2.9). Although exit rates are not comparable across countries because of differences in survey timing and in social, economic, and political dynamics, exit rates still provide important insights into firm dynamism across several African countries. Egypt has the highest annual exit rate, at about 12.8 percent over 2013–16, a reflection in part of the especially difficult business environment in the aftermath of the Arab Spring of 2011. Half the firms surveyed in Egypt and other countries in the region identified political instability as the top obstacle to doing business.[31] The lowest annual exit rates, at 2.4 percent, are in Mali (2010–16) and Sierra Leone (2009–17). Although there is considerable variation across countries, smaller firms are more likely to exit the market than medium and large firms.

Not surprisingly, in African countries, entry rates are much higher for small firms than for medium and large firms. For firms starting up in the two years before the survey, entry rates were 5.8 percent for small firms, 3.7 percent for medium firms, and 1.2 percent for large firms (figure 2.10a). Similarly, 23 percent of small firms started operation in the five years before the survey compared with 13 percent of medium firms and 7.5 percent of large firms. This underscores how the dynamism in the African formal enterprise landscape is driven largely by small firms exiting and entering; the entry rate of large enterprises has been very low. These firm dynamics vary widely across African countries (figure 2.10b). To benefit from the productivity and wage premiums that large firms have over smaller firms, African countries need to increase the entry of large firms and the growth of small and medium firms.

Firms in Africa face multiple obstacles that impede their dynamism, reducing their profitability, global competitiveness, growth, and even survival

Major obstacles to doing business

Firms in Africa face multiple obstacles that impede their dynamism, reducing their profitability, global competitiveness, growth, and even survival. In responses to World Bank Enterprise Surveys, more small firms report obstacles to their business operations than do medium and large firms (figure 2.11a). Small firms are generally younger than large firms and have less capability to deal with obstacles—less knowledge of regulations,

FIGURE 2.9 Annual firm exit rates in Africa vary by country and firm size, various years

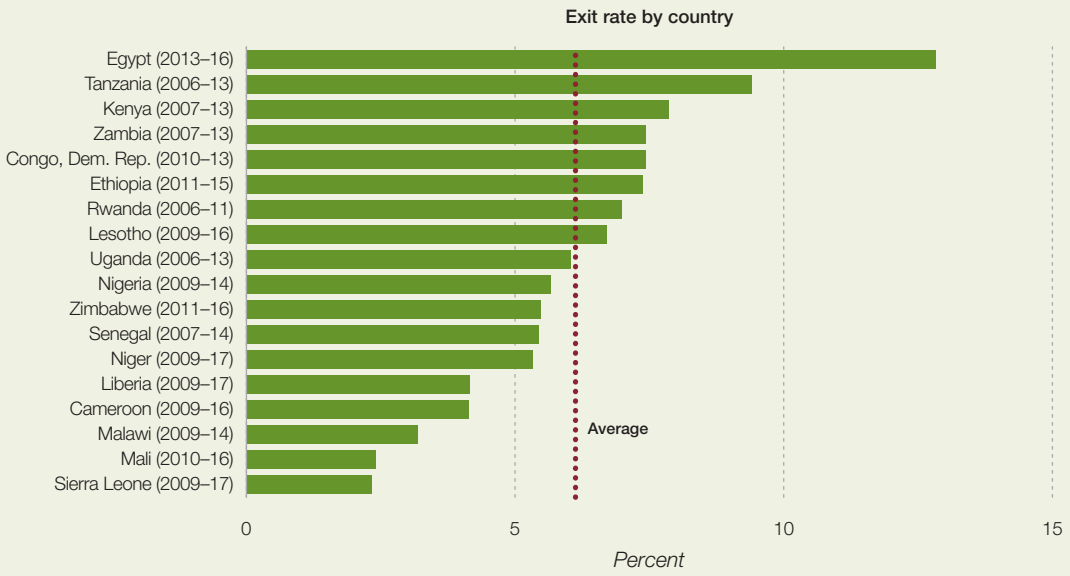
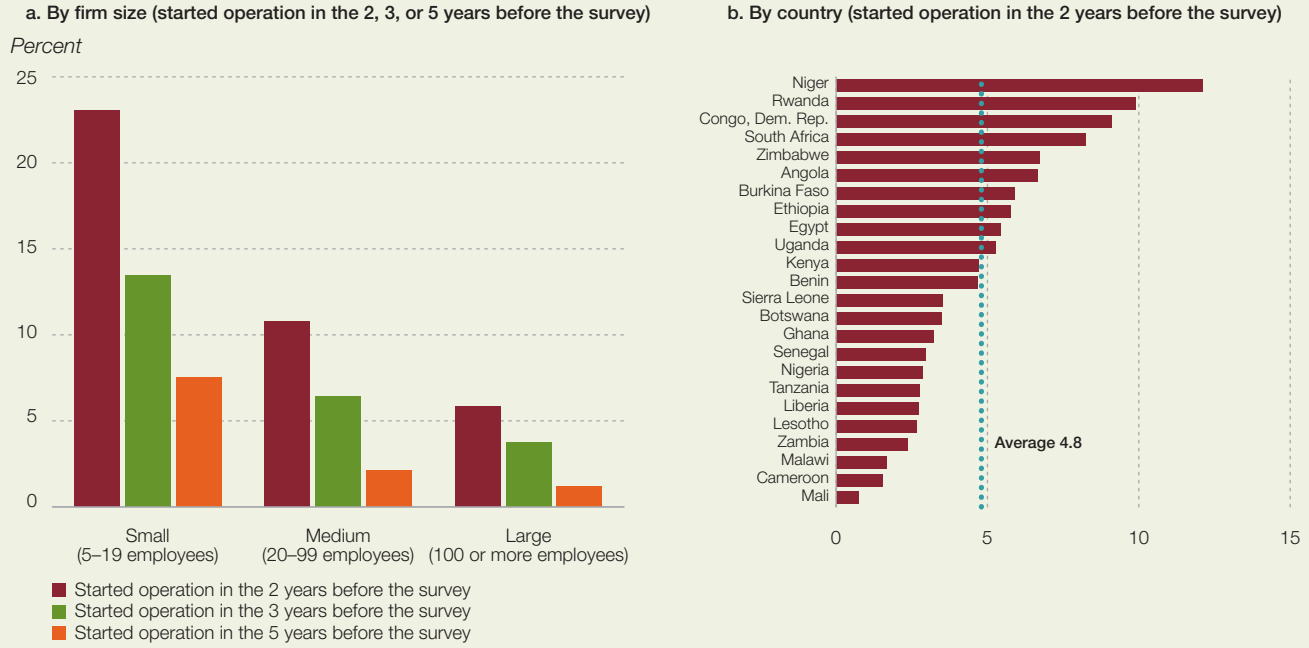


FIGURE 2.10 Entry rates vary by firm size and country, various years



Source: Data from World Bank Enterprise Surveys.

less experience, and less capital to deal with business problems.[32] Of 15 business obstacles, the biggest is lack of finance, reported by 18 percent of small firms and nearly 14 percent of medium firms. The second biggest obstacle is unreliable access to electricity (15 percent of small firms and 12 percent of medium firms). For large firms (100 or more workers), the biggest obstacles are access to electricity (12 percent), political instability (12 percent), and high taxes (11 percent).

For manufacturing firms, reliable access to electricity is the biggest obstacle affecting their operations, followed by finance, both reported by about 8 percent of firms (figure 2.11b). The same two obstacles are reported by service firms, but finance is the biggest obstacle (15 percent), followed by electricity (10 percent).

Major obstacles vary across regions (figure 2.12). The biggest obstacle reported by firms of all sizes in North Africa, including Egypt, Mauritania, Morocco, and Tunisia, is political instability (23–29 percent), followed by finance and electricity. In Central, Southern, and West Africa, the two biggest obstacles are finance and electricity, with political instability the third biggest in Central Africa and competition from informal operators the third biggest in Southern and West Africa. In East Africa, the biggest obstacle reported by firms of all sizes is electricity (26 percent), with more than a third of large enterprises reporting it as their biggest obstacle, followed by finance (11 percent) and high taxes (12 percent).

Business obstacles and lost jobs

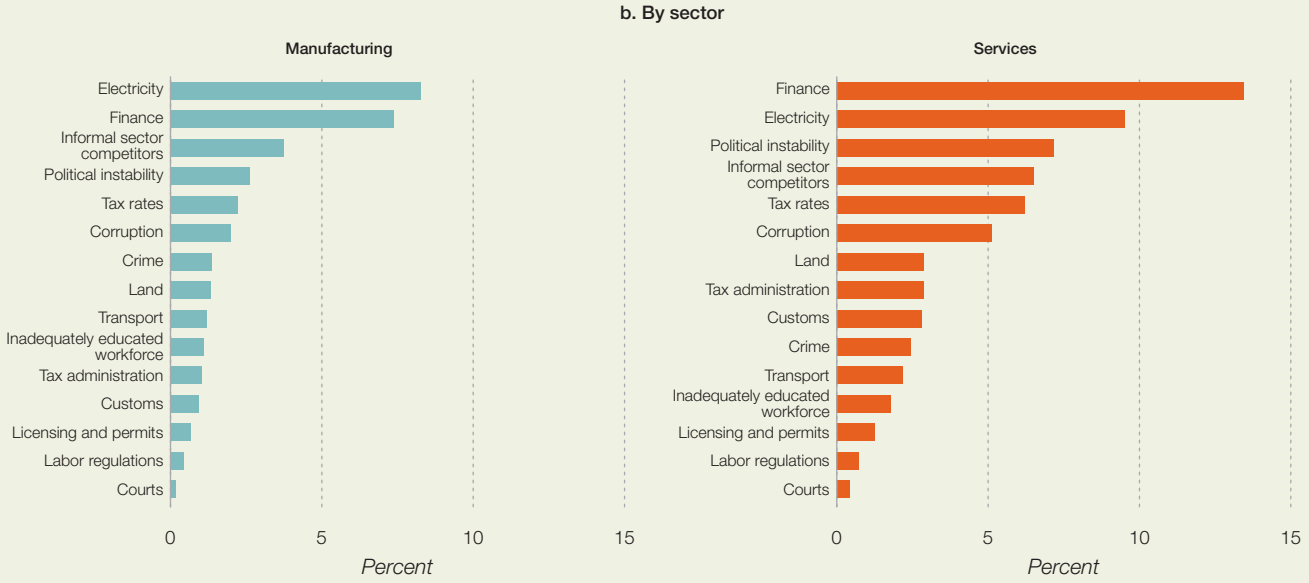
Business obstacles also have an impact on job creation, largely through lower firm survival rates and staff cutbacks. When obstacles are too severe, firms may decide to shut down, resulting in a loss of job opportunities. Firms that survive despite severe obstacles might decide to optimize profits or minimize losses by hiring fewer workers or by laying some off. In Africa, the biggest impact on jobs is through firm survival; the employment effects are less severe among surviving firms.

Business obstacles have a significant impact on firm survival (figure 2.13). Of the 15 obstacles in the World Bank Enterprise Surveys, 10 have a statistically significant negative effect on the survival

FIGURE 2.11 Biggest obstacles to doing business in Africa, by firm size and sector, most recent year available during 2006–17

(continued)

FIGURE 2.11 Biggest obstacles to doing business in Africa, by firm size and sector, most recent year available during 2006–17 *(continued)*



Source: Data from World Bank Enterprise Surveys.

Note: All values are survey weighted.

of firms after firm-level characteristics, location, year, and country are accounted for.[33] Firms that report unfair or corrupt courts as their biggest obstacle have about a 0.17 probability point lower chance of survival than other firms. Similarly, firms that report access to finance as their biggest obstacle have a survival chance that is 0.12 probability point lower than other firms. And firms that report competition from informal sector operators as their biggest obstacle have a survival chance that is 0.11 probability point lower.

Firms that survive seem to cope reasonably well with business obstacles, although firms still report them as a detriment to their operations. Each obstacle to doing business reduces annual employment growth among surviving firms, controlling for age, by 0.1–0.34 percentage point.[34] This translates into a 1.5–5.2 percent loss in annual employment growth.[35]

By rough estimate, the continent loses an average of 176,000 private sector jobs every year because of each of the business obstacles examined, for a total of 1.2–3.3 million jobs lost every year (figure 2.14). The number of estimated jobs lost ranges from 74,000 due to customs and trade regulations to 264,000 due to licensing and permitting. These rough estimates are indicative only, and actual and potential job losses could be much higher. They do, however, indicate how detrimental the obstacles are to both creating new jobs and maintaining existing high-quality jobs in the formal sector. Licensing and permitting, courts, political instability, and corruption are associated with the highest numbers of private sector jobs lost in Africa. Related to governance, these obstacles are thus amenable to reform.

POLICY IMPLICATIONS

The rapid growth in Africa's labor force and widespread poverty make job creation in high-productivity sectors a top priority for policymakers. The informal sector has long been the default source of employment for the growing workforce, but wages are low and jobs are insecure, leaving many workers with informal jobs living in poverty. While striving to exit the informality trap,

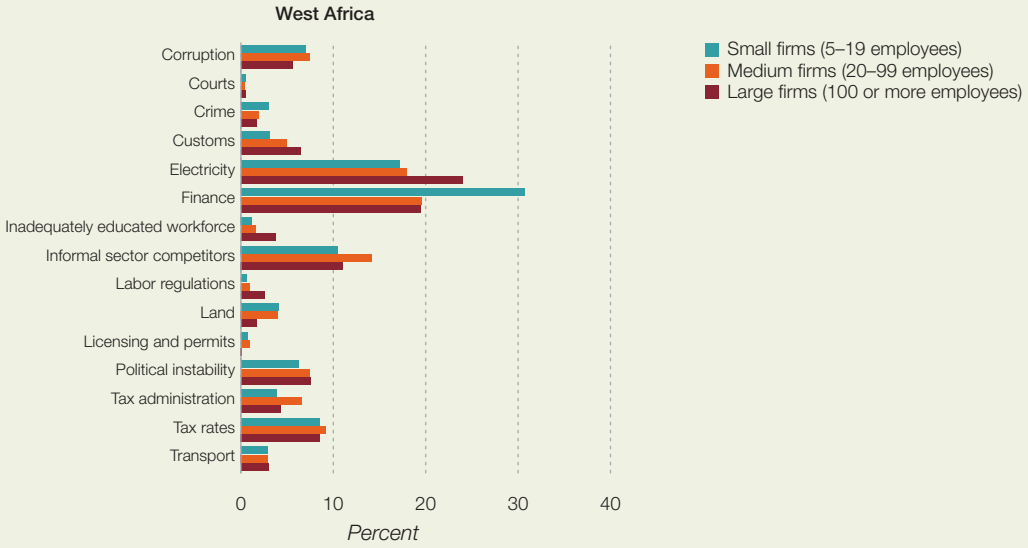
FIGURE 2.12 Biggest obstacles in Africa, by firm size and region, most recent year available during 2006–17

(continued)

countries need to protect vulnerable workers without making the labor market too rigid. Incentives should encourage informal firms to formalize. And structural transformation needs to be advanced through steady and rapid industrialization that moves labor from low- to high-productivity sectors and ultimately creates more high-quality jobs.

This chapter has shown that growth acceleration driven by a dynamic manufacturing sector can create more jobs than growth driven by any other sector. However, Africa's potential for industrialization is limited by the premature deindustrialization in recent decades despite intensive reforms to improve the business and investment climate in many countries and diligent sector-specific industrial strategies implemented in some cases. The question is thus: How can African countries tip the scale in favor of manufacturing and reap the

FIGURE 2.12 Biggest obstacles in Africa, by firm size and region, most recent year available during 2006–17 *(continued)*



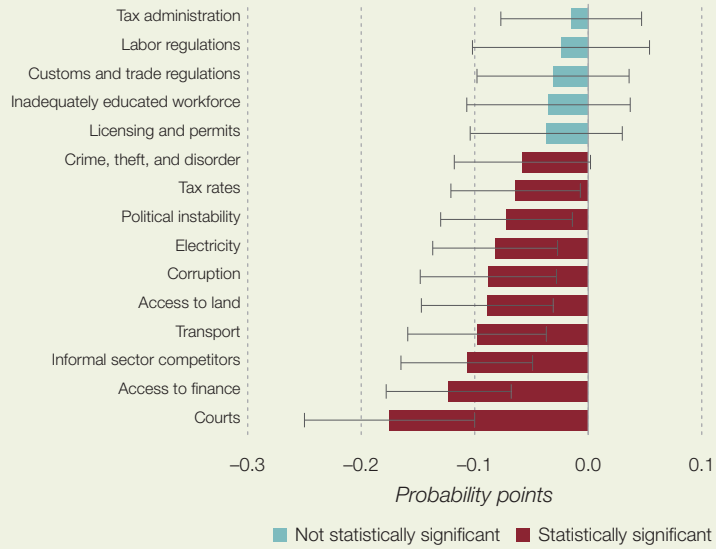
Source: Data from World Bank Enterprise Surveys.
Note: All values are survey weighted.

benefits of structural change and rapid economic growth?

Evidence from around the world on successful industrialization suggests that firm productivity and thus firm growth are shaped by four interrelated factors, often determined by policy choices. The first, and perhaps most frequently mentioned, is to get the basics right. These include adequate infrastructure (utilities, transport, communications, and the like), human capital (skills), and functioning institutions. This chapter clearly showed how these basics were identified as the biggest constraints for firm operations. The second is the type of market firms target to sell their products. A wealth of research in Africa and other developing regions has identified manufactured exports as an important source of productivity growth. Third is formation of industrial clusters, and fourth is the ability to attract foreign direct investment.[36]

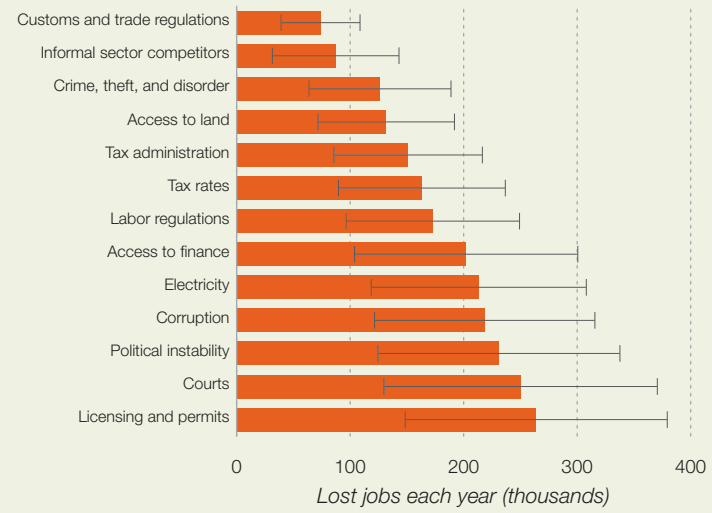
As can be inferred from the results on the analysis of enterprise surveys in this chapter, the most cited constraint affecting firm operations and survival is getting the basics right. Bureaucratic hurdles, corruption, poor tax administration, poor infrastructure, and unfair or corrupt court

FIGURE 2.13 Estimated marginal effects of business obstacles on firm survival, most recent year available during 2003–17



Source: Woldemichael and Joldowski (2018) using World Bank Enterprise Survey panel data.
Note: The figure reports estimated marginal effects with standard error bands (the gray lines on each bar). The logit model of survival controls for various confounding factors.

FIGURE 2.14 Estimated number of jobs lost each year in Africa because of business obstacles, most recent year available during 2003–17



Source: Data from World Bank Enterprise Surveys.

Note: The figure reports simple predictions based on parameter estimates using survey data, assuming 4,883,347 private sector firms, average firm size of 15 employees, average survival rate of 93.9 percent, and unconditional employment growth of 6.1 percent. The gray lines on each bar are standard error bands.

rulings were at the top of the list of impediments in most African countries. Policies to ease these constraints—such as bureaucratic reform, digitization of tax administration, improving the accountability and transparency of court administrations, and related solutions that get the civil service to function and serve the business community—become extremely important.

Some African governments have set up presidential investors advisory councils (PIACs), chaired by the head of state to regularly review and seek solutions for firm constraints that are bureaucratic, legislative, financial, infrastructure-related, and regulatory. PIACs were first created by the presidents of Ghana, Tanzania, and Senegal in 2002 and Mali and Uganda in 2004. Later, councils were set up in Benin and Mauritania. Ethiopia launched a Public–Private Consultative Forum—loosely modeled on the PIAC—in 2010. The intentions of the PIACs were to bring investors, both domestic and foreign, closer to the highest decisionmaking body in a country to loosen constraints, coordinate policies and regulations, and streamline them to get better returns on private investment.

This approach worked well in rapidly industrialized countries such as the Republic of Korea because it offers the country's leadership an opportunity to take corrective action before firms either stop operations or remained stunted. The performance of PIACs in Africa has not been stunning. Most faded into obscurity, leaving investors to their own devices to deal with multiple constraints on their operations.[37] Reviving such regular consultations between the private sector and policymakers and decisionmakers would be one bold step forward in modernizing African economies and enhancing the productivity of firms.

One way to improve infrastructure support for firm entry and survival is to set up industrial zones.[38] The evidence is clear that African firms that engage in exporting, operate in proximity to other firms, and attract foreign direct investment tend to be more competitive and therefore to thrive.[39] With many African countries dependent on extractive industries, building economic complexity is challenging. The capabilities and productive knowledge in extractive industries have little overlap with those needed to produce more complex manufactured products. Policymakers should identify the proximate frontier products that countries can diversify into, as well as the capabilities needed. And they should alleviate unnecessary constraints to doing business, especially those that firms have identified as primary obstacles and that are within government's ability to deal with quickly. These include unclear and uneven enforcement of regulations, disregard for the rule of law, and rampant corruption.

Over the longer term, it will be vital to strengthen physical infrastructure by reliably providing electricity and other utilities, whose absence inhibits the competitiveness of African firms in global markets. Job creation everywhere is driven by strong private sector growth. But such growth requires a conducive business and regulatory environment that encourages firms of all sizes to set up operations and enables incumbent firms to become competitive in global markets. Improving the ease of entry would pave the way for Africa's informal

enterprises to formalize their businesses and create better jobs. Although removing some of these obstacles will take time (notably weak infrastructure and limited access to finance), policymakers could boost private-sector job creation in the short run by improving the quality of public service and easing bureaucratic burdens.

There is also a need for industrial strategies developed in collaboration with stakeholders, particularly the private sector, to identify priority issues and create a strong competitive environment.[40] Countries need to clear their own paths to sustainable economic transformation.[41] Finally, to avoid redundancy and unintentional competition between neighboring countries, regional industrial zones could be established to reap the benefits of externalities and agglomerations and to build a critical mass of skilled labor.[42] Establishing a regional integration framework to implement such policies is the focus of the next chapter.

ANNEX 2.1 DETAILED SAMPLE RESULTS

TABLE A2.1 African countries in the analytic sample for growth acceleration episodes

	Growth acceleration episode	
Country	**Start date**	**End date**
Botswana	1964	2014
Burkina Faso	1970	2014
Cameroon	1965	2014
Egypt	1960	2012
Ethiopia	1961	2014
Ghana	1960	2014
Kenya	1969	2014
Lesotho	1970	2014
Malawi	1966	2014
Mauritius	1970	2014
Morocco	1960	2012
Mozambique	1970	2014
Namibia	1960	2014
Nigeria	1960	2014
Rwanda	1970	2014
Senegal	1970	2014
South Africa	1960	2014
Uganda	1952	2014
Zambia	1965	2014

Source: Expanded Africa Sector Database (https://www.merit.unu.edu/themes/3-economic-development-innovation-governance-and-institutions/expanded-africa-sector-database-easd-1960–2015/).

TABLE A2.2 Average annual growth rates of value added in sample African countries, by growth acceleration episode and sector *(percent)*

	Growth acceleration episode						
Country	**Start date**	**End date**	**Manufacturing**	**Services**	**Agriculture**	**Mining**	**All sectors**
Botswana	1967	1979	17.94	17.29	6.23	25.04	16.76
	1979	1984	–0.03	–1.20	–6.57	30.74	10.54
	1984	2008	6.11	9.97	3.27	3.16	6.14
Burkina Faso	1994	2005	5.20	5.58	5.49	–2.87	5.40
Egypt	1958	1979	6.76	6.95	3.00	10.25	6.73
	1979	1988	7.88	8.18	3.77	0.26	5.21
	1988	2002	3.64	5.60	4.18	–0.62	3.85
	2002	2016	4.81	6.32	4.10	6.80	5.68
Ghana	2006	2016	6.91	8.14	3.75	21.03	7.29
Kenya	2004	2016	5.89	5.52	5.38	9.25	5.59
Mauritius	1969	1979	10.83	8.88	17.15	8.91	10.51
	1981	1999	7.17	5.77	–0.04	4.10	5.51
	2005	2015	2.26	4.96	1.91	–5.92	4.08
Morocco	1957	1967	5.03	2.89	2.08	2.37	3.13
	1981	1997	3.03	4.37	3.58	1.03	3.79
	2002	2007	4.78	5.79	1.85	6.97	5.01
	2007	2015	3.06	4.60	7.40	0.54	4.52
Namibia	2003	2015	6.07	6.08	–1.11	4.08	5.24
South Africa	2001	2016	2.62	4.14	2.60	0.23	3.40
Uganda	2009	2016	5.88	6.66	2.31	11.94	5.57
Average			5.79	6.33	3.52	6.86	6.20

Source: Data from the Expanded Africa Sector Database.

TABLE A2.3 Average annual growth rates of employment shares in sample African countries, by growth acceleration episode and sector

	Growth acceleration episode					
Country	**Start date**	**End date**	**Manufacturing**	**Services**	**Agriculture**	**Mining**
Botswana	1967	1979	13.92	7.95	–3.00	21.70
	1979	1984	2.82	3.05	–1.88	0.03
	1984	2008	1.20	1.78	–1.63	–2.19
Burkina Faso	1994	2005	3.69	5.47	–0.84	14.47
Egypt	1958	1979	2.52	0.61	–1.23	2.07
	1979	1988	1.21	1.35	–1.90	–2.10
	1988	2002	0.12	1.04	–1.42	–4.27
	2002	2016	1.06	0.93	–2.64	–5.77
Ghana	2006	2016	–3.04	3.77	–3.33	6.34
Kenya	2004	2016	1.60	1.47	–1.65	5.48
Mauritius	1969	1979	7.28	–0.90	–5.25	–1.90
	1981	1999	0.67	0.82	–3.78	8.26
	2005	2015	–1.46	1.10	–2.98	5.20
Morocco	1957	1967	2.67	0.73	–0.88	1.95
	1981	1997	0.13	0.79	–0.65	–3.98
	2002	2007	1.30	1.48	–2.61	–2.85
	2007	2015	0.13	2.33	–3.51	–7.86
Namibia	2003	2015	2.81	–0.65	–0.11	4.15
South Africa	2001	2016	–0.51	0.05	0.70	–2.11
Uganda	2009	2016	–1.80	0.11	0.24	–1.32
Average			1.82	1.66	–1.92	1.76

Source: Data from the Expanded Africa Sector Database.

TABLE A2.4 Effects of growth acceleration episodes on employment intensity of growth in sample African countries, by sector

	Elasticity of employment to growth		
Employment	**Overall**	**During growth acceleration episodes**	**Effects of growth acceleration episodes**
Total	0.55	0.56	0.0078***
Manufacturing	0.88	0.88	0.0063*
Services	0.96	0.97	0.0138***
Agriculture	0.31	0.23	–0.0806
Mining	0.81	0.80	–0.0144*
Manufacturing-driven growth acceleration episodes			
Total	0.57	0.59	0.017***
Manufacturing	0.91	0.94	0.034***
Services	1.01	1.05	0.038***
Agriculture	0.32	0.34	0.022***
Mining	0.83	0.88	0.053***
Services-driven growth acceleration episodes			
Total	0.55	0.56	0.005***
Manufacturing	0.89	0.89	–0.005
Services	0.97	0.98	0.005*
Agriculture	0.32	0.31	–0.01***
Mining	0.85	0.49	–0.360***
Agriculture-driven growth acceleration episodes			
Total	0.56	0.56	–0.003
Manufacturing	0.89	0.88	–0.012***
Services	0.99	0.98	–0.01**
Agriculture	0.30	0.31	0.007**
Mining	0.80	0.76	–0.046***
Mining-driven growth acceleration episodes			
Total	0.56	0.57	0.016***
Manufacturing	0.88	0.90	0.021***
Services	0.98	1.01	0.029***
Agriculture	0.30	0.31	0.013***
Mining	0.78	0.81	0.024**

* Significant at the 10 percent level; ** significant at the 5 percent level; *** significant at the 1 percent level.

Source: Data from Penn World Tables 9.1 and the Expanded Africa Sector Database.

Note: The sample includes countries in table A2.1. Elasticities are estimated using ordinary least squares regressions and the following specification: $\ln(E_{i,j,t}) = \beta_1 \ln(GDP_{i,t}) + \beta_2 \ln(GDP_{i,t}) \times Growthspkes_{i,j,t} + \epsilon_{i,j,t}$, where $Growthspkes_{i,j,t}$ is a dummy variable indicating whether country *i* experienced at least one growth acceleration episode driven by sector *j*. The elasticities are given by the estimated coefficient β_1 (outside growth acceleration episodes) and $\beta_1 + \beta_2$ (during growth acceleration episodes).

TABLE A2.5 Industry shares in value added and employment, with income and decade effects

Variable	(1) Industry value added share	(2) Industry employment share
Ln(Pop)	–0.132 (–0.784)	0.021 (0.172)
$Ln(Pop)^2$	0.003 (0.523)	0.001 (0.178)
Ln(GDP per capita)	0.467** (2.265)	0.118 (1.012)
Ln(GDP per capita squared)	–.0285** (–2.253)	–0.005 (–0.697)
Decade 1960	0.093** (3.279)	–0.009 (–0.809)
Decade 1970	0.116** (3.023)	–0.011 (–0.678)
Decade 1980	0.130** (2.520)	–0.0185 (–0.858)
Decade 1990	0.152** (2.142)	–0.023 –0.864
Decade 2000	0.161* (1.857)	–0.034 –1.076
Decade 2010	0.158 (1.647)	–0.040 –1.093
Constant	–0.466 (–0.249)	–0.997 –0.964
Number of observations	970	959

* Significant at the 10 percent level; ** significant at the 5 percent level.

Source: Data from Penn World Tables 9.1 and the Expanded Africa Sector Database.

Note: Numbers in parentheses are *t*-statistics. All estimates include country fixed effects. Standard errors are clustered by country to consider serial correlation within countries, which strongly affects the significance of the results. When this is not done, coefficients for decade dummy variables are significant and negative.

TABLE A2.6 Multinomial estimates of conditional firm dynamics, various years

Two-year period

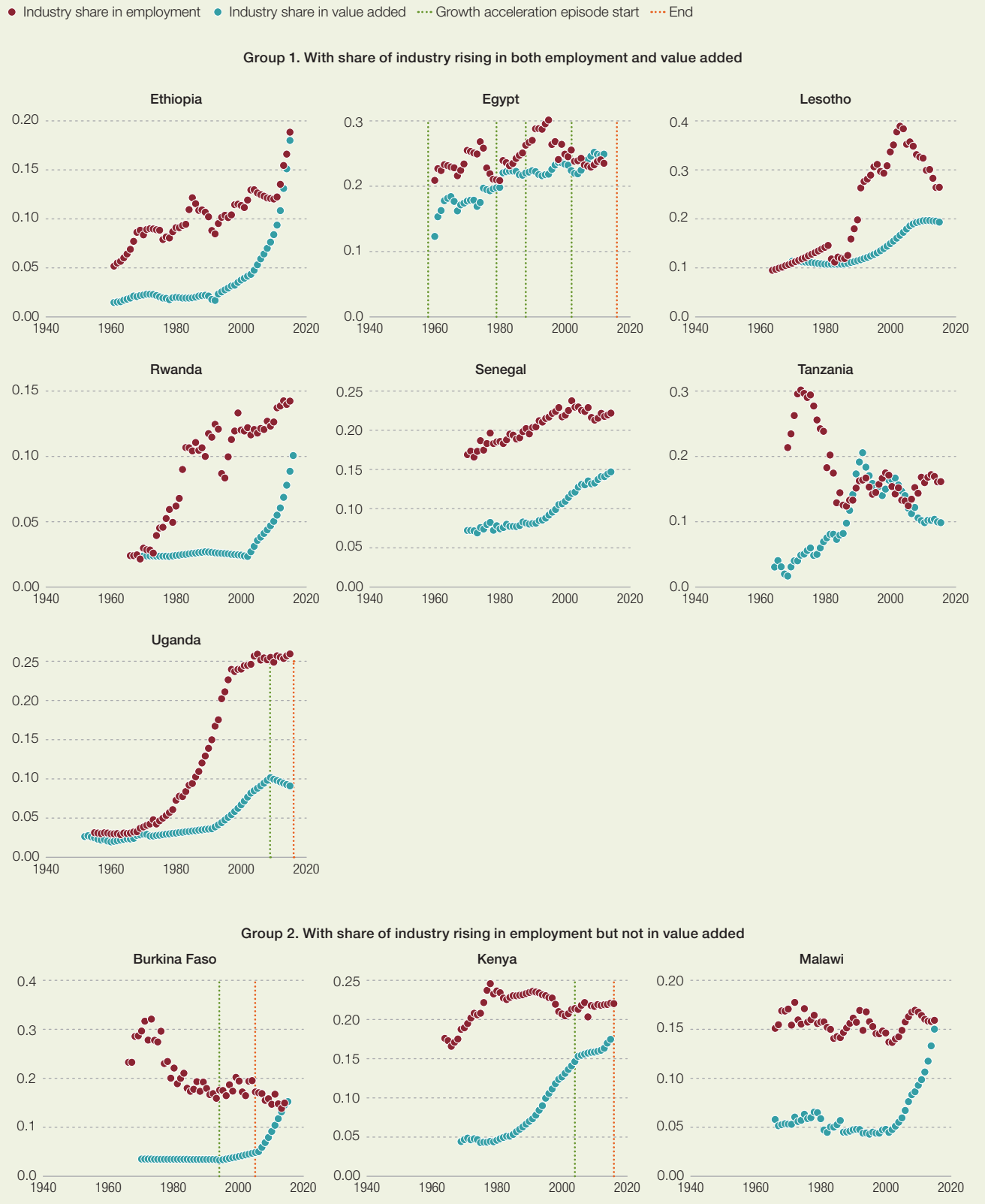
	Africa		Latin America		South Asia	
	[t] Medium	[t] Large	[t] Medium	[t] Large	[t] Medium	[t] Large
[t-2] Small	–0.822*** (0.00447)	–0.900*** (0.00291)	–0.793*** (0.00465)	–0.865*** (0.00361)	–0.861*** (0.00499)	–0.896*** (0.00424)
[t-2] Medium	0.758*** (0.00535)	–0.0197*** (0.00607)	0.717*** (0.00539)	–0.0585*** (0.00550)	0.809*** (0.00585)	–0.0772*** (0.00534)
[t-2] Large	0.0639*** (0.00329)	0.920*** (0.00576)	0.0756*** (0.00312)	0.923*** (0.00440)	0.0525*** (0.00325)	0.973*** (0.00352)
Number of observations	22,865	22,865	22,325	22,325	13,574	13,574

*** Significant at the 1 percent level.

Source: Harmonized data from World Bank Enterprise Surveys.

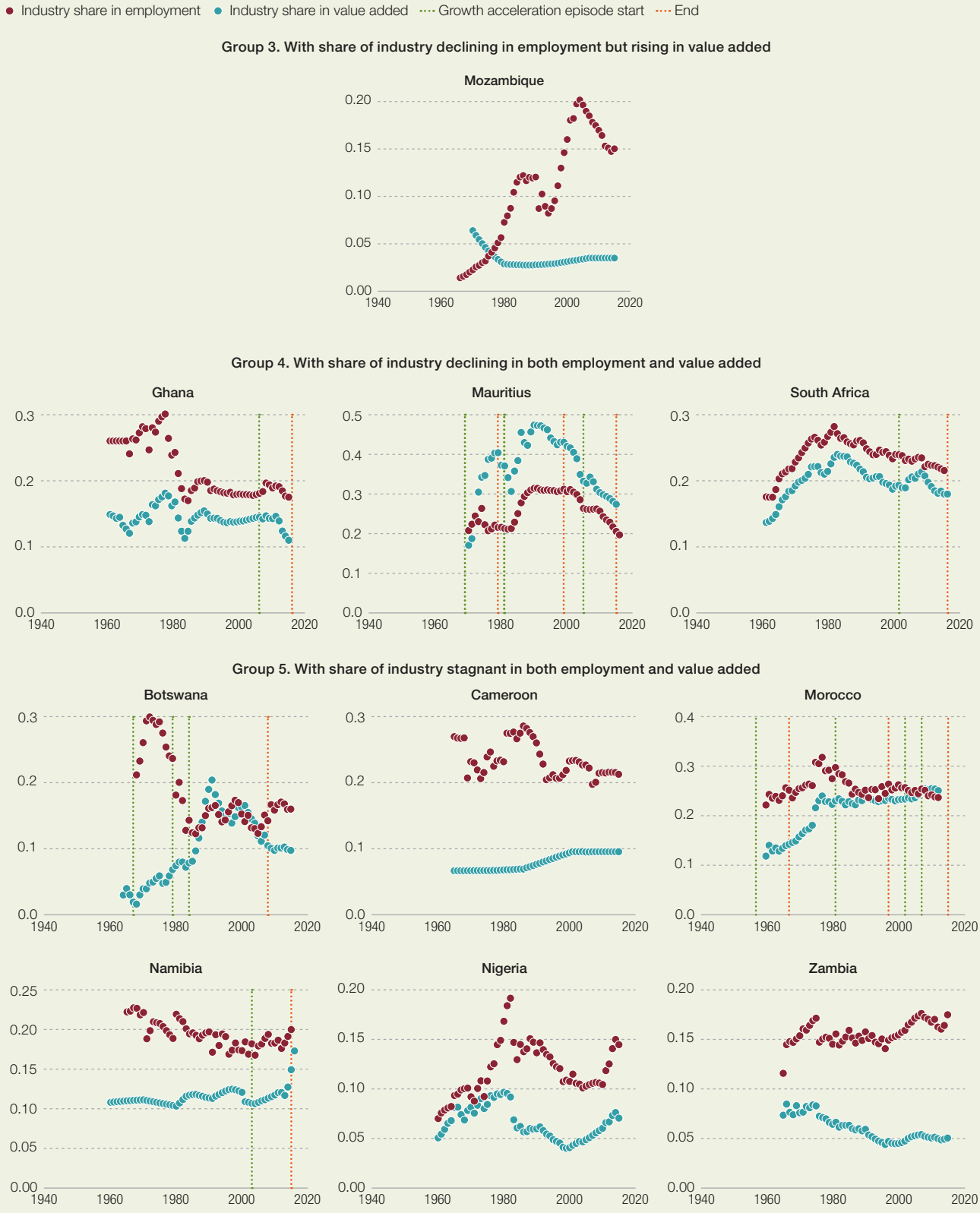
Note: Numbers in parentheses are standard errors. Small firms are the reference group. The analysis controls for productivity of firms, country, and year fixed effects.

FIGURE A2.1 Employment and value added shares in Africa, by country, 1960–2016



(continued)

FIGURE A2.1 Employment and value added shares in Africa, by country, 1960–2016 *(continued)*



Source: Data from Penn World Tables 9.1 and the Expanded Africa Sector Database.

NOTES

1. ILOSTAT (https://www.ilo.org/ilostat).
2. African Development Bank 2018.
3. Newman et al. 2016.
4. With the level of economic growth controlled for, a 1 percent increase in agriculture's share of total employment is associated with a 0.08 point increase in the Gini coefficient of inequality and a 0.25 percentage point increase in poverty (at the $1.90 a day poverty line in 2011 constant prices), while the same increase in the informal sector's share of total nonagricultural employment is associated with a 0.05 point increase in inequality and a 0.64 point increase in the poverty rate (World Development Indicators data for 2018).
5. The International Labour Organization definition is as follows: "Informal employment comprises persons who in their main job were: (a) own-account workers, employers or members of producers' cooperatives employed in their own informal sector enterprises; (b) own-account workers engaged in the production of goods exclusively for own final use by their household; (c) contributing family workers, irrespective of whether they work in formal or informal sector enterprises; or (d) employees holding informal jobs, whether employed by formal sector enterprises, informal sector enterprises, or as paid domestic workers by households."

   Informality can be a default (involuntary) option, when workers resort in the absence of decent jobs or unemployment benefits or when firms are unable to formalize due to, for example, the high cost of formalization. It can be a chosen option, when workers or firms choose not to be part of the regulated economy. The focus of this chapter is on the former.
6. ILO 2018.
7. Fiess, Fugazza, and Maloney 2008.
8. Khamis 2012.
9. Bargain and Kwenda 2014.
10. Benjamin and Mbaye 2012.
11. Page and Shimeles 2015.
12. Bigsten, Mengistae, and Shimeles 2013.
13. Hausmann, Pritchett, and Rodrik 2005.
14. African Development Bank 2018; Berthelemy 2017.
15. African Development Bank 2018.
16. Hausmann, Pritchett, and Rodrik 2005.
17. African Development Bank 2018.
18. African Development Bank 2018.
19. African Development Bank 2018; Berthelemy 2017. The analysis here is based on data from the Expanded Africa Sector Database. The sectoral dynamics might be affected by the changing nature of these sectors. The "servicification" of the manufacturing sector and the outsourcing of professional and business services is one such example. In the US context, Berlingieri (2013) shows that professional and business outsourcing accounts for 36 percent of the increase in services and 25 percent of the fall of manufacturing. The Expanded Africa Sector Database includes the following 10 sectors: agriculture (agriculture, hunting and forestry, fishing); mining (mining and quarrying); manufacturing; utilities (electricity, gas, and water supply); construction; trade services (wholesale and retail trade; repair of motor vehicles, motorcycles, and personal and household goods; hotels and restaurants; transport (transport services, storage, and communications); finance (financial intermediation, renting, and business activities, excluding owner occupied rents); government services (public administration and defense, education, health, and social work); and others (personal services; community, social, and personal service activities; activities of private households).
20. Only one growth episode is observed in mining that occurs without growth acceleration episodes in other sectors (Botswana between 1979 and 1984). In the seven other cases, growth episodes in mining are associated with growth acceleration episodes in manufacturing (four cases) and services (six cases).
21. Rodrik 2014.
22. Rodrik 2013. However, Cadot et al. (2016) challenge the view that manufacturing is the only sector exhibiting absolute convergence. In the African context, they show that dynamic service sectors might share the same characteristics.
23. Following Rodrik (2016), the following equation was estimated to establish the existence of premature deindustrialization: where is the employment or value added share of industry in country *i* and year *t*, is the logarithm of total population, is the square of the logarithm of population, is the logarithm of GDP per capita, is the square of the logarithm of GDP per capita, and is a dummy variable for the decade. Excluding Mauritius, a strong manufacturing exporter, does not change the results.
24. Rodrik 2016.

25. Soderbom, Teal, and Wambugu 2005.
26. Based on firm-level data from World Bank Enterprise Surveys covering 135,000 firms in 139 countries.
27. The shares are calculated from World Bank Enterprise Surveys for 2010–17.
28. The estimated marginal effects are conditional on productivity using logarithm of sales per worker, country, and year.
29. World Bank 2009.
30. Aga and Francis 2015.
31. EBRD, EIB, and World Bank 2016.
32. Aterido, Hallward-Driemeier, and Pagés 2011; Seker and Correa 2010.
33. Woldemichael and Joldowski 2018.
34. The overall effect of business obstacles on jobs can be calculated by multiplying the effect on firm survival and the effect on conditional employment growth. The value for the upper bound is from Woldemichael and Joldowski (2018).
35. Data from the SME Finance Forum, based on International Finance Corporation (IFC) Enterprise Finance Gap Database summary data, show that there are about 4.9 million formal enterprises in Africa (https://finances.worldbank.org/Other/MSME/9ffj-qvnk). In 2010, the IFC conducted a study to estimate the number of micro, small, and medium enterprises in the world, and to determine the degree of access to credit and use of deposit accounts for formal and informal firms. The study used data primarily from World Bank Enterprise Surveys. In 2011, the data were revisited as new Enterprise Surveys became available. The resulting database, IFC Enterprise Finance Gap Database, covers 177 countries and provides summary values for different categories. The database includes 50 African countries.
36. Newman et al. 2016.
37. Page and Tarp 2017.
38. Lin and Monga 2017.
39. Newman et al. 2016.
40. African Development Bank 2017.
41. Lin and Monga 2011.
42. Boly and Kéré 2017.

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3

INTEGRATION FOR AFRICA'S ECONOMIC PROSPERITY

KEY MESSAGES

- The Continental Free Trade Agreement (CFTA) can offer substantial gains for all African countries as new and timely analytics show.
- Night light data suggest that barriers to trade from border impediments have fallen over the past 20 years.
- Eliminating today's applied bilateral tariffs would increase intra-Africa trade by up to 15 percent, but only if rules of origin are simple and transparent.
- To move to systemwide rules of origin and avoid product-specific rules of origin, regional economic community (REC) member countries should move to a single value added rule—say, 40 percent of value added from within the REC—with a more lenient threshold for less developed countries. They should also exempt shipment sizes below $1,000.
- Removing nontariff barriers with countries outside Africa could increase trade and boost the continent's tariff revenues by up to $15 billion.
- The World Trade Organization's Trade Facilitation Agreement (TFA) is expected to reduce trading costs by 14–18 percent and increase world trade by 0.5 percent, with developing and especially least developed countries benefiting the most. It is also likely to reduce the time needed to import goods by a day and a half and the time needed to export goods by almost two days.
- Implementing the TFA would increase the gains to about 4.5 percent of Africa's GDP, or an additional $31 billion, bringing the total real income gains to $134 billion. (A 0.2 percent tariff on imports from high-income countries could bring in $850 million to finance trade facilitation projects.)
- Bold reforms, especially at the institutional level, can synchronize financial governance frameworks across Africa and remove any remaining legal restrictions to cross-border financial flows and transactions. To harmonize payment systems, RECs should pursue stronger technological advances that facilitate movement of funds across borders.
- Electricity markets in Africa have developed vertically within national boundaries rather than horizontally across countries. Trade in electricity would bring many benefits, especially to small countries, if the hard infrastructure is at scale and functioning—and if soft infrastructure (logistics) is trustworthy.
- Africa's infrastructure financing needs are estimated to be $130–$170 billion a year. But total commitments came to just $63 billion in 2016, representing a financing gap of approximately $67–$107 billion a year. To close Africa's infrastructure deficit, RECs could consider regional infrastructure bonds, while countries could further mobilize domestic resources and provide incentives for the private sector to join public–private partnership operations for regional public infrastructure.

Africa has been integrating along various dimensions for the past 60 years. In a first phase, during the 1960s and 1970s, inward-looking integration reflected the desire to develop independently from the former colonial rulers. Economic unification was to be the solution to Africa's development dilemma, and many thought that this required a political union. But most leaders of the young African states were reluctant to encourage the erosion of national sovereignty and the emergence of a supranational authority to coordinate and manage the affairs of the African Union.

Starting in the 1980s, initiatives entered a second, more outward-looking phase of RECs under the Abuja Treaty, which became operational in 1994. While still a work in progress, a third phase saw the launch of the CFTA in March 2018, reflecting the African Union's Agenda 2063, its 50-year vision launched on the 50th anniversary of the Organization of African Unity.[1] Titled "The Africa We Want," Agenda 2063 calls for "a prosperous Africa based on inclusive growth and sustainable development." If anything, the CFTA recognizes in its deeper reach the many dimensions of integration. This chapter reviews the progress in regional integration and the opportunities and challenges that the CFTA presents. Throughout, the focus is on manufactures, since industrialization is the overarching challenge facing Africa.

All RECs have ambitious and wide-ranging objectives that reflect the desire to accommodate interests across members and accelerate industrial development

Over the past decades, much has been written about Africa's promise and progress on regional integration, notably in the series of reports *Assessing Regional Integration in Africa,* published since 2004. As noted in the eighth edition—prepared jointly by the African Union Commission, the United Nations Economic Commission for Africa, and the African Development Bank—the CFTA has the potential to provide new impetus and dynamism to economic integration in Africa. That report spelled out in considerable detail the need to base CFTA institutional structures on practical approaches that can work in Africa—and to track progress with the Regional Integration Index.[2]

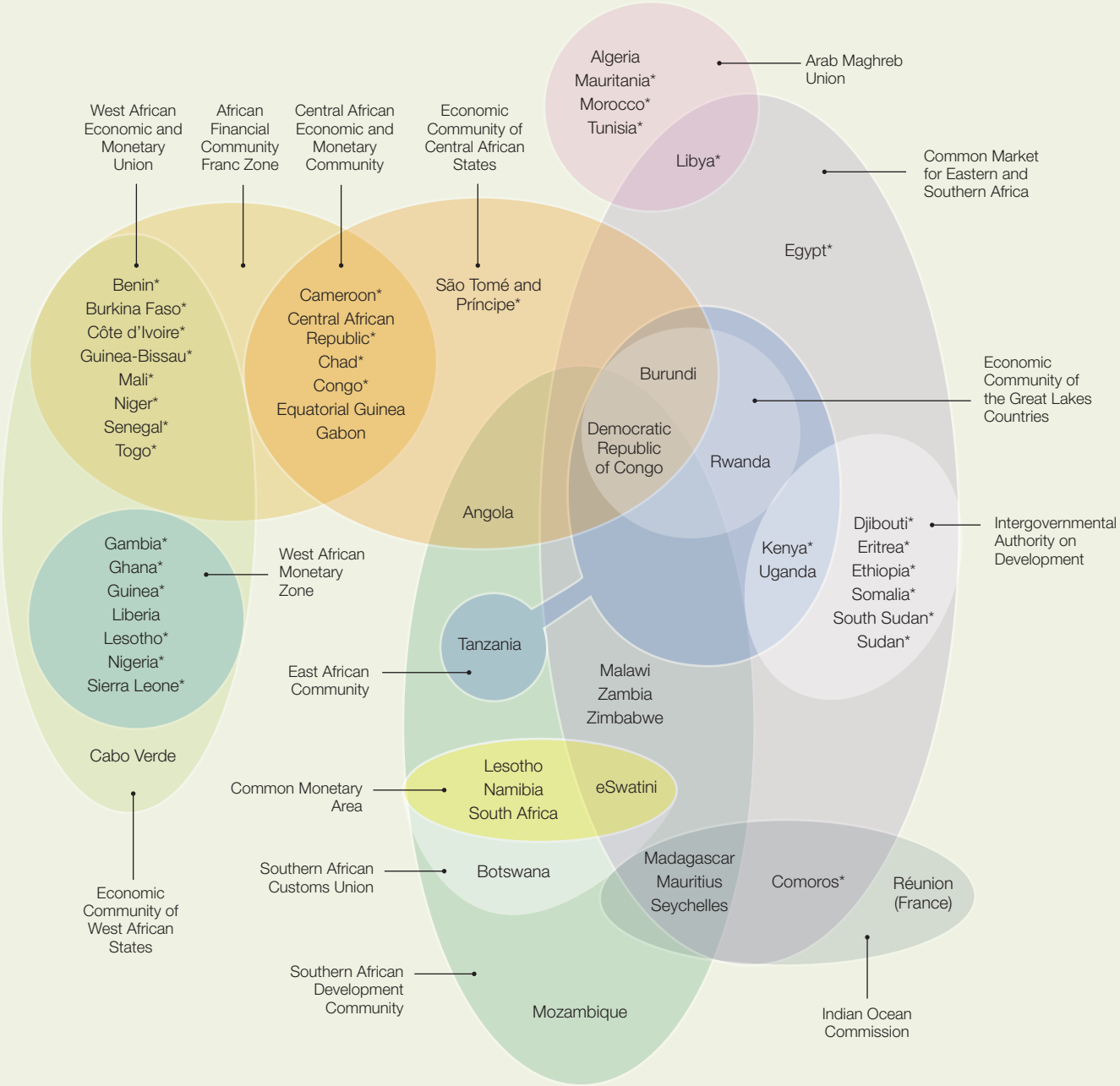
This chapter emphasizes two dimensions of regional integration that have received little attention in previous evaluations: the free movement of services and capital and the provision of regional public goods (such "hard" infrastructure as roads and such "soft" infrastructure as the regulatory environment). The chapter also discusses the challenges of achieving breadth (enlarging the market by removing barriers to trade for many countries), depth (extending integration beyond measures covering trade in goods, which requires trust), and solidarity (for the special and differential treatment of least developed members). Wherever possible, evaluations compare the eight African RECs recognized as the building blocks of the African Union with three other South–South regional integration arrangements: the Andean Community, Association of Southeast Asian Nations (ASEAN), and Southern Common Market (Mercosur).

The chapter takes for granted that regional integration is good politics and, ultimately, good economics in the fragmented African landscape. But to survive—and thrive—African regional integration arrangements must extend beyond good intentions and have a sound economic basis. While this is also the starting point of other progress reports, the emphasis here is on measurable achievements rather than on what should be done. Wherever possible, indicators of progress avoid relying on commonly used composite indices that can mask the underlying diversity of challenges ahead.

All RECs have ambitious and wide-ranging objectives that reflect the desire to accommodate interests across members and accelerate industrial development. They deal with removing tariffs and nontariff barriers and implementing trade facilitation measures and harmonizing rules of origin when several RECs are included, as in the Tripartite Free Trade Area, which brings together the East African Community (EAC), the Common Market for Eastern and Southern Africa (COMESA), the Southern African Development Community (SADC), and now the CFTA. The 15 African trade and economic organizations (plus the African Union) have memberships that overlap considerably (figure 3.1).

At a deeper level, integration requires cooperation between governments and people: to foster peace and security, conserve shared natural resources, develop and manage regional infrastructure, and share systems of rules and policy regimes. Integration thus provides regional public goods. These forms of cooperation call for

FIGURE 3.1 Africa trade and economic organizations



Source: https://au.int/en/organs/recs.

Note: Asterisks indicate the 29 members of the Community of Sahel-Saharan States.

collective action, which requires trust and some supranational delegation of authority.

INTEGRATING THE AFRICAN MARKET: OUTCOMES SO FAR

With 16 landlocked countries, Africa is more fragmented than any other continent. The small size of many countries and the resulting fragmentation of domestic markets result in various diseconomies of scale, impeding economic development. In 2017, 76 percent of African countries had fewer than 30 million people, and about half had a GDP of less than $10 billion. Deeper market integration for goods, infrastructure services, and key factors of production (labor and capital) is especially important for Africa's small and fragmented economies and for their global competitiveness.

The vision articulated by several generations of African leaders is an "integrated continent with free movement of people, goods, capital, and services and infrastructure connections"

A borderless Africa is the foundation of a competitive continental market that could serve as a global business center. It would allow agricultural and industrial production across national boundaries and therefore offer economies of scale to investors, while creating much bigger markets and providing new opportunities for small firms and large. It would help eliminate monopoly positions while enhancing cross-border spillovers between coastal and landlocked countries. At a deeper level, regional integration can improve regional security, since the expansion of international trade often correlates with a reduced incidence of conflict.

Regional integration in support of broad-based economic and human development has been part of the African Development Bank's mandate since its creation in 1963. It is also a key priority for the African Union under the New Partnership for Africa's Development, Agenda 2063, and the RECs. The vision articulated by several generations of African leaders is an "integrated continent with free movement of people, goods, capital, and services and infrastructure connections."

What is integration?

Markets are integrated when arbitrage (buying in locations where prices are low and selling in locations where prices are high) erases differences in prices (nothing is left on the table) and trade costs are low. Trade costs are high when governments put up barriers and when officials extract informal payments. Trade in goods exemplifies arbitrage. So do the movement of people from locations where wages are low to locations where wages are high and the movement of capital from areas where returns are low to areas where they are high.

Integration in RECs (and in other preferential trade agreements) covers measures that go beyond obligations taken in WTO multilateral negotiations. Either they go deeper in the provisions covered at the WTO (such as tariff reductions beyond levels bound at the WTO and referred to as WTO+), or they cover provisions not covered at the WTO (such as capital and labor regulations, environmental regulations, and regulatory policies and referred to as WTO-X). WTO+ measures in RECs are obligations covering "shallow" integration (generally preferential agreements that deal with border measures), and WTO-X measures cover "deep" integration measures (agreements that include rules on other domestic policies).[3] Economic theory suggests that the degree of trade openness is a determinant of deep integration. In this respect, shallow and deep integration are complementary, with shallow integration generating demand for the governance that the deep integration can provide.[4] Together, these measures reflect efforts at trade facilitation, the expression given to all measures seeking to reduce the costs of crossing borders.

Because it is difficult to appreciate progress in integration, it is useful to have a benchmark whenever possible. Here the benchmarks are three comparable preferential trade agreements among (mostly) developing countries: the Andean Community (5 countries), ASEAN (10), and Mercosur (4).

Policy measures to integrate goods markets

The first expected outcome of an effective preferential trade agreement is an increase in trade among members—through three channels. The first is reducing tariffs between members. The second is reducing nontariff barriers that arise from policies and from non-policy-induced rent extraction. The third, and hardest to apprehend, is through the two components of trade facilitation:

a "hard" component, related to tangible infrastructure such as ports, roads, highways, and telecommunications, and a "soft" component, related to transparency, customs management, the business environment, and other intangible institutional aspects that affect the ease of trading. The first two are the outcomes of measures taken under shallow integration, and the third is associated with deep integration.

Tariffs

Traditionally, and certainly for the RECs, the first stage of integration has always been eliminating tariffs on substantially all trade, where "substantially" is left purposely vague, at least at the WTO. Consider the applied intra–preferential trade agreement tariffs with applied most favored nation (MFN) tariffs for all eight African RECs (and a few more African economic communities) and for the three comparators (table 3.1). Several patterns stand out. First, indeed as imposed by the MFN obligation on non-WTO members, bilateral tariffs do not exceed MFN tariffs, a reminder of the benefits of WTO membership even for non-WTO members. Second, except for the Gulf Cooperation Council, average MFN tariffs are lower for

TABLE 3.1 Applied tariffs: Average intraregional tariffs and most favored nation tariffs, 2016

Agreement	Intraregional tariff	Most favored nation tariff
AU-recognized regional economic communities		
Arab Maghreb Union (AMU)	0.05	0.11
Common Market for Eastern and Southern Africa (COMESA)	0.05	0.12
Community of Sahel-Saharan States (CEN-SAD)	0.12	0.13
East African Community (EAC)	0.0	0.13
Economic Community of Central African States (ECCAS)	0.09	0.15
Economic Community of West African States (ECOWAS)	0.11	0.12
Southern African Development Community (SADC)	0.04	0.09
West African Economic and Monetary Union (WAEMU)	0.09	0.12
Other preferential trade agreements		
Agadir Agreement	0.00	0.13
Central African Economic and Monetary Community (CEMAC)	0.0	0.18
Gulf Cooperation Council (GCC)	0.0	0.05
Intergovernmental Authority on Development (IGAD)	0.09	0.16
Pan-Arab Free Trade Area (PAFTA)	0.00	0.09
Southern African Customs Union (SACU)	0.0	0.08
West African Monetary Zone (WAMZ)	0.12	0.13
Comparators		
Andean Community	0.0	0.09
Association of Southeast Asian Nations (ASEAN)	0.01	0.07
Southern Common Market (Mercosur)	0.00	0.12

Source: Data from the International Trade Centre. Most data for 2016 are from Espitia et al. (2018).

Note: All averages are simple averages of applied tariffs calculated in two steps. First, averages on the statutory schedules at the six-digit Harmonized System level are averaged for each country. Second, an average is taken among all group members. Column 1 reports the bilateral averages and column 2 the average applied most favored nation rates. Tariffs at the regional trade agreement level are obtained by taking a simple average across members.

The first expected outcome of an effective preferential trade agreement is an increase in trade among members

the comparator group. Mercosur has an average MFN tariff similar to tariffs in the African preferential trade agreements. Third, except for the EAC, there is a very sharp difference between the average bilateral tariffs of the RECs and those of the comparator group, which are mostly zero.

In the absence of compensation mechanisms for members of a customs union, differences in economic power have also contributed to a common external tariff (CET) unfavorable to households, especially low-income households. Producer interests, especially in the most powerful REC members, have resulted in CET schedules with exception lists unfavorable to consumers, especially to low-income households. Even taking into account temporary protection measures, the CET has (or will, for the Economic Community of West African States, ECOWAS) raise the cost of living for households, especially those in the poorest deciles. Producer interests in the large partners largely determined the negotiated outcome (box 3.1).[5]

Many nontariff barriers are opaque, difficult to identify, and difficult to distinguish from nontariff measures. Often nontariff measures do not have a trade focus, even though they affect trade flows

The EAC is the only fully operational customs union in Africa. It is currently reviewing its three-band CET—0 percent for raw materials and capital goods, 10 percent for intermediate goods, and 25 percent for final goods—complemented by a sensitive items list (products such as wheat and milk have tariffs above 30 percent). This review, which could lead to a fourth band, reflects, at least partly, pressures from globalization-induced repercussions.[6] The outcome of the current negotiations will likely be a form of "universalism" whereby each member acquiesces to the demands of other members in return for getting support for its own demands. This possible backtracking when adjustments to the CET are well under way would create further adjustment costs and likely reduce credibility for future integration efforts.

In sum, political economy pressures internal to the RECs resulting from heterogeneity along economic, cultural, and institutional dimensions —but also from globalization-driven competition pressures—have left the RECs far from completing stage 1 of economic integration. Although *Assessing Regional Integration in Africa VIII* concludes that five of eight RECs (COMESA, EAC, the Economic Community of Central African States [ECCAS], ECOWAS, and SADC) have reached free trade area status, the applied tariffs for intra-REC trade suggest otherwise.[7] Only EAC has completed stage 1 (and stage 2) of integration, and it is the only REC that closely monitors progress, with its Common Market Scorecard (box 3.2).

Nontariff barriers

Tariff liberalization alone has generally proven unsuccessful in providing genuine market access, which has drawn attention to nontariff measures that restrict market access and competition.[8] Nontariff measures may be intended to influence competition in export and import markets, as tariffs do (such as quotas, subsidies, and export restrictions), or they may have public policy aims, such as protecting health, safety, and the environment (technical barriers to trade). While nontariff measures influenced by public policy concerns have consumer welfare as their stated goal, they may nonetheless be designed to benefit producers, in the form of hidden protection. Both types of nontariff measures have trade consequences.[9]

Nontariff barriers are also explicitly identified for elimination during stage 1 of integration as policy-imposed restrictions to trade. Very difficult to measure, many nontariff barriers are opaque, difficult to identify, and difficult to distinguish from nontariff measures, which have shifted generally from a protectionist motive toward a precautionary one. And not all are the results of policy. For example, excessive verifications to extract rents also represent important barriers to trade. Even looking only at policy-imposed nontariff barriers, separating them from the increasing array of nontariff measures is difficult. Often nontariff measures do not have a trade focus, even though they affect trade flows. In some instances, they stimulate trade flows because they provide information, and even when they diminish trade flows, they can increase efficiency because they take into account the full social costs of production.

Even when nontariff measures do not have an overtly protectionist aim, compliance with differing requirements across countries is complex and costly for companies seeking to export. African nontariff barriers are particularly intrusive for smaller firms, female traders, and informal cross-border traders. Mentioned most frequently are customs and trade procedures, immigration

BOX 3.1 Common external tariffs: Challenges for poor countries

As regional economic communities (RECs) deepen integration by moving from a free trade agreement to a customs union with a common external tariff (CET), small countries can be left on the sidelines during the negotiations if appropriate measures do not accommodate their peculiar status. Rwanda and Liberia illustrate the contrast between depth and breadth across RECs.

The East African Community (EAC) exemplifies relatively deep integration, reaching customs union status by 2005, before expanding membership from three to five members when Burundi and Rwanda joined in 2009. As latecomers, Burundi and Rwanda adopted a three-band CET (0 percent for raw materials, 15 percent for semifinished products, and 25 percent for finished products)—and a sensitive items list of products exempt from the three-band tariff schedule, with tariffs up to 70 percent. Both newcomers received an adjustment period of two years.

Despite the EAC's fairly transparent trade policy and emphasis on removing nontariff barriers, the high tariffs for the sensitive items list fell disproportionately on goods consumed by poor people in Rwanda. Prices of these goods increased by an average of 3.8 percent. In addition, government revenue from tariffs fell by about half in the following two years because of the lower CET. On the positive side, the CET led to an average increase in exports of 1–2 percent.[1]

In contrast, the Economic Community of West African States (ECOWAS) has a less transparent trade policy. When Liberia joined in 2015, the trade liberalization scheme that had been adopted in 1994 was not yet implemented. The five-band CET was fairly high, at 0 percent for necessities, 5 percent for raw materials and capital equipment, 10 percent for intermediate products, 20 percent for consumer products, and 35 percent for goods for regional development.

Adopting the CET will more than double Liberia's import-weighted tariff, from 6.3 percent to 14.7 percent, pushing up urban household spending by 3 percent and rural household spending by 6 percent just to maintain their current well-being.[2] In effect, adopting the CET called for a deep adjustment in Liberia's statutory tariff regime, with an upward adjustment for 45 percent of the tariff lines and a downward adjustment for 25 percent. Tariffs will increase by at least 15 percentage points on some 233 products. These changes will harm producers, since most imported goods are not produced domestically, and consumers will have to pay more for imported goods.

In addition, ECOWAS adopted temporary special protection measures in 2013, which penalized the five members with the lowest per capita GDP: Gambia, Guinea, Guinea-Bissau, Liberia, and Niger. These members export primarily raw agricultural and mining products. Even during the adjustment period, the special protection measures allow no leeway from raising most favored nation tariffs, even though they can exceed the CET rate by up to 20 percentage points, with a cap at 70 percent.

For Côte d'Ivoire, the CET raises the cost of living by about 3 percent among all income groups.[3] The CET is slightly progressive, though losses are slightly lower for the richest 1 percent of households. For Guinea, the CET is regressive.

So, for both the EAC and ECOWAS, the CET raises the cost of living of poorer households by raising the cost of goods consumed by poor people more than the cost of other goods. In ECOWAS, the smaller low-income country members, with similar interests and tariff structures, would benefit from closer cooperation and a common negotiating stance to alter the composition of the CET, which is ill-suited to their needs.

Notes

1. Frazer 2012.
2. de Melo, Laski, and Mancellari 2014.
3. Cadot and Gourdon 2014, table 7.

BOX 3.2 Monitoring progress toward a customs union in the East African Community

The East African Community (EAC) Common Market Protocol is one of the most ambitious globally. The EAC is a customs union that covers goods, capital, and services. For goods, in addition to zero tariffs on intraregional trade, there is a common external tariff toward nonpartners and the removal of nontariff barriers. For capital, free movement covers 20 operations related to securities, direct investments, and credit operations, and personal capital operations are to be free of restrictions. For services, partner states are obliged to guarantee the free movement of services and service suppliers. This amounts to fairness and nondiscrimination. Especially important, in addition to progressively removing restrictions, EAC customs laws prevent member states from introducing any new restrictions on the provision of goods, capital, and services.

Monitoring progress is essential to detect implementation problems related to technical capacities, domestic political factors, and overlapping trade negotiations. The EAC Common Market Scorecard, introduced in 2014 and updated in 2016, assesses progress. A team of 14 trade lawyers and a statistician reviewed and coded 683 laws and regulations and administered a survey to 60 respondents. These regulations were then coded and assembled into indices reported in the scorecard, which measures de jure compliance through national laws not de facto compliance.

For free movement of capital, the 2014 scorecard reported that all but 2 of the 20 operations faced at least one restriction by at least one partner. And exemptions to the protocol or new restrictions —often guided by prudential supervision or money laundering concerns—were introduced without notification. The scorecard tallies the application of the 20 operations for each country and makes recommendations, taking into account the risk of financial contagion and the potential risk of reducing oversight of domestic regulators. The 2016 scorecard reported that members carried out few reforms in the freedom of capital movement and increased the use of exemptions while still not complying with the notification requirement, suggesting that exemptions could substitute for a reduction in restrictions.

For free movement of services, more than 500 sectoral laws and regulations cover professional services (legal, accounting, architectural, and engineering), road transport, distribution, and telecommunications legislation. Countries adopted a positive list, scheduling only subsectors they were willing to open. Some 63 nonconforming measures were identified, most relating to professional services. These were against the World Trade Organization principles of transparency in services, set up to attract trade and investment. None of the partner states complied with the obligation to inform the EAC Council. The 2016 scorecard reported a slight improvement, with 59 nonconforming measures.

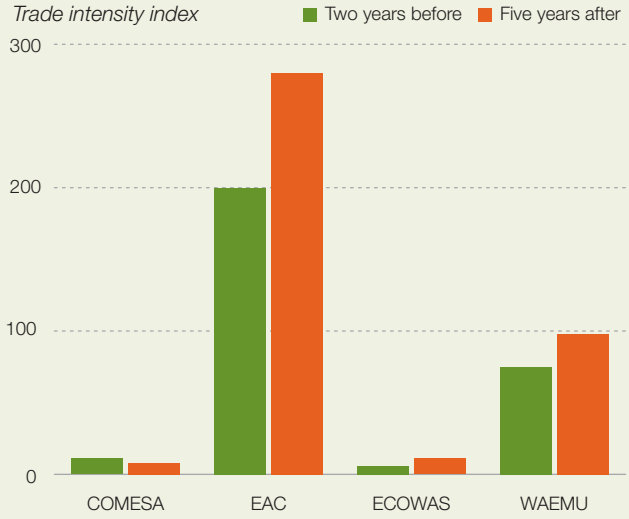
For free trade in goods, the 2014 scorecard reported that while all partners have eliminated tariffs on intraregional trade, they also introduced charges equivalent to tariffs, such as additional taxes and surcharges that affect import costs or import unit values. Nonrecognition of EAC certificates of origin at the borders and fake certificates of origin were also reported, as were nontariff barriers related to technical barriers to trade in dairy, pharmaceuticals, and aluminum. The 2016 scorecard showed an increase in reported nontariff barriers, often for goods on the sensitive items list, suggesting that the high tariffs were insufficient to protect domestic industries. It also acknowledged faster resolution of reported nontariff barriers. Unresolved nontariff barriers, common to all EAC countries, included a lack of harmonization of working hours at customs, a lack of coordination among institutions testing goods, a lack of harmonization of road tolls, and numerous monetary charges for exports of milk.

Other measures affect the freedom of trade in goods. Because all member states are also members of other free trade areas, the common external tariff was not applied to all non-EAC countries, resulting in a total revenue loss of $22.7 billion in 2014. The 2016 scorecard reports that countries continue to rely on tariff equivalent measures and to not recognize certificates of origin, significantly reducing the benefits of the customs union.

procedures, quality inspection procedures, transport-related requirements, and roadblocks. Agricultural products and leather and wood products frequently face technical measures (sanitary and phytosanitary measures and technical barriers to trade).[10] The index values for border control measures are also relatively high.

Unfortunately, such descriptive indices are of limited value for measuring progress, even just for legal engagements, which requires tracking the nontariff barriers reported by each partner (and accepted by the others), then checking whether they have been removed. The EAC Common Market Scorecard does such detailed monitoring for goods, capital, and services (see box 3.2). For example, in the EAC, where rules of origin are still necessary because countries are also members of other RECs, the scorecard reports that certificates of origin are not always recognized and are sometimes fake. The scorecard also monitors whether countries have enacted and applied legislation to penalize those producers of fake certificates. Other RECs serious about progress on de jure market access should follow in the EAC's footsteps.

FIGURE 3.2 Trade intensity indices two years before and five years after implementation of regional economic communities



Source: Adapted from de Melo and Tsikata (2015), table 2.

Note: The trade intensity index is the ratio of the bloc's share in member exports to its share in nonmember exports. Time periods are 1991–92 and 1997–98 for COMESA and ECOWAS, 1997–98 and 2003–04 for EAC, and 1992–93 and 1998–99 for WAEMU. WAEMU members are not included in the values for ECOWAS.

Goods trade within regional economic communities remains low, at 2–5 percent

Successive reports have noted that intra-Africa trade remains low.[11] Has integration since the Abuja Treaty increased intra-Africa trade? To detect changes in trade patterns around the time of implementation, intra-REC trade shares 5 and 10 years after implementation are compared with those 2 years before the announcement of reduced trade barriers. These values remain low, in the 2–5 percent range, while extrabloc import shares hover in the 20–30 percent range.[12] The exception is ASEAN, where intrabloc import shares increased from an already high base. Intrabloc import shares across all RECs and the other two comparators remain low. That is the case even though intrabloc shares increased substantially for ECOWAS and SADC as well as for the West African Economic and Monetary Union (WAEMU), where a common currency and language should have intensified intraregional trade.

The trade intensity indices in figure 3.2 take into account the overall growth of REC trade in world trade since intrabloc trade is now normalized by the bloc's share in nonmember exports. The EAC and, to less extent, WAEMU stand out with a strong rise in intra-REC trade. These patterns contrast sharply with those for ECOWAS and COMESA, where leading economies Nigeria and Egypt have practically no trade with other REC members.

In sum, with the possible exception of the EAC, there is little evidence that the moderate increases in intraregional trade were driven by reduced barriers to intrabloc trade. The overall small increases in intra-Africa trade could also reflect that policies to reduce barriers to cross-border trade are largely ineffective if weak rule of law or inappropriate regulatory policy creates insecurity in international transactions.[13]

Regionalizing trade in new manufactured products

Has integration led to new products being shipped to geographically closer locations? A

pillar of Africa's development strategy is to accelerate industrialization by promoting regional value chains, since countries are often said to get richer by producing the goods that rich countries consume. Is there evidence that trade in new products is developing along regional supply chains? Figure 3.3 compares the average distance of partners for manufactures for two decades, 1995–2005 and 2005–10, to detect whether new manufactures are shifting toward REC members. It shows a robust shift in exports of new products toward REC partners over 2005–15 relative to 1995–2005. All new manufactures are shipped to closer destinations in 2005–15 than were manufactures in 1995–2005 (all points are below the 45 degree line). For example, the average distance of trade for manufactured products fell from approximately 6,500 kilometers (km) for traditional products to 3,800 km for new products for ASEAN and from 4,500 km to 3,900 km for EAC. This shift toward geographically closer partners might reflect growing trust, greater knowledge of demand, or characteristics of the products, each of which could translate into lower trade costs.[14]

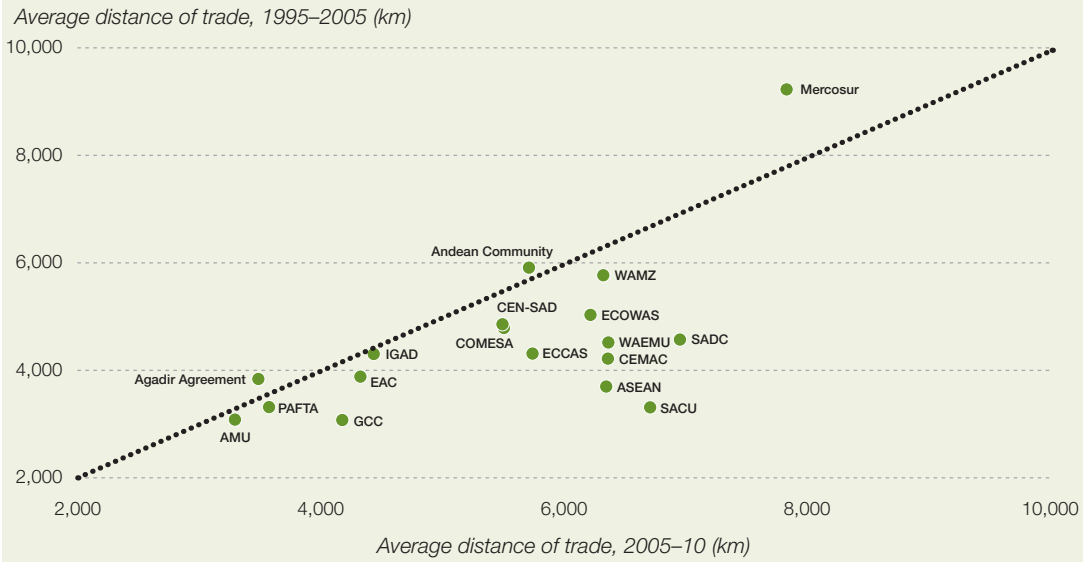
This pattern holds across a larger sample of countries where newly exported manufactures (over three or more years) are both high-cost relative to traditional goods and are sold only on markets with low trade costs (close, contiguous, or part of a regional trade agreement). And when the newly exported goods reach the age of 10, they are still exported mostly toward geographically and culturally closer destinations, unlike traditional goods.[15]

This shift toward geographically closer partners might reflect growing trust, greater knowledge of demand, or characteristics of the products, each of which could translate into lower trade costs

Trade costs are falling everywhere, but more slowly for African regional economic communities

Volumes and patterns of trade display two very strong regularities: the volume of bilateral trade is proportional to the countries' economic size and inversely proportional to the distance, a robust, if approximate, proxy for trade costs. These regularities have been observed repeatedly for goods trade and somewhat less for services trade, where

FIGURE 3.3 New manufactured products are going regional



Source: Data from the four-digit level of the Harmonized System Comtrade (mirror data).

Note: The dotted line is the 45° fitted line. New products are products exported for at least three consecutive years during 2005–15 and not exported for three consecutive years during 1995–2005. Products do not include agricultural products, extractive resources, and Harmonized System categories not elsewhere specified, for a total of 993 potential products.

data are spottier. These regularities are captured in the gravity model of trade, from which one can construct time series of bilateral trade costs from observed trade flows. These calibrated trade costs are the ad valorem equivalents of total bilateral trade costs that include all sources of trade costs (tariffs, ad valorem equivalents of nontariff measures, differences in language, hard and soft infrastructure, and so on).[16]

The model predicts that countries improve their standing—that is, trade more intensely—when external trade costs fall faster than internal trade costs and when their external trade costs fall faster than those of others. Calibrated costs are a convenient way to summarize the evolution of trade shares while also explicitly recognizing the primacy of trade costs that have occupied center stage in the African Union's continental integration agenda.

The three panels in figure 3.4 compare the evolution of trade costs relative to those of the 15 largest importers according to several classifications: by income group across Africa (panel a), relative to comparator income groups (from which African countries are excluded; panel b), and relative to the three comparator trade blocs (panel c). To see more clearly the evolution of trade costs across groupings and across panels during the 20-year period, trade costs in the base year (1995) are normalized to 100. On average, the 25 low-income African countries had bilateral trade costs that were 274 percent above those of the 15 largest importers in 1995 and 238 percent in 2015. These estimates are not that high considering that, on average, the trade costs of the other high-income countries were 115 percent above those of the top importers in 2015. Still, bilateral trade costs are roughly two to three times those of the largest importers.

- Panel a shows some catchup for all African country groups. Catchup was greatest for upper-middle-income countries, which started from a lower trade cost disadvantage, while low-income countries started from the highest.
- Panel b shows that all comparator countries except the lower-middle-income ones started from a higher cost disadvantage and caught up, a pattern that is also evident from the evolution of trade shares in world trade during this period.
- Panel c compares the evolution of average bilateral trade costs of three African RECs with those of the Andean Community, ASEAN, and Mercosur, whose trade costs are lower than those of the African countries in panel a.

Summing up, the comparisons in figure 3.4 confirm some catchup over the past 20 years, mostly for upper-middle-income countries, and a lag of African least developed countries and landlocked countries relative to comparators.[17]

Deep integration beyond the multilateral trade agenda: Factor markets and other provisions

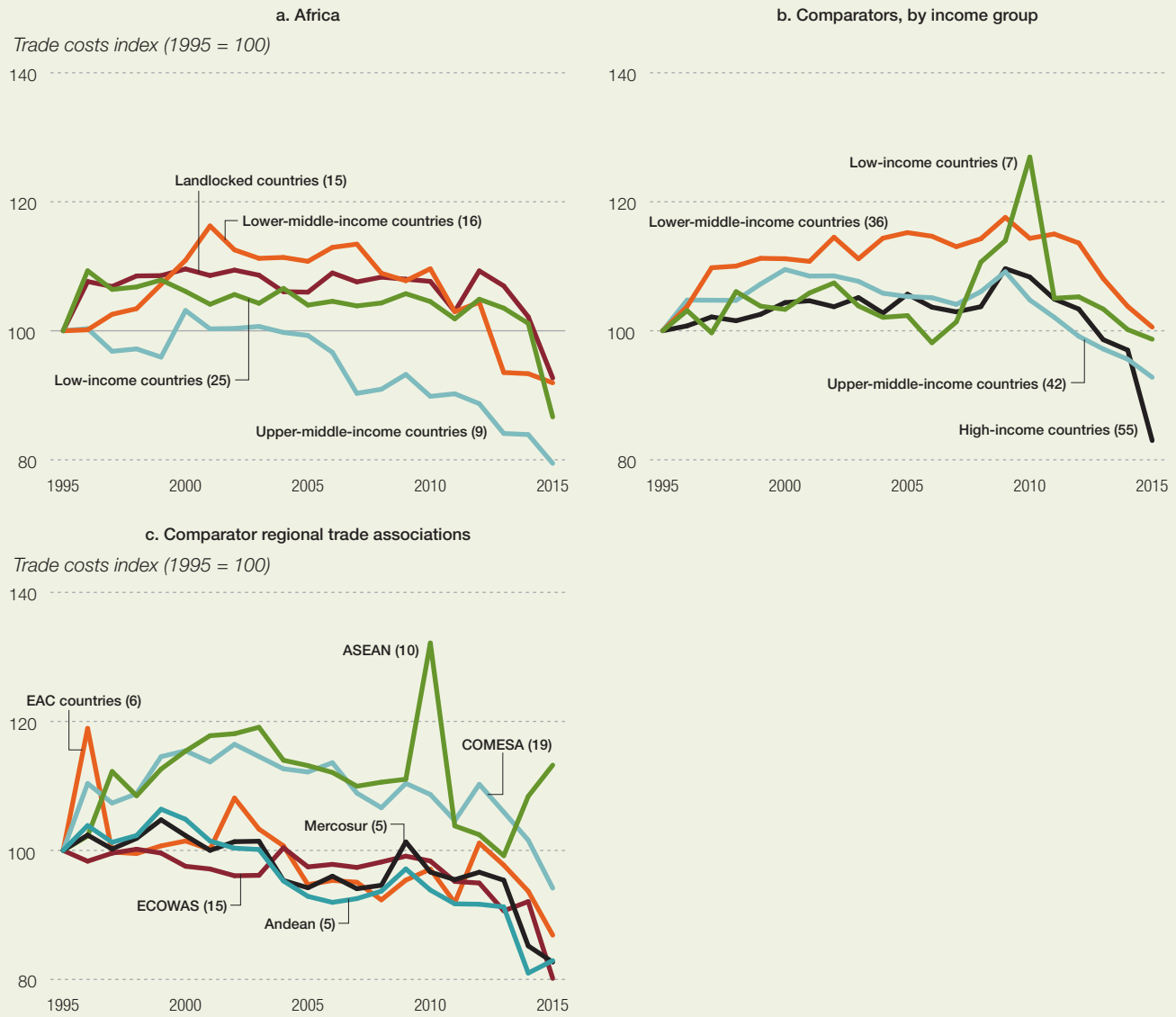
Before 2000, 90 percent of the 81 preferential trade agreements notified to the WTO dealt exclusively with trade in goods. A drastic change occurred over 2000–15, when 64 percent of the 194 preferential trade agreements notified to the WTO included provisions on trade in services.[18] This extension of coverage to services, observed in free trade agreements around the world, reflects the increasing importance of services as complementary inputs to production but also the slow progress in multilateral negotiations toward liberalizing trade in services and in dealing with regulatory measures.

This section compares the depth of integration in seven African regional trade agreements with data and in other South–South preferential trade agreements. The comparisons are for measures covered in WTO negotiations (but labeled WTO+ to signify that they go deeper than measures taken at the multilateral level) and measures not covered in the multilateral negotiations (called WTO-X measures). For both categories, covered provisions are categorized by their legal enforceability. This distinction is based on the wording in the provision. For example, "parties shall cooperate" is deemed not legally enforceable, while "neither party may expropriate or nationalize a covered investment" is deemed legally enforceable.

Not surprisingly, legal enforceability is much higher for the WTO+ provisions, which are covered under the WTO, than for the WTO-X provisions, which are not covered under the WTO (figure 3.5). For all the WTO+ provisions combined, the aggregate coverage ratio (across all

There has been some catchup over the past 20 years, mostly for upper-middle-income countries, and a lag of African least developed countries and landlocked countries

FIGURE 3.4 Africa's calibrated trade costs are falling, in line with global trends, 1995–2015



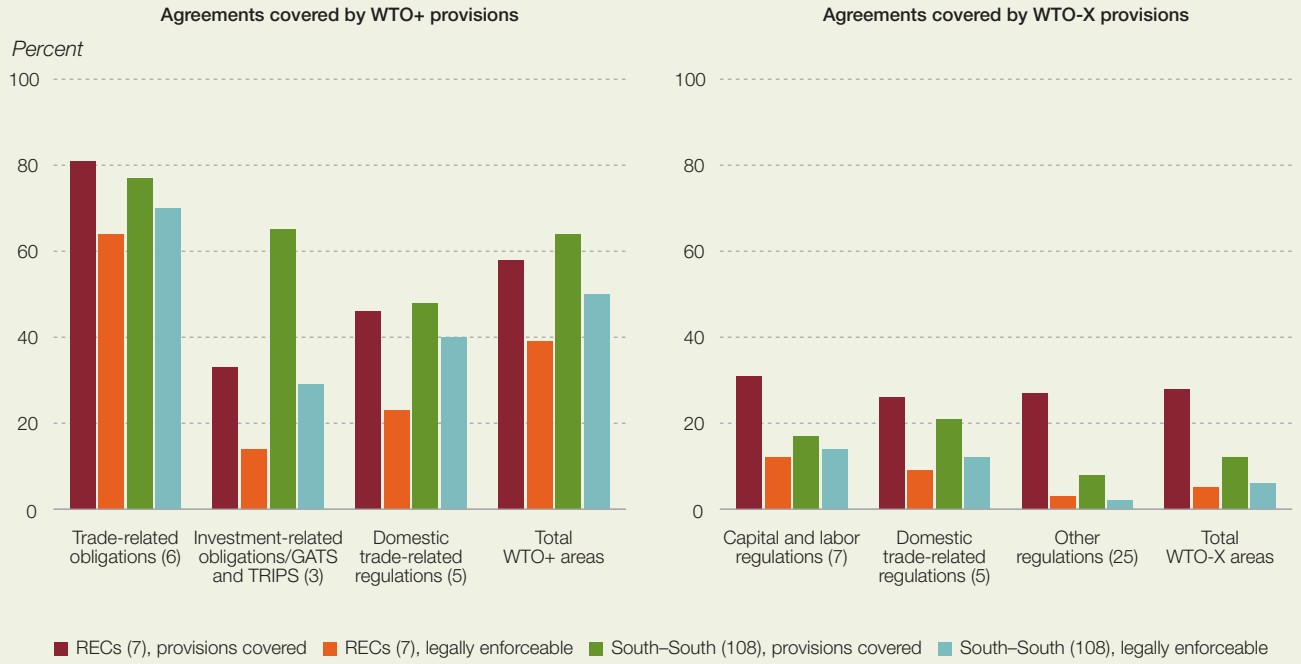
Source: United Nations Economic and Social Commission for Asia and the Pacific and World Bank trade costs dataset.

Note: Figure shows average trade costs for all goods (aggregated), calibrated relative to the bilateral trade with the 15 largest world importers: United States, China, Germany, Japan, United Kingdom, France, Hong Kong, Netherlands, the Republic of Korea, Italy, India, Canada, Mexico, Belgium, and Spain. Numbers in parentheses are the number of countries in each group.

categories) is only slightly lower in African RECs (58 percent) than in other South–South regional trade agreements (64 percent). But the legal enforceability is significantly lower. For the WTO-X provisions, legal enforceability in African RECs (5 percent) is slightly lower than in other South–South regional trade agreements (6 percent). But for both the WTO+ and the WTO-X provisions, on average in each category, legal enforceability is almost always lower in African regional trade agreements than in other South–South regional trade agreements.[19]

The high coverage ratio of WTO-X provisions in African regional trade agreements could

FIGURE 3.5 Coverage of provisions covered by the World Trade Organization and provisions not covered by the World Trade Organization in seven African regional trade agreements and South–South regional trade agreements, by legal enforceability



GATS is General Agreement on Trade in Services; TRIPS is Trade-Related Aspects of International Property Rights.

Source: de Melo, Nouar, and Solleder (2019) with data from Hoffman, Osnago, and Ruta (2017).

Note: African regional trade agreements included are CEMAC, COMESA, EAC, ECOWAS, SACU, SADC, and WAEMU. Percentages are by category of provisions covered distinguishing those that are legally enforceable. For example, for agreements covered by WTO-X provisions, for the 7 African RECs, of the 49 (7 × 7) provisions for capital and labor requirements, 31 percent (15) are covered, with 12 percent (6) deemed legally enforceable.

reflect three factors. First, high coverage could be inspired by coverage in EU agreements, where regional integration arrangements are the main diplomatic arm of the European Union.[20] Second, high coverage could be a way to build trust by including the preferences of all participants. Third, and related, high coverage could be a sign of compromise among countries with large differences in preferences. This is akin to "universalism" in the politics of rent-sharing in regional trade agreements, where every government wants a share of the spoils when voting on protection so that all countries vote for measures that are not in their interest in exchange for getting the support of other members for measures they benefit from.[21]

Producer services—in finance, consulting, accounting, transportation, and information and communication technologies—are all complementary inputs in production and thus necessary to expand the production of intermediate and final goods. Many are specialized inputs, for investment-related obligations, domestic trade-related regulations, and capital and labor regulations. On average, African regional trade agreements have lower enforceability than other South–South agreements—particularly for investment-related obligations, which have both lower coverage and lower enforceability.

Access to a wide range of inputs from domestic and foreign suppliers is needed for participation in supply chain trade. Panel regressions on bilateral trade in parts and components carried out for 155 South–South regional trade agreements over 1980–2014 show that three measures of depth of

integration enter positively and statistically significantly in the intensity of bilateral trade.[22]

The importance of trade in parts and in services that are complementary inputs into goods trade raises the issue of barriers to trade in services. Few such barriers discriminate between services provided by domestic firms and services provided by foreign firms. Average estimated values of ad valorem tariff equivalents of the barriers to trade at the AU level and for comparator groups (estimates at the REC level) are in table 3.2.[23] These estimates are constructed from a careful reading of regulatory texts for 103 countries. They show great dispersion in estimates across RECs.

The business climate has been improving across Africa and in individual countries

The ad valorem tariff equivalents are always higher for all categories of services in Africa (using an average across African RECs as an indicator for Africa) than in Organisation for Economic Co-operation and Development (OECD) countries. Estimates are orders of magnitude higher for the hard infrastructure component of trade costs: rail, road, and maritime transport. For the soft infrastructure component, the ad valorem equivalents for banking and insurance are also higher in Africa (see table 3.2). Significantly, the average ad valorem tariff equivalent is also higher in Africa than in comparators.

The barriers to trade in services suggested by these high ad valorem tariff equivalents are increasingly recognized as important determinants of manufacturing productivity. Firm-level estimates show that policies that restrict foreign access to upstream service markets reduce the productivity of downstream firms using these services.[24] Similar results are reported at the sector level across a large sample of developing countries at different stages of development.[25] Notably, policies that reduce barriers to cross-border trade are largely ineffective when indicators of the quality of institutions (weak rule of law, bad regulatory quality) have low values.

In conclusion, the business climate has been improving across Africa and in individual countries. A record 80 business climate reforms in 37 of 48 Sub-Saharan countries in 2017 represents a 14 percent increase over 2016.[26] Even so, the ad valorem tariff equivalents suggest room for improvement (see table 3.2). Between 2018 and 2019, there were 107 reforms across 40 countries in Sub-Saharan Africa, which has registered the

TABLE 3.2 Service trade restrictions are generally much higher in Africa than elsewhere, 2015

Ad valorem tariff equivalents (percent)

Service	African Union[a]	Comparator group			
		ANDEAN	ASEAN	Mercosur	OECD+EU
Accounting	35	32	50	30	29
Legal services	47	27	68	32	31
Air transport	28	28	58	58	15
Rail transport	59	8	62	28	16
Road transport	32	8	60	22	18
Banking	15	18	21	12	2
Insurance	31	30	26	24	14
Fixed line	485	9	175	11	35
Mobile line	3	0	1	1	1
Retail	3	2	5	1	1
Maritime transport	28	25	50	39	9
Average (simple)	70	17	52	23	16

Source: Calculations from ad valorem tariff equivalent data in Jafari and Tarr (2015, table 3).
a. Simple average across RECs.

largest number of reforms among regions since 2012.[27]

Labor mobility

In 2017, 22 percent of immigrants in Africa came from outside the continent, showing that Africa is home to many migrants from the rest of the world (table 3.3). Migration from Africa to the rest of the world, particularly to Europe and Asia, also increased between 2005–10 and 2010–15.[28]

Migration patterns and trends

In 2017, West Africa had the highest intraregional migration—97 percent of intra-Africa migration remained in the region (86 percent of 88.8). That was followed by East Africa (73 percent, or 64.7 percent of 88.6) and Central Africa (58 percent, or 48.8 percent of 84.1). Regions with higher intra-Africa migration are also more open in their visa policies. Sharing a common currency is correlated with a more open visa policy in well-integrated regions, such as in WAEMU, but not necessarily in less-integrated regions, such as the Central African Economic and Monetary Community (CEMAC).

Remittance flows are another yardstick of migration's importance. Interregional trade and remittances are both important channels for growth spillovers. In 2015, total intraregional remittances in Sub-Saharan Africa accounted for a third of total remittances—$11.5 billion, or 0.6 percent of GDP. This is higher than in Asia, Europe, and the Americas, where they account for less than 0.3 percent GDP.[29]

Mismatches between regulation and implementation

Since most migration is within the continent, it helps to understand the rules and treaties on free movement of persons within the regional integration framework and the way they relate to migration. Free movement of persons is an important measure of integration, as captured in the Regional Integration Index.[30] Whether regional integration promotes intraregional mobility is conditional on harmonizing national laws[31] and effectively implementing the regulatory framework across countries. All RECs, except the Intergovernmental Authority on Development (IGAD), have free movement of persons protocols that aim to eliminate obstacles to people's free mobility.[32] But full implementation of these protocols encounters many obstacles.

Free movement of persons protocols, including regulations on labor mobility, differ across RECs and in countries belonging to the same REC. And not all countries in a REC have ratified the associated free movement of persons protocol. Even if all member countries have ratified it, they may not all have implemented it, resulting in a mismatch between the protocol and its application. Even for the relatively well-integrated ECOWAS, some

Not all countries in a REC have ratified the associated free movement of persons protocol. Even if all member countries have ratified it, they may not all have implemented it

TABLE 3.3 Nearly 80 percent of Africa's immigrants came from elsewhere in the region, 2017 *(percent)*

	Destination						
Origin	**Africa**	**Central Africa**	**East Africa**	**North Africa**	**Southern Africa**	**West Africa**	**Outside Africa**
Africa	77.7	13.1	30.3	5.2	3.3	25.8	22.3
Central Africa	84.1	48.8	11.1	10.6	1.4	12.2	15.9
East Africa	88.6	13.7	64.7	9.3	0.7	0.2	11.4
North Africa	42.7	4.6	29.9	6.5	0.1	1.7	57.3
Southern Africa	55.8	4.6	33.2	0.4	16.4	1.2	44.2
West Africa	88.8	2.3	0.1	0.4	0.0	86.0	11.2
Outside Africa	46.9	2.4	8.5	26.9	2.1	7.0	

Source: Data from the United Nations Department of Economic and Social Affairs.

efforts are still required to achieve full realization of the right of residence and establishment and of functioning labor market policies.

Several factors contribute to this gap. One is a lack of harmonization of rules and regulations across countries. A second is the lack of reliable data on subregional migration flows.[33] A third is differences in the levels of development of members, which make some countries more attractive than others to migrants. A fourth is the lack of information and acceptance of those policies by African citizens, who may not have the relevant information to enter another country, such as the required travel documents. Institutional, infrastructure, and safety constraints make the journey between countries difficult.[34] Migrants can also face discrimination in the labor market,[35] which may be a disincentive to intraregional mobility. Finally, because of fears that these flows may disrupt local labor markets,[36] policymakers may be reluctant to open their borders. To be really successful, free mobility policies should take into account noneconomic implications, including fears related to a loss of national sovereignty or identity.

When all member countries ratify and implement a free movement of persons protocol, it is correlated with higher migration

Regional labor mobility

Does bilateral migration change after ratification or implementation of a free movement of persons protocol?[37] Yes, but the patterns differ.

- In ECOWAS, migration increased after the REC adopted the protocol since all countries ratified and implemented the first phase.
- In EAC, migration is higher in countries that have implemented the protocol but not in countries that have not. In SADC, the same is true for countries that have ratified the protocol and those that have not.
- In COMESA, adoption of the protocol is correlated with higher migration for countries that have implemented it but not for countries that have not ratified it, at least in the first years after the protocol's adoption.
- In ECCAS, countries that have implemented the protocol have had more migration, but there seems to be a positive dynamic regardless of implementation, with no significant difference in migration between the two groups after 2005.
- In the Arab Maghreb Union (AMU), migration was already increasing in member countries before they formed the REC and then rose at a higher rate for countries that ratified the protocol. However, there was no significance difference between countries that implemented the protocol and those that did not: despite the implementation, two of three countries still require a visa.

To summarize, when all member countries ratify and implement a free movement of persons protocol, it is correlated with higher migration (as in ECOWAS). Ratifying the protocol without effectively implementing it is not correlated with an increase in migration (as in SADC, EAC, and to less extent ECCAS). Moreover, when all countries have ratified the protocol, migration is higher in countries that have implemented the protocol than in countries that have only ratified it (as in EAC). Once a group of countries ratifies or implements the protocol within a REC, there are some positive spillover effects of the protocol's adoption in countries that have not ratified or implemented it (as in EAC, SADC, and to less extent COMESA).

Intraregional migration in Africa is more prevalent than migration from Africa. There is considerable heterogeneity among RECs in their regulations on free movement of persons and in their relationships with migration. Although this heterogeneity can make comparisons among RECs tricky, some general patterns appear. First, ratifying the protocol matters. Indeed, adopting a free movement of persons protocol without having countries ratify it would have little or no effect on migration. Second, implementation beyond ratification matters. Third, in RECs that are relatively well integrated, there can be some positive dynamism and spillover effects on migration in countries that have not ratified or implemented, led by the countries that have ratified and implemented.

Recommendations for labor mobility

Migration is happening in Africa even if not all free movement of persons protocols are ratified and implemented. Fully implementing all of them might increase flows among African countries. That makes it important to focus on what prevents

countries from implementing the protocols. The Africa Union Passport, launched in July 2016 at the African Union Summit in Kigali, encourages the free movement of people in general and labor mobility in particular. And the first objective of the African CFTA is to "create a single continental market for goods and services, with free movement of business persons and investments, and thus pave the way for accelerating the establishment of the Continental Customs Union and the African customs union."[38] For these initiatives to be successful and effective, it is useful to proceed by first improving the effectiveness of the policies within each REC before scaling up efforts to the continent. And because integration should happen not only in the goods market but also in factors of production, the discussions should attend more to the free movement of persons.

Financial integration

Africa generates more than $520 billion a year in domestic taxes. Its public pension fund assets are growing impressively. It earns more than $168 billion a year from minerals and fuels. And its central banks hold more than $400 billion in international reserves.[39] African countries now have a wide variety of financing options beyond foreign aid ($50 billion), including $60 billion in remittances and $60 billion in foreign direct investment inflows.[40] There is also high liquidity in the banking sector, and about 10 African countries have sovereign wealth funds.

In this context of a deepening financial sector, financial integration across countries becomes more important. It has progressed de jure through better codification of regulations on international transactions and de facto through the actual flows of funds and co-movements of prices. Yet, other nonregulatory barriers to integration persist. A proposal pursued at the continent level would establish three pan-African financial institutions: the African Investment Bank, the African Central Bank, and the African Monetary Fund, all in line with the Consultative Act of the African Union.[41] If implemented, this initiative would accelerate financial integration in the region while guaranteeing appropriate safeguards.

The African Development Bank is supporting five stages in the regional financial integration strategy (contained in the African Development Bank Group Regional Integration Policy and Strategy). The first, preparatory, stage calls for improving national payment systems, strengthening supervision and regulatory frameworks, and complying with core Basel principles. The second stage involves harmonizing policies for inward foreign direct investment flows, removing barriers to entry of regional and foreign banks, and harmonizing regional physical (hard) infrastructure. The third, cooperative, stage involves gradually liberalizing exchange controls with the rest of the world and implementing regionally agreed convergence criteria. The fourth stage involves merging stock markets, and the fifth involves adopting a regional common currency.

The African Development Bank is supporting regional financial integration by enhancing banking and financial standards and focusing on the African Peer Review Mechanism. It is building capacities for regional payment systems with COMESA, EAC, ECCAS, and ECOWAS. It is implementing the Africa Financial Markets Initiative, with Making Finance Work for Africa and the Association of African Central Banks. And it is building capacity for cross-border and regional regulation of financial institutions with other development partners.

For countries, the desire to integrate with regional markets is driven by the advantages that would accrue from enhanced competition in the domestic market for financial services, from greater opportunities for portfolio diversification and risk-sharing, and even from such external factors as the peer pressure associated with the Washington Consensus prescriptions for free mobility of capital as good macroprudential and financial policy (box 3.3).

Along some dimensions, there is increasing progress toward financial integration, but it is checkered by regional and country differences. Financial market activities remain shallow, since financial markets are still characterized by low capitalization, low liquidity, short-term instrument structures, and a limited number of financial instruments. In 2017, 11 African countries still had no capital markets, and only 15 countries had capital markets that simultaneously traded in treasury bills, sovereign bonds, corporate bonds, and equity instruments (table 3.4).

Financial integration has progressed de jure through better codification of regulations on international transactions and de facto through the actual flows of funds and co-movements of prices

BOX 3.3 Does financial integration drive economic activity in Africa?

Despite the postulated benefits of financial integration to participating economies, it is unclear to what extent the progress in regional financial integration in Africa has catalyzed aggregate economic activity and thus provided the rationale for accelerating financial integration.

Recent research by the African Development Bank shows that improvements in financial integration are associated with higher levels of economic activity. This relationship remains valid even when financial development, human development, institutional quality, and the macroeconomic environment are controlled for. The research assesses the degree and timing of financial integration in Africa and tries to shed light on contemporary patterns of increasing financial globalization relative to regionalization. Using parametric and nonparametric regression analyses, it finds that higher financial integration is generally associated with higher growth and investment, but not necessarily growth of total factor productivity. The relationships become even clearer when the focus is on the so-called nonparametric iso-growth surface plots, which show a threshold of financial development that is consistent with growth in a financially segmented economy.

One of the key policy implications is that tighter interest rate spreads in credit markets enhance growth. So, by strengthening competition in regional banking, in addition to coordinating monetary policy frameworks at a continental level, tighter spreads could stimulate further growth through financial integration.

But these conclusions from just one study should be complemented by alternative views expressing skepticism about the positive growth effects of financial integration carried out under monetary unions that give priority to political goals and lead to overvalued exchange rates and loss of competitiveness, as has been the case in the Franc Zone.

As an extension of regional integration, monetary unions in Africa are seen as a way to achieve prosperity and better governance, sparked to some extent by the example of European monetary integration. But African monetary unions have underperformed, failing to bring about economic prosperity and poverty reduction.[1] In many cases, even the weaker requirements of free trade areas and customs unions have not been met. Yet African political leaders have consistently chosen to forge ahead without first taking the bold institutional and economic coordination measures that would enable monetary unions to strengthen integration in Africa. In the absence of true fiscal and economic coordination, the opportunity cost of maintaining a single currency is too high.

While some studies have found that existing monetary unions in Africa seem to be economically viable, relatively low regional trade and strong shocks and fiscal asymmetries have limited the scope for new or expanded monetary unions to enhance welfare.[2] For example, the wide disparities in per capita income and economic structure across Southern African Development Community members have stalled monetary integration. Lessons from the European Union suggest that the institutional requirements for success are more stringent than previously thought, and there has been limited progress on the needed institutional steps.

A study that modeled the economic costs and benefits of monetary union in the West and Central African CFA franc zones and three monetary/exchange rate unions in Africa (the Central African Economic and Monetary Community, Common Monetary Area, and West African Economic and Monetary Union) gave a qualified yes in some cases but not in others to whether monetary unions are desirable on economic terms and therefore should be expanded.[3] While noting that members of these unions fared better on inflation than the rest of Sub-Saharan Africa and traded twice as much with each other as with other countries, their output performance did not show a clear pattern.

While the treaty creating the African Union envisions a single currency for Africa, and many regional economic communities have plans to create regional currencies, these plans are in most cases more aspirational than concrete guides to national policy.[4] Countries have failed to implement the institutional building needed to make a monetary union successful, such as close coordination of banking supervision, a willingness to come to the assistance of countries in economic crisis, and political federation to coordinate fiscal policies and control deficits (see discussion of the challenges of financial and monetary integration in chapter 1).

Source: Ekpo and Chuku 2017.

Notes

1. Monga 2015.
2. Masson, Pattillo, and Debrun 2014.
3. Masson, Pattillo, and Debrun 2014.
4. Masson, Pattillo, and Debrun 2014.

TABLE 3.4 Structure of capital markets in Africa, 2017

No markets	Treasury bills	Plus sovereign and corporate bonds	Plus equity instruments	All four instruments
Burundi	Congo	Angola	Benin	Algeria
Central African Rep.	Ethiopia	Gambia	Burkina Faso	Botswana
Chad	Guinea	Senegal	Cabo Verde	Egypt
Comoros	Guinea-Bissau	Seychelles	Cameroon	Ghana
Congo, Dem. Rep.	Lesotho		Côte d'Ivoire	Kenya
Eritrea	Madagascar		Gabon	Lesotho
Equatorial Guinea	Malawi		Mauritius	Libya
Liberia	Sierra Leone		Mozambique	Namibia
Mali	Togo		Rwanda	Nigeria
Niger			Zimbabwe	South Africa
São Tomé and Príncipe				eSwatini
				Tanzania
				Tunisia
				Uganda
				Zambia

Source: African Development Bank staff.

Financial integration should lead to the convergence of the costs of and returns to comparable assets

Regulations and institutional restrictions on financial movements

Overall, financial openness has been progressing slowly (figure 3.6). It spiked in the early 1990s with the increased financial liberalization that was part of the structural adjustment programs of the time. From a de jure perspective, integration is deepest in EAC, with a Chinn-Ito Index of financial openness higher than in other regions and approaching the global average of 0.5. With more stringent restrictions in the AMU, integration and openness are more segmented in countries in North Africa.

Are credit and stock market prices and returns converging?

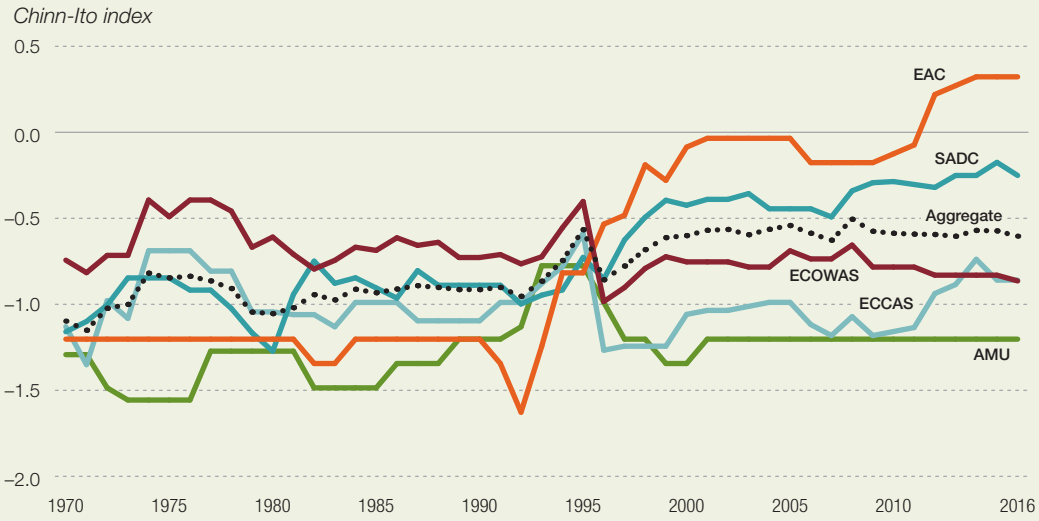
Asset prices in equity markets and interest rates in retail banking are other measures of the depth of financial integration. An increase in pan-African banks does not seem to have trickled down into greater financial integration—for two main reasons.[42] Retail lending products are less exposed to pressure from international competition, mainly because proximity to customers is important, and integration is lessened by asymmetric information and switching costs.

The cross-sectional dispersion of interest rates across countries is a simple indicator of financial integration in credit markets. Under the law of one price, financial integration should lead to the convergence of the costs of and returns to comparable assets. Thus, dispersions in asset costs and returns would imply financial market segmentation.

Two major episodes can be identified in the evolution of Africa-area credit market measures of banking integration (figure 3.7). The first is between 1995 and 1998, when the standard deviation of both deposit (not shown) and lending rates spiked across the region. The period coincided with the wave of financial liberalization and deregulation following structural adjustment policies. This period also coincided with the Asia financial crisis, which had ripple effects across the globe, including frontier economies in Africa, and led to tightening of financial regulations.

A second episode of increased financial segmentation occurred before and during the global

FIGURE 3.6 Financial openness is progressing slowly, except in the East African Community, 1970–2016



Source: African Development Bank staff.

Note: The Chinn-Ito index converts the de jure measures on the International Monetary Fund's *Annual Report on Exchange Arrangements and Exchange Restrictions* into a numerical measure of financial openness. It is calculated as a principal component of the indices indicating the presence of multiple exchange rates, restrictions on current account transactions, restrictions on capital account transactions, and requirements to surrender export proceeds. Positive values closer to one indicate more openness to cross-border financial transaction and thus financial integration; negative values indicate greater restrictions in cross-border financial transactions and thus greater financial segmentation.

Institutional restrictions to financial flows suggest that a lot more needs to be done from a governance perspective

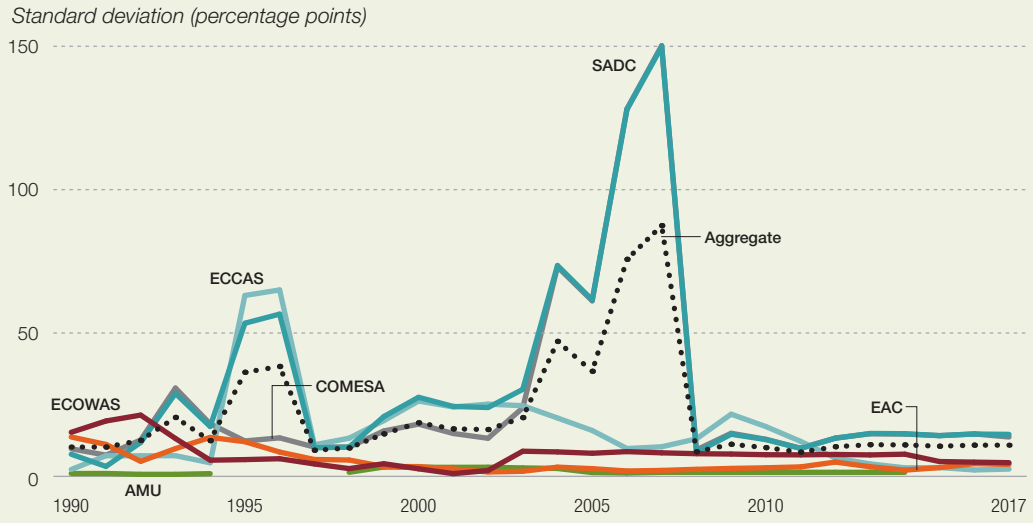
financial crises of 2007–08. Again, the cross-sectional deviation in the lending and deposit rates spiked across the region. It could be that the global financial crises affected African countries to different degrees and perhaps even in different directions, particularly in the case of lending rates, whose dispersion peaked in 2008. For both lending and deposit rates after the global financial crises, there has been convergence in the indicators of credit market integration and price-based measures of banking integration. By 2017, the standard deviation of lending rates across the region was only 4.4 percent, close to the zero mark, and seven times less than during the global financial crisis in 2008.

Evidence of financial globalization is stronger in African stock markets. While the stock markets in Ghana and Namibia are more sensitive to the South African stock market, the stock markets in Botswana, Kenya, Nigeria, eSwatini, and Tanzania are more sensitive to the global market. When a country's equity market and that of the dominant regional market (South Africa) are converging, the value of a time-varying parameter would approach zero. Conversely, when a country's market and a global dominant market (the US market) are converging, the value would approach one. Therefore, values closer to zero indicate regional financial sensitivity, while values closer to one indicate financial globalization.

Policy recommendations

Despite progress, financial markets in Africa are still weakly integrated. Measures of institutional restrictions to financial flows suggest that a lot more needs to be done from a governance perspective. The correlations between domestic savings and investment rates are still strong, even though they should have been weakening in the absence of barriers to capital movements. Interest

FIGURE 3.7 Dispersions in lending rates spiked in 1995–98 and 2003–06, revealing fragmented financial markets in Africa, 1990–2016



Source: African Development Bank staff.

Note: Values closer to zero indicate stronger integration in credit markets, and values further from zero indicate greater segmentation.

All RECs should monitor progress toward the free movement of goods, capital, and services

rate spreads on retail banking are still wide but have stabilized in the past few years. And African stock markets are more sensitive to global benchmarks than to the South African benchmark. Bold reforms, especially at the institutional level, are needed to synchronize financial governance frameworks across the region and to remove any remaining legal restrictions to cross-border financial flows and transactions. It is important to pursue stronger technological advances in the harmonization of payment systems across the continent, as this would facilitate actual movement of funds across borders.

- All RECs should monitor progress toward the free movement of goods, capital, and services more closely at a detailed level, along the lines of the EAC Common Market Scorecard. The progress-tracking scorecard is based on indices derived from an in-depth examination of all relevant laws and regulations. This is needed because of the slow progress at eliminating tariffs on intraregional trade and reducing nontariff barriers documented in the report.
- Monitoring should be carried out regularly at the REC level (for free movement of goods, capital, and services), as EAC does. Expert reviews need to be carried out systematically and regularly.
- For nontariff barriers on goods trade and barriers to the movement of capital and services, monitoring includes detecting the barriers and reviewing progress.
- Implementing the free movement of persons protocols has increased migration flows, important because there are spillovers from the movement of people between ratifiers and nonratifiers.
- Financial governance frameworks need to be synchronized within and across RECs, with prudential regulations developed and carefully implemented to prevent destabilizing capital flows.

COOPERATING FOR REGIONAL PUBLIC GOODS

Regional integration has always been about more than market access. Regional cooperation has always been important, if only because of the need for rail, roads, and other means of communication,

and it is now attracting more attention on several fronts. Increasing physical linkages across the African continent have spread environmental externalities beyond national jurisdictions. Beyond the eight RECs and seven other regional organizations aiming at deepening intraregional trade, the majority of regional organizations deal with regional public goods: 5 deal with energy, 15 with the management of rivers and lakes, 3 with peace and security, and 1 with the environment (table 3.5). The large number of organizations dealing with rivers and lakes attests to the importance of transborder issues across Africa.

The subsidiarity principle calls for addressing these issues at the regional level,[43] deciding which level of governance or what size of region is best suited to provide the regional public good.[44] From an economic perspective, the scope of the established regional institutions should match the region benefiting from the spillover, and the number of countries should be as small as possible to reduce transaction costs.

A regional public good is any good, service, system of rules, or policy regime that is public in nature (in the sense that it would be underprovided and often overused if governed by the market alone), that generates shared benefits for the participating countries, and whose provision is the result of collective action. Regional public goods are transnational public goods. Their distinctive feature is that, unlike national public goods, there is no single body with the authority of a state to ensure the supply of the good. Since collective action refers to a situation with more than two providers, all RECs have to muster some collective action to provide regional public goods.

TABLE 3.5 Beyond economic integration—to regional public goods

AU-recognized regional economic communities
Arab Maghreb Union
Common Market for Eastern and Southern Africa
Community of Sahel-Saharan States
East African Community
Economic Community of Central African States
Economic Community of West African States
Intergovernmental Authority on Development
Southern African Development Community
Other economic organizations
Central African Economic and Monetary Community
Economic Community of the Great Lakes Countries
Gulf of Guinea Commission
Indian Ocean Commission
Mano River Union
Southern African Customs Union
West African Economic and Monetary Union
Energy-based organizations
Maghreb Electricity Committee
Eastern Africa Power Pool
West African Power Pool
Central Africa Power Pool
Southern African Power Pool

River and lake organizations
Niger Basin Authority
Integrated Development Authority of the Liptako-Gourma Region
Lake Chad Basin Commission
International Congo-Ubangui-Sangha Commission
Limpopo Water Course Commission
Lake Tanganyika Authority
Lake Victoria Basin Commission
Nile Basin Initiative
Permanent Okavango River Basin Water Commission
Organization for the Management of the Gambia River
Organization for the Development of the Senegal River
Orange-Senqu River Commission
Tripartite Permanent Technical Commission
Volta Basin Authority
Zambezi Watercourse Commission
Peace and security organizations
Eastern Africa Standby Force
International Conference of the Great Lakes Region
G5 Sahel
Environmental organizations
Central African Forest Commission

Source: African Development Bank staff.

Collective action by governments in the region should then create positive spillovers across the region that are greater than the spillovers that individual governments acting alone could generate. This requires regional governance by a regional body with real authority over member states to deliver regional public goods. States must be willing to cede a significant amount of authority to the body, something that has so far occurred only in the European Union.[45] That is why most regional cooperation is intergovernmental. Each state retains veto power, and the regional organization is a secretariat to coordinate and harmonize policies, set standards, and provide services—but with no authority.

Cooperation on cross-border infrastructure investment, development corridors, and spatial development initiatives are part of the regionalism pursued by the African Economic Community. The Action Plan for Boosting Intra-African Trade, and now the CFTA, call for countries to delegate national sovereignty for closer cooperation. So far, however, most evaluations of regional integration across Africa have concentrated on outcomes in trade in goods—at the expense of cooperation to raise the provision of regional public goods.[46]

Yet, the geography of Africa is the strongest rationale for regional integration. The share of straight-line (artificial) borders is about 80 percent across Africa, the highest across continents. Ethnic partitioning across borders is also strongest in Africa. The mean of the share of an average African country's population that comes from partitioned ethnicities is 47 percent, while for non-African countries it is 18.2 percent.[47] Africa also has the highest share of countries per area across continents, mechanically increasing the importance of transboundary issues.

The benefits of common policies are thus high because of widespread cross-border policy spillovers (air transport, corridors) and physical spillovers (environmental). The costs are also high because differences in policy preferences across member countries are large. Common decision-making internalizes the spillovers, but it moves the common policy away from preferred national policy (in a loss of national sovereignty). In Africa, spillovers are important because transport and communications infrastructure are underprovided, while the ethno-linguistic diversity across borders suggests strong differences in policy preferences. Evidence of cooperation in three areas is illustrated here: energy and mining, hard infrastructure, and soft infrastructure.

Infrastructure regulation for energy and mining

Most infrastructure industries across Africa have performed poorly. Regionalizing infrastructure reform would help in several ways. First, inefficiencies in infrastructure become more important as barriers to trade fall, if only because goods transit through infrastructure networks. Second, as trade liberalization has resulted in regionalized communication infrastructure, the associated networks will operate more efficiently if organized internationally. Third, the likelihood that national regulation will serve as protection against international competition will be reduced if regulation is regional.[48] Coordinating policies and harmonizing regulations and, to the extent possible, legal institutions are important on the path toward deep regional integration. Developing regional power grids and taxing mining activities show how difficult this can be.

With regionalized communication infrastructure, the associated networks will operate more efficiently if organized internationally

Developing regional electricity markets has been a challenge worldwide. As in developed countries, electricity markets in developing countries have developed vertically within national boundaries rather than horizontally across countries. Physical interconnection through the construction of cross-border lines has been slow to develop. Cross-border trade in electricity is low everywhere.[49] In Africa, with many small countries, trade in electricity would bring many benefits if the hard infrastructure is at scale and functioning —and if soft infrastructure (governance) is trustworthy (boxes 3.4 and 3.5).

Many African countries are pursuing minerals-based industrialization. This requires responsible use of natural resources. African heads of state have adopted the Africa Mining Vision to lessen the continent's exposure to harmful boom-bust cycles. The African Minerals Development Centre was set up to carry out this vision. One of its objectives is to incentivize collective action that would help build a regional approach to

BOX 3.4 From desert to powerhouse

Almost two-thirds of the Sahel's people—in Burkina Faso, Chad, Djibouti, Eritrea, Ethiopia, Mali, Mauritania, Niger, Nigeria, Senegal, and Sudan—live without electricity, with severe consequences for health, education, and business. Because the lack of energy remains a big impediment to Africa's economic and social development, the African Development Bank has embarked on the Desert to Power Initiative, a huge desert solar program to make Africa a renewable powerhouse.

Stretching across the Sahel region, the program is expected to connect 250 million people with green electricity by tapping into the region's abundant solar resource. It will develop and provide 10 gigawatts of solar energy by 2025 through a combination of public, private, on-grid, and off-grid projects. To fund them, the Bank is cooperating with fellow development funding institutions, climate change funds, and other donors and investors. The blended finance will help fill in capital shortfalls in the renewable energy project cycle.

Increasing the affordability of electricity for low-income households will enable people to transition away from unsafe and hazardous energy sources, such as kerosene. The project will also create jobs and attract private involvement in renewable energy. And it has the potential to increase female participation in economic activities and decisionmaking processes.

Estimated to save 2–4 percent of the continent's GDP every year, the project has been launched with the Green Climate Fund, a global pot of money created by the 194 countries party to the UN Framework Convention on Climate Change.

Source: https://www.afdb.org/en/news-and-events/desert-to-power-initiative-for-africa-18887/.

Increasing the affordability of electricity for low-income households will enable people to transition away from unsafe and hazardous energy sources

BOX 3.5 Integrating power grids as a regional public good

Poorly functioning electricity markets with frequent power outages hamper the productivity of African firms. Outage durations are roughly the same for 25 Sub-Saharan low-income countries as for five low-income countries elsewhere. Average estimated losses in annual sales for Africa are about half those for the other low-income countries based on data from the World Bank Enterprise Survey database. This large difference is likely due in part to African firms producing less energy-intensive goods. Better functioning national grids and regional trade in electricity would help. Power pools are a good example of the conditions for providing public goods.

Power pools require incentives and collective action since no single body with the authority of a state exists to ensure the supply of the good. Effective delegation of authority through public, private, or a combination of parties is necessary to develop regional projects like electricity power pools. The regional economic communities promote regional electricity trade through their respective power pools: for the Economic Community of West African States, the West Africa Power Pool; for the Economic Community of Central African States, the Central Africa Power Pool; for the Southern African Development Community, the Southern Africa Power Pool; for the Arab Maghreb Union, the Comité Maghrébin de l'Electricité; and for the Common Market for Eastern and Southern Africa, the Eastern Africa Power Pool. The mandates of each of these African regional power pools vary from planning, development, and coordination of cross-border power generation and interconnections to regional market coordination and capacity building. At the planning stage, engaging in a power pool is subject to the hold-up problem, a major reason for the low trade in electricity.[1]

(continued)

BOX 3.5 Integrating power grids as a regional public good *(continued)*

But many potential benefits from integrating these power grids are significant. The gains include less instability and greater security of supply and increased efficiency. And integration of power grids when electricity is produced by renewables increases environmental sustainability by accelerating the transition to a green economy. For instance, ESKOM, the South African power utility, has secured through a treaty 2,500 megawatts of clean hydropower from the Inga-3 development in the Democratic Republic of Congo.

The ultimate development stage of all the Africa regional power pools is to reach full market operation, where electricity can be traded through the power pool on the network. Since the fixed costs of investments are usually not recouped, electricity would then be considered a regional public good. Two characteristics of public goods apply to the infrastructure necessary for an energy market network. First, a transboundary infrastructure is a club good since nonparticipants can be excluded. Infrastructure also has characteristics of a weighted-sum aggregator as different parties reach different scales, raising the prospects for supply. But maintaining network integrity is a weakest link aggregator, and hence is more challenging than getting support to construct the network. (This challenge also applies to transport corridors.)

The Nord Pool (Denmark, Estonia, Finland, Latvia, Lithuania, Norway, and Sweden) experience suggests success factors for the Africa regional power pools. To build trust, start with a small number of countries as in the Nord Pool, and as suggested by Andrews-Speed for energy-market integration in East Asia. Rely on external finance to increase capacity. Then combine generation with transmission and have sufficient transmission capacity to promote competition (including the monitoring of competitive behavior of market players). This requires physical interconnection complemented by burden sharing and efficient congestion management (by a single system operator if politically possible). Then accept temporarily high prices following a supply shock even though these may be perceived as "unfair." Success will also depend on effective husbanding of energy resources, good data on the market and reserves, and sustained network integrity and security. And some regulatory oversight, perhaps by a cross-border regulatory agency, is necessary.

Note

1. The "hold up" problem refers to a situation where two parties would gain from cooperation but refrain from doing so because of concerns that they may give the other party increased bargaining power and thereby reduce their own profits.

Source: African Development Bank 2013; Andrews-Speed 2011; Oseni and Politt 2016.

Power pools require incentives and collective action since no single body with the authority of a state exists to ensure the supply of the good

illicit financial flows in extractive industries, estimated at $25 billion a year.[50] The success of this endeavor rests on coordination. But it has proven difficult. Box 3.6 summarizes the fiscal regimes across 21 African gold exporters and compares the sharing of rents implied by the different regimes. Across WAEMU, despite a community directive applying to all countries, tax rates on gold exports varied between 2 percent and 16 percent in 2016. National reforms reduced this spread somewhat, but the possibility of a race to the bottom persists.

Hard infrastructure

Roads, ports, railways, and corridors have always been important for African integration. During 2012–15, transport accounted for 22 percent of disbursements across Africa.[51] For the longer run, China and the African Union Commission signed a far-reaching agreement within the framework of the African Union's Agenda 2063 to link all African capitals by road, train, and air transport.

The world's least urbanized region, Africa has an urbanization rate of one-third, compared with over one-half in the rest of the world. Africa's road

BOX 3.6 Cooperating to tax mining

Improving public revenue mobilization in the mining sector is a priority for both the African Union and the United Nations Economic Commission for Africa. Harmonizing tax regimes and ensuring transparency are the two main means to achieve that objective.[1] In the mining sector, governments need to reconcile two objectives: attract foreign direct investment for natural resources exploitation and capture an adequate share of mining income to fund development. These dual goals can lead to competition in the sharing of income between government and investors and could have an impact on countries' fiscal policies.

As early as 2000, Economic Community of West African States (ECOWAS) members stated their strong commitment to harmonizing tax regimes in the extractive sector, with a view to avoiding tax competition and its negative impact on public revenues. West African Economic and Monetary Union (WAEMU) member countries agreed on a common policy and common mining code for the mining sector in 2003, which set the tax and customs benefits that can be granted to mining companies in member states. The code also specifies provisions at the national level (lease term, rights and obligations, amount of fixed fees and duties on plot area) and at the community level (mining tax basis and rates, duration of exemptions, government participation, and terms of the stability clause).

Harmonizing tax regimes and ensuring transparency are the two main means to improve public revenue mobilization in the mining sector

But the code was never implemented. So tax regimes differ widely across members. In the 21 gold-producing African countries, tax regimes applicable to the mining sector and revenue agreements differ considerably.[2] While taxation instruments are fairly standardized, the tax rates, bases, and exemptions and their durations are specific to each country. In many cases, they do not comply with WAEMU directives. As a result, in 2016, gold mining royalties ranged from 2 percent to 12 percent. Corporate tax rates are set in the general tax code in some countries, while in other countries they are higher or lower than those in the tax code. The mean effective tax rate, which is a revenue sharing indicator, varies from 32 percent to 49 percent in WAEMU members.

The relatively high mean effective tax rate in WAEMU members is due to tax reforms conducted in the 2010s, following rising world prices for gold. For instance, new mining codes were adopted in Mali (2012), Côte d'Ivoire (2014), and Burkina Faso (2015). Senegal embarked on a comprehensive reform program in 2012 to improve the consistency and clarity of the tax system. The exercise led to the adoption of a new general tax code, a law amending special tax arrangements, and a new mining code in late 2016. Some countries took measures to increase mining royalties. Burkina Faso and Côte d'Ivoire opted for variable rates, following trends in gold prices, while Mali and Senegal added a second levy. In addition, benefits that excessively favored mining title holders, such as exemptions or discounts on corporate tax rates, were reduced.

Though undertaken at the national level and without coordination among countries, those reforms began a convergence of mean effective tax rates within WAEMU. The average mean effective tax rate rose from 39 percent to 44 percent, and the standard deviation dropped from 9.1 percent to 6.4 percent. But with falling world commodity prices and without a genuine common policy, tax competition may re-emerge. Tax competition would lead to reduced government revenues, benefiting no country. Harmonizing incentives to investments in the mining sector through WAEMU is therefore a prerequisite to maintaining revenue sharing favorable to governments, generating resources for development, and reducing risks of conflict. Such harmonization should occur within a framework encompassing all WAEMU countries, which implies negotiation of an ECOWAS-wide mining code.

Notes

1. UNECA, AMDC, and AU 2016; UNECA et al. 2018.
2. https://fiscalite-miniere.ferdi.fr.

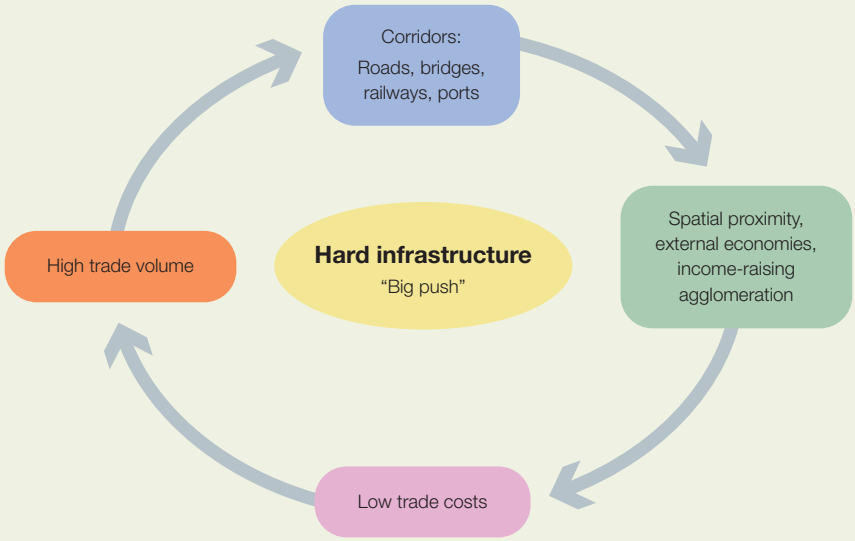
density of 3.4 km per 1,000 inhabitants is less than half the global average, and its paved road density of 0.7 km per 1,000 inhabitants is just one-fifth the global average.[52] This combination of low urbanization and poor connectivity means that a large chunk of Africa's population does not have access to national and global markets. Moreover, since doubling a city size has been estimated to raise productivity by 3–8 percent in Europe,[53] increasing market access for rural populations is a first-order priority for Africa to raise productivity.

By reducing trade costs, the investment in new hard infrastructure is intended to improve connections across cities, accelerate urbanization, and encourage regional integration. A virtuous cycle leads from investments in hard infrastructure to increased trade that in turn makes further investments profitable (figure 3.8). By contrast, poorly functioning logistics markets lead to a vicious circle of low trade volume and high trade costs (figure 3.9). This strategy has strong support. Recent geographic models, with space ordered and continuous, support the contention that transport infrastructure has agglomeration-creating effects that raise income through positive spillover and multiplier effects. The effects captured by these more realistic geographic models produce larger gains from trade than those predicted by the traditional space-less trade models used to measure the trade creation and trade diversion effects of preferential trade agreements.[54]

Early studies based on model predictions suggest high returns from the "big push" infrastructure strategy now being pursued under the African Union's Agenda 2063.[55] The African Development Bank and other funding agencies and governments expect transformative results from this high level of funding for hard infrastructure, including accelerating growth and regional integration. New data support these hopes.[56] Outside of South Africa, little rehabilitation of railways has taken place, leading some to conclude that railways are the "colonial" transportation technology while roads are the post-colonial transport technology. Only a quarter of roads are paved in Africa compared with 60 percent in India and two-thirds in China. In 2015, Sub-Saharan Africa had only 3,700 km of highways compared with 24,000 km in India and 111,000 km in China.[57] These statistics support the conclusion that along most dimensions of infrastructure, Sub-Saharan Africa lags behind all developing regions.[58]

By reducing trade costs, the investment in new hard infrastructure is intended to improve connections across cities, accelerate urbanization, and encourage regional integration

FIGURE 3.8 Investments in hard infrastructure increase trade and make further investment profitable



Source: African Development Bank staff.

Data for 1960–2015 show strong conditional correlations between economic and political factors and five-year growth in infrastructure (mostly paved roads). More urbanized and faster urbanizing countries have built more roads.[59] Centralization and European settlement are consistently correlated positively with more paved road construction, while mineral dependence is associated with less paved road construction.

Increased market access from improved roads contributed an extra 5–10 percent to urbanization over 1960–2010.[60] Applying these estimates to the proposed Trans-African Highway project, which calls for increasing the network from 1,490 km (in 2010) to 42,000 km, suggests that by 2040 the induced increased market access from the highway would increase urbanization by 0.7–6.0 percent. A road rehabilitation program in Sierra Leone following the civil war had a substantial pro-competition effect, reducing the monopsony power of intermediaries.[61]

Trade costs due to poorly functioning logistics markets may be a greater barrier to trade than tariffs and nontariff barriers

The Quadrilateral Highway upgrading in India provides other evidence of the impact of improved transport infrastructure on firm outcomes. Georeferenced data for 311 districts during the period of highway upgrading shows that output increased by 49 percent over the decade for firms in the 0–10 km range from the highway, while there was no growth for firms in the 10–50 km range. This output growth alone should have easily covered the costs of the upgrades.[62]

Although the India case relates to upgrading rather than to new infrastructure, the results suggest what might be expected from the current "big push" across Africa. First, the sharp difference in results between the 0–10 km and 10–50 km distances from a highway suggests that current donor targets of investing in roads so that rural households are within 2 km of a road may lead to overinvestment in rural roads. Close to 60 percent of the population in Africa is already less than 5 km from a regional or national road.[63] Second, the low population density in Africa would probably mean that outcomes will be less favorable than in India. African farmers have lesser transport requirements and generally only over short distances. Intermediate means of transport are thus likely to be more appropriate. Improving pathways would have more economic impact than rehabilitating secondary roads alone.[64] In Malawi, bus service providers cannot break even because of the low population density.[65] So where population density is low, motorized services need to be subsidized.

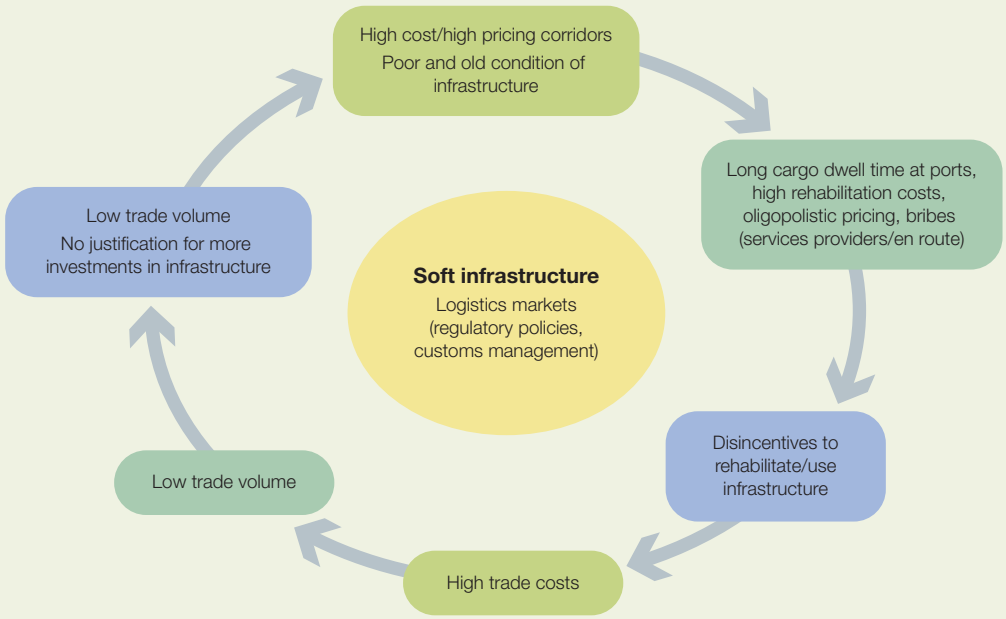
Soft infrastructure

Good logistics are necessary to operate the close-to-seamless transport corridors necessary for successful regional integration (see figure 3.9). Efficient services, including trucking services, freight-forwarding and handling, and smooth terminal operation, are all necessary. Logistics markets operate more efficiently when freight forwarding and handling services and terminal operations are opened up to competition regionally and goods are submitted and cleared through customs expeditiously.[66] Trade costs due to poorly functioning logistics markets may be a greater barrier to trade than tariffs and nontariff barriers.[67] Lack of well-functioning corridors impedes the development of regional value chains, where goods often cross borders several times during production.

Recent estimates on activity along borders over 1993–2012, using data from night time lights, suggest that barriers to trade from border impediments have fallen over the past 20 years (see box 3.7). These patterns suggest three conclusions. First, although borders are still "thick," they have become progressively thinner, easing concerns expressed in some studies on regional integration in Africa that concentration of activity has increased. Second, membership in a regional trade agreement does not seem to affect agglomeration. Third, trade facilitation projects—an integral component of current and planned integration efforts—can alleviate the fears of unbalanced development across the continent by leading to the development of peripheral areas.

Low costs for air transport are also important for the supply chains of time-sensitive products. Development of the African aviation sector would have positive impacts on employment, tourism, regional integration, trade, investment, and productivity. Recent initiatives to delegate authority for air transport to the continental level should help develop commercial aviation. These include the

FIGURE 3.9 Unfriendly soft infrastructure explains why transport costs are so high in Africa



Source: African Economic Outlook team.

BOX 3.7 What night lights reveal about trading across borders

Economic activity is very poorly recorded as remoteness, informality, and poor statistical capabilities combine to produce unreliable GDP and trade data, especially at the subnational level. Poor and sporadic data make it difficult to test whether closer integration concentrates or disperses economic activity.

To get around these data problems, illumination (or night lights) captured at a very detailed level from satellite images during 1995–2013 can be used to study light intensity along cross-border corridors, measured as distance to the border. Once corrected for overglow and other confounding influences, light radiance along cross-border corridors proxies the intensity of economic and trade activity across the continent. In a first step, a 2014 study confirmed that light intensity increased as one moved up to 200 km from the border. In comparing 2000 and 2013 satellite data, the study detected a lower agglomeration effect far from the border in 2013. This is prima facie evidence that borders are not as thick now as they used to be, indicating progress in integrating markets.

In a second step, the study split the sample between borders within regional trade agreement areas and borders between countries not in the same regional trade agreement. It found no discernible difference in patterns between the two samples. This suggests that "shallow integration," as captured by any reductions in tariffs and nontariff barriers, was not strong.

When the sample is split into two groups of "smooth" and "rough" cross-border corridors, according to their score on the World Bank's Logistic Performance Index, the iron-curtain effect is much steeper, starting at 120 km from the border for the sample with rough borders.

Source: Cadot, Himbert, and Jouanjean 2015.

January 2018 launch by the African Union of the Single African Air Transport Market initiative. The continent is home to 15 percent of the global population and makes up 20 percent of the world's landmass, but its aviation industry represents only 3 percent of the global market. This small share reflects market failures in logistics services in air transport, among other factors (see box 3.8).

African borders are thinning

Cooperation among countries has been increasing in Africa, and many indicators of efficiency in both soft and hard infrastructure show improvements. While countries still hesitate to delegate more authority to supranational institutions, the stakes are high. The growing evidence of the expected benefits should inspire countries to move ahead in developing along the regionalism path proposed in Agenda 2063.

One comprehensive measure of the status of integration is the Africa Regional Integration Index,[68] which is useful for broad comparisons of progress in regional integration across RECs. Another is the EAC Common Market Scorecard,

BOX 3.8 Open skies in Africa

Air transport volumes are much lower in Africa than in other regions (box map 1). As measured by seat capacity, air traffic in Sub-Saharan Africa (104 million seats) is less dense than in Brazil (120 million seats). Traffic density distribution in Africa is also striking: the main air transport corridors are in the East African region, stretching from South Africa to Kenya and north to Ethiopia (three key air transport hubs).

BOX MAP 1 Global aircraft positions, 11 November 2018 (14:54 GMT)

Source: Flightradar24 2018.

Across market segments (intercontinental, international, domestic) in 2015, African air travel routes range from highly concentrated (30 percent) to monopolies (70 percent). Africa has a mix of established private carriers (mainly Ethiopian, Kenyan, and South African) and small state-owned airlines that are mostly unsustainable and create market distortions by flying protected routes. In the early 1960s, many newly independent African states founded their own national airlines. Market protection measures have had detrimental effects on transport costs, market integration, air traffic growth, aviation safety and security, and coordinated infrastructure development.

Other challenges to development of the aviation sector include lack of connectivity, in particular in West and Central Africa, and high ticket costs that dampen demand (1.1 flight ticket per capita annually in Africa compared with 5.4 in Latin America and 33 in North America; see box figure 1). Underdeveloped ground infrastructure reduces traffic-handling capacity, while airport charges (to finance sometimes overambitious investments) are high. Other factors that impede growth are safety problems due to poor regulatory oversight, shortages of skills in air and ground operations, and scarcity of financing.

The Yamoussoukro Decision of November 1999 aimed to boost the aviation sector by liberalizing international travel between African countries. While this liberalization has been unevenly implemented, it has contributed to the success of some African carriers such as Ethiopian Airlines, which relies on the Yamoussoukro Decision as a basis for its country partnership negotiations.

The launch by the African Union of the Single African Air Transport Market initiative in January 2018, a key element of the African Union's Agenda 2063, should give new impetus to more effective operationalization of the Yamoussoukro Decision. The agreement was signed by 22 countries, representing about 75 percent of intra-African air transport and a population of around 600 million people. Its success will depend on close collaboration between the industry and government to ease the

(continued)

BOX 3.8 Open skies in Africa *(continued)*

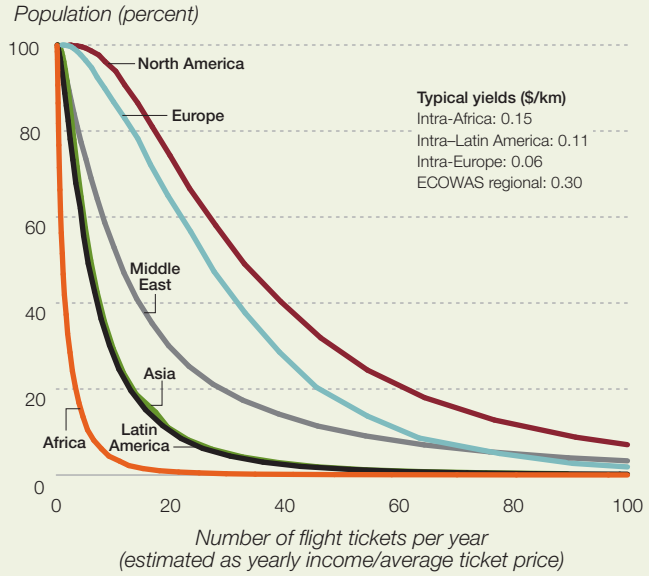
constraints facing the aviation sector. There have been some successes in deregulating markets, as in Mozambique, which opened its domestic market to foreign airlines.

The experience of some African countries in liberalizing air transport markets is instructive for the Single African Air Transport Market initiative. The open skies agreement signed between the European Union and Morocco in December 2006 to promote tourism by lowering airfares and opening new routes led to a 51 percent increase in seats offered by 2010 and a notable increase in new routes. The share of low-cost airlines rose from 3 percent in 2006 to 36 percent in 2010. While competition for the state-owned Royal Air Maroc increased considerably, it continues to operate profitably and retains a dominant market share.

Aviation stakeholders should pursue four main objectives to enable the aviation sector to reach its potential: liberalize the African market; improve the operational efficiency and sustainability of African airlines to reduce airfares; increase private sector participation and promote air transport infrastructure development (airports and air navigation services); and improve implementation of international standards and recommended practices in civil aviation to reach minimum safety and security targets.

Air transport can accelerate connectivity in Africa, which faces particular challenges related to geographic obstacles between communities and countries. The African Development Bank has invested more than $1 billion over the past 10 years in the aviation sector, 75 percent of it for airport infrastructure and 25 percent for aircraft acquisition.

BOX FIGURE 1 Affordability of flight tickets by region



Source: African Development Bank 2018b.

Source: African Development Bank 2018b; Bernardo and Fageda 2017; Bofinger 2017; CAPA 2018.

which documents progress in implementing de jure commitments across goods, capital, and service markets. Another approach is to use night light data to view activity along the borders. Recent estimates indicating that impediments to cross-border activities have fallen over the past 20 years are encouraging (see box 3.7).

THE CONTINENTAL FREE TRADE AREA IN THE BROADER LANDSCAPE OF AFRICAN INTEGRATION

African integration has always meant more than increasing intraregional trade to accelerate industrialization. African integration encompasses development more broadly. Developmental regionalism recognizes an extended agenda of African integration, including a shift from noninterference to nonindifference to poor economic governance, which calls for greater collective action. The African CFTA is one element of this agenda.

The areas covered by the CFTA are numerous, and not all have been finalized.[69]

Africa's economic, cultural, and geographic landscapes present challenges to the CFTA. Consider the small size of Africa's 54 economies, smaller than that of France (figure 3.10). In this simple setting of isolated countries, there is a tradeoff between the size of jurisdiction and the preferences of populations. In large political jurisdictions, larger markets lower the cost of production, raise incomes, and lower the cost of providing public goods. These gains come at the cost of not recognizing the heterogeneity of preferences in large populations. Nonetheless, international economic integration as set out by the RECs would, by reducing trade costs, increase the number of economically viable countries because the size of the domestic market would matter less for productivity. It is hard to escape the conclusion that domestic markets across Africa are too "small" in all but a handful of countries[70] and that the solution is to pursue economic integration, the objective of the RECs and the African Union.

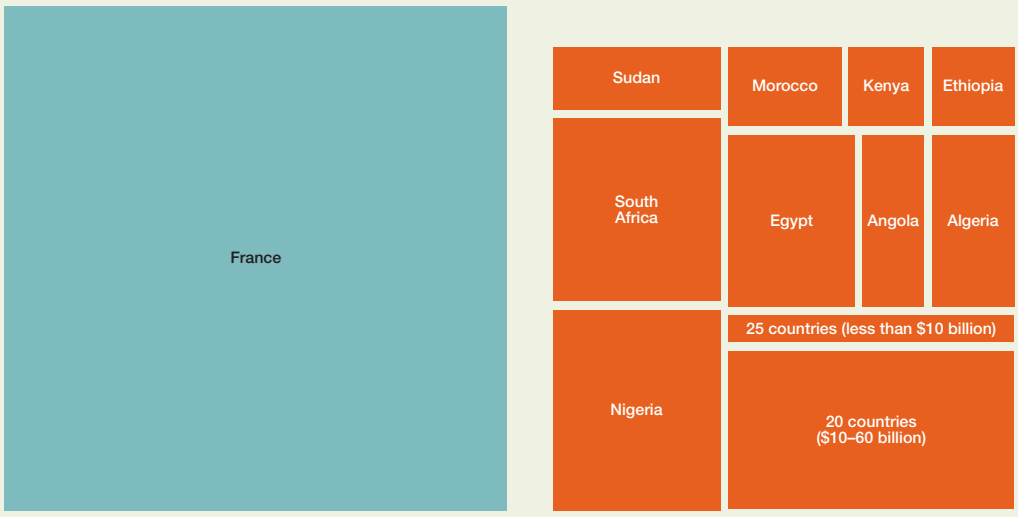
Now consider how African countries are heterogeneous along many dimensions that count for successful economic integration. This diversity is generally considered to be greater in Africa than in other regions and is both a source of richness and a handicap in the quest to integrate and industrialize. Because of economies of scale, successful industrialization also depends on economic integration. The boundaries, inherited from colonial times, are often artificial, splitting ethnic groups and disregarding natural boundaries like rivers and mountains. The realities of the African landscape complicate the quest to integrate economically and to industrialize. Typically, REC members include both coastal and landlocked countries, resource-rich and resource-poor countries, and countries with large and small populations, economies, and land masses. These diversities point to tradeoffs (box 3.9).

An immediate objective of the CFTA is to increase participation in cross-border supply chains by reducing trade costs

Reducing trade costs to increase participation in trade supply chains

An immediate objective of the CFTA is to increase participation in cross-border supply chains by reducing trade costs through regional integration. African countries have participated little in global trade supply chains except in upstream activities as providers of unprocessed goods and raw materials. But experience in textiles and apparel, supermarkets, and automotives show that African

FIGURE 3.10 Africa's economy, with many small markets, is smaller than France's



Source: Data from IMF; IEA analysis.
Note: Size is GDP measured in 2011 purchasing power parity US dollars.

BOX 3.9 Tradeoffs in an integration trilemma

Three objectives compete for Africa's integrators: pan-African solidarity across the continent's diverse states, large memberships to break the curse of small markets, and deep integration to reap all the benefits of integration. Solidarity requires special and differential treatment for the least developed countries, along with financial resources (in short supply) to compensate for integration costs—and for trust, which falls as membership size increases.[1] The African Union Road Map calls for increasing the depth of integration while embracing African diversity. Pan-African solidarity still dominates the political rhetoric about rebuilding Africa, consolidating unity, achieving self-reliance, and ensuring peace and security. And the formation of regional economic communities was often motivated more by political cooperation than by economic interests and trade.

The three objectives are difficult to reconcile. African integration is moving along a path of regionalism, where much of the emphasis is on cooperation through the African Governance Platform, as with the Africa Peer Review Mechanism and the Africa Standby Force.[2] Fully reaping economies of scale requires large membership (Common Market for Eastern and Southern Africa, Economic Community of West African States) and low trade barriers. This precludes special and differential treatment for the least developed countries, which segment markets by raising trade costs and effectively limits the size of the market.

Depth of integration (financial markets, mobility of people) calls for greater trust. Trust is more easily achieved in a small membership setting (such as the East African Community) and in contexts with less diversity. Because of the lack of trust needed to delegate authority to supranational institutions, embracing diversity to satisfy political objectives impedes deep integration. And while diversity boosts the potential gains from closer economic integration, realizing the gains requires compensating countries when the expected gains from closer integration are smaller.[3]

Notes

1. During the Continental Free Trade Agreement negotiations, South Africa strongly opposed financial compensation (Parshotam 2018). The compromise is that special and differential treatment is to be built into the treaty case by case, and least developed countries have an extended implementation period.
2. The African Government Platform has six pillars: security; political governance and transition; human rights, justice, and reconciliation; humanitarian/emergency assistance; reconstruction and socioeconomic development in post-conflict countries; and gender equality.
3. The wasteful Common Agricultural Policy, amounting to 1 percent of EU GDP, has often been explained as a political compromise between France and Germany, which gave German manufacturers access to the French market while German taxpayers helped subsidize French farmers. In the African context, the African Union finances only 44 percent of its budget from member state contributions. Reaching financial viability via a 0.2 percent levy on all eligible goods imported to the continent could be controversial under current World Trade Organization rules (see discussion in chapter 8 of UNECA, AU, and African Development Bank 2018).

countries are getting progressively more involved in trade in tasks through regional value chains. Key to this is a reduction in trade costs as goods cross borders multiple times. To develop cross-border supply chains, improving customs management and adopting simple and transparent rules of origin are essential.

Rapidly implementing the TFA would introduce a first set of cost-reducing measures that African WTO members could carry out. The WTO estimates that reducing time delays at customs could lower trade costs by about 15 percent for developing countries.[71] Further estimates at the country level prepared for this report confirm the gains

Rapidly implementing the TFA would introduce a first set of cost-reducing measures that African WTO members could carry out

from improving transparency and reducing red tape at customs.

In a world of spreading preferential trade agreements and greater trade in tasks, rules of origin stand in the way. One of the challenges of "multilateralizing regionalism"[72] is to prevent rules of origin from working at cross-purposes with the rise in global and regional value chains. Nowhere is this challenge greater than across African RECs. While rules of origin are necessary to prevent transshipment, if too restrictive they will undo any trade-creating effects of preferences since product-specific rules of origin are then tailored to producers' demand for protection.

In a world of spreading preferential trade agreements and greater trade in tasks, rules of origin stand in the way

Increasing participation in value chains through deep interventions

Over 1997–2013, supply chain trade has largely eluded Africa, evident in the shares of foreign value added in exports across regions.[73] Exports from Africa have lower shares of foreign value added, while their exports are mostly embodied in the exports of other regions. Sub-Saharan Africa has the least downstream activity. Morocco and Tunisia, which are close to the European market, are the only countries in North Africa that have integrated supply chain trade on the downstream side, while the other countries in the region have concentrated on the upstream side.

The foreign value added shares are lowest for African oil exporters and for countries with nonoil resource-intensive export baskets. The shares are generally lower than in the selected comparators (Poland and Vietnam) but are similar on average to shares in China and India, two large countries whose companies have engaged in vertical integration. Even if its borders were seamless, Africa would face challenges in developing effective regional supply chains because of its small market size.

Two partial success stories are the rise of apparel exports and the spread of supermarket chains.

A regional supply chain developed in textiles and apparel in Africa, mostly through preferential access to the South African market, which exempted beneficiaries from the 45 percent MFN tariff on apparel and the 30 percent MFN tariff on finished textile goods (box 3.10). This access, combined with a single-transformation rule, led firms in South Africa to relocate to lower cost SACU partners, Lesotho and eSwatini. Two SADC members, Mauritius and Madagascar, also participated in the regional value chain while exporting to US and EU markets.

Several firms in South Africa's grocery store retail chain have developed outlets in the rest of Africa, an example of integration along a regional value chain (box 3.11). While this expansion could be an opportunity for upgrading suppliers in the region, trade has been dominated by South Africa, and supermarket chains may be using their buying power to limit upgrading.

The textiles and apparel chain and the supermarket chains show the potential for boosting participation by African countries in supply chain trade, which can involve goods crossing borders multiple times. Low tariffs are needed on

BOX 3.10 Lessons for regional integration from the textile and apparel sector

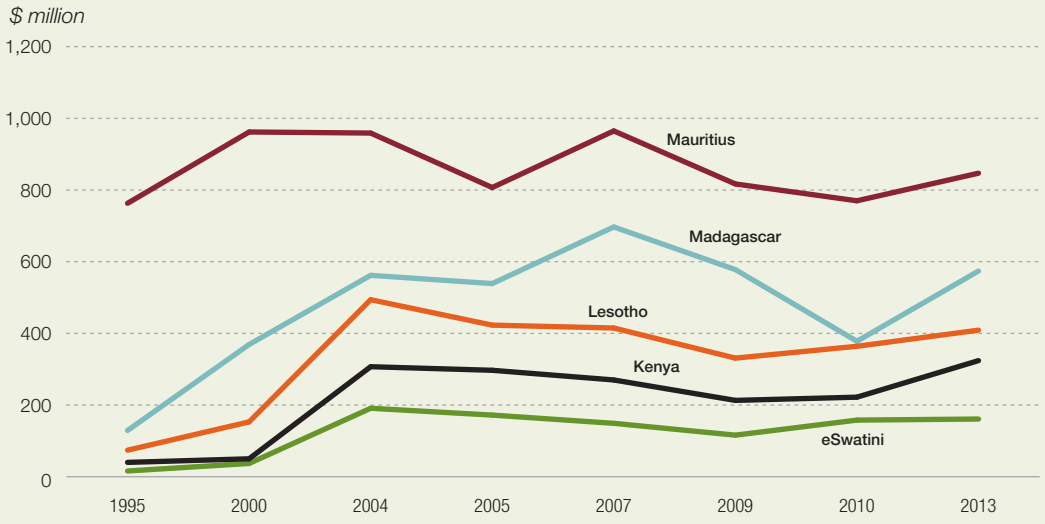
Since 2000, apparel exports from the Southern and East African regions have accelerated, driven by preferential trade access through the US African Growth and Opportunity Act and the EU Everything but Arms agreements that allowed selected African countries tariff-free access into US and EU markets (box figure 1). Along with preferential quota access through the Multi-Fiber Agreement, these preferential arrangements kick-started apparel exports from these regions. The US African Growth and Opportunity Act, with its single transformation rules of origin, had a greater initial impact on Kenya, Lesotho, and eSwatini. Madagascar and Mauritius had a different trajectory, exporting to both the United States and the European Union. Mauritius was already an established apparel exporter, and the new trade access consolidated its position.

(continued)

BOX 3.10 Lessons for regional integration from the textile and apparel sector *(continued)*

Asian transnational firms, already well connected within global value chains, drove this apparel export growth by establishing subsidiary plants in Kenya, Lesotho, eSwatini, Madagascar, and Mauritius. Large locally owned export-oriented firms emerged in Mauritius and Madagascar.

BOX FIGURE 1 Sub-Saharan clothing exports to the United States and the EU-15



Source: Data from UN Comtrade.

A regional supply chain developed in textiles and apparel in Africa, mostly through preferential access to the South African market

Several lessons for regional integration and the role of regional value chains that can be drawn from this experience of developing an export apparel industry:

- *Preferential trade access provides access to different market opportunities, which are particularly important in kickstarting regional industrialization by overcoming trade barriers to give firms access to global and regional value chains.*
- *Foreign direct investment and ownership are important.* Lead firms in global value chains determine how suppliers link into and move up apparel value chains and shape how rents are extracted, upgrading occurs, and dynamic capabilities are built. How strongly embedded they are in local economies affects the ability to take advantage of upgrading and market opportunities.
- *Economic hubs create market dynamism.* Dynamic regional economic hubs extend the scope of regional market opportunities and expand the reach of local firms and production units. Regional value chains are often built around strong hub economies, extending supplier chains into neighboring countries and creating export possibilities and learning opportunities for other economies in the region.
- *Good infrastructure oils frictionless trade of inputs and outputs within the region.* Poorly maintained hard infrastructure and cumbersome regulatory frameworks and other soft infrastructure inhibit regionally and locally embedded firms from taking advantage of regional market and linkage opportunities.
- *Policy matters.* Cutting-edge industrial policy, especially measures that take account of the dynamics driving global and regional value chains, allows sectors to flourish, regional linkages to develop, and industrialization to accelerate.

Source: Morris, Plank, and Staritz 2016; Staritz, Morris, and Plank 2016.

BOX 3.11 South African supermarket chains and their impact on regional integration

Private firms with strong commercial interests in gaining regional market access, lowering other trade barriers, and improving cross-border infrastructure can pressure governments to improve regional integration. But countervailing interests may seek to block integration, and their concerns also need to be addressed, as shown in the development of supermarket chains across the region.

By 2015, South Africa's largest retail chain, Shoprite Holdings, had some 250 outlets in other African countries (box table 1). While revenues in the rest of the continent are still much smaller than those from sales in South Africa, they are rising as a share of smaller neighboring economies. These outlets are mainly supplied from South Africa, which means that these retail giants have a strong interest in easing cross-border constraints. Poor infrastructure and logistics, as well as delays at borders and ports, raise operating costs and constrain expansion. Expansion of these supermarket chains would enable the upgrading of suppliers in the region, which could then also supply the South African market. But trade is currently largely one way: in 2017, the value of South African exports of processed foodstuffs to the rest of the continent was more than five times that of its imports.

Exacting standards and certification, large volume requirements, and competitive pricing make it difficult for local suppliers to get a foothold

BOX TABLE 1 South African supermarkets in Africa, 2015

	Revenue ($ million)		Number of stores	
Firm	**Total**	**Rest of Africa**	**South Africa**	**Rest of Africa**
Shoprite Supermarkets	7,947.3	1,311.0 (16.5 percent)	1,198	250
Massmart	6,107.3	496.1 (8.2 percent)	398	35
Pick n Pay	5,332.5	287.6 (5.4 percent)	1,126	116
Spar	4,298.1	na	1,711	153
Woolworths Food	1,785.0	72.1 (4.1 percent)	397 (total)	

na is not available.

Source: Adapted from Kaplan and Morris (2016).

A key issue is developing domestic suppliers. The supermarket chains may have a longer term interest in developing local suppliers to diversify their supply base. And many supplier trucks come back empty on their return trips, driving intraregional freight rates higher.[1] But the supermarket chains may also be using their buying power to limit upgrading and supplier development to protect their market position.[2]

The countries that are hosting this South African retail expansion are increasingly concerned with the disadvantaged position of domestic suppliers. With the support of local firms, neighboring countries are starting to pressure the supermarket giants to expand domestic supply.[3] Member states of the Southern African Development Community and the Southern African Customs Union have imposed trade restrictions and local content requirements on imports of certain food products from South Africa. For example, Botswana, Zambia, and Zimbabwe ban imports of poultry, maize meal, and cooking oil, and Zimbabwe's competition and tariff by-laws require supermarkets to purchase at least 20 percent of their products domestically.[4]

The retail chains prefer to deal with large suppliers. Exacting standards and certification, large volume requirements, and competitive pricing make it difficult for local suppliers to get a foothold. A lack of finance to upgrade capacity and delayed payments by the large retail chains are

(continued)

BOX 3.11 South African supermarket chains and their impact on regional integration *(continued)*

further constraints. Local suppliers often fail to fully understand the procurement criteria of the retail chains.[5]

The supermarket chains in South Africa have all instituted supplier development programs, partly in response to pressure from governments. Indeed, a condition of the Walmart/Massmart merger was the establishment by the company of a 240 million rand supplier development fund. But such initiatives are much less evident in neighboring host countries. In Zambia, Shoprite has signed memoranda of understanding with the Zambia Development Agency and Private Enterprise Programme Zambia to promote small firms. Namibia has a formal retail charter, though it is voluntary.[6] The expansion and harmonization of such charters across the region may be useful in encouraging a more balanced approach to regional development.

Notes

1. Vilakazi 2018.
2. das Nair, Chisoro, and Ziba 2018.
3. Kaplan and Morris 2016.
4. das Nair, Chisoro, and Ziba 2018.
5. Ziba and Phiri 2017.
6. das Nair, Chisoro, and Ziba 2018.

Reducing the supply chain barriers to trade could increase global GDP up to six times more than removing tariffs

intermediate inputs, many from outside the region. The average tariff on intermediate goods across African countries is still around 10 percent—twice the average in other regions—and has fallen only slowly over the past 15 years (figure 3.11a). The trade-weighted average is much closer to the simple average in Africa than in the other regions, an indication of little substitutability toward domestic intermediates (figure 3.11b).

Taking advantage of the World Trade Organization's Trade Facilitation Agreement

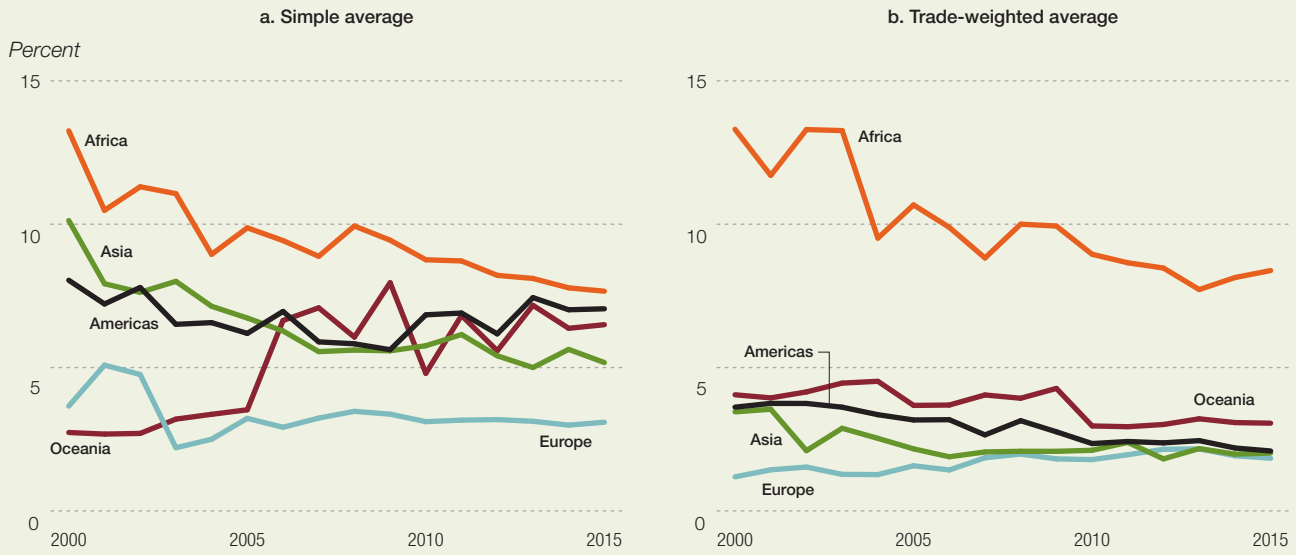
Tariff reductions and market access have become much less relevant for economic growth than a generation ago.[74] The reason? Trade is no longer about manufacturing a product in one country and selling it elsewhere—it is about cooperating across borders and time zones to minimize production costs and maximize market coverage.

Reducing the supply chain barriers to trade could increase global GDP up to six times more than removing tariffs. If all countries could bring border administration, together with transport and communications infrastructure, up to just half the level of global best practice, global GDP would grow by $2.6 trillion (4.7 percent), and total exports would increase by $1.6 trillion (14.5 percent). By comparison, the elimination of all tariffs worldwide would boost global GDP by only $400 billion (0.7 percent) and exports by $1.1 trillion (10.1 percent).[75]

Clearly, global value chains are now the dominant framework for trade. And as seen, African countries such as Rwanda (and Ethiopia and Morocco) are already taking advantage of this paradigm shift. Rather than waste time in unproductive policy discussions over tariffs, they are redirecting their strategies to focus on trade facilitation.

Recognizing this changing reality, 139 of 164 WTO members (including 44 African countries) have ratified the TFA amendment to the WTO agreement.[76] Signed in 2013 and entering into force in 2017, the TFA is the first multilateral trade agreement since the creation of the WTO. The principal aim of the TFA is to reduce the time it takes to cross borders to reduce trade transaction costs tied to nontariff measures.[77] In effect, the TFA is like a tariff agreement without tariff

FIGURE 3.11 Tariffs on intermediate goods are still higher in Africa than in other regions, 2000–15



Source: Data from the World Integrated Trade Solution.

Note: Intermediate goods are defined according to classification by Broad Economic Categories. Number of African countries: 53 for simple average and 46 for trade-weighted average.

schedules. Best practices on trade facilitation recommended by the World Customs Organization are part of the TFA, but service-related measures are not included. Because the TFA has been ratified by most WTO members, it is rules-based rather than discretionary and includes appeal and review procedures. Low-income countries have been given extensive leeway in delaying implementation of the TFA until they can receive capacity building support. This flexibility may be welcome, but delay in implementing these time-saving trade facilitation measures is equivalent to a loss of competitiveness relative to those who implement them and may slow integration.

The reduction in fixed trade costs related to time in customs and the associated monetary costs should encourage greater diversification of trade to other markets and in other products to the same market. It should also lead to greater participation in supply chain trade at both the regional and global levels, where goods have to cross borders multiple times.

Training customs clearance officials and customs brokers reduces clearance time at customs. According to World Bank Doing Business estimates, regular training reduces customs clearance time by 34 percent relative to no regular training. Pilot testing of phased implementation of the Automated System for Customs Data reduced clearance times for Angola and Lesotho.[78] Estimated gains from a one-day reduction in clearance times[79] are equivalent to a 1.3 percent reduction in trade costs. Average border compliance time is 23.2 hours for imports and 163 hours for exports, equivalent to a 3.9 percent penalty on exporting activities.[80]

Harmonizing rules of origin

Because duties and import restrictions may depend on the origin of imports, criteria are needed to determine the country of origin of a product. These are referred to as rules or origin, and they are an integral part of all trade agreements. They are categorized as nonpreferential and preferential. Nonpreferential rules are generally used to establish the country of origin of a good for the allocation of quotas and for contingency protection measures (measures to counteract particular adverse effects of imports in the market of the importing country). Preferential rules

of origin are used to enforce preferential schemes by establishing which products can benefit from preferential access. Preferential rules are further divided into rules on general preferential treatment (under Generalized System of Preferences schemes) and those relating to regional trade agreements. From an economic standpoint, preferential rules of origin have a direct effect on international trade because they affect the rate of import taxation. The increasing fragmentation of production processes across countries means that rules of origin need to be stringent and complex to serve their primary purpose. However, complying with stringent and complex rules can impose substantial additional costs, sometimes even eroding the benefits.

Since the CFTA will not harmonize external tariffs until the customs union stage, countries need to agree on a set of common preferential rules of origin. This will be a monumental task because rules of origin are complex, opaque, and difficult to assess and because of the large number of members who will need to agree on a common set of rules. Negotiations on rules of origin delayed conclusion of the Tripartite Free Trade Area among COMESA, EAC, and SADC because negotiators decided to apply product-specific rules of origin "entailing the highly onerous, time-consuming, and technically demanding process of determining particular rules for over 5,000 products."[81]

Rules of origin have two main objectives. First, to prevent arbitraging of external tariff difference in free trade areas, which could lead to a race to the bottom as members compete for tariff revenue by choosing lower MFN tariffs. This makes rules of origin redundant in customs unions, although Mercosur does have them. Second, rules of origin are intended to prevent superficial assembly operations, with little or no value added (such as packaging), which would extend the benefits of preferential access to noneligible intermediate producers. A third, less often mentioned, reason is the development objective. During negotiations of the SADC rules of origin, the objective was to enable member states to develop through privileged access to an enlarged market area that would remain protected and relatively isolated from external markets.[82] In effect, the objective was to develop regional value chains behind relatively high tariffs.

As in other free trade agreements, the negotiations on rules of origin for the CFTA are likely to be dominated by strong industry lobbying. During the negotiations so far, West and Central Africa have preferred general rules of origin, which would probably resemble those in the East Asia and the Pacific region. On the other side, Egypt, Kenya, and South Africa have pushed for product-specific rules of origin, and South Africa has lobbied for adoption of the SADC rules of origin on a sector- or product-specific basis.[83]

In this situation, the political economy considerations underlying negotiations would resemble those that have prevailed in the agreements between developing countries and the European Union and the United States, which led to restrictive product-specific rules of origin.[84] If South Africa's position prevails, the result would be costly rules of origin that would likely deny preferences to the low-income partners (such as Ethiopia, Mozambique, Tanzania, and Zambia). When the more developed partner has a comparative advantage in the upstream capital-intensive sector, such as weaving in textiles and apparel or engine building in the automobile sector, rules of origin create a captive market in the low-income partner, which has no choice but to source (at a higher cost) from the more developed partner.

This is what happened in the hegemonic model followed by the European Union and the United States, which used preferences to create mini-worlds where the gains from specialization could be reaped at the same time as some degree of protection was maintained against efficient Asian firms, especially in the textiles and apparel sector. The outcome was captured by interest groups in the sector in the European Union and the United States, a denial of preferences for intended beneficiaries, and a captive market for the upstream activities in which the European Union and the United States often had a comparative advantage in the integrating region, but not worldwide. Thus, despite large preferential margins in textiles and apparel in the European Union and the United States, the technical requirements related to origination have greatly limited access to these markets. The same pattern could be repeated under CFTA.

In contrast, the East Asia and the Pacific region model is not hegemonic and is relatively simple

Since the CFTA will not harmonize external tariffs until the customs union stage, countries need to agree on a set of common preferential rules of origin

and less demanding in resources. ASEAN's rules of origin are based largely on 40 regional value content specifications. In many cases, the importer has a choice between two rules: a regional value chain rule or a change of tariff classification. To facilitate supply chain trade, the CFTA should incorporate relatively simple and transparent rules of origin, like those applied in AFTA and ASEAN.

Rules of origin will also have to deal with the regime-wide rules covering certification, verification, and cumulation. Because there are few differences in certification and verification methods across the African RECs, agreeing on these should be relatively easy—especially if, as recent evidence suggests, administrative costs are not as high as previously estimated.[85] Thus, it might be easier to agree first on harmonizing rules governing certification and verification. In contrast, provisions on cumulation (treatment of intermediates from other countries in the bloc or countries with special cumulation status) differ across RECs.

The CFTA should incorporate relatively simple and transparent rules of origin, like those applied in AFTA and ASEAN

Cumulation rules are often associated with different product-specific rules of origin, which make it difficult to assess how strict they are. Proving cumulation may be very resource intensive, discouraging firms from using preferences. In addition, the provisions are different across RECs. Multilateralizing provisions on cumulation at the continental level will thus be a big challenge, especially if accompanied by multiple product-specific rules of origin, as is the case under the SADC regime.

The extensive evidence on the effects of rules of origin around the world shows that they go well beyond the role of preventing trade deflection and preventing superficial assembly operations. Rather, they are shaped by powerful partners and their firms.

EXPECTED GAINS FROM THE CONTINENTAL FREE TRADE AGREEMENT

Phase I of the CFTA calls for eliminating tariffs and nontariff barriers in goods and services. Several studies have estimated the potential gains using simulation models. For this report, estimated gains are based on an extended version of the Global Trade Analysis Project (GTAP) model using new data. Two new sets of estimates of barriers to trade are incorporated in the model: estimates of the time reduction in customs from applying the provisions of the TFA and estimates of the discriminatory barriers to trade in services reported in table 3.2.

Estimates from customs improvements

Following the signing of the TFA in December 2013, the OECD produced a series of 11 trade facilitation indicators (identified from A to K) for monitoring the TFA targets. Data for these indicators are available for 43 African countries. Each indicator takes a value between 0 (no implementation) and 2 (full implementation). Some indicators are averages of subcomponents. Within each REC, some countries have remarkably higher scores on some indicators than other REC members. The largest disparities are for the information availability indicator (A) and for the governance and impartiality indicator (K). Taken together, these indicators suggest substantial room for improvement in customs management within and across RECs.

As an illustration of orders of magnitude of potential gains, table 3.6 reports estimates of reductions in time at customs in ad valorem tariff equivalents from an improvement in trade facilitation indicator values. The estimates are from a model that predicts observed time in customs as a function of basic structural variables (GDP, Logistics Performance Index, and Infrastructure Quality Index); policy variables (World Governance Indicators); and the trade facilitation variables captured by the trade facilitation indicator (row L).[86] The model shows, after controlling for the structural and policy variables, that a higher trade facilitation indicator score reduces the probability of a longer time in customs (not reported here).[87]

Model simulation 1 focuses on improvements within Africa, and simulation 2 focuses on improvements relative to the rest of the world. The overall differences in reductions in costs reflect disparities in trade facilitation indicator values and in time in customs for imports, while differences between the two simulations reflect the predicted

TABLE 3.6 Simulated reduction in trade costs for imports from implementing the Trade Facilitation Agreement *(average across African RECs and other country groups)*

Regional economic community (number of countries)	Mean time in customs (days)	Mean of OECD Trade Facilitation Index value	Reduction in trade costs from reducing time in customs (ad valorem equivalents, %)	
			Simulation 1	Simulation 2
African Union members (43)	7	0.77	9.5	10.8
Central African Economic and Monetary Community (5)	11	0.63	19.5	23.1
Common Market for Eastern and Southern Africa (16)	7	0.77	5.1	7.9
Community of Sahel-Saharan States (19)	5	0.72	7.6	8.5
East African Community (5)	8	0.85	7.9	9.2
Economic Community of Central African States (9)	9	0.65	15.8	17.9
Economic Community of West African States (12)	5	0.66	8.6	8.7
Intergovernmental Authority on Development (5)	7	0.79	5.6	8.1
Southern African Development Community (15)	8	0.81	7.7	8.0
West African Economic and Monetary Union (7)	4	0.65	3.6	3.9
Landlocked countries (15)	6	0.63	5.0	9.1
Least developed countries (26)	6	0.63	7.7	8.1

Source: de Melo and Sorgho forthcoming; Hummels and Schaur 2013.

Note: See de Melo and Sorgho (forthcoming) for estimates and choice of simulations. The ad valorem tariff equivalents are computed as the average estimated reduced time in customs across group members multiplied by 1.3 percent. The estimated reduction in transport costs from a day's reduction in transport is taken from Hummels and Schaur (2013). Reduction in trade costs are computed for the following simulations:

Simulation 1: Each African landlocked country takes the average value of the top two landlocked countries in Africa, and each African nonlandlocked country takes the average value of the nonlandlocked countries in Africa.

Simulation 2: Each African landlocked country takes the average value of the top two landlocked countries in the developing world, and each African nonlandlocked country takes the average value of the nonlandlocked countries in the developing world.

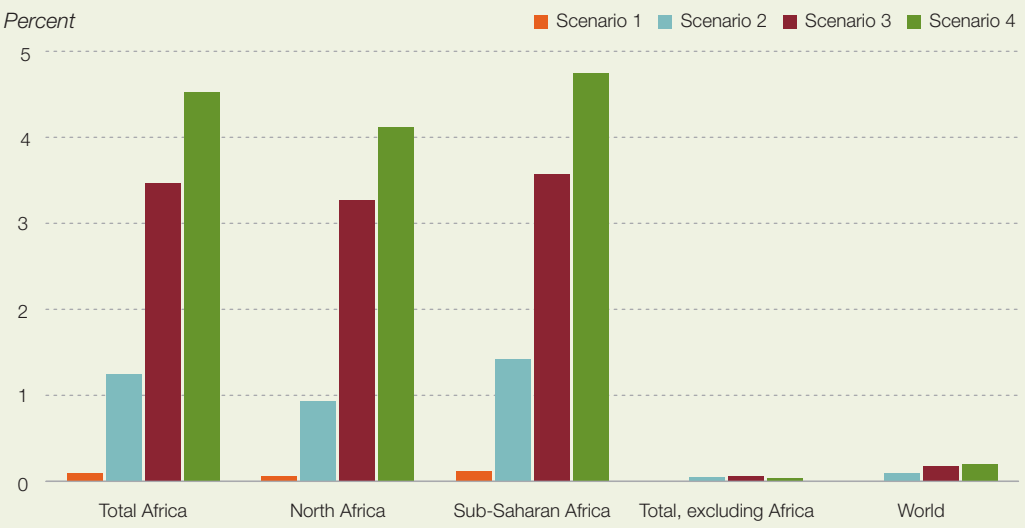
Scenario 1 would bring a 0.1 percent increase in net real income for the continent, a gain of $2.8 billion

extra gain from an improvement in customs management beyond Africa's current best performers. These orders-of-magnitude estimates may be on the high side since time in customs reported by firms is less than the time recorded in Doing Business data from the World Bank, and the sample is small.[88] But with the development of supply chain trade, the gain for exports from reduced time in customs should also be taken into account, as discussed below.

Simulated impacts on real income

At the continental level, scenario 1 (removal of tariffs on intra-African trade, the focus of current negotiations for phase I of CFTA) would bring a 0.1 percent increase in net real income[89] for the continent (figure 3.12), a gain of $2.8 billion (box 3.12).[90] However, rules of origin will still be needed since countries will not have a common external tariff, so the actual gains will be much smaller unless the adopted rules of origin are simple.

FIGURE 3.12 Percentage change in real income across four trade integration scenarios for Africa and the world



Source: African Development Bank forthcoming.

Note: Scenario 1 is the removal of bilateral tariffs across all African countries. Scenario 2 is scenario 1+ removal of ad valorem tariff equivalents of nontariff barriers on a most favored nation (MFN) basis. Scenario 3 is scenario 2 + Trade Facilitation Agreement on an MFN basis. Scenario 4 is scenario 3 + 50 percent reduction in tariffs and nontariff barriers in other developing countries on an MFN basis.

Scenario 2 increases the total real income gains 13-fold, for a 1.25 percent increase in net real income, or $37 billion. Scenario 3 yields an additional gain, for an estimated aggregate real income gain of 3.5 percent, or some $100 billion

Extending the CFTA to removing the ad valorem tariff equivalents of nontariff barriers on goods and services on an MFN basis in scenario 2 increases the total real income gains 13-fold, for a 1.25 percent increase in net real income, or $37 billion.

Scenario 3 adds implementation of the TFA, also on an MFN basis, yielding an additional gain, for an estimated aggregate real income gain of 3.5 percent, or some $100 billion. This large gain is probably an upper bound, considering that the mean estimate of transport cost reductions,[91] which assumes that one extra day in customs is equivalent to a 1.3 percent extra tariff at destination, is taken from maritime trade flows to the United States.

Scenario 4 adds an increase in market access in other developing countries to the domestic reform agenda. This would increase the gains from implementing the TFA to 4.5 percent of the continent's GDP over the reference scenario, or an additional $31 billion, bringing the total gain to $134 billion.

The rest of the world is only mildly affected in these scenarios with very small changes in most scenarios and a roughly 0.2 percent gain in scenarios 3 and 4 (full removal of tariffs and ad valorem tariff equivalents in Africa and full implementation of the TFA). Scenario 5 (which adds a 0.2 percentage point increase in tariffs on African imports from non-African sources) has a small, net positive gain for the continent. Importantly, it raises an estimated $850 million in revenues for funding trade facilitation measures.

These headline estimates hide significant heterogeneity across subregions (figure 3.13). While the five subregions do not correspond to the RECs, they are representative of the geographic context of some policy discussions in Africa. In percentage terms, Central Africa gains the most,[92] at upward of 7 percent, under the most optimistic scenario 4—much higher than the gain of just over 5 percent in West Africa, 4 percent in North and East Africa, and under 3 percent in Southern Africa.[93] As order-of-magnitude estimates, the ranking of gains is plausible and likely reflects the

BOX 3.12 Estimating efficiency and revenue gains in five scenarios

The results reported here concentrate on the longer run effects under full implementation of the CFTA using a version of the GTAP model adapted for capturing the expected long-run effects of the CFTA and full implementation of the TFA (see table A3.1 in the online annex for country and sector aggregations). The model is disaggregated into the following regions: Africa, China, the United States, Western Europe, rest of East Asia, and rest of the world. Results are reported for North Africa (4 countries) and Sub-Saharan Africa (28).[1]

Five scenarios were simulated. Scenarios 1–3 apply only to the 32 African countries and regions[2] in the model; scenarios 4 and 5 include other countries.

The scenarios are mostly cumulative. Scenario 1 models the removal of all tariffs on a bilateral basis across African countries, while scenario 2 adds the removal of the ad valorem tariff equivalents of all nontariff barriers in Africa. Scenario 2 is probably an upper-bound estimate because the ad valorem equivalents of nontariff barriers probably include some nontariff measures whose effects are nondistortionary (such as some technical barriers to trade and some sanitary and phytosanitary measures). This simulation might correspond to an upper bound of the expected gains from phase I of the CFTA since any regulatory harmonization that might be carried out at the regional level is not considered here.

Scenario 3 captures the expected benefits from an improvement in customs management through application of the TFA based on the estimates reported in simulation 2 in table 3.6. As is common, improvement is captured as a percentage reduction in the iceberg cost parameter on the import demand system. For example, if the TFA ad valorem tariff equivalent measure is 20 percent, this implies that initial exports of 100 units translate into only 80 units arriving at their destination as the cost is subtracted from the volume. Full implementation of the TFA leads to equality between units exported and imported. Since improvements at customs relate to trade with all partners, improvements in customs are carried out on a multilateral basis.[3]

These long-run scenarios assume that no change takes place elsewhere. This is highly unlikely since the TFA will be implemented in other developing countries as well. Scenario 4 assumes that other developing countries also carry out reforms, in this case a 50 percent reduction in import tariffs and in the ad valorem tariff equivalents of nontariff measures.[4]

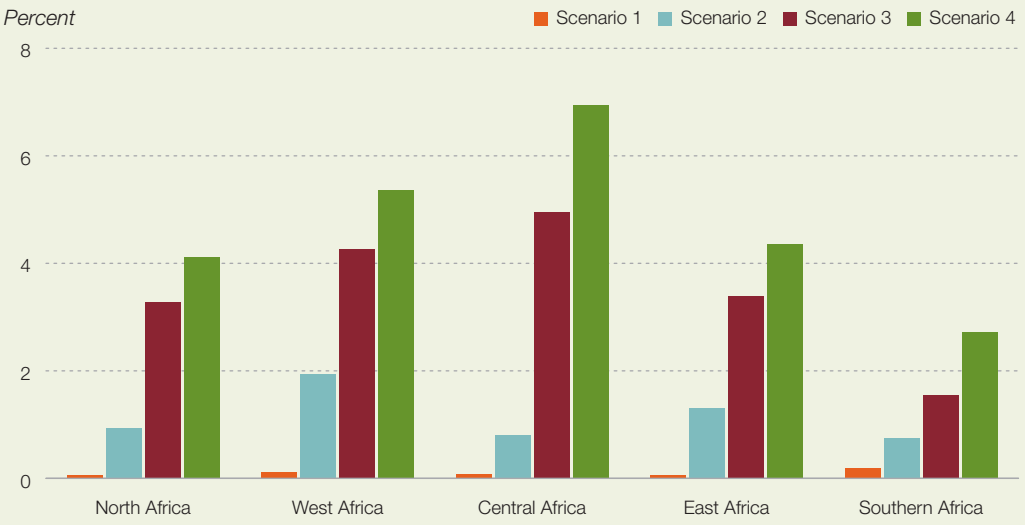
Finally, scenario 5 explores orders of magnitude for financing CFTA activities by leveraging an extra 0.2 percentage point tariff on imports from high-income countries (not shown in figures or tables).

Notes

1. There are four different compositions of the "rest-of-the region," one for each of the four African subregions, resulting in 32 African "countries." Table A3.2 in the annex (available online) also reports the aggregates for the other regions.
2. The current version of the GTAP database divides the economies in Africa into 26 individual countries, with all other countries, which lack input-output tables, grouped into six composite regions.
3. Three sectors are excluded from the TFA improvement: mining, fossil fuels, and refined petroleum products. The exclusion had relatively minor impacts on the results, as these products are not heavily imported in Africa.
4. For the purposes of this scenario, we have defined other developing countries to include China (CHN), rest of East Asia (XEA), and rest of the world (ROW). Note that the aggregate regions (XEA and ROW) contain some high-income countries. For numerical reasons, reductions in the ad valorem estimates were limited to a maximum of 50 percentage points. This cap on reductions affects only a small number of trade flows. Thus, if the initial ad valorem tariff equivalent is 51 percent, under full reduction the final ad valorem equivalent would be 1 percent and not 0 percent. Similarly, if the initial ad valorem equivalent is 102 percent, the final ad valorem tariff equivalent would be 52 percent, not 51 percent under a 50 percent reduction scenario.

An increase in market access in other developing countries would increase the gains from implementing the TFA to 4.5 percent of the continent's GDP, bringing the total gain to $134 billion

FIGURE 3.13 Percentage change in real income across four trade integration scenarios, by African subregion



Source: African Development Bank forthcoming.

Note: Scenario 1 is the removal of bilateral tariffs across all African countries. Scenario 2 is scenario 1 + removal of ad valorem tariff equivalents of nontariff barriers on a most favored nation (MFN) basis. Scenario 3 is scenario 2 + Trade Facilitation Agreement on an MFN basis. Scenario 4 is scenario 3 + 50 percent reduction in tariffs and nontariff barriers in other developing countries on an MFN basis.

Scenario 3 provides the largest boost to the African economies—particularly for Central Africa

extent of regional integration across the continent. Barriers to trade, policy-imposed or not, are generally considered to be highest in Central Africa and lowest in Southern Africa, which reflects the inclusion of South Africa. Also, as shown earlier, East Africa is the most integrated in terms of market access, and the region has made considerable progress in soft infrastructure, notably in transport infrastructure.

To the extent that the scenarios are truly additive, the TFA scenario 3 provides the largest boost to the African economies—particularly for Central Africa (additional 4 percent), with North, West, and East Africa next (about 2 percent), and Southern Africa last (0.8 percent; see figure 3.13). The removal of trade distortions in scenario 2 brings relatively large gains for West Africa (nearly an additional 2 percent), but less for the other regions, particularly Southern Africa (0.5 percent). The market-access scenario (4) brings large gains for Central Africa (additional 2 percent), but mostly around 1 percent for the other regions. In summary, there is no clear ranking of the various reform channels—though the TFA scenario dominates the gains, with the exception of Southern Africa, which benefits more from the market-access scenario.

Simulated impacts on trade

In scenario 1, where only bilateral tariffs are removed, intraregional trade increases by 14.6 percent (table 3.7), which corresponds to an elasticity of trade to tariffs of around 3. Because the share of intraregional trade in total trade is small, intraregional trade relative to total trade increases only from 12 percent to 13.6 percent. There is modest trade diversion—Africa exports somewhat less to the rest of the world (–4.3 billion), and the rest of the world exports a bit less to Africa, with reductions of about 0.8 percent.

As would be expected from the high ad valorem tariff equivalents of nontariff barriers in Africa, their removal on imports into Africa leads to a large boost in intra-African trade of around 107 percent in scenario 2. This increase in intra-African trade is accompanied by a large 44 percent increase in

TABLE 3.7 Changes in trade value and volume across four trade integration scenarios relative to reference solution

Scenario and exporting region	Importing region					
	Value change ($ billion)			Volume change (%)		
	Africa	Rest of world	World	Africa	Rest of world	World
Scenario 1						
Africa	10.1	–4.3	5.8	14.6	–0.8	1.0
Rest of world	–4.3	2.6	–1.7	–0.8	0.0	0.0
World	5.8	–1.7	4.1	0.9	0.0	0.0
Scenario 2						
Africa	74.3	181.8	256.1	107.2	35.7	44.3
Rest of world	139.7	–108.7	31.1	24.8	–0.7	0.2
World	214.1	73.1	287.1	33.8	0.5	1.7
Scenario 3						
Africa	92.0	203.6	295.6	132.7	40.0	51.1
Rest of world	200.8	–122.5	78.4	35.6	–0.8	0.5
World	292.8	81.1	374.0	46.2	0.5	2.2
Scenario 4						
Africa	76.3	252.4	328.6	110.0	49.6	56.8
Rest of world	267.8	–140.9	126.9	47.5	–0.9	0.8
World	344.0	111.5	455.5	54.3	0.7	2.7

Source: African Development Bank forthcoming.

Note: The reference solution is the calibrated initial equilibrium solution to observed trade flows in 2014. Scenario 1 is the removal of bilateral tariffs across all African countries. Scenario 2 is scenario 1 + removal of ad valorem tariff equivalents of nontariff barriers on a most favored nation (MFN) basis. Scenario 3 is scenario 2 + Trade Facilitation Agreement on an MFN basis. Scenario 4 is scenario 3 + 50 percent reduction in tariffs and nontariff barriers in other developing countries on an MFN basis.

Scenario 4, which sees an increase in market access in other developing countries, also raises total African exports, by 57 percent

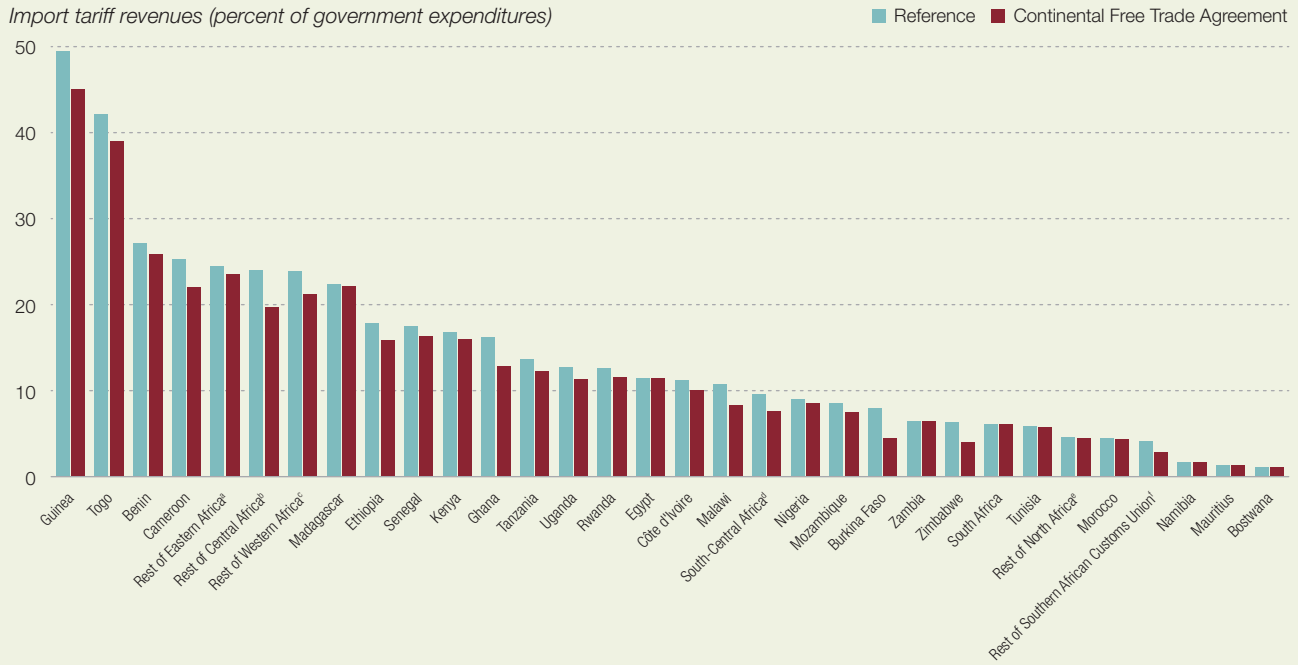
exports to the rest of the world. These large gains reflect both the high ad valorem tariff equivalents and the (plausible) assumption that nontariff barriers would be removed on an MFN basis. Under this scenario, intra-African trade as a share of total African exports rises from 12 percent in the reference solution to 17.2 percent. Implementation of the TFA on an MFN basis in scenario 3 also adds a significant boost to trade. African trade grows by 51 percent—with a higher multiplier effect on intra-African trade than on trade with the rest of the world. The share of intra-African trade thus jumps to 18.5 percent.

Scenario 4, which sees an increase in market access in other developing countries, also raises total African exports, by 57 percent. But there is a modest rotation away from intra-African trade toward exporting to the rest of the world relative to the reference scenarios.

Simulated impacts on government revenue

The impact of trade integration on government revenues was simulated for scenarios 1, 3, and 5. In the aggregate, the effect on government revenues of the removal of intra-African bilateral tariffs at the country level (scenario 1)[94] is small, but for countries where tariff revenues represent a larger share of government revenue, the impact is larger (figure 3.14). A few African economies

FIGURE 3.14 Tariff revenues before and after eliminating bilateral tariffs on intra-African trade



Source: African Development Bank forthcoming.

a. Includes Burundi, Comoros, Djibouti, Eritrea, Kenya, Mayotte, Réunion, Rwanda, Seychelles, Somalia, and Sudan.

b. Includes Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, Gabon, and São Tomé and Príncipe.

c. Includes Benin, Burkina Faso, Cabo Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Saint Helena, Sierra Leone, and Togo.

d. Includes Angola and Democratic Republic of Congo.

e. Includes Algeria and Libya.

f. Includes Lesotho, Namibia, and eSwatini.

rely heavily on tariff revenues to finance current expenditures, according to the GTAP database. At the high end are Guinea (49 percent of current expenditures), Togo (42 percent), and Benin (27 percent), with eight countries having a share over 20 percent. The greatest percentage losses of tariff revenue as a percentage of current expenditures are in Guinea (4.4 percent), Togo (3.5 percent), and Benin (2.0 percent). The largest revenue losses are in Burkina Faso (44 percent), Zimbabwe (36 percent), Malawi (22 percent), and Ghana (21 percent).

The fiscal impacts of scenario 5, which increases the tariff on African imports from high-income countries by 0.2 percentage point, is relatively small—an increase of $850 million for the continent over scenario 3. A somewhat more intriguing—though still plausible—prediction is that removing the ad valorem tariff equivalents for full implementation of the TFA (scenario 3, the most aggressive form of the CFTA) would boost tariff revenues by nearly $15 billion over scenario 1 (the least aggressive). Removal of the ad valorem tariff equivalents on an MFN basis leads to a significant increase in imports, which increases tariff revenues from non-African imports, an effect rarely mentioned in policy discussions.

DOS AND DON'TS FOR INTEGRATION POLICY MAKERS

All African countries would fare better with well-designed integration than without it. What, then, are the policy responses to maximize the benefits of regional integration and to mitigate the potential risks?

Here, first, are some things integration policymakers should not do.

- Do not worry overly about ceding national sovereignty to supranational authority because that facilitates harmonizing regulatory policies, building trust, and checking the political pressure to erect nontariff barriers.
- Do not neglect the soft infrastructure (logistics and the like) that's essential to reap the gains from investments in hard infrastructure (roads, rails, bridges, ports).
- Do not believe that integration will necessarily concentrate even more economic activity in big countries because trade facilitation has spread economic activity all along the corridors.
- Do not underestimate how poor households are hit most by high-tariff sensitive lists for, say, rice and sugar, as the common external tariffs do in ECOWAS and (less) in the East African Community.
- Do not impose sector-specific or product-specific rules of origin. Word in policy circles, however, has it that African trade negotiators already have identified 800 products for specific treatment.

Now turn to the dos for trade.

- Monitor progress in reducing bilateral tariffs and nontariff barriers, as the East African Community does with Common Market Scorecard tracking compliance in the free movement of capital, services, and goods.
- Eliminate all of today's applied bilateral tariffs in Africa and keep rules of origin simple, flexible, and transparent. That could increase intra-Africa trade by up to 15 percent, for a gain of $2.8 billion, small but welcome in these times of rising protectionist stances in the global economy and the China–United States and Britain–mainland Europe divides.
- Remove all nontariff barriers on goods and services trade on a most favored nation basis, since they apply overwhelmingly to all partners for trade across Africa. When added to eliminating tariffs, this would increase trade and boost the cumulative income gains to $37 billion—and the continent's tariff revenues by up to $15 billion, which is more than small change.
- Implement in addition the WTO's Trade Facilitation Agreement to reduce the time it takes to cross borders and the transaction costs tied to nontariff measures. When added to the removal of tariffs and nontariff barriers, that could yield a cumulative income gain of 3.5 percent of the continent's GDP, bringing the gains to just over $100 billion.
- Consider the effect of other developing countries reducing by half their tariffs and nontariff barriers on a most favored nation basis. That could bring Africa's gains to 4.5 percent of its GDP, for an additional $31 billion, bringing the total gains to $134 billion.
- Also consider a 0.2 percent tariff on imports from high-income countries. That could bring in $850 million a year to finance trade facilitation projects.

Then, put much more emphasis on regional public goods, a no-brainer because every country benefits, but especially the low-income countries.

- Synchronize financial governance frameworks across the region and tighten prudential frameworks for supervising financial flows, while removing any remaining ill-founded legal restrictions to cross-border financial flows and transactions.
- Pool power to tap the enormous potential of cross-border trade in electricity. And as the Nord Power Pool in northern Europe shows, start with a small number of countries, rely on external finance to increase capacity, combine generation with transmission, and have enough transmission capacity to stabilize supply and promote competition.

Do eliminate all of today's applied bilateral tariffs in Africa and keep rules of origin simple, flexible, and transparent

- Open your skies to competition, as with Mozambique, which recently opened to foreign carriers. The African Union's Single African Air Transport Market, launched in January 2019, has so far been signed by 22 countries with 75 percent of intra-African air transport. Morocco's open skies policy shows how lowering airfares and opening new routes can increase the seats offered by half (compared with 10 percent in Tunisia) and boost the share of low-cost airlines from 3 percent in 2006 to 36 percent in 2010 (from only 7 percent to 10 percent in Tunisia).
- Open your borders to free movements of people—say, by ratifying and implementing the African Union Passport, launched in 2016 and expected to be fully rolled out by 2020.

Do open your borders to free movements of people—say, by ratifying and implementing the African Union Passport

Here are some more specific items for the integration agendas for Africa's diverse economies.

For landlocked economies—Botswana, Burkina Faso, Burundi, Central African Republic, Chad, Ethiopia, Lesotho, Malawi, Mali, Niger, Rwanda, South Sudan, eSwatini, Uganda, Zambia, and Zimbabwe.

- Advance efforts to delegate regional public goods.
- Continue to develop national multimodal rail, road, air, and pipeline networks.
- Strengthen regional transport corridors. Under the Northern Corridor Transit and Transport Agreement, long-distance transport prices in 2011–15, despite large increases in traffic, came down 70 percent from Mombasa to Kampala and 30 percent from Mombasa to Kigali. By contrast, they rose along the Central Corridor by almost 80 percent from Dar to Kampala and by 36 percent from Dar to Kigali. The main difference was the better improvement of logistics in the Northern Corridor.
- Revamp the transport regulatory frameworks. Landlocked countries in Africa, many of them low income, tend to engage more in intra-Africa trade than coastal or middle income countries. But an estimated 77 percent of their export value consists of transport costs, a high barrier to regional and international trade.
- Push for improving the conventions and instruments that facilitate transit trade (beyond the stalled multilateral negotiations).

For coastal economies—Algeria, Angola, Benin, Cabo Verde, Cameroon, Comoros, Congo, Democratic Republic of Congo, Côte d'Ivoire, Djibouti, Egypt, Equatorial Guinea, Eritrea, Gabon, Gambia, Ghana, Guinea-Bissau, Kenya, Liberia, Libya, Madagascar, Mauritania, Mauritius, Morocco, Mozambique, Namibia, Nigeria, São Tomé and Príncipe, Senegal, Sierra Leone, Somalia, South Africa, Sudan, Tanzania, Togo, and Tunisia.

- Expand port facilities, including storage and customs administration, and increase the efficiency of handling vessel traffic and loading and unloading containers. The cost of African port facilities is estimated to be 40 percent above the global norm, and they have long container dwell times, delays in vessel traffic clearance, lengthy documentation processing, and low containers per crane hour (except South Africa). Ultimately, over 70 percent of delays in cargo delivery come from extra time in ports.
- Increase the speed and reliability of rail and road networks by reducing congestion and delays at checkpoints, and diversions of trucks and rolling stock for maintenance.
- Push for improving conventions and instruments beyond the stalled multilateral negotiations to facilitate transit trade.

For larger economies—Egypt, Morocco, Nigeria, and South Africa.

- Lead the move toward a customs union by accepting greater delegation of decision-making to a supranational REC, resisting internal pressure to protect domestic producers, and limiting competition.

For resource-rich economies—Botswana, Democratic Republic of Congo, Ghana, Guinea, Mozambique, Namibia, Niger, South Africa, Tanzania, and Zambia.

- Apply the core principles of the National Resource Charter.
- Cooperate to harmonize taxation of oil, gas, and minerals to avoid races to the bottom and the associated overexploitation.

NOTES

1. AU 2015.
2. UNECA, AU, and African Development Bank 2018.
3. This expression, introduced by Horn, Mavroidis, and Sapir (2010), is commonly used in evaluations of regional trade agreements.
4. WTO 2011.
5. Frazer and Steenbergen (2017) discusses the suspension of US African Growth and Opportunity Act preferences to Rwanda for banning imports of used clothing. This measure is likely to harm poor households most.
6. Rodrik (2018) shows that new technologies—which may be transmitted to developing countries through their participation in global value chains—hurt developing countries since they put upward pressure on high-skill labor, with little possibility to substitute with low-skill labor whose wages are subject to downward pressure. It then becomes harder for low-income countries to offset their technological disadvantage with their low-skill labor-cost advantage.
7. UNECA, AU, and African Development Bank 2018, table 2.1.
8. UNCTAD 2012.
9. WTO 2011.
10. African Development Bank forthcoming.
11. The observation that intra-African bilateral trade is less than gravity model predictions has led Naudé (2009) to describe this situation as the manifestation of a proximity gap.
12. African Development Bank forthcoming.
13. For a large sample of manufactures from 83 countries, Nunn and Trefler (2013, table 4) show that indicators of contract intensity are quantitatively as important as the traditional indicators of comparative advantage (product markets, labor markets, and financial markets) are as important determinants of comparative advantage as the traditional indicators (technology and factor endowments).
14. Brülhart (2009) reports the following intra-industry trade shares (internal, external) as a share of trade: EU-15 (46.6, 24.5); CEMAC (1.2, 0.1); WAEMU (0.9, 0.4); EAC (0.3, 0.4); SACU (0.3, 9.0).
15. Regolo (2017) explores these patterns of bilateral trade for a sample of 116 countries over the period 2000–10. She shows that export diversification is accompanied by the regionalization of trade, at least in the medium term.
16. It is assumed that the data represent an equilibrium in which bilateral trade and income are jointly determined with bilateral trade costs. Bilateral trade costs may vary across partners, and the elasticity of trade flows to trade costs is common to all partners. See Novy (2013) for the foundations and Arvis et al. (2016) for an application similar to this one.
17. Initial and terminal year trade costs are 273 and 230 for African least developed countries, 283 and 263 for African landlocked countries, and 208 and 198 for non-African least developed countries.
18. Egger and Shingal 2017.
19. The database covers 279 regional trade agreements notified to the WTO between 1985 and 2015. See Hoffman, Osnago, and Ruta 2017. Table A2.1 in the annex online gives the coverage for category of provisions for each African REC.
20. In their comparison of WTO-X areas in EU and US free trade agreements, Horn, Mayroidis, and Sapri (2010) note that 75 percent of 310 provisions in EU agreements are nonenforceable, while 85 percent of 82 provisions in US agreements are enforceable.
21. Schiff and Winters 2003.
22. The three measures of depth are all provisions; core provisions (WTO+ provisions plus competition and the movement of capital); and percentage of provisions covered. See de Melo, Nouar, and Solleder (2019; table 5). Drawing on this database, Laget et al. (2018) also produce evidence that vertical foreign direct investment is positively correlated with the depth of legal commitments in regional trade agreements.
23. See African Development Bank (forthcoming) for details and estimates at the REC level.
24. See Duggan, Rahardja, and Varela (2013) for Indonesia and Bas and Berthou (2012) and Arnold et al. (2012) for India.
25. Beverelli, Fiorini, and Hoekman 2017.
26. World Bank 2017.
27. World Bank 2019.
28. Abel 2018.
29. Arizala et al. 2018.
30. UNECA 2016a; see also https://www.integrate-africa.org.
31. Adepoju 2002.
32. UNECA, AMDC, and AU 2016; UNCTAD 2018. The status of the Free Movement of Persons protocol in CEN-SAD remains unclear (UNECA, AMDC, and AU 2016). However, it is worth noting that many CEN-SAD countries also belong to ECOWAS.

33. Adepoju, Boulton, and Levin 2010.
34. AU 2014.
35. Friebel, Gallego, and Mendola 2013.
36. Biavaschi et al. 2018.
37. The difference-in-difference analysis permits comparing the variation in bilateral migration stock between the group of countries that have ratified/implemented a protocol and those that did not before and after a free movement of persons protocol was adopted. For more details regarding the data and methodology, see Mbaye and Wahba (forthcoming).
38. https://au.int/en/ti/cfta/about.
39. UNECA 2017.
40. African Development Bank 2018a.
41. UNECA and AU 2008.
42. Ekpo and Chuku 2017.
43. Subsidiarity indicates that decisionmaking jurisdiction should coincide with a public good's spillovers (multilateral institutions for transnational public goods; regional institutions for regional public goods such as infrastructure, lakes, rivers, and waterways; and national institutions for national public goods).
44. Governance (implementing shared standards and policy regimes) is the intermediate public good necessary to generate the desired regional public goods. Regional public goods across the RECs include knowledge (education and scientific research); construction and operation of cross-border infrastructure; environment; and health, peace, and security.
45. As a reminder of the difficulty of delegating national authority, the European Union embarked on an ambitious program to create a seamless "single market" for energy in 1988. It is still far from being realized (see box 3.2).
46. UNECA, AU, and African Development Bank (2018, ch. 2) briefly covers cooperation in mining, health, and security. Newfarmer (2017) discusses the importance of cooperation beyond integration in goods markets. He argues that collective action on infrastructure and coordination of macroeconomic and regulatory policies have large returns to low-cost investments and that "these elements of regional cooperation may well have a larger return to the time invested of policymakers than focusing on tariff policy."
47. Alesina, Easterly, and Matuszeski 2011.
48. See Kessides, Noll, and Benjamin (2010) for further discussion and a discussion of the West African Telecommunications Regulatory Association.
49. In 2012, exports of electricity were around 3 percent of global production, compared with 17 percent for coal, 31 percent for gas, and 52 percent for oil (IEA 2014).
50. UNECA, AU, and African Development Bank 2018, p. 22.
51. UNECA, AU, and African Development Bank 2018, figure 2.8.
52. Gwilliam 2011.
53. Collier and Venables 2009.
54. Armenter and Koren (2014) develop such a model and give supporting evidence from the development of agglomerations around bridges in the United States. Also see the evidence on the Golden Quadrilateral highway rehabilitation project in India in box 3.5.
55. In a pioneering study, Limão and Venables (2001) estimated that a 10 percent reduction in trade costs raised trade by 30 percent and that hard infrastructure shortcomings accounted for nearly half of the transport cost penalty borne by intra-Sub-Saharan trade. They estimated that 1,000 km of overland travel added $1,380 to container freight costs compared with sea travel adding only $190. Building on this work and on World Bank estimates of the cost of road improvement and rehabilitation ($127,000 per km for the median project), Buys, Deichmann, and Wheeler (2010) use gravity coefficients to estimate the extra trade from improved road infrastructure. After taking into account cost effects of local variations, they estimate a one-year payback, with $254 billion of extra trade generated over the project's estimated lifetime at a cost of $32 billion.
56. For example, Jedwab and Storeygard (2017) have produced and assembled new data on railways and roads that cover 43 African countries over 1960–2015.
57. There were almost no roads or railroads at the end of the 19th century. About one-third of colonial budgets were devoted to the construction of railroads. Roads and railroads were not connecting cities, but they were directed to the interior to extract cash crops and minerals (Papaioannou and Michalopoulos 2018). Thus, connections across cities were still minimal at independence.
58. Calderón and Servén 2010.
59. Jedwab and Storeygard 2017.
60. Based on follow-up work by Jedwab and Storeygard (2018) for 39 African countries combining

data on railways and roads with georeferenced data and estimates of trade-cost elasticities to distance.

61. Casaburi, Glennerster, and Suri 2013.
62. Ghani, Goswami, and Kerr 2016.
63. Raballand, Macchi, and Petracco 2010.
64. Sieber 1999.
65. Raballand et al. 2011.
66. In a survey of South African firms for a sample of 1,300 shipments to Durban and Maputo, Sequeira and Djankov (2014) show that the probability of a bribe and the amounts were much higher in Maputo, where documentation is processed in person rather than online. Sequeira (2016) estimates a sharp reduction in the probability and amounts of bribes paid following the 2008 tariff reduction of 5 percentage points between South Africa and Mozambique. Thus, the reduction in bribes paid to avoid paying high tariffs may, in part at least, explain the low response of traded quantities to trade liberalization in contexts of corruption and the low import elasticities to trade costs estimated in the literature, which do not take into account bribes.
67. Teravaninthorn and Raballand (2009) were the first to show systematically that logistics markets such as bilateral agreements and queuing systems rather than road conditions and road controls contributed most to vehicle operating costs. They showed that operating costs of trucking fleets were similar to those in Europe but that transport prices (the prices paid by users) were much higher. Balistreri et al. (2018) give supporting microsimulation evidence for SADC.
68. UNECA, AU, and African Development Bank 2018, ch. 8.
69. UNECA, AU, and African Development Bank 2018.
70. Of course, in today's globalized world, there is no such thing as a "small country market," as we have learned from Singapore's success. Every country's market is the world market. Regional integration helps largely on the supply/production side, where it can achieve economies of scale and attract investors. But on the demand side, no one would invest thinking only about a country's domestic market. They would locate production there mainly to export to regional and world's markets.
71. If the TFA is fully implemented, the WTO predicts an increase of access to foreign markets of 39 percent for developing countries and 60 percent for least developed countries, with potential gains of up to $50 trillion annually for African exports (WTO 2015).
72. An expression coined by Baldwin (2006).
73. Del Prete, Giovannetti, and Marvasi 2017.
74. WEF 2013.
75. WEF 2013.
76. Most (44 of 47) WTO African countries have ratified, and 14 of 15 landlocked countries are signatories. Check the status: http://www.tfafacility.org/ratifications.
77. In a broader view, as reaffirmed in October 2013 by the AU governments, priorities through the TFA "include enhancing infrastructure and boosting productive and trade capacities, in addition to reducing transaction costs, barriers, incentivising the undertaking of reforms and improvements to the customs regulatory systems as well as boosting intra-African trade" (ICTSD 2017).
78. World Bank 2019.
79. Applying the mean estimate of Hummels and Schaur (2013) to the benchmark average estimates for the African Union in table 3.6.
80. These estimates are illustrative since part of the time spent in customs is likely to be higher for exports because comparative advantage is likely to be in agricultural products that require additional sanitary and phytosanitary–related controls at customs.
81. UNECA, AU, and African Development Bank 2018, p. 88.
82. Erasmus, Flatters, and Kirk 2006.
83. There are three categories of product-specific rules of origin. Changes in tariff classification impose the restriction that when a final good is produced using intermediates imported from outside the bloc, it should not belong to the same category as those intermediates. Regional value content takes several forms, including a minimum share of originating intermediates or a maximum share of nonoriginating intermediates. Technical requirements can take as many forms as imagination allows. Very often technical requirements are tailor-made to benefit narrow interests.
84. Product-specific rules of origin are numerous and hard to interpret. They are not available across the RECs, nor are data on the uptake of preferences, often referred to as preference utilization rates. Preference utilization rates are available on a systematic basis only for Australia, Canada, the European Union, and the United States. High preference

utilization rates usually indicate that preferences fulfill the objective of providing market access, while low ones are suggestive of restrictive rules of origin.

85. Keck and Lendle 2012.
86. The distribution of these indicator values and the model used to estimate the results in table 3.6 are described in a background paper.
87. In results not reported, estimates of time in customs are always greater for imports than exports. De Melo and Sorgho (forthcoming) report other simulations.
88. Other estimates of the gains from reducing time in customs are reported in de Melo and Wagner (2016). Controlling for many intervening factors, for the universe of exports of Uruguayan firms over 2002–11, Volpe Martincus, Carballo, and Grazianon (2015) estimate that a 10 percent reduction in median time spent in customs is associated, on average, with a 1.8 percent increase in the growth of firm-level exports.
89. Measured as equivalent variation, summed over private, public, and investment expenditures.
90. All dollar amounts are in 2014 prices and nominal exchange rates.
91. Hummels and Schaur 2013.
92. Note that Central Africa is a "composite" region that is based on less reliable data—though calibrated to the observed national accounts and UN-based trade statistics.
93. The aggregate numbers—particularly in the case of the first two scenarios focused on the standard trade distortions (tariffs and nontariff barriers)—mask the fact that some countries could witness losses in real income as the efficiency gains in removing the trade distortions can be overwhelmed by losses in the terms of trade that are typical in Armington-based trade models.
94. The government closure rule keeps real government expenditures constant. So, the fall in government real revenues under scenario 1 is an estimate of the increase in household taxes needed to keep government expenditures at their base level.

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COUNTRY NOTES

Algeria

Macroeconomic performance

Real GDP growth was an estimated 2.5% in 2018, up from 1.4% in 2017, driven mainly by growth in the non-hydrocarbon sector (5.2% growth) and significant fiscal spending (36.7% of GDP). The hydrocarbon sector remained sluggish (shrinking 0.1%).

Growth estimates and projections over 2018–20 are based on the conservative hypothesis of a weak hydrocarbon sector and a slightly improving nonhydrocarbon sector. Economic growth is projected to be 2.7% in 2019 and 1.9% in 2020. The subdued 2020 growth is due partly to a more restrictive fiscal policy—as of 2019 public expenditures are projected to decline due to budgetary consolidation, which is projected to reduce the fiscal deficit from 5.3% of GDP in 2018 to 5.0% in 2019 and 4.7% in 2020.

Faced with contracting bank deposits since 2015, the Bank of Algeria resumed bank refinancing and stimulated the interbank money market by reducing reserve requirements and better regulating the capital markets. Inflation remained under control at 4.8% in 2015, 6.4% in 2016, and 5.6% in 2017.

Tailwinds and headwinds

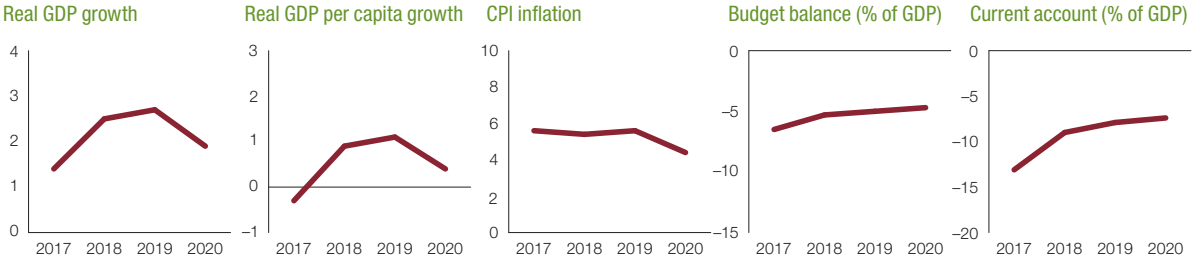
Algeria's infrastructure, geographic position, diaspora, domestic market, and natural resource endowment provide the assets to transform and diversify its economy. In addition, the external debt reduction policy over the past decade and substantial foreign exchange reserves, though declining, enable Algeria to better withstand economic shocks.

Algeria has not financed its deficit through increased external debt, which remains negligible at less than 2% of GDP. Likewise, government debt, consisting mainly of domestic debt, is limited to 40% of GDP. A major decline in external financial resources led authorities in 2016 to adopt the New Economic Growth Model 2016–2030, aimed at structural transformation. The main reforms relate to improving the business climate and replacing direct and indirect subsidies with targeted social protection for low-income populations.

To respond to the sharp deterioration in the country's external position in 2015, import restrictions were introduced on 850 products. The large current account deficit in 2018 (9% of GDP) is smaller than in 2017 (13.1%) and is projected to reach 7.4% in 2020. Official foreign exchange reserves decreased from 22.5 months of imports at the end of 2016 to 18.6 months in June 2018, and the drop is expected to continue. Inflation is projected to drop further to the 4% range by 2020.

Despite efforts to diversify the economy, Algeria still depends on external resources from oil and gas exports. Directly or indirectly, around 80% of the economy relates to hydrocarbons. The economic outlook will depend mainly on hydrocarbon prices, which started to fall in June 2014, rebounded to nearly $80 a barrel in October 2018, and fell again toward the end of the year. Between 2012 and 2017, falling oil prices reduced the hydrocarbon sector's contribution to GDP from 37.1% to 21.1%. Real GDP growth, projected at 2.7% in 2019 and 1.9% in 2020, seems insufficient in the medium term to tackle social protection and unemployment reduction.

The terms of trade improved in 2017 and 2018. The real exchange rate depreciated by 8.8% in 2018.



Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

Angola

Macroeconomic performance

A sharp decline in oil prices since 2014 has harmed the oil-dependent economy, and real GDP shrank by 0.2% in 2017 and an estimated 0.7% in 2018.

Fiscal revenues declined by more than 50% between 2014 and 2017. Fiscal consolidation through better mobilization of nonoil fiscal revenue and spending cuts reduced the budget deficit to an estimated 2.8% of GDP in 2018 from 4.8% in 2017. Public debt, largely external, increased from 40.7% of GDP in 2014 to an estimated 80.5% in 2018, raising concerns about its sustainability.

The country's external imbalances created a shortage of foreign currency, which dampened growth in the nonoil sectors. In January 2018, the central bank adopted a more flexible foreign exchange regime that resulted in an overall depreciation rate of more than 40%. Inflation decreased from 31.7% in 2017 to an estimated 21.1% in 2018. As oil prices recovered, the current account deficit stabilized at 0.1% of GDP in both 2017 and 2018.

Poverty incidence fell from 68% in 2000 to 37% in 2018. Poverty is more dominant in rural areas (58%) than in urban areas (19%). Although the country's Gini coefficient was last estimated at .427 in 2008 by the World Bank, anecdotal evidence suggests that inequality remains high, at around .65. The unemployment rate was an estimated 20% in 2018 and remained high among young people in urban areas (38%).

Tailwinds and headwinds

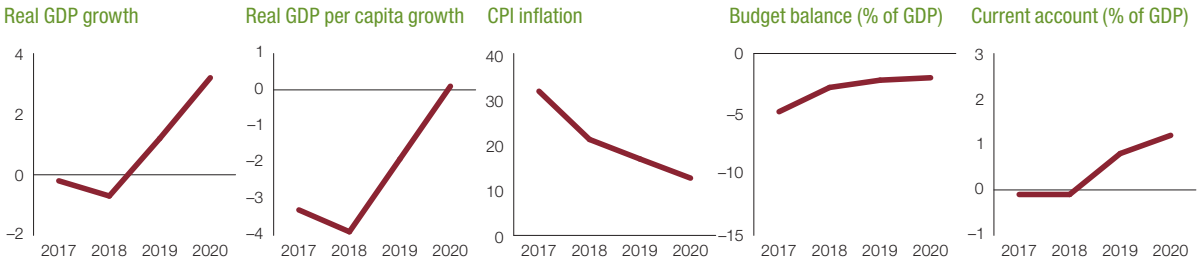
Angola is projected to emerge from recession with real GDP growth of 1.2% in 2019 and 3.2% in 2020. The recovery will be driven mainly by the production and export of diamonds (growing by 8.2%), agriculture (5%), and construction (2.1%). Changing to a floating exchange regime in 2019 could eventually eliminate the gap between the official and parallel market exchange rates. A 14% value added tax to be introduced in July 2019 will also mobilize domestic resources.

Despite being a Lusophone country sandwiched between Anglophone and Francophone countries, Angola plays a vital role in Southern Africa. It is a member of the Community of Portuguese Language Countries and the Southern African Development Community and is a signatory to the African Continental Free Trade Agreement. In efforts to open Angola's borders, a 2018 law allows for exemption and facilitated tourist visa processing.

To attract foreign investment, a new private investment law approved in June 2018 reduces the minimum capital requirement, facilitates repatriating capital, and eliminates a requirement that local investors have a 35% stake. But the law does not cover specific sectors regulated by other laws, such as mining, oil and gas, and financial services. The country is also working to improve market regulation by addressing governance issues, enacting a competition law in May 2018, and improving the efficiency of state-owned enterprises through privatization.

High dependence on oil remains the key risk to Angola's outlook. Oil production fell by 9% in the first half of 2018 compared with 2017 due to declining investments, mostly in offshore fields. Angola's oil revenues may also suffer from US–China trade tensions if stringent tariffs slow China's economic growth and thus hamper its demand for crude oil.

Angola's economic outlook is also linked to implementing two medium-term plans: the Macroeconomic Stability Program addressing macroeconomic imbalances and the National Development Plan fostering stronger governance, sustainable and inclusive growth, and competitiveness in the nonoil sector.



Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

Benin

Macroeconomic performance

Real GDP growth was an estimated 6.0% in 2018, up from 5.4% in 2017, due to good performance in agriculture, especially cotton (with 5.6% growth); the industrial sector (6.7%), driven by cotton ginning plants (18%); and the building and public works sector (8.5%). The services sector grew by 7.5% because of dynamism in transport, post, and telecommunications (with 10.6% growth); banks and other financial institutions (9.5%); and trade and the food and hotel industries (6.9%). On the demand side, growth was driven mainly by final consumption (up by 3.6%). The trade deficit fell slightly to 8.3% of GDP from 9.1% in 2017.

The budget deficit (including grants) declined to an estimated 4.7% of GDP in 2018, from 5.9% in 2017, due to mobilizing revenue (1.2% of GDP) and reducing current expenditures. Domestic debt (60% of total public debt) was 30.9% of GDP, and the risk of debt distress went from low to moderate. Benin operates a common monetary policy established by the Central Bank of West African States. The inflation rate increased to an estimated 1.6% in 2018 from 0.1% in 2017.

Tailwinds and headwinds

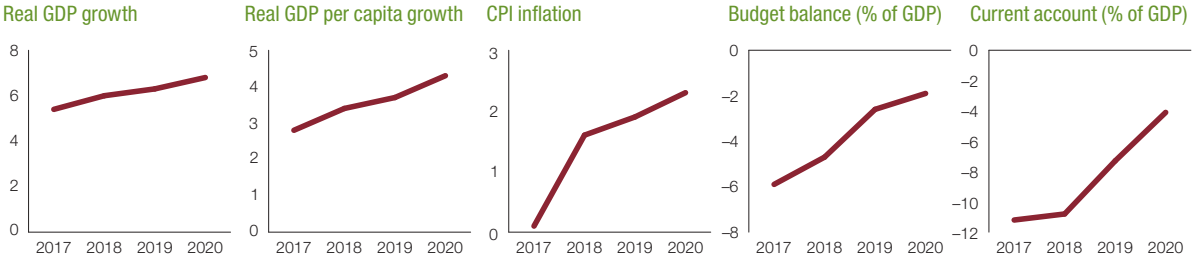
Real GDP growth is projected to be 6.3% in 2019 and 6.8% in 2020. Growth in the raw materials extractive sector is projected to reach 5.7% in 2019, driven mainly by the cotton sector. Industrial growth is projected to expand by 13.3% in 2019, owing to building and public works (growing by 25%) and the electricity and water sectors, projected to grow 8% as the 120 MW Maria-Gléta power plant begins production. The budget deficit is projected to level off at 2.6% of GDP in 2019 and 1.9% in 2020. Total public debt is projected to fall to 53.3% of GDP in 2019 and 48.9% in 2020.

Under the 2017–25 Strategic Plan for the Development of the Agricultural Sector and the 2017–21 National Plan for Agricultural Investments, Food, and Nutrition Safety, seven agricultural development poles were created in 2017. The strategy to promote several subsectors—maize, rice, cotton, cashew, cassava, and pineapple—is ongoing.

Business creation procedures have improved. Electricity sector reforms initiated in 2016 should improve governance and double installed capacity to 500 MW by 2021. The gross enrollment ratio was estimated at 124.82% in 2015, and implementing the 2018–21 National Policy of Education should improve the sector. In the fight against HIV/AIDS, progress is visible, with prevalence estimated at 1%.

Benin is a member of the African Union, the Economic Community of West African States (ECOWAS), and the West African Economic and Monetary Union. Benin is highly integrated with the regional market: 70% of its exports go to the ECOWAS zone (mainly Nigeria). However, regional trade opportunities have been reduced since 2015 due to economic reforms in Nigeria removing oil and gas sector subsidies and banning the re-export of rice, used cars, and used clothing. The port of Cotonou remains a transit corridor for hinterland countries such as Burkina Faso, Mali, and Niger. Benin is also integrated into the regional capital markets and is host to subsidiaries of regional banking groups. The free movement of people remains hampered by unofficial border barriers, which raise transaction costs. The main challenges for the country are diversifying exports and modernizing trading services and trade and transport services.

Economic growth prospects are good but remain vulnerable to external shocks, especially rainfall, global cotton and oil prices, and changes in Nigeria's economic situation.



Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

Botswana

Macroeconomic performance

Real GDP growth was an estimated 4.2% in 2018, up from 2.4% in 2017, boosted largely by the recovery in mining and broad-based expansion of nonmining activities. The growth in mineral production was driven mainly by favorable global trading conditions and the commencement of operations at the Damtshaa Mine in January 2018. The nonmining expansion was driven largely by continuing accommodative fiscal and monetary policies, as well as recovery in downstream diamond industries. Though subdued, agricultural growth was sustained in 2018, buoyed by good weather conditions. Manufacturing also picked up slightly, benefiting from stable water and electricity supply.

The fiscal deficit in 2018 was an estimated 1.0% of GDP, due to higher spending and a decline in revenues from the volatile Southern African Customs Union. The government is financing the deficit by issuing additional securities under the existing government note program. Public debt fell to 20.4% of GDP (12.7% external and 7.7% domestic) in 2018 from 21.1% in 2017. The overall debt remains sustainable and well below the country's statutory ceiling of 40% of GDP.

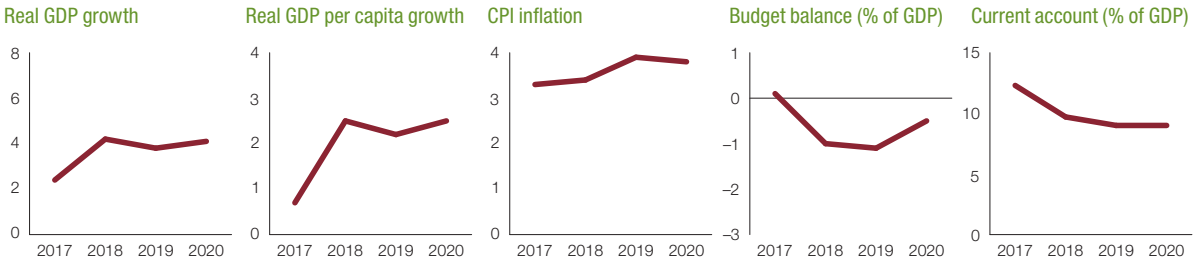
Monetary policy aims mainly at price stability and remains accommodative, taking advantage of low inflation. Inflation was an estimated 3.4% in 2018, up marginally from 3.3% in 2017 but within the Bank of Botswana's medium-term target of 3%–6%. The real effective exchange rate has remained stable and competitive because of the crawling peg exchange rate regime. In September 2018, gross reserves amounted to about $7.1 billion, or 17 months of imports.

Tailwinds and headwinds

Growth prospects for the medium term are favorable, with real GDP growth projected at 3.8% in 2019 and 4.1% in 2020. The outlook for the mining sector is positive due to an anticipated increase in demand for Botswana's rough diamonds (diamonds account for three-fourths of Botswana's total exports). The nonmining sectors are expected to pick up further, driven by structural reforms, including an amended immigration law that ensures expeditious processing of work and residence permits and a move that provides utilities at reasonable prices to encourage domestic manufacturers. Construction is expected to continue benefiting from the ongoing fiscal stimulus.

But growth prospects are clouded by high unemployment (particularly youth unemployment) and income inequality. Downside risks associated with weak global demand for diamond exports remain elevated in light of the threat to global growth from escalating trade tensions. Other notable risks include persistent drought affecting livestock and agricultural production and lower Southern African Customs Union revenues if South Africa's economic conditions remain unfavorable.

The risks underscore the need to accelerate structural reforms to promote economic diversification and higher productivity and thus reduce vulnerability to external shock. With promising medium-term growth prospects and ample fiscal space, policies could prioritize the economic transformation needed to deliver more inclusive, resilient, and job-creating growth. Overcoming the skills shortage, infrastructure bottlenecks, and high cost of doing business could expedite integration into regional and global value chains and thus economic diversification.



Note: Data are for fiscal years, so 2017 refers to the 2016/17 fiscal year.
Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

Burkina Faso

Macroeconomic performance

Real GDP growth continued at an estimated 7.0% in 2018, compared with 6.7% in 2017. Key contributors were food agriculture (up 14.2% in 2018), extractive industry (20.5%), and cotton ginning (8.0%). Final consumption was the main component of domestic demand. The tax burden rose to approximately 18.0% of GDP in 2018 from 16.5% in 2017, while total outstanding public debt declined from 36.6% of GDP to 33.4%. Inflation increased to an estimated 1.4% in 2018, reflecting higher food prices. The current account deficit improved to an estimated 7.2% of GDP in 2018 from 7.6% in 2017.

Tailwinds and headwinds

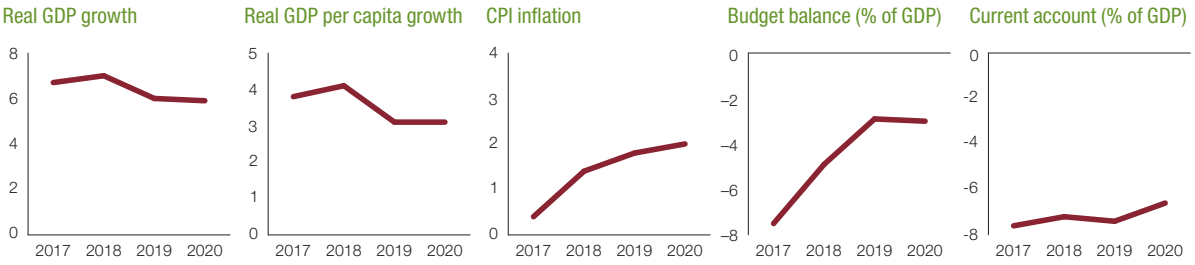
Real GDP growth is projected to be 6.0% in 2019 and 5.9% in 2020, driven mainly by cotton ginning, cash crop farming, and financial services. As cooperation with China resumes, anticipated investment in such sectors as energy should strengthen economic growth—installed electricity generation capacity is projected to reach 1,000 MW in 2020, up from 650 MW in 2018. On the demand side, final consumption and investment will remain the key drivers of GDP growth in 2019. Budgetary policy will aim to reduce the fiscal deficit below 3% from the estimated 4.9% in 2018. Key interventions will aim to improve agro-sylvo-pastoral productivity and raise the manufacturing sector's contribution to GDP to 12% in 2020 from 8% in 2018.

Burkina Faso is pursuing reforms in several sectors. In the energy sector, 2017 legislation broadened the powers of the Energy Regulatory Authority, and the construction of eight additional solar power plants is expected to add 100 MW to the country's installed capacity. In the agricultural sector, Burkina Faso is pursuing development of growth poles, following the success of the Bagré Growth Pole Project. Establishing a cotton ginning unit in Koudougou should contribute to local transformation. The mining sector expected 15,000 new jobs and 3.5 billion CFA francs in investment in 2018. On the social front, about 10.8 million instances of illness in children under age 5 were treated under the free health care policy.

Burkina Faso is a member of the Economic Community of West African States (ECOWAS) and the West African Economic and Monetary Union (WAEMU). But trade with regional partners remains weak, due partly to nontariff barriers. Interconnecting Burkina Faso's customs system with Togo's in May 2018 is expected to reduce the time spent at the Cinkansé checkpoints from a few days to about two hours. The free movement of goods and people faces racketeering and other obstacles, which have increased with the jihadist threat in the region. The banking system is integrated into the WAEMU payment system. Regional banking groups have quickly established their subsidiaries in the country.

Burkina Faso is a cultural crossroads in the ECOWAS region. It hosts such flagship events as the Panafrican Film and Television Festival of Ouagadougou and the International Handicrafts Fair of Ouagadougou.

Risks weighing on the country's outlook come from social tensions, deteriorating security conditions, and price shocks due to rainfall and global commodity prices for oil, gold, and cotton. Burkina Faso is landlocked and depends heavily on its neighbors for transit, so that transportation costs can account for up to 60% of the cost of goods—a situation aggravated by poor infrastructure.



Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

Burundi

Macroeconomic performance

Real GDP growth improved to an estimated 1.4% in 2018, following a 0.2% contraction in 2017. The slight recovery in GDP was due to resurgence in the services sector (7.4%) following the return of relative calm, and increased production of key export items such as coffee and tea. Manufacturing and agro-processing also contributed to the recovery by growing at 3.2%. The transport and telecommunications sectors weathered the political instability and insecurity better than the construction and hotel and tourism sectors, which depend heavily on foreign financing.

The budget deficit for 2018 was an estimated 8.8% of GDP, up from 6.5% in 2017. The first quarter of 2018 recorded tax and nontax income that was 19.2% higher than in the first quarter of 2017, due mainly to 28.3% more tax revenue from domestic trade and 27.1% more from income. Public spending increases are expected to be 4.6% in comparison with 2017.

In 2018, the central bank continued an expansionary monetary policy that began in 2015. Inflation in 2018 was an estimated 12.7%, due mainly to higher food prices. The official exchange rate was 1,795 Burundian francs per US dollar in October 2018, compared with 1,670 in October 2015—a 3.5% depreciation. The parallel market sees increased pressure on the exchange rate: 2,710 Burundian francs per dollar in October 2018. The current account deficit fell slightly in 2018 to 10.4% of GDP from 11.6% in 2017.

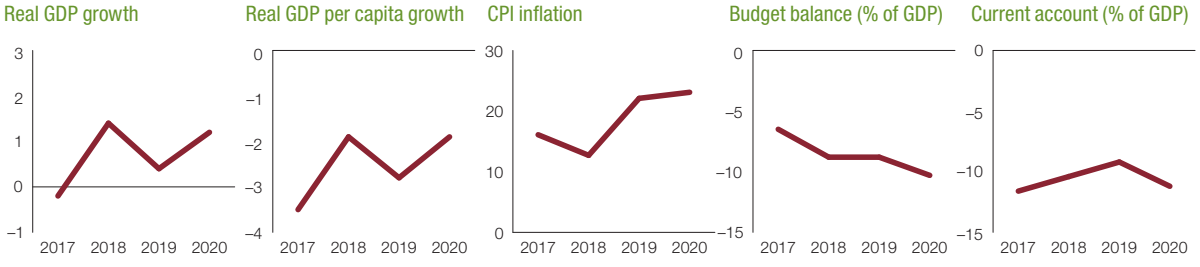
Tailwinds and headwinds

Economic growth is projected to continue at a slower pace—0.4% in 2019 and 1.2% in 2020—driven primarily by increased production and export of coffee and tea, improved terms of trade (from –11.7% in 2018 to 1% in 2019), and higher investment (from 11.8% of GDP in 2018 to 12.4% in 2019). Inflation is projected to nearly double to 22.1% in 2019 and 23.1% in 2020. With a portion of international assistance frozen, the budget deficit is projected to remain at 8.8% in 2019 but to worsen to 10.3% in 2020. The current account deficit is projected to fluctuate between 9.2% in 2019 and 11.2% in 2020.

Several strengths and opportunities, if tapped, will have a considerable impact on growth and job creation. They include underexploited mining potential for peat, limestone, nickel, coltan, phosphates, vanadium, carbonatites, and other minerals; exploitable hydropower potential of 1,300 MW, with less than 40 MW tapped; and the development of the 650 kilometer Lake Tanganyika, whose roughly 10 ports could make it an interregional trade hub. In this regard, renovating Bujumbura port will boost trade, especially among countries of the subregion, such as Democratic Republic of Congo, Rwanda, Tanzania, Uganda, and Zambia.

These economic prospects are filled with uncertainty. Agricultural production remains vulnerable to climate shocks, as happened in 2015 when flooding caused by El Niño was followed by drought. Burundi is also subject to international sanctions that reduce foreign aid that could finance development. The country will have to find new sources of finance if the situation does not change.

Finally, the economic prospects face political and economic uncertainty, especially as the 2020 elections approach. Fragility persists in weak capacity, widespread poverty and youth unemployment, and low capacity to generate or use fiscal space.



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Cabo Verde

Macroeconomic performance

Economic growth was an estimated 3.9% in 2018, down marginally from 4.0% in 2017. This performance was supported by strong growth in the electricity and water sectors (22.8%), manufacturing (14.2%), tourism and hotels (14.9%), fisheries (9.4%), retail trade (8.1%), and financial intermediation (8.1%).

Fiscal consolidation helped reduce the fiscal deficit to an estimated 2.4% in 2018 from 3.1% in 2017, and the deficit is projected to continue to narrow gradually, to 1.9% in 2019. But public debt has been above a sustainable threshold—126% of GDP in 2017.

The Banco de Cabo Verde's cut its policy rate by 200 basis points to 1.5% in June 2017, prompting a decline in commercial banks' average lending interest rate from 6.5% to 4.5% at the end of 2018. As a result, credit to the economy expanded by 7.5%. Consumer price index inflation remains low, rising to 1% in 2018 from 0.8% in 2017 due to expected price increases in food and energy products. Foreign reserves cover about 5.9 months of imports of goods and services and remain adequate to maintain the unilateral exchange rate peg to the euro.

The current account deficit widened from 7.6% in 2017 to 8.5% in 2018 as total import growth outpaced export revenues (in particular those from tourism) amid declining remittances. Apart from tourism, the country's main exports are fisheries and manufactured goods (clothing and footwear). The main imports are fuel, equipment, machinery, and consumer goods, mostly from Spain and Portugal, the country's largest trading partners.

The economy is expected to maintain real GDP growth, projected at 4.1% in 2019 and 4.8% in 2020. Growth is expected to be driven by remittance inflows, manufacturing, continued growth in tourism, and increased public infrastructure spending. Private investment supported by favorable domestic credit conditions will also contribute to economic growth.

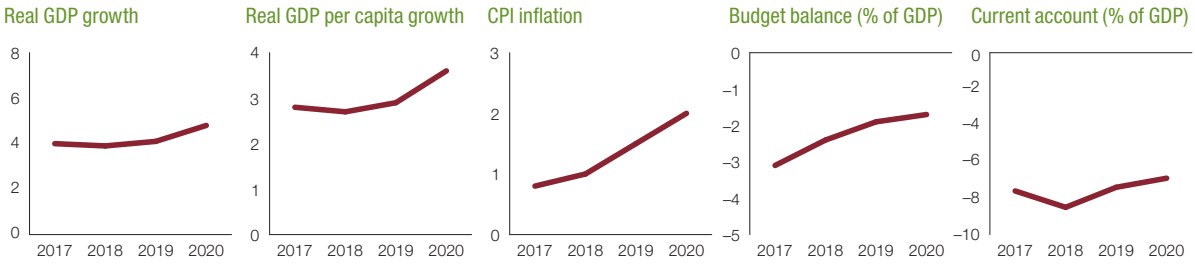
Tailwinds and headwinds

Headwinds to the outlook are exogenous. Emerging global trade tensions among China, Europe, and the United States—key trading partners to the island economy—could hurt exports. As an archipelago state, Cabo Verde is highly fragile and vulnerable to climate change, thus requiring additional resources to build resilience. The unilateral exchange rate (pegged to the euro) requires fiscal buffers sufficient to absorb future shocks.

Cabo Verde's economic development model depends on remittances, external transfers, and development aid, so the country is vulnerable to external shocks. The government has adopted a Strategic Plan for Sustainable Development (2017–2021), which identifies priority sectors for economic diversification, such as tourism, agriculture, infrastructure, and light industry.

The government has financed its fiscal deficit through concessional loans from bilateral and multilateral lenders (about 75% of total public debt) and treasury bonds issued to commercial banks and other private creditors. Bringing down the high public debt (126% of GDP in 2017) and lowering the risk of external debt distress require sustained effort. Planned fiscal consolidation, especially privatizing nonperforming state-owned enterprises and creating public–private partnerships for large investment projects, could reduce debt vulnerabilities.

Income inequality and social exclusion remain critical. To increase productivity and address high youth and female unemployment, the government is currently supporting micro, small, and medium enterprises through business incubator grants and employability pilot projects.



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Cameroon

Macroeconomic performance

The regional, economic, and financial environment has remained fragile and challenging, despite fiscal consolidation by Central African Economic and Monetary Community (CEMAC) countries, rising oil prices, and restrictive monetary policy in CEMAC, which led to improved economic performance in 2018. Real GDP growth reached an estimated 3.8% in 2018, up from 3.5% in 2017. Domestic demand (consumption and investment) was the mainstay of economic growth. The fiscal deficit continued to fall to an estimated 2.6% of GDP in 2018 from 4.9% in 2017 and 6.2% in 2016.

Financing through commercial and public loans of infrastructure projects carried out as part of the country's emergence policy led to an accumulated government debt of 34% of GDP (38% including large state enterprises) in 2018, compared with 12% of GDP in 2007. As in 2017, common monetary policy remained restrictive in 2018. Inflation was an estimated 1.1% in 2018, below the 3% community requirement. The current account balance remained in deficit, at an estimated 3.2% in 2018, up from 2.7% in 2017.

Tailwinds and headwinds

Real GDP is projected to grow by 4.4% in 2019 and 4.7% in 2020, following energy and transport production infrastructure startup, as well as rising world oil prices. The current account deficit is projected to level off at 3.1% of GDP in 2019 and 2020. Inflation is projected to remain below the 3% community requirement.

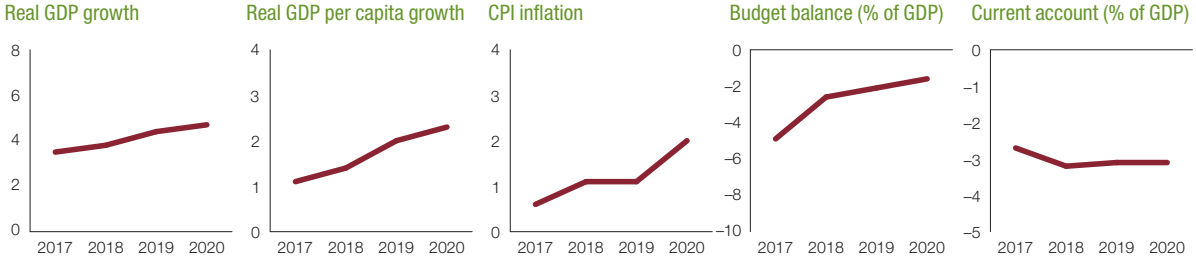
But the growth prospects have some uncertainties. Expected budget revenue in 2019 depends heavily on fluctuating world oil prices. Cameroon will also have to continue efforts to restore the fiscal balance, rebuild foreign exchange reserves, and strengthen regional currency parity.

Deterioration in the security situation in the North-West and South-West regions, in the throes of a persistent sociopolitical crisis, could also darken prospects for economic growth because these regions house important areas of agricultural production and the country's largest agribusiness. If the crisis continues, it could increase expenditures for defense and security and affect the 2019 budget.

Although Cameroon's economy remains the most resilient in Central Africa in terms of diversification, the weakness of its growth base and its great exposure to fluctuations in world prices for raw materials are significant factors of economic vulnerability.

Implementing value chain projects in the agro-sylvo-pastoral and fisheries sectors could help strengthen the country's economic resilience. Strengthening resilience also requires improving the economy's competitiveness, especially with greater support for facilitating transport, developing trade at the regional level, taking account of the country's geographic location, and providing support for private sector development.

To reach economic emergence by 2035, and based on the Strategic Document for Growth and Employment (2010–2020), a 10-year strategy for the Vision 2035, the government has implemented a substantial investment program to accelerate growth, create decent jobs, and reduce poverty. The program involves implementing structuring projects in key sectors of the economy. For example, the government has already implemented a variety of power generating facilities to reduce the lack of infrastructure and increase installed capacity, which is close to 1,300 MW, and has turned the energy sector into a key export sector.



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Central African Republic

Macroeconomic performance

The economy is experiencing a slow recovery after a period of recurring sociopolitical crises that began at the end of 2012. Real GDP grew by an estimated 4.3% in 2018, up from 4.0% in 2017, led by the primary sector through a rebound in logging, agriculture, and mining.

The fiscal balance improved to an estimated surplus of 1.0% of GDP, from a deficit of 1.5% in 2017. Despite the tightening of the Bank of Central African States's monetary policy, due to difficult security conditions, inflation was an estimated 3.9% in 2018, down from 4.1% in 2017 but still above the Central African Economic and Monetary Community's 3% requirement. The current account deficit improved to an estimated 8.3% of GDP in 2018 from 9.4% in 2017, thanks to improvements in the trade balance.

Tailwinds and headwinds

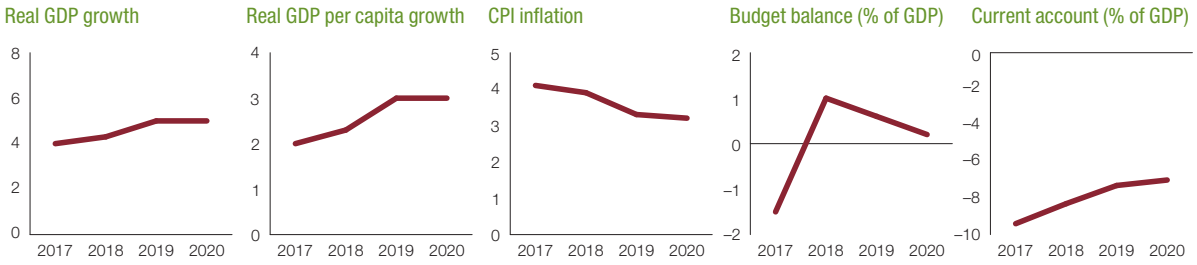
The economic recovery is projected to continue in 2019 and 2020, with real GDP growth of 5.0%. The primary sector is expected to benefit from a resumption of farming and the continued good performance of mining operations. Public investment and private consumption are expected to be the drivers of growth. Inflation is projected to fall gradually to 3.2% in 2020, reflecting improved security conditions and declining food prices. The fiscal surplus is projected to be 0.6% of GDP in 2019, dropping to 0.2% in 2020, as a result of the gradual rise in revenue and control of public spending. The current account deficit is projected to fall to 7.3% of GDP in 2019 and 7.0% in 2020, reflecting a recovery in domestic production, improved current transfers, and a narrower trade deficit.

The economic outlook is favorable, albeit uncertain. Economic growth depends largely on political stability, continued reform, improved performance of the forestry sector, and public investment under the National Development Plan. Low economic diversification and heavy dependence on foreign aid (more than 40% of the budget) and oil products leave the economy vulnerable to external shocks.

Despite the 2016 return to constitutional rule, the country remains fragile, particularly in terms of security, and is characterized by a limited infrastructure network, a low Human Development Index value, weak governance, and high vulnerability to external shocks.

The restoration of peace throughout the country and the improvement of the business climate are necessary conditions to attract private investment, which could enable the country to take advantage of its enormous forestry and mining potential. Authorities have already revised the trade and tax code and submitted a revised investment charter to parliament to strengthen the dialogue between the public and private sectors.

The country's forestry and ecotourism resources cover some 34 million hectares. In 2017, the exploitation of some of these forestry resources, which contain a broad range of varieties, accounted for about 40% of export earnings. In addition, the country has substantial mineral resources such as diamonds, gold and uranium, iron, and copper. However, only diamonds are mined by an artisanal sector and account for about 35% of export earnings, thanks to the partial lifting of the Kimberley Process embargo.



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Chad

Macroeconomic performance

Real GDP grew by an estimated 2.8% in 2018, after contracting 3.8% in 2017, supported by the Glencore debt renegotiation in February 2018 and substantial external financing. The fiscal balance was an estimated surplus of 0.1% of GDP, up from a deficit of 0.8% in 2017, thanks to increased revenue (mainly from oil), budget support, and control of total expenditure, particularly salaries (down 6%). The second review of the International Monetary Fund's (IMF) Extended Credit Facility was approved in July 2018.

Monetary policy is part of the Central African Economic and Monetary Community (CEMAC) stabilization policy. Inflation rose to an estimated 2.1% in 2018, from –0.9% in 2017. The current account deficit improved to an estimated 4.3% of GDP in 2018 from 6.6% in 2017, in conjunction with the improved trade balance (from 3.0% in 2017 to 8.4% in 2018) following the recovery in oil prices.

Tailwinds and headwinds

Real GDP growth is projected to pick up in 2019 (4.2%) and 2020 (5.8%), aided by the surge in oil prices and the renegotiation of the Glencore debt. The secondary sector, heavily affected by the crisis, is projected to recover (growing by 2.2%) in 2019, like the tertiary sector, which could grow by up to 1.2%.

Since 2017, the IMF has rolled out a financing program for Chad. With the approval of the first two reviews in 2018, the consolidation of the public and external accounts is expected to continue in 2019 and 2020. The budget balance is projected to record a surplus of 0.2% in 2019 and 0.5% in 2020, while the current account deficit is projected to be 4.3% in 2019 and 4.5% in 2020. Inflation is projected to settle at 2.3% in 2019 and 2020, in line with the CEMAC requirement.

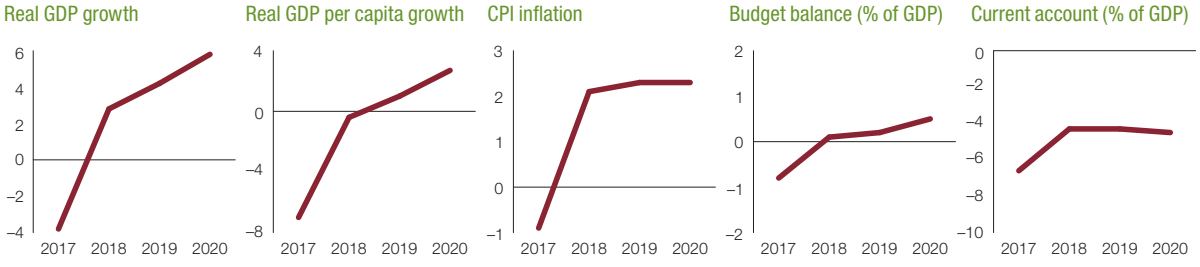
Threats that could undermine these prospects include volatile oil prices, insecurity linked to Islamist groups disrupting cross-border trade, and the effects of climate change (particularly drought and locust infestation), which could affect the agricultural sector.

The economy depends heavily on oil, which accounted on average for 78% of total exports in 2016–18 and 89% in 2018. Oil revenues averaged more than 65% of total nongrant revenues in the precrisis period (2009–14). So the economy needs diversification, which could pay off if the agricultural sector were to be developed.

Moreover, the country lacks an industrialization strategy (though a study aimed at formulating an industrialization policy was launched recently). The secondary sector accounts for less than 15% of GDP. The infrastructure deficit is very pronounced, with an index score of 7.239 out of 100 (resulting in a rank of 51 out of 54 countries) in 2018.

With a Human Development Index value of 0.396, Chad was ranked 186 out of 188 countries in 2016, indicating that the country is lagging significantly in this area. Declining oil prices, which have plunged the country into a fiscal crisis since 2015, have weakened some of the progress in social indicators.

Chad has considerable agricultural potential. In 2017 the sector accounted for almost 50% of GDP and employed 90% of the population. In 2018, the government adopted an agricultural policy in support of value chain development. A large landlocked country, Chad has made regional integration a pillar of its development strategy. It is making a major contribution to the development of regional integration infrastructure, including electricity interconnection, preservation of the Chad Basin, a fiber optic backbone project, and the Algeria–Niger–Nigeria–Chad trans-Saharan road.



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Comoros

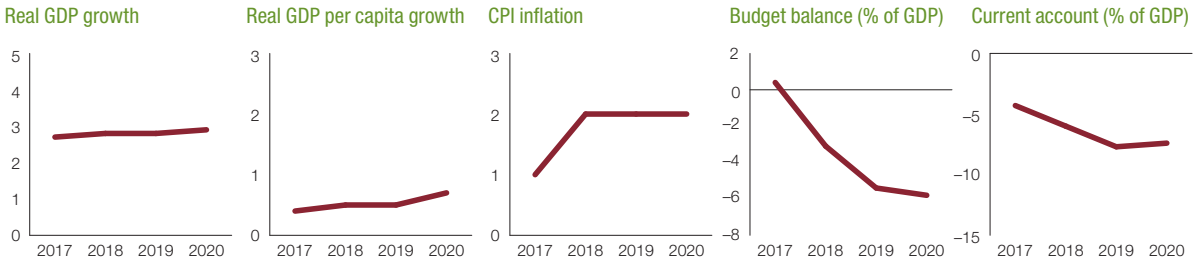
Macroeconomic performance

In 2018, real growth remained stable at an estimated 2.8%, close to the 2.7% in 2017. From the supply side, growth was driven mainly by improved access to electricity, increased telecommunications activity, and diaspora remittances. From the demand side, growth was driven by public investment and exports, which benefited from rising vanilla prices. The fiscal balance turned to an estimated deficit of 3.1% of GDP in 2018 from a surplus of 0.4% in 2017. With the Comorian franc's peg to the euro and the goal of price stability, the country does not resort to monetizing the budget deficit. External debt, an estimated 26.5% of GDP in 2018, down from 30.1% in 2017, is considered sustainable. The currency peg promotes monetary stability through compliance with convergence norms. In 2018, inflation was an estimated 2.0%, up from 1.0% in 2017, a result of the decrease in fuel and communication prices, the latter due to the entry of a private telephone provider. The current account deficit was an estimated 6.0% of GDP in 2018, up from 4.3% of GDP in 2017. The trade balance has a feature of structural deficit and often is financed by large flows of remittances. The real exchange rate was almost stable between 2017 and 2018 but is generally considered to be overvalued. Foreign exchange reserves are comfortable, at 6.6 months of imports in 2018.

Tailwinds and headwinds

Real GDP growth is projected to reach 2.8% in 2019 and 2.9% in 2020, almost unchanged from 2018. But the economic outlook is expected to be more favorable due to a gradual improvement in the electricity sector (though it remains fragile) and to the government's commitment to a major development program, with the gross investment rate expected to increase from 22.5% in 2017 to 25.1% in 2019. The country has defined its 2030 Emergence Plan and is implementing the roadmap towards its 2030 goals. In January 2018, the government promulgated a law to increase the share of renewable energy in its overall consumption to improve energy independence. There is also a favorable trend projected in trade, with levels of –0.6% in 2019 and 2.7% in 2020, from –3.8% in 2018.

But a turbulent political environment could affect economic activity. There are mixed opinions on the results of the constitutional referendum of July 2018, which suspended the rotating presidency of the three islands until 2030. The fiscal situation also remains fragile, with continued underexpenditure on equipment and weaknesses in medium-term budget planning. The continued high nonperforming loans limit credit to the private sector. Finally, Comoros continues to face weak institutional capacities, which hamper the effectiveness of macroeconomic and sector management; a lack of basic infrastructure (energy and roads), whose poor quality hinders economic transformation; vulnerability to external shocks and heavy dependence on external aid; the low overall competitiveness of the private sector; high unemployment, especially among young people; and the high exposure to threats related to the overexploitation of natural resources (deforestation, land degradation, groundwater pollution, and coastal erosion) and climate change.



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Congo

Macroeconomic performance

Real GDP growth was an estimated 2.0% in 2018, after two years of contraction in 2016 (2.8%) and 2017 (3.1%). The recovery, which is not enough to reduce a 40% poverty rate, is due to rising oil prices and increased domestic production of hydrocarbons, supported by private investment in the Moho Nord oil field and increased exports of oil products. The fiscal deficit was an estimated 4.8% of GDP in 2018, down from 12.5% in 2017, thanks to an increase in revenue (13%) and a reduction in expenditure (24%) as part of the fiscal consolidation measures under the Central African Economic and Monetary Community (CEMAC) regional program.

As a CEMAC member, Congo is part of a regional strategy launched in 2017 to address the fiscal and external imbalances experienced by all countries in the zone following the fall in oil prices in 2014. This regional program, supported by technical and financial partners, is producing encouraging results, though additional and coordinated efforts are still needed.

Public debt remains a major concern: total public debt was around $10.6 billion at the end of 2017, or 118.5% of GDP, almost six times the 2010 level (20% of GDP). Although the debt ratio in 2018 decreased to 86%, in view of the recovery in growth and the rise in budgetary revenues, debt restructuring remains necessary to restore medium-term sustainability.

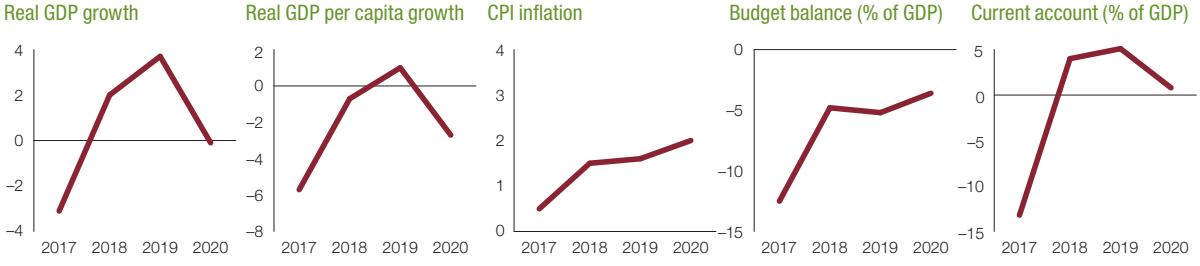
Tailwinds and headwinds

The economic recovery that began in 2018 is projected to gain momentum in 2019 with real GDP growth of 3.7%, driven by higher oil production and higher global oil prices. The improvement in electricity production resulting from the commissioning of the Liouesso hydropower plant, which will generate an additional 19.2 MW, is expected to enhance the competitiveness of the manufacturing sector. In addition, reforms aimed at strengthening the business climate should help boost investment. A contraction of 0.1% in real GDP is projected in 2020 due to declining oil production, which in turn is due to the depletion of reserves in some wells. Inflation is projected to remain under control at 1.6% in 2019 and 2.0% in 2020. The budget and current account balances are projected to improve.

But the favorable economic prospects are not immune to some threats. A drop in oil prices could increase pressure on the fiscal and external accounts as well as on the financial sector, which depends heavily on oil revenue. It is also important to improve the ratio of nonperforming loans, which has increased over the past two years due to the impact of the government's arrears to private providers. Moreover, unsuccessful disarmament, demobilization, and reintegration could be detrimental to the political and security environment, which is stable today.

Like other CEMAC countries, Congo faces important challenges. With the oil sector accounting for 55% of GDP, 85% of exports, and 80% of budget resources in 2017, the economy has not coped well with the fall in oil prices. Its necessary diversification requires improvements in the business climate and economic governance. Improved governance remains essential for macroeconomic rebalancing, the sustainability of public finances, good debt and spending management. It also requires strengthening human capital.

As a result of the oil boom, Congo has invested heavily in developing infrastructure (transport and energy) that could support the country's development efforts. The country has enormous potential for higher value added activities and productive employment. Congo has an immense potential in natural resources including forests and mines.



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Côte d'Ivoire

Macroeconomic performance

Real GDP growth reached an estimated 7.4% in 2018, down from 7.7% in 2017, supported by external demand for agricultural and oil products and stronger domestic demand resulting from major investment projects and households consumption. The economy faced several shocks in 2017, including a sharp decline in cocoa prices, higher oil prices, and social tensions. As a result, the budget deficit increased to 4.2% of GDP, but it improved to an estimated 3.8% in 2018. Public debt increased to 48.2% of GDP in 2018, driven by Eurobond issuances in 2017 and 2018. The risk of debt distress remains moderate. Inflation was low, at an estimated 0.5% in 2018, down from 1.0% in 2017. The current account deficit widened to an estimated 2.7% of GDP in 2018 from 1.8% in 2017.

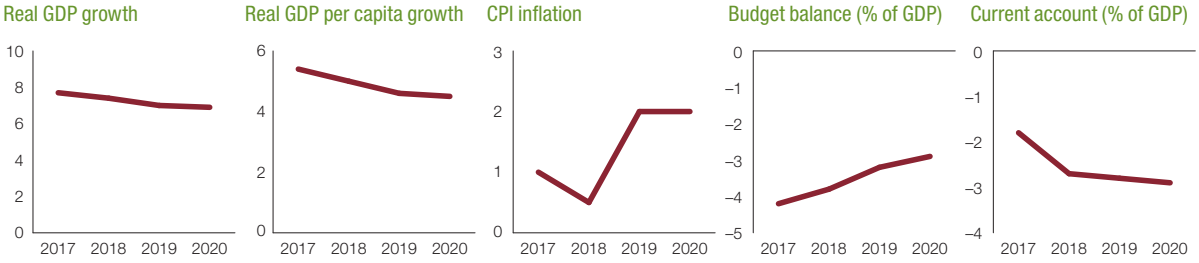
The economic outlook remains favorable, with real GDP growth projected at 7.0% in 2019 and 6.9% in 2020. A good performance in the agricultural sector will keep inflation below the 3% convergence threshold for the West African Economic and Monetary Union (WAEMU). The current account deficit is projected to stabilize at 2.8% in 2019, in connection with sustained imports of capital goods related to infrastructure projects.

The economy remains vulnerable to external shocks that may stem from unfavorable evolution of commodity prices (mainly cocoa and oil) and adverse climate conditions. Another pressing challenge is to sustain economic growth and ensure a more balanced distribution across sectors, with a view to achieving a structural transformation of the economy. This would require improving the quality of agricultural products and upgrading the industrial sector toward higher value added and high–job creation activities.

Tailwinds and headwinds

Côte d'Ivoire has implemented many reforms as part of its 2016–2020 National Development Plan. In energy, reforms have focused on ensuring the sector's financial sustainability, clearing arrears for independent producers, and investing in supply capacity. As a result, installed capacity increased by 56% between 2011 and 2018 to 2,200 MW. Rural electricity coverage has also expanded from 33% of the rural population to 54%. In agriculture, reforms have focused on accelerating the development of value chains and increasing local processing for major agricultural products, including cocoa, cashew nuts, palm oil, and rubber. Investment has also improved the quality of and access to basic education and health services. But poverty and inequality reduction remain a challenge.

Côte d'Ivoire is party to most of the relevant continental institutions dedicated to regional integration. The country has historically been an important destination for immigration and remains at the center of one of the continent's most dynamic migration routes. Côte d'Ivoire is also an important transit corridor for its landlocked neighbors, thanks to its ports in Abidjan and San Pedro. It is a key partner in the regional electricity market and is part of an electricity interconnection network with Benin, Burkina Faso, Ghana, Togo, and soon Mali, as well as to the Mano River Union countries (Guinea, Liberia, and Sierra Leone). Côte d'Ivoire is the major player in WAEMU's financial markets and hosts the regional securities exchange. Côte d'Ivoire has also increased investment in regional energy, road, and air infrastructure and telecommunication networks.



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Democratic Republic of Congo

Macroeconomic performance

Real GDP growth was an estimated 4.0% in 2018, up from 3.7% in 2017, due to higher commodity prices and greater mining production. The primary sector continued to be the key driver of growth, sustained by a dynamic extraction sector. Because of budget pressures on the country's own resources linked to elections, the fiscal balance slipped to an estimated deficit of 0.6% of GDP, down from a surplus of 0.1% in 2017. Management of government debt remained controlled, at an estimated 18.2% of GDP at the end of 2017. In 2018, the Central Bank of the Congo lowered its key interest rate from 20% to 14% in view of more favorable developments in economic activity. Inflation was an estimated 27.7% in 2018, down from 41.5% in 2017. The current account deficit fell to 1.1% of GDP in 2018 from 3.6% in 2017, as a result of greater mining production.

Tailwinds and headwinds

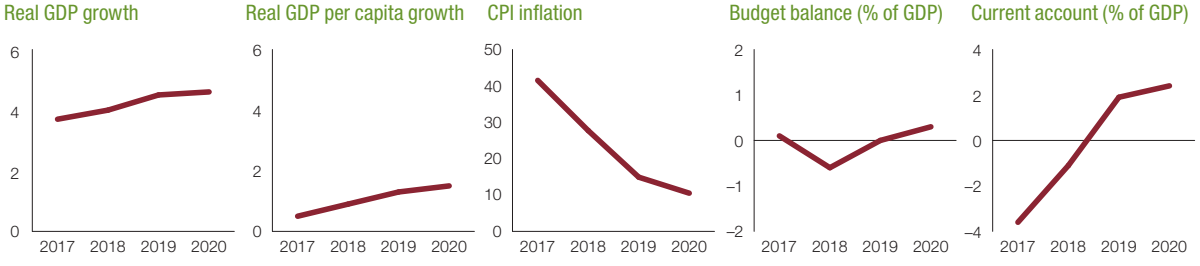
Growth is projected to settle at 4.5% in 2019 and 4.6% in 2020. The primary sector, sustained by mining, should remain the key driver of growth. This outlook could be influenced positively by firm prices for the country's commodities on the international market, successful elections in December 2018 (with results accepted by all stakeholders), progress in the security situation in the central and eastern parts of the country, control over the Ebola virus epidemic, and a start to diversification in the fabric of production. Contraction in production from China, the country's main trading partner, could also affect the pace of growth.

The economy lacks diversity, with growth dependent largely on the extraction sector, which in 2017 accounted for 99% of the value of exports, 34% of total government revenue, and 2 points in GDP growth. The productive base of the economy must therefore be diversified for sustained, sustainable, and resilient growth. To achieve this, several constraints need to be removed. The main one is the infrastructure deficit that limits the country's performance in terms of trade integration. In fact, the country has the highest import and export transactional costs in Africa because of the poor quality of railways, ports, air transport, and energy supply. With a ranking of 184 out of 190 countries on the World Bank's *Doing Business 2019* report, greater efforts must be made to improve the business climate.

The main challenge to budget policy is the structural weakness of domestic revenue (an average of 9% of GDP over 2016–18, compared with the average of 17% for Sub-Saharan Africa). More reform aimed at increasing domestic revenue will have to be made.

The country could better use the opportunities provided by the agriculture and wood sectors in its diversification efforts. The National Strategic Development Plan, now being finalized, aims for Democratic Republic of Congo to become a middle-income country by 2022 thanks to agricultural transformation. Establishing agribusiness parks in various areas and ensuring that small producers' interests are taken into account will help. Industrializing the wood sector would strengthen the efforts being made in the agricultural sector.

Finally, the energy sector must be further liberalized to receive more investment. This would reduce the production costs of businesses and increase the population's access to energy.



Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

Djibouti

Macroeconomic performance

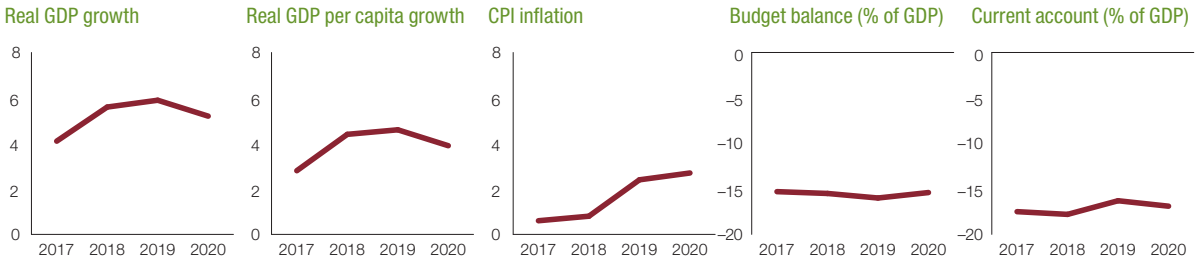
Real GDP growth was an estimated 5.6% in 2018, up from 4.1% in 2017, due to normalization of the situation with Ethiopia and large infrastructure investments. On the supply side, growth was driven by the tertiary sector, especially construction, transport, and storage. The fiscal deficit worsened slightly, to an estimated 15.5% of GDP in 2018, from 15.3% in 2017, due to large imports of goods for infrastructure projects started in 2014 and financed by foreign loans and foreign direct investment. Inflation rose by only 0.2 point, to an estimated 0.8% in 2018 from 0.6% in 2017. Inflation control is largely a result of anchoring the Djibouti franc to the US dollar at a fixed rate.

Foreign debt was estimated at 102.9% of GDP in 2018, up from 49.9% in 2014 and 97.4% in 2016. World Bank and International Monetary Fund analysis of debt sustainability at the end of 2017 showed high risk of insolvency in the short term. The current account deficit was an estimated 17.8% of GDP in 2018, up slightly from 17.5% in 2017, due mainly to the structural deficit in the balance of trade. The country does not export much (essentially cattle to the Gulf States), whereas imports are large, especially food and petroleum products, as well as capital goods. As a result, the current account balance depends less on fluctuations in the real exchange rate.

Tailwinds and headwinds

Real GDP is projected to grow by 5.9% in 2019 and 5.2% in 2020, based on sustained growth in exports and private investment, promoted by structural reforms in line with the country's strategy of infrastructure investment aimed at transforming the economy and positioning the country as the subregion's logistics and trade hub. As part of this, the largest free trade zone in Africa was opened in July 2018. Moreover, because of the country's geostrategic location on the Indian Ocean, it is at the center of the major global trade, economic, development, and security challenges. This explains its attractiveness, illustrated by the presence of several military bases. The country's stability since independence is an asset in a region experiencing several political crises. Djibouti is also profiting from being a neighbor of landlocked Ethiopia, which has experienced a decade of strong economic growth, since it is a point of sea access.

Despite these favorable outlooks and developments, Djibouti is weakened by several factors. First, high debt is likely to reduce the government's ability to finance the infrastructure investment strategy. Second, the recent peace between Ethiopia and Eritrea, with the resulting opportunity for Ethiopia to use Eritrea's ports, could hurt the Djibouti economy in the medium term. Finally, the country continues to face persistently high unemployment (39% in 2017), an unstable regional geopolitical situation faced with crises, a poorly diversified economy with little resilience to outside shocks, and a fragile ecosystem when faced with risks from climate change that translate into strong environmental vulnerability.



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Egypt

Macroeconomic performance

Real GDP growth was an estimated 5.3% in 2018, the highest rate in a decade. The growth was associated with a decrease in unemployment to around 10% from 12% in 2017. On the supply side, recoveries in tourism and in natural gas production sustained growth. On the demand side, net exports and investment rebounded, while private household consumption weakened due to inflation. With the ongoing broad fiscal consolidation effort, the fiscal deficit declined to 9.0% in 2018, and the fiscal balance excluding interest payments (primary balance) reached a modest surplus. The debt-to-GDP ratio decreased to 92.5% in 2018 from 103% in 2017. Following the 2016 devaluation, the nominal and real effective exchange rates dropped substantially, benefiting exports due to increasing price competitiveness and improving terms of trade.

Tailwinds and headwinds

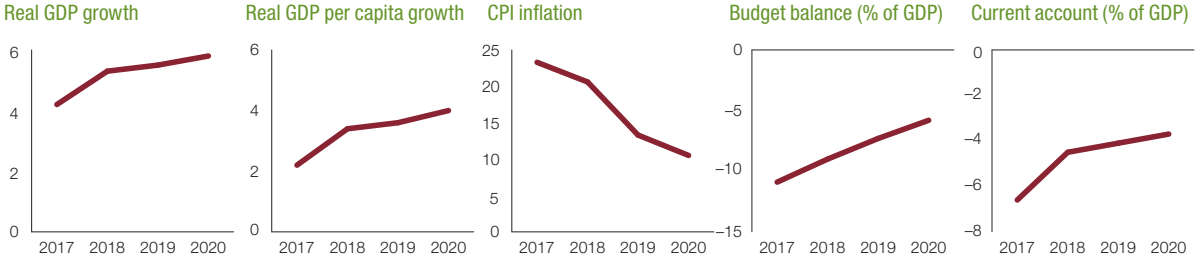
Real GDP is projected to reach 5.8% in 2020. An improved business climate is leading to a major recovery in foreign direct investment, while better security conditions benefit tourism. Moreover, the natural gas production of the Zohr field should keep rising, allowing the country to reach self-sufficiency and become a net gas exporter.

Egypt undertook impressive structural reforms in 2017–18. Landmark policies eased starting a business, strengthened legal rights, improved the bankruptcy law, and enhanced access to credit. The energy sector has become more sustainable and competitive, with improved governance. A large public investment in power generation turned the country's power supply from shortage to surplus, and the government is planning to establish the country as a regional energy hub. Egypt's grid, currently being expanded, should absorb the new generation capacity and serve the growing number of consumers. Bold energy tariff reforms aim to remove subsidies over 3–4 years. Moreover, the new energy sector law should enable higher private investment and stronger competitiveness.

However, the country faces headwinds. Debt, above 90% of GDP, remains high though sustainable. Servicing the debt accounts for about 30% of fiscal spending —almost 10% of GDP. Increased foreign currency–denominated debt, the opening of the capital account, and rising foreign investment in the local currency sovereign debt market increase Egypt's sensitivity to international capital market volatility. Nevertheless, a flexible exchange rate and rising net international reserves (currently 8.5 months of imports) provide buffers. Egypt would also be adversely affected by a sharp increase in oil prices or security risks.

Water and sanitation remain key challenges for Egypt, especially given the rapidly rising population of 96.7 million. Renewable water resources average 59.3 billion cubic meters a year, while water use is 100 billion cubic meters a year. Egypt fills the gap with desalinized seawater, reuse of drainage water, shallow ground water, and treated wastewater. The government has made considerable achievements in monitoring, controlling, and minimizing water pollution on the Nile. Moreover, over four years, 80 sanitation projects have been completed, covering 414 villages, at a cost of 9 billion Egyptian pounds. Expanding and upgrading mega-urban wastewater treatment remain a top government priority.

Poverty remains a key challenge exacerbated by high inflation. The government has beefed up its poverty eradication efforts, notably through improved targeting and cash transfers. But ongoing population growth precludes Egypt from benefiting from a demographic dividend over the medium term. Thus, private sector–led inclusive growth remains paramount.



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Equatorial Guinea

Macroeconomic performance

Despite rising oil prices, real GDP contracted by an estimated 7.9% in 2018, compared with 2.9% in 2017, continuing a recession due to lower oil prices and weak economic diversification that led to a total contraction of about 29% from 2015 to 2018. The primary factor in the decline was reduced yields at working oil wells, which lowered oil output by 14%. The country still depends heavily on hydrocarbons, which in 2017 accounted for 56% of GDP, 95% of exports, and 80% of fiscal revenues.

The budget deficit fell to 0.9% of GDP in 2018, from 2.9% in 2017 and 8.6% in 2016, thanks to substantially lower government spending (capital and operating expenditures) combined with improved revenue collection. Inflation was moderate at an estimated 0.6% in 2018, down from 0.7% in 2017, thanks to Central African Economic and Monetary Community (CEMAC) membership and lower prices of foodstuffs and nonalcoholic beverages.

Tailwinds and headwinds

The CEMAC strategy for reducing fiscal and external imbalances caused by lower oil prices should continue to have positive impacts in Equatorial Guinea. After reducing the fiscal deficit to a projected 0.5% of GDP in 2019, the budget balance is projected to turn to a surplus of 0.3% in 2020. Inflation is projected to be 1.4% in 2019 and 1.9% in 2020, below CEMAC's 3% requirement.

Real GDP is projected to further contract by 2.7% in 2019 and 2.5% in 2020 due to lower hydrocarbon production and fiscal adjustments. The government is relying on additional foreign direct investment in the oil sector to boost production in the medium term, with positive growth expected from 2021.

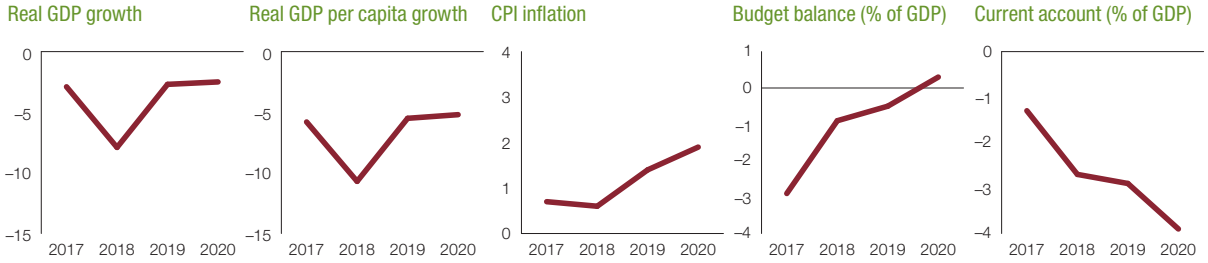
Additional government efforts are needed to continue macroeconomic consolidation undertaken with the International Monetary Fund, particularly with regard to external accounts; enhance human capacities overall, and particularly in public policy design and implementation; transform agriculture to diversify the economy; ensure efficient use of the improved infrastructure the country has acquired in recent years; and revive the hydrocarbon sector, the driving force of the economy, to fully capitalize on rising oil prices.

Like other CEMAC countries, Equatorial Guinea faces serious challenges, including low reserves, weak economic activity, and insufficient protection for the most vulnerable groups of the population. To overcome these challenges and shore up progress, the country must remain aligned with the coordinated efforts of CEMAC countries and continue the fiscal consolidation already under way. To this end, Equatorial Guinea must protect priority expenditures and continue reforms aimed at improving the business climate and governance to stimulate growth and diversification, with the private sector becoming the main growth catalyst.

Governance also presents a challenge. Weaknesses include limited access to information; procedural inefficiencies in public finance management in planning, execution, oversight, transparency, and accountability; and inadequate institutional resources and systems, particularly a lack of qualified staff to ensure good day-to-day administrative management and implementation of reforms.

Over the past two decades, Equatorial Guinea has used oil revenues to invest heavily in infrastructure (such as transport and energy) to sustain an upward development trajectory.

In line with the community efforts of CEMAC countries, authorities now seem prepared to implement additional reforms to promote growth and economic diversification. In 2019, they will revise the National Economic and Social Development Plan to stimulate nonoil growth. The updated plan aims to diversify the economy and improve the business climate.



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Eritrea

Macroeconomic performance

Real GDP growth was an estimated 4.2% in 2018, down slightly from 5.0% in 2017, driven mainly by increased investment in the mining and housing construction sectors. The service sector's growth was estimated at 2.3% in 2018, down slightly from 2.7% in 2017, while industry grew by 1.0% in 2018 and agriculture by 0.9%. Investment in infrastructure development, notably in roads, energy, and irrigation facilities, supported growth.

The fiscal deficit declined to an estimated 12.6% of GDP in 2018 from 13.8% in 2017. The country is in debt distress. Total external debt was an estimated 20.1% of GDP in 2018. The bulk of the debt was domestic, with external debt accounting for only 20% of GDP.

Monetary policy is geared toward price stability. Broad money supply declined from 119% of GDP in 2011 and 2012 to 14.3% in 2014. The reduction was due to a shift from expansionary to tight monetary policy by the central bank that included fiscal consolidation. Inflation was an estimated 9.0% in 2018, mainly because of insufficient food supply and scarce foreign currency—vital for importing essential commodities. To contain inflation, the money supply was tightened through reduced government borrowing and spending.

The current account surplus declined from 0.7% of GDP in 2017 to an estimated 0.3% in 2018 as the economy continued to face fluctuating commodity prices for its traditional exports—gold and copper. Gross foreign reserves continued to improve, increasing from 5.1 months of imports in 2017 to 7.3 months in 2018 due to increased mining sector revenue.

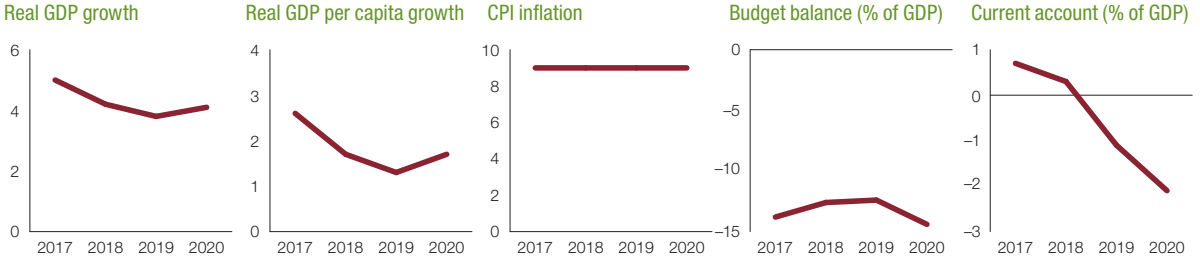
Tailwinds and headwinds

Growth is projected to slow to 3.8% in 2019 due to energy shortages, reduced remittances, foreign exchange shortages, a weak business environment, and low human and institutional capacity. But growth is projected to increase to 4.1% in 2020, due to increased foreign investment in the country's extractive sector and to benefits from the Eritrea–Ethiopia peace accord. Tourism is another possible source for sustainable development.

Normalized relations with Ethiopia are expected to bring a substantial peace dividend. The cessation of hostilities and the removal of UN sanctions will facilitate Horn of Africa stability and open economic opportunities between the two countries, their neighbors, and the international community. Anecdotal evidence already suggests that trade has begun to thrive between Eritrea and Ethiopia and that investors are flocking to Eritrea looking for opportunities. Ethiopia's use of the Eritrean ports of Assab and Massawa will relax the foreign exchange constraints Eritrea faces. The peace dividend also includes the release of a large number of conscripts for productive activity in labor-intensive sectors such as services, construction, and agriculture.

Downside risks include Eritrea's vulnerability to climate shocks because of its heavy dependence on rainfed agriculture and its vulnerability to global shocks due to its narrow export base and dependence on imports. Institutional weaknesses include deficient infrastructure for agriculture and water and sanitation, as well as a lack of reliable statistics to guide planning, decision-making, program implementation, and monitoring and evaluation. And the nascent private sector confronts restrictive economic and financial policies, skills gaps and mismatches, and other challenges

Finally, Eritrea's isolation and the lingering effects of international sanctions constrain development. Fragile neighbors generate spillovers such as refugee influxes, creating humanitarian challenges for the country.



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Ethiopia

Macroeconomic performance

Real GDP growth slowed in 2017/18, due partly to civil unrest, political uncertainty, and policy adjustments that involved fiscal consolidation to stabilize the public debt. On the supply side, GDP growth was driven by services (8.8% growth) and industry (12.2%), facilitated by the development of energy, industrial parks, and transport infrastructure. On the demand side, private consumption and investment continued to drive growth, along with the government's stable spending on public infrastructure and strong foreign direct investment inflows.

With a public debt–to-GDP ratio of 61.8% at the end of June 2018, Ethiopia remains at high risk of debt distress, according to a 2018 debt sustainability analysis. A tax transformation program is under way to strengthen tax policy and administrative efficiency.

A reduced trade deficit and strong growth in remittances helped improve the current account deficit from 8.1% of GDP in 2016/17 to 6.0% in 2017/18. Gross official reserves remained low, at 2.5 months of imports in 2016/17 and 2.1 months in 2017/18.

Tailwinds and headwinds

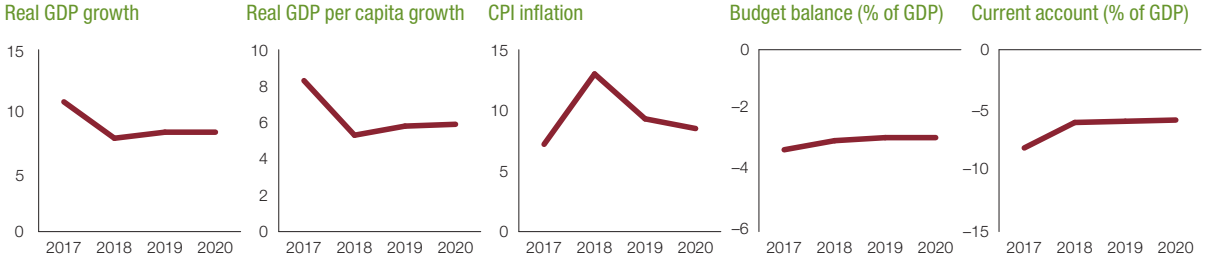
Real GDP growth is projected to recover from 7.7% in 2017/18 to 8.2% in 2018/19 and 2019/20, supported by industry and service sector expansion and agricultural sector recovery. Industrial growth will be boosted by ongoing industrial zone development, and agriculture will benefit from investments in fertilizer, irrigation, and improved seeds. Public investment will remain moderate, reflecting efforts to stabilize the public debt. The impending privatization of the state-owned railway, maritime, air transport, logistics, electricity, and telecommunications sectors is expected to boost private investment and mitigate the reduction in public spending.

Ethiopia's rising incomes, 94 million people, emerging consumer goods market, and increasing urbanization provide economic opportunities. Its export-led industrialization strategy includes developing industrial zones across the country and business enablers for energy, transport, and trade logistics. Abundant low-cost and trainable labor presents a comparative advantage in export-oriented light manufacturing, notably in leather, textiles, and agro-processing. The country's strategic location eases access to lucrative markets in the Middle East and Europe. And investments in renewable energy will generate up to $1 billion in exports by 2020. Political reforms and normalized relations with neighboring Eritrea should boost prosperity and stabilize the region.

Political reforms implemented in the last few months led to stabilization of the Ethiopian economy and restored overall calm in the country. The reforms focused mainly on institutionalizing democracy and rule of law and expanding the political space. But these achievements are not without risks. There are disruptions of economic activities in some parts of the country, displacements of people in large numbers, and skirmishes that could affect overall economic performance in the short to the medium term.

Despite reducing the extreme poverty rate from about 46% in 1995 to 23.5% in 2016, Ethiopia still has more than 25 million poor people. Demographic dynamics and a low initial level of development make poverty reduction challenging. Promoting inclusive growth through deep structural transformation becomes essential.

Only 60% of the population has access to electricity, 65.7% of households have access to potable water, and paved road density is among the lowest in Sub-Saharan Africa. The leading exports are coffee, oil seeds, and pulses, and manufacturing accounts for less than 10% of GDP. Private sector development faces limited financial access, foreign currency shortages, and a costly and weak business regulatory environment. And frequent droughts driven by climate change have major fiscal and humanitarian consequences.



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Gabon

Macroeconomic performance

One of Central Africa's largest hydrocarbon producers, Gabon is gradually recovering from the unfavorable economic climate created by lower energy prices. Despite oil production declining by 4.3%, real GDP growth reached an estimated 2.0% in 2018, up from 0.5% in 2017. The upturn was spurred by nonoil sectors, particularly commercial agriculture (13% growth), manganese mining (45%), logging (14%), lumber (10%), and telecommunications (18%). Unemployment remains a major concern because the hydrocarbon sector, the primary driver of the economy, generates few jobs and because the economic crisis's impact on employment can be only partially offset by other economic sectors, such as wood processing and export agriculture.

The fiscal deficit improved from 6.6% in 2016 to 3.6% in 2017 to an estimated 0.3% in 2018, largely through fiscal consolidation, a component of the Central African Economic and Monetary Community (CEMAC) response to reduced oil prices. Gabon concluded a three-year agreement (2017–19) with the International Monetary Fund for an Extended Credit Facility, supported by the African Development Bank and other international partners.

One important move by the Bank of Central African States in 2018 was to tighten monetary policy while raising the interest rate from 2.95% to 3.5%. Inflation was an estimated 2.8% in 2018, down from 3.0% in 2017 and below the CEMAC requirement of 3%.

The current account deficit dropped to 1.5% of GDP in 2018 from 4.9% in 2017. Despite lagging oil production, total export revenue has increased thanks to stable oil prices as well as lumber and manganese exports.

Tailwinds and headwinds

Short-term outlooks project real GDP to grow by 3.4% in 2019 and 2020. Growth will be spurred by nonoil sectors (agriculture, mining, and manufacturing) thanks to the ongoing diversification of the productive base of the economy. On the demand side, exports (6.3% growth) and investment (3.0% growth) will be the primary growth factors. Inflation is projected to remain low at 2.3% in 2019 and 2.5% in 2020. The budget balance and current account balance are also projected to improve.

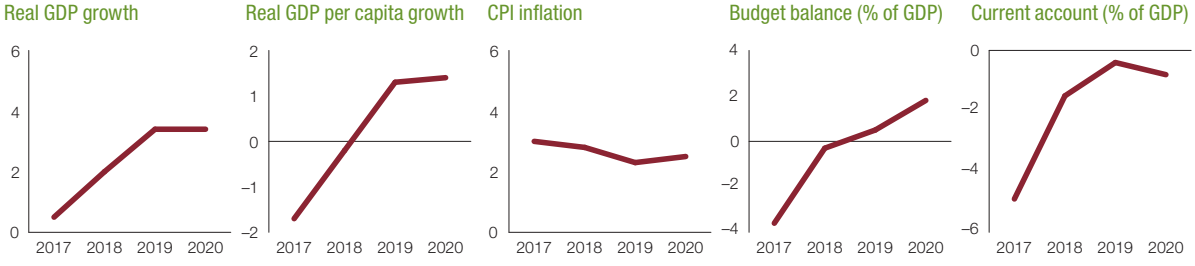
The growth outlook will hinge on authorities' ability to continue implementing reforms to consolidate the macroeconomic framework. Sound budget execution and cash flow management will be important to avoid the recurrent problem of accumulating external arrears, which reduces the country's solvency. Given the weight of the oil sector, another risk factor is declining oil production, particularly if new fields do not become productive.

Like other CEMAC countries, Gabon faces serious challenges. These include low reserves, low economic activity, and insufficient protection for the most vulnerable groups of the population. To overcome these challenges and shore up progress, Gabon must remain aligned with the coordinated efforts of CEMAC countries and continue the fiscal consolidation already under way. To this end, Gabon must protect priority expenditures and continue reforms aimed at improving the business climate and governance to stimulate growth and diversification of the economy, with the private sector the main growth catalyst.

Gabon views structural transformation of the economy as a key development strategy. Specifically, Gabon has promoted the local processing of timber, palm oil, and manganese. As a result, manufacturing accounted for roughly 10% of GDP in 2017, compared with 6% in 2012.

A timber processing industry emerged in Gabon after the 2009 ban on the export of raw logs. This has been made possible through a special economic zone and public–private partnerships. Gabon is now Africa's largest exporter of wood veneers and plywood and one of the world's top 10 producers.

Three plants for processing palm oil have opened. The country is exporting palm oil-derived products, which has boosted the agrofood sector.



Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

Gambia

Macroeconomic performance

As confidence resumes following the sharp slowdown in 2016, economic recovery is gaining traction. Real GDP growth was an estimated 5.4% in 2018, up from 3.5% in 2017, driven largely by services—tourism and trade and financial services and insurance—which expanded by 10% in 2018, coupled with robust growth in transport, construction, and telecommunications. In tourism, the number of arrivals was expected to reach 225,000 in 2018 after surpassing its pre-Ebola peak of 171,000 in 2017.

The fiscal deficit narrowed to 3.9% of GDP in 2018 from 7.9% in 2017, thanks to increased fiscal discipline and international community support. However, the debt-to-GDP ratio stood at about 130% of GDP in 2017, and the country has been classified as being in debt distress. Inflation decreased to an estimated 6.2% in 2018 from 8% in 2017. Gross international reserves increased to 3.1 months in 2018 from 2.9 months in 2017, helped by increased financial assistance from development partners

The current account deficit remains large—an estimated 19% of GDP in 2018, down slightly from 2017. For the first half of 2018, total imports rose by 9.2% compared with the first half of 2017, while total exports increased by 8.5% to $54.9 million. The export basket contains mainly primary commodities, including groundnuts (55.6%), fish and fishery products (21.6%), and cashew nuts (10.6%). Short-term economic prospects are expected to steadily improve over the medium term. Real GDP is projected to grow by 5.4% in 2019 and by 5.2% in 2020.

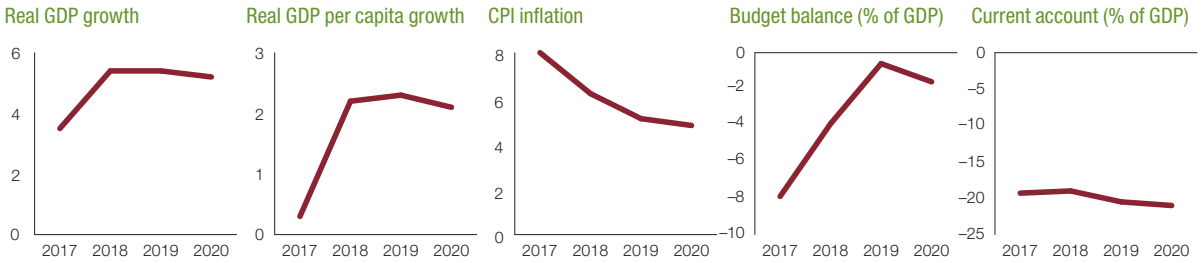
Tailwinds and headwinds

Insecurity and political instability pose risks in 2019 with the withdrawal of the Economic Community of West African States mission and possible contention over the three-year presidential term limit. In addition, high public debt will continue to crowd out government spending in key socioeconomic sectors such as health, education, and infrastructure development unless the government restructures its debt.

Other headwinds likely to affect the economic outlook include a resurgence of political instability, the large increase in public spending, delays in implementing structural reforms, and adverse weather that could weaken rain-fed agriculture.

The budget deficit remains a challenge for policymakers, and fiscal consolidation is a key pillar in the National Development Plan 2018–21, which garnered $1.7 billion in commitments from donors at a May 2018 conference in Brussels. Disciplined implementation of the reform agenda for state-owned enterprises, lower domestic borrowing, and greater commitment to administrative austerity measures could help reduce the deficit. Overall, policies must focus on enhancing efficiency in service delivery using limited government resources.

Addressing energy and water shortages remains a vital policy priority. Access to electricity is 47% nationally but only 13% in outlying provinces. Only 60 MW of the 106 MW of total installed capacity are available, with transmission and distribution network losses reaching 26% in 2016. Unreliable electricity supply also affects availability of water in Greater Banjul, compounding the problem of limited access to piped water.



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Ghana

Macroeconomic performance

After two years of sluggish growth from 2014 to 2016, real GDP growth recovered to 8.5% in 2017 and was estimated to be 6.2% in 2018, driven mainly by the oil sector. The fiscal account deficit improved marginally, from 5.9% in 2017 to an estimated 5.7% in 2018, as did the current account deficit, from 4.5% in 2017 to an estimated 4.4% in 2018. Inflation declined to the single digits, at 9.8%, and average lending interest rates declined by 4.71 percentage points to 16.23% in September 2018. The Ghanaian cedi stabilized against major currencies, except for a slight depreciation against the US dollar in the second quarter of 2018. In September 2018, Ghana rebased its GDP from 2006 to 2013. The rebased 2017 GDP is 24.6% greater than the previous 2017 GDP. Private consumption increased by 6.2% of GDP in 2018. The economy is projected to grow by 7.3% in 2019 and a slower 5.4% in 2020 as the effects of increased oil production from new wells fade.

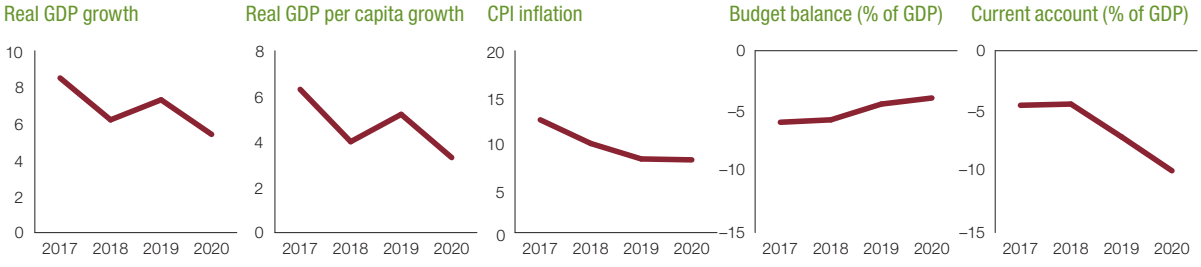
Tailwinds and headwinds

Despite the positive outlook, Ghana faces potential domestic and global headwinds. On the domestic front, the government faces a challenge in bridging its financing needs, with domestic revenues at about 10% of GDP and gross financing needs of more than 20% of GDP. This challenge is compounded by a high external debt–to-GDP ratio, which declined from 40.5% of GDP in 2017 to 38.5% in 2018. On the external front, dependence on primary commodity exports continues to expose the economy to international commodity price shocks, which could weaken GDP growth and the current account balance. Domestic private consumption is also projected to slow down, to 4.9% of GDP in 2019 and to 3.5% in 2020. The potential weakness in oil prices could lower exports receipts and hence revenues.

Continued strengthening of external demand for oil and cocoa will support medium-term growth. But years of growth based on the extractive industry have not addressed widening inequality and the creation of decent jobs. Agriculture remains the main employer of labor. Low productivity in agriculture has triggered a large movement of labor from the sector into mostly informal services in urban areas. This phenomenon explains the country's high employment rate but low-quality jobs. Ghana is undertaking proactive measures to increase productivity through a phase approach to industrialization, as defined in the country's 10-point industrialization agenda.

Ghana is gradually building industrial capacity, and growth in industry is projected at 9.8% in 2019 and 5.9% in 2020. Recent trends reflect more machinery in the country's import basket. Between 2000 and 2017, the total value of machinery imports increased fourfold, to $670 million. This rapid increase in machinery imports had a substantial adverse effect on the country's current account balance, but it reflects a gradual shift toward industrialization. While total machinery imports have increased over time, the government's capital expenditure has been on the decline since 2016. This implies greater private participation in industrialization, which is consistent with the government's private sector–led agenda for economic transformation.

Under high debt and low public and private savings, the government's main recourse for financing its economic transformation agenda is foreign direct investment. Such financing would require increased focus on sustaining achievements in macroeconomic stability and the business environment. Complementing these gains with enhanced domestic revenue mobilization would expedite the path to debt sustainability and increase fiscal space for further government capital and social spending.



Source: African Development Bank statistics; figures for 2018 are estimates; figures for 2019 and 2020 are projections.

Guinea

Macroeconomic performance

Real GDP growth was an estimated 5.9% in 2018. Growth was attributed to the industrial sector (which grew by 8.7%), dominated by mining (15.3%), but the manufacturing sector grew by 3.2%. The primary sector grew by 3.1%, and the services sector by 5.1%. Growth was bolstered by reforms aimed at improving the business climate, access to electricity, and investment in the agrofood sector.

The budget deficit increased to an estimated 4.4% of GDP in 2018, from 2.2% in 2017, due largely to loans to finance public investment. Public debt went from 37.4% of GDP in 2017 to 39.0% in 2018, 18% of which is external debt. A debt sustainability analysis released in August 2018 placed the country at a moderate risk of debt distress. Restrictive monetary policy offset the uptick in pump prices for oil products, keeping inflation in check.

Exports of goods increased by an estimated 9.8% in 2018 from 2017. Imports increased more—by 22.7%. The share of exports to Economic Community of West African States countries (0.9% in the first half of 2018) and Europe (1.1%) remained marginal. Some 99% of exports were mining products, 96% of which went to Asia in the first half of 2018, compared with 84% in the first half of 2017. The current account balance reversed from a surplus of 4% of GDP in 2017 to an estimated deficit of 4.9% in 2018.

Tailwinds and headwinds

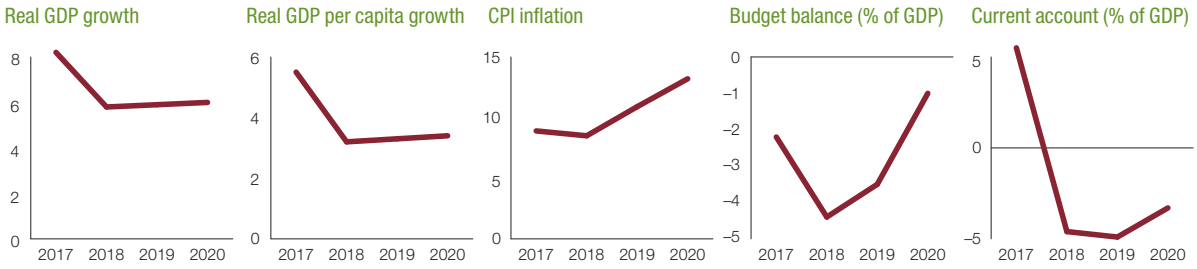
Real GDP is projected to grow by 6% in 2019 and 2020, underpinned by expansion in services and the extractive subsector, while manufacturing's contribution remains weak. On the demand side, the return of private investment, particularly in the mining sector, should increase the contribution of capital expenditure to growth.

The private sector is dominated by the informal sector, which accounts for about 95% of jobs in the economy, mainly in agriculture. Investment was an estimated 36% of GDP in 2018 after a record 75% in 2017, when investment in the mining sector was 58% of GDP, investment in other private branches was 10%, and investment in the public sector was 7%.

The National Plan for Agricultural Investment and Food Security (2018–2025) aims to reduce the food trade deficit, which reached $686 million in 2017. Ongoing reforms include a new land code reducing the time required to transfer land ownership and developing 10 agrofood processing zones throughout the country.

Guinea has exceptional mining potential, including two-thirds of the world's known bauxite reserves, as well as gold, iron, and diamonds. Although the mining sector produces more than 90% of Guinea's exports, it accounts for only 17% of tax revenue, 12% of GDP, and 2.6% of employment. With about 20 megaprojects planned for the next five years, the mining sector is expected to grow considerably. In response, Guinea will complete by the end of 2019 a strategy paper on the domestic links between mines and other strategic sectors of the economy.

Within the subregion, power grids are being constructed among seven countries, with Guinea as the energy hub. Guinea could export up to 1,493 gigawatt-hours of electricity by 2022. But Guinea does not yet have paved roads to the three countries it borders—Côte d'Ivoire, Guinea-Bissau, and Liberia—and work under way will take five years to link them to Guinea's capital, Conakry. Recent laws addressing road maintenance and public–private partnerships for infrastructure will help.



Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

Guinea-Bissau

Macroeconomic performance

Real GDP growth stabilized at an estimated 5.3% in 2018, slightly below the 5.9% in 2017, supported by robust agriculture (with 6.3% growth) and fisheries (with 8.3% growth). The country relies heavily on agriculture, especially rice and cashew nut production. Agriculture accounts for 45.3% of GDP, almost 85% of total employment, and more than 90% of exports. On the demand side, growth was driven by exports and private consumption.

The government has maintained a restrictive fiscal policy and improved revenues, so the budget deficit remained moderate at an estimated 2.5% of GDP in 2018. Total public debt declined to 49.2% of GDP in 2017 from 55.1% in 2014 through debt restructuring. Guinea-Bissau is at a moderate risk of debt distress.

Inflation was an estimated 2.0% in 2018, up from 1.4% in 2017, driven by high domestic demand and rising prices for rice and other essential food items.

The current account deficit deteriorated to 3.2% of GDP in 2018 from 0.6% in 2017, despite sharp increases in cashew nut export volume and international prices. About 90% of Guinea-Bissau's exports are from cashew nut, while imports are dominated by machinery and construction materials (19%), fuel and refined products (18%), services (16%), and food and agricultural products (12%). Official reserves stood at $3.3 billion (or 4.6 months of imports) in 2018.

Tailwinds and headwinds

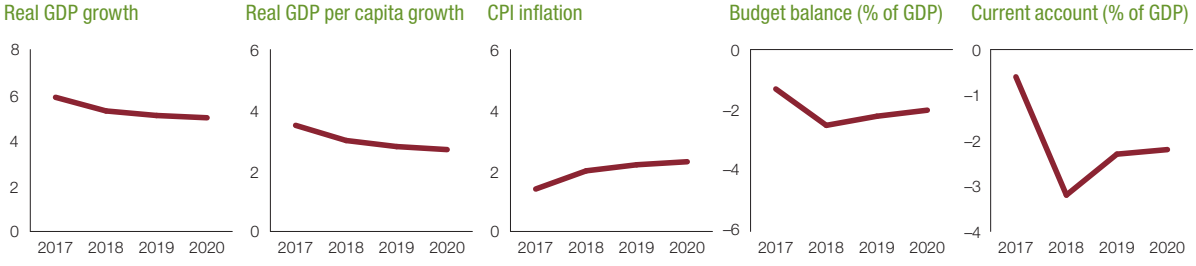
Real GDP is projected to grow by 5.1% in 2019 and 5.0% in 2020, supported by favorable cashew nut prices amid weaker harvests and by high public investment in energy, construction, and water supply. Overall, inflation is projected to be 2.2% in 2019 and 2.3% in 2020, below the 3% convergence criterion for the West African Economic and Monetary Union.

The current account deficit was an estimated 3.2% of GDP in 2018 and is projected to reach 2.3% in 2019 because of increased investment and a rising import bill of higher oil prices.

The economic outlook is highly uncertain due to political instability and volatile cashew prices, the main income source for more than two-thirds of households. Other headwinds include risks from banking instability, higher-than-expected oil prices, and heavy reliance on rain-fed agriculture that can be threatened by adverse weather.

The large concentration of domestic currency debt (39.7% of GDP) could threaten the banking sector. Improved public financial management is thus key to avoiding crowding out private investment. The government is rationalizing public expenditure through a zero-program target (zero nonregularized expenditures, zero new arrears, and zero credit to the central government from commercial banks).

Sustaining strong and inclusive growth requires addressing infrastructure gaps. Only 10% of the national road network is tarred, and the national energy access rate is about 14.7%. Health and education services remain dire, held back by political instability and weak governance. The country ranked 178 of 188 on the Human Development Index in 2016. Poverty affects more than 70% of the population. Income inequality, measured by the Gini index, was last estimated at 50.7, as women remain marginalized with constrained access to credit and professional training. Managing fragility and resolving political and institutional instability will lay a solid foundation for development.



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Kenya

Macroeconomic performance

Real GDP grew an estimated 5.9% in 2018, from 4.9% in 2017, supported by good weather, eased political uncertainties, improved business confidence, and strong private consumption. On the supply side, services accounted for 52.5% of the growth, agriculture for 23.7%, and industry for 23.8%. On the demand side, private consumption was the key driver of growth. The public debt–to-GDP ratio increased considerably over the past five years to 57% at the end of June 2018. Half of public debt is external. The share of loans from nonconcessional sources has increased, partly because Kenya issued a $2 billion Eurobond in February 2018. An October 2018 International Monetary Fund debt sustainability analysis elevated the country's risk of debt stress to moderate.

A tighter fiscal stance reduced the fiscal deficit to an estimated 6.7% of GDP in 2018, with the share of government spending in GDP falling to 23.9% from 28.0% in 2017. To stimulate growth, the Central Bank of Kenya reduced the interest rate to 9% in July 2018 from 9.5% in May. Nonetheless, a law capping interest rates discourages savings, reduces credit access to the private sector (especially small and medium enterprises), and impedes banking sector competition, particularly by reducing smaller banks' profitability. The exchange rate was more stable in 2018 than in 2017. The current account deficit narrowed to an estimated 5.8% of GDP in 2018 from 6.7% in 2017, thanks to an improved trade balance as a result of increased Kenyan manufacturing exports. Kenya's gross official reserves reached $8.5 billion (5.6 months of imports) in September 2018—a 7% increase from a year before.

Tailwinds and headwinds

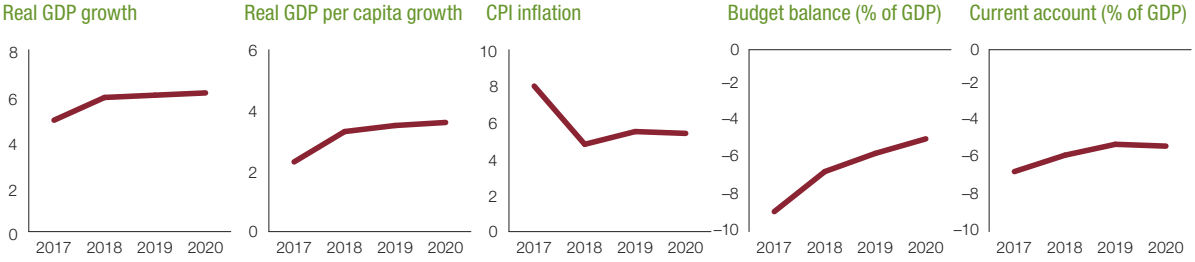
Real GDP is projected to grow by 6.0% in 2019 and 6.1% in 2020. Domestically, improved business confidence and continued macroeconomic stability will contribute to growth. Externally, tourism and the strengthening global economy will contribute.

The government plans to continue fiscal consolidation to restrain the rising deficit and stabilize public debt by enhancing revenue, rationalizing expenditures through zero base budgeting, and reducing the cost of debt by diversifying funding sources. Inflation is projected to be 5.5% in 2019 and 5.4% in 2020 due to prudent monetary policy. Kenya also benefits from renewed political momentum (including the 2010 constitution and devolution), a strategic geographic location with sea access, opportunities for private investors, and the discovery of oil, gas, and coal along with continued exploration for other minerals.

Among downside risks are possible difficulties in making fiscal consolidation friendly to growth and in finding affordable finance for the budget deficit caused by tightening global markets. Boosting domestic resource mobilization and enhancing government spending efficiency are critical to restrain public borrowing.

Kenya continues to face the challenges of inadequate infrastructure, high income inequality, and high poverty exacerbated by high unemployment, which varies across locations and groups (such as young people). Kenya is exposed to risks related to external shocks, climate change, and security. The population in extreme poverty (living on less than $1.90 a day) declined from 46% in 2006 to 36% in 2016. But the trajectory is inadequate to eradicate extreme poverty by 2030.

Kenya's Big Four (B4) economic plan, introduced in 2017, focuses on manufacturing, affordable housing, universal health coverage, and food and nutrition security. It envisages enhancing structural transformation, addressing deep-seated social and economic challenges, and accelerating economic growth to at least 7% a year. By implementing the B4 strategy, Kenya hopes to reduce poverty rapidly and create decent jobs.



Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

Lesotho

Macroeconomic performance

The economy showed signs of recovery in 2017/18, with real GDP growth estimated at 0.9% following a 2.3% contraction in 2016/17. Growth was constrained by the slow recovery of South Africa's economy and a 27% decline in receipts from the Southern African Customs Union (SACU) in 2016/17, which have not yet fully recovered.

The fiscal deficit improved to an estimated 3.7% in 2017/18 from 4.0% in 2016/17, due to fiscal consolidation. Recurring fiscal deficits largely reflect declining SACU revenue (which constitute 50% of Lesotho's total revenue) and a huge wage bill (about 24% of GDP—three times the Sub-Saharan average) that crowds out capital spending and spending on goods and services. To diversify revenue sources, the government has introduced a simplified tax regime and simplified procedures for small taxpayers. With external debt estimated at 39.3% of GDP in 2018, Lesotho has moderate risk of debt distress.

Lesotho maintains parity between its currency, the loti, and the South African rand. Since July 2018, the central bank policy rate has been set at 6.5%, compared with 7% in the second half of 2017. Inflation has fallen from its peak of 6.8% in 2015/16 to an estimated 4.8% in 2017/18, despite high energy prices.

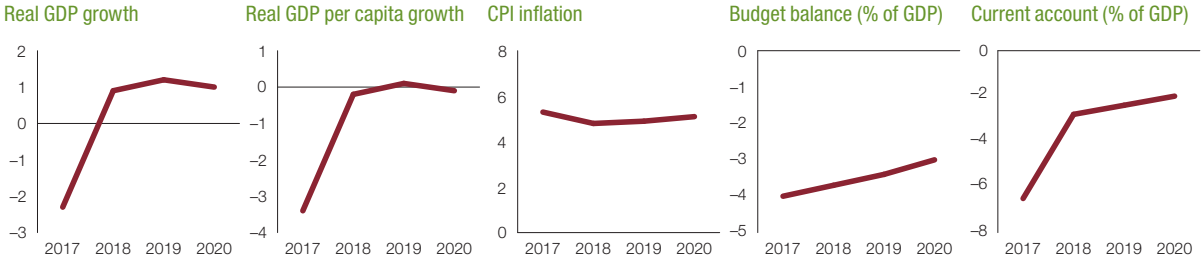
The current account deficit reached an estimated 2.8% in 2017/18, down from 6.5% in 2016/17, owing mostly to increased diamond exports in response to favorable international prices. The government's international reserves currently cover almost 3.1 months of imports.

Tailwinds and headwinds

Real GDP is projected to grow by 0.9% in 2018/19 and 1.2% in 2019/20, supported largely by increased diamond exports and a strong rebound in construction of the Lesotho Highland Water Project Phase II. Growth will also benefit from emerging opportunities for the textile and clothing industry created by the South African market.

Government structural reforms include a subsidy for agricultural mechanization and a program that facilitates rehabilitating irrigation schemes, controlling the spread of livestock diseases, constructing greenhouses and shade nets, and constructing woolsheds to boost wool and mohair production. Lesotho is also integrating climate change into agricultural policies and strategies. The initiatives are consistent with the "Feed Africa" and "Improve the Quality of Life for the People of Africa" priorities among the African Development Bank's High 5s. For "Industrialize Africa," another of the High 5s, the government is constructing a geoscience laboratory to facilitate diversification of the mineral industry. In parallel, the government introduced a strategy to increase access to financial services in the rural areas. A public–private dialogue platform was launched for tourism, manufacturing, and commercial agriculture to accelerate job creation and poverty reduction. Finally, the government is empowering small and medium enterprises by establishing cooperatives.

The business and investment climate faces political uncertainties due to a fragile coalition government. Slow recovery of the South African economy threatens Lesotho's worker remittances and SACU revenues.



Note: Data are for fiscal years, so 2017 refers to the 2016/17 fiscal year.
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Liberia

Macroeconomic performance

Real GDP growth rebounded to an estimated 3.2% in 2018, from 2.5% in 2017, driven largely by mining and manufacturing. Agriculture, forestry, and fishing dominate the economy, contributing 70.3% of GDP in 2017.

A moderate increase in revenues, combined with a decrease in spending, reduced the fiscal deficit to 3.9% in 2018 from 7.9% of GDP in 2017. Liberia remains at a moderate risk of debt distress. Total public debt was 41.3% of GDP in 2017, about 69.6% of which (or 29% of GDP) was external.

The Liberian dollar depreciated by 24.5% against the US dollar in 2017 and by 27% by the end of June 2018. The depreciation was caused by deteriorating terms of trade and high demand for foreign exchange for imports. Nevertheless, inflation was an estimated 11.7% in 2018, slightly lower than in 2017, due partly to high dollarization (about 70% of broad money).

The current account deficit improved marginally to 22.4% in 2018 from 22.7% in 2017 as exports increased due to gold production and a modest recovery of commodity prices. Gross foreign reserves increased slightly from 3.0 months of imports in 2017 to 3.6 months at the end of June 2018.

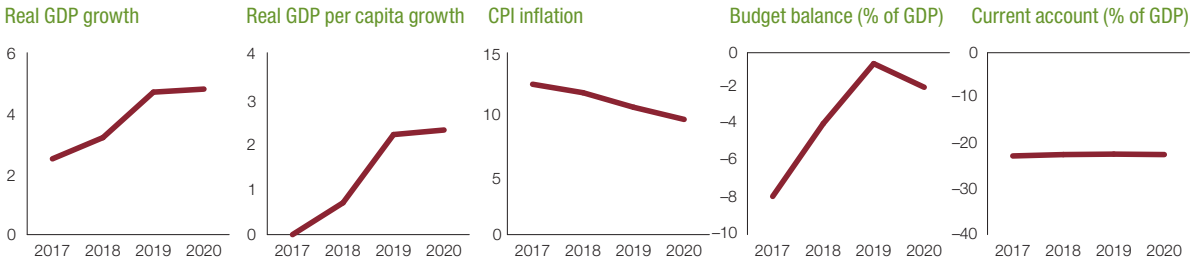
Tailwinds and headwinds

The economic outlook is positive, with real GDP growth projected to increase to 4.7% in 2019 and 4.8% in 2020, underpinned by modest growth in agriculture, fisheries, and services. Inflation is expected to decrease further to 10.5% in 2019 and 9.5% in 2020 because of a stable exchange rate, prudent monetary and fiscal policies, and a modest increase in domestic food production. The current account deficit is expected to remain slightly above 22% in both 2019 and 2020.

The positive outlook could be overshadowed by the risk of debt distress, which could go from moderate to high if borrowing to meet large public investment needs increases while the output of key export sectors declines.

A decline in aid inflows after the 2014–16 Ebola crisis and the 2018 completion of the UN peacekeeping mission in Liberia may affect the economic outlook. The shortage of foreign exchange could constrain the highly dollarized banking sector. The dependence on exports of primary commodities (gold and iron ore) and imports of food and fuel make it highly vulnerable to external shocks. In particular, demand for Liberia's commodity exports could be reduced by a slowdown in the advanced economies or in China, due to recent trade tensions.

The infrastructure deficit constrains development, particularly, roads, energy, and water and sanitation. For instance, the country has an estimated 12,000 kilometers of roads, only 7% of which is paved. The country is undertaking various structural reforms toward accelerated, inclusive, and sustainable development. Expanding and improving the road network are priorities, including a plan to pave at least 650 kilometers of primary roads in the next 5 years. Increasing access to affordable energy and water and sanitation is also at the top of the agenda. Infrastructure development, based on establishing special economic zones, is essential for industrialization. Building young people's skills will boost their employment.



Source: African Development Bank statistics; figures for 2018 are estimates; figures for 2019 and 2020 are projections.

Libya

Macroeconomic performance

Key macroeconomic indicators remain volatile. They are determined by oil production, which is lackluster and uneven due to insecurity, unstable politics, poor infrastructure, and constrained government fiscal spending. In June 2018, following an attack on oil fields and the main terminals, production plummeted from almost 1 million barrels a day to 400,000. In October and November, as turmoil receded, oil production increased to around 900,000 barrels a day, but renewed tension in December further disturbed it, and some damaged infrastructure has not been fully rebuilt. Consequently, real GDP growth in 2018 did not repeat 2017's, though it remained considerable at an estimated 10.9%.

Inflation—a cumulative 80% over the past few years—reflects the lack of goods and services and the existence of a parallel exchange market driven by foreign currency availability. Inflation fell to an estimated 13.1% in 2018 from 28.5% in 2017 due to the appreciation of the dinar on the parallel market because of increased hard currency supply. But fiscal spending could not reduce economic hardship caused by inflation because the bulk of it went to security, while 24.5% went to salaries, 6.6% to subsidies, and only 4.7% to development. Thanks to increased oil revenue due to rising oil prices in 2018, the fiscal deficit fell to an estimated 4.2% of GDP from 43.2% in 2017 and 113% in 2016.

The current account balance remained in surplus in 2018, at an estimated 1.5% of GDP, much lower than the 8.4% in 2017. Imports continued to decrease in the first quarter of 2018 due to import restrictions.

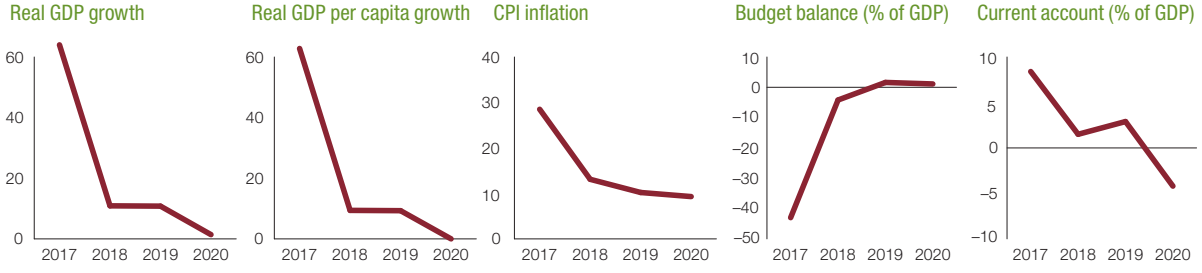
Tailwinds and headwinds

GDP growth is projected to be 10.8% in 2019 but 1.4% in 2020. Despite the political situation, the government approved an economic reform program in September 2018 under which fuel subsidies will fall and the dinar will be devalued to eliminate the sizable differential between the official and parallel market exchange rates.

In 2017, Libya had the second largest foreign exchange reserves in Africa—an estimated $79.4 billion. They have fallen from their 2012 peak of about $124 billion but rebounded from a lower level in 2016 thanks to a better oil sector and the country's fiscal stance. If Libya produces more than 1 million barrels of crude oil a day, the government will have enough resources in 2019 to devise a diversified economic and social recovery plan.

In 2018, as Libya suffered from its political crisis, the humanitarian situation continued to worsen, with an estimated 1.1 million people in need of life-saving assistance and protection, according to the January 2018 humanitarian bulletin of the United Nations Support Mission in Libya. The elections planned for 2018 were postponed again, to 2019, due to the security situation.

Lack of capacity and coordination in the public sector impedes effective and efficient governance, and public institutions lack technical expertise and a strategic framework for planning. The country remains on the list of fragile states. It needs more stable institutions to address its most pressing challenges, including high unemployment, low human capital, and the lack of water, electricity, and infrastructure.



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Madagascar

Macroeconomic performance

Real GDP growth reached an estimated 5.0% in 2018, up from 4.2% in 2017. The agricultural sector expanded by 4.5% in 2018 (down from 6.6% in 2017). The industrial sector expanded by 6.7%, driven mainly by textiles and the manufacture of essential oils. Despite the plague epidemic in early 2018, the service sector expanded by 5.4%. Growth in aggregate demand in 2018 was driven largely by public and private investments in infrastructure (roads, airports, energy, and the port of Toamasina). External demand for textiles, vanilla, and essential oils also contributed to growth.

The budget deficit was contained at an estimated 2.3% of GDP in 2018, compared with 2.4% in 2017, thanks to measures targeting some low-priority expenditures. Total public debt, 70% of which is from multilateral creditors, fell from 38.4% of GDP in 2016 to 35.1% in 2018. According to the International Monetary Fund, public debt remains sustainable, with a moderate risk of external debt overhang. Inflation declined slightly from 8.3% in 2017 to an estimated 7.7% in 2018. Gross official reserves reached 4.1 months of imports in 2018. The current account deficit deteriorated to an estimated 2.0% of GDP in 2018, due to a 19% rise in the value of oil imports and a 13% rise in the value of capital goods. Exports are dominated by products with little added value, including cloves, vanilla, and mining products.

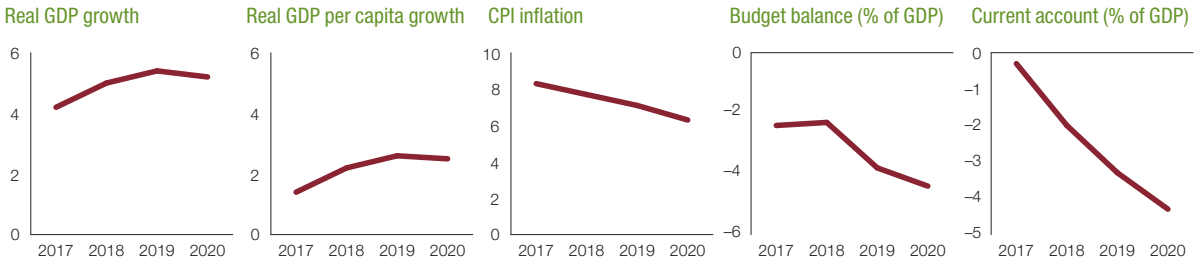
Tailwinds and headwinds

Real GDP growth is projected to be 5.4% in 2019 and 5.2% in 2020. The main drivers remain transport, energy, public works, extractive industries, and businesses in the export processing zone. Inflation is projected to level off at 7.1% in 2019 and 6.1% in 2020.

Madagascar has a comparative advantage in some niche products (such as cloves, lychee, vanilla, cocoa beans, green coffee, and essential oils) that can be easily processed locally with high value added. Effectively implementing industrial policy and the special economic zone regime could turn this potential into jobs and economic growth.

Political instability that could result from the 2018 presidential election is the greatest risk to economic prospects. In addition, Madagascar has benefited little from membership in the Indian Ocean Commission, the Southern African Development Community, and the Common Market for Eastern and Southern Africa and from being a signatory to the African Continental Free Trade Agreement. Like other island states, it faces high transportation costs. The infrastructure deficit makes commercial transactions expensive, hindering private sector competitiveness. To better integrate with the rest of Africa, the country should improve logistics at the main ports and airports and along the main corridors. Applying international norms and standards and eliminating nontariff barriers could boost trade with regional partners.

Madagascar faces a high incidence of poverty and inequality. The electricity access rate, 15.2%, is one of the lowest in Africa. Agriculture is still traditional and highly vulnerable to climatic shocks, such as cyclones and drought. Other shocks, such as the 2018 plague epidemic, reduced prices for raw materials, or increased oil prices, could also compromise the country's prospects.



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Malawi

Macroeconomic performance

Real GDP growth was an estimated 3.7% in 2018, down from 5.1% in 2016/17, which was a recovery from 2.7% in 2015/16. In 2016/17, growth was boosted by agricultural growth of 6.3%, up from a contraction of 0.1% in 2015/16, driven by better weather.

The fiscal deficit widened to an estimated 4.8% of GDP in 2018 from 3.7% in 2016/17. In 2017/18, the debt-to-GDP ratio was declined marginally to an estimated 58% of GDP from 59% in 2016/17, up from 30% in 2012/13. Malawi is now classified as being at a moderate risk of debt distress.

Inflation declined to an estimated 10.4% in 2017/18 from 11.5% in 2016/17, due partly to improved food supply. The Reserve Bank of Malawi gradually reduced its policy rate from 24% in November 2016 to 16% in December 2017, where it remained in 2018. In response, lending rates fell to 26.9% in July 2018, down from 33.6% in July 2017. The nominal exchange rate remained stable, fluctuating around 722 Malawian kwacha to the dollar in 2016 and 2017. Foreign exchange reserves continued to grow from 2.9% of GDP in 2013 to about 12% in 2017, in parallel with an equivalent increase in import cover from 2.1 months in 2013 to 3.6 months in July 2018.

The current account deficit was 9.8% of GDP in 2016/17, down from 13.0% in 2015/16. The improvement was due largely to a reduced import bill following the 2017 bumper harvest. However, the current account deficit worsened to an estimated 11.3% of GDP in 2017/18 but is projected to narrow slightly to 10.9% in 2018/19.

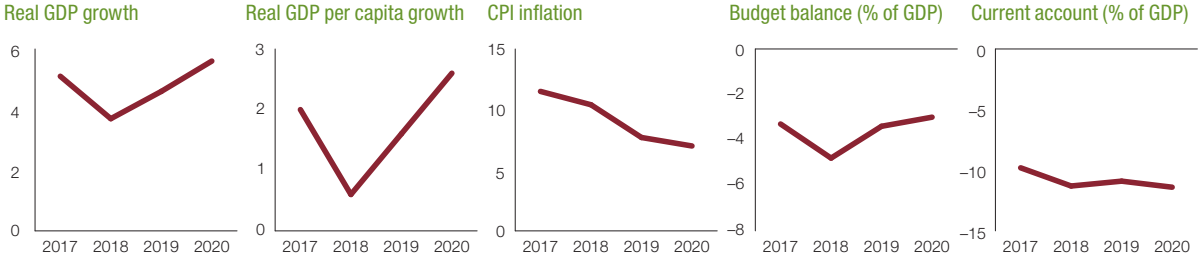
Poverty remains widespread at 51.5% nationwide in 2017, up from 50.4% in 2010, particularly in rural areas (56.6%). Extreme poverty is high, largely because of food insecurity. Incomes are very low, with GNI per capita of $360 in 2016. Inequalities are acute and rooted, with a Gini coefficient of .46 in 2010 and .44 in 2014.

Tailwinds and headwinds

GDP is projected to grow by 4.6% in 2018/19 and 5.6% in 2019/20. Agricultural improvements, stable macroeconomic fundamentals, the recovery in global commodity prices, and continued foreign direct investment inflows are projected to drive growth.

Due to high dependence on rain-fed agriculture, weather-related shocks are key risks to export commodities such as tea, tobacco, and other products, as experienced in 2017. The long dry spell in the first half of 2018 and fall 2018's armyworm infestation reduced the maize output, contributing substantially to GDP deceleration in 2018.

A number of government initiatives aim at more resilient growth. To strengthen the industrial base, constrained by inadequate energy and water supplies, a feasibility study was completed in 2017 for the Kholombidzo Hydropower Generation Project, which will increase the country's electricity generation capacity. Recognizing that agricultural performance continues to be hampered by adverse weather shocks, the government launched the National Agricultural Policy 2016 to increase production and the National Irrigation Policy 2016 to support irrigation, agricultural diversification, and value addition. In 2016, parliament enacted new land laws, including the Land Act, the Physical Planning Act, the Customary Land Act, and the Land Acquisition (Amendment) Act, to accelerate land registration for improved food production and infrastructure development.



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Mali

Macroeconomic performance

The economy's strong growth continues, with real GDP growth an estimated 5.0% in 2018, down slightly from 5.3% in 2017, driven mainly by agriculture (cotton in particular) and services (financial activities and trade). On the demand side, household consumption is the primary driver. The budget deficit was reduced from 2.9% of GDP in 2017 to an estimated 2.5% in 2018. Public debt stood at 35.9% of GDP in 2018, up narrowly from 35.6% in 2017, but external debt declined slightly to 24.1% of GDP. Mali continues to face a moderate risk of debt distress. Inflation slowed to an estimated 1.7% in 2018 thanks to lower prices of foodstuffs and imported oil products. In the external sector, the current account deficit rose slightly from 6.0% in 2017 to an estimated 6.5% in 2018, with import growth (9.3%) outpacing export growth (7.2%).

Tailwinds and headwinds

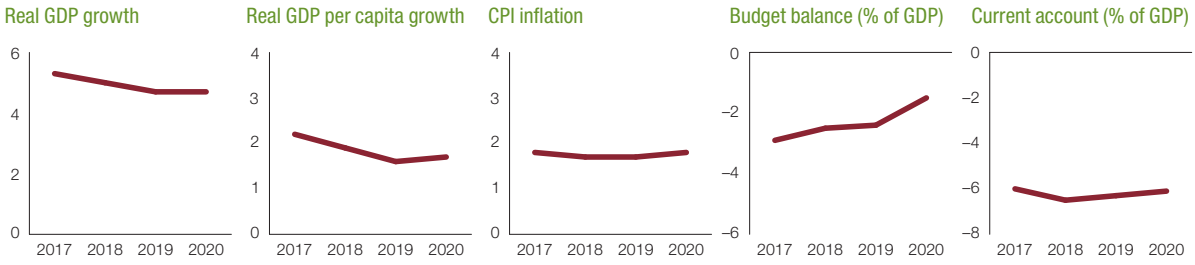
Real GDP growth is projected to slow in 2019 to 4.7% and remain there in 2020. Inflation is projected to be 1.7% in 2019 and 1.8% in 2020. The budget deficit is projected to shrink gradually from 2.4% of GDP in 2019 to 1.5% in 2020 thanks to consolidation. The current account deficit is projected to remain above 6% through 2020.

Mali has begun to mobilize more revenue and increase the efficiency and quality of public spending, aiming to create the fiscal space required for public investment. It is streamlining tax exemptions, improving the efficiency of the mining tax regime, and strengthening the administration and efficiency of value added tax recovery. The government has also set up a consultation framework to facilitate the implementation of the 2015 peace agreement.

Authorities began to implement a law against illicit enrichment, in particular by requiring senior civil servants to declare their assets. In the energy sector, reforms have sought to strengthen the finances of the public company, Électricité du Mali, to mitigate associated budgetary risks and to free resources for investment and spending in other areas.

Mali has ratified all agreements relating to the free movement of persons and labor within the framework of the Economic Community of West African States (ECOWAS) and the West African Economic and Monetary Union. No measure limits the movement of persons or the right of establishment in self-employment, and ECOWAS nationals need no residence permit and can settle freely in Mali to work or to exercise a liberal profession. However, in practice these rights are hindered by unofficial obstacles at the border, where multiple checkpoints of various kinds create high transaction costs.

The economic outlook could be compromised by several factors, in particular security conditions related to delays in implementing the Peace and Reconciliation Agreement and exogenous shocks such as climate variability, the volatility of gold and cotton prices, and fluctuations in the euro/dollar exchange rate. The recapitalization of some commercial banks has contributed to banking sector stability, but the high ratio of nonperforming loans (16.5% in 2018) could threaten private sector financing.



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Mauritania

Macroeconomic performance

Real GDP growth was an estimated 3.5% in 2018, the same as in 2017 and up from 1.8% in 2016, driven mainly by irrigated agriculture, fisheries, construction, stronger metal prices, and manufacturing. The upswing is projected to continue in 2019. Inflation stayed within price stability targets, at an estimated 2.9% in 2018. The fiscal position remains viable, with an estimated surplus of 0.1% of GDP, up slightly from being balanced in 2017. The current account deficit deepened to 16.0% of GDP in 2018, from 14.4% in 2017, due mainly to rising oil prices.

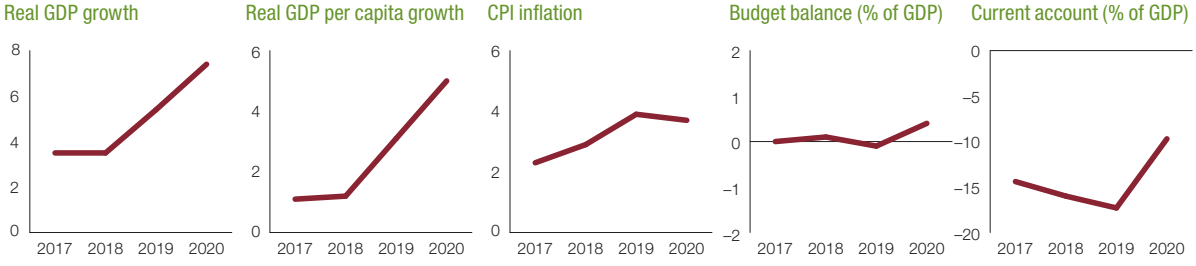
Tailwinds and headwinds

In general, Mauritania is well placed economically thanks to its ongoing reforms. The country is among the top 10 global reformers, climbing 26 places in just three years in the World Bank's Doing Business rankings, from 176 in 2015 to 150 in 2018. But the foreign trade imbalance persists and remains vulnerable to external shocks.

Speeding up structural economic transformation is a key challenge facing Mauritania. Despite government efforts, the economy is failing to diversify. In the second quarter of 2018, exports of iron, gold, and copper accounted for 47% of total exports, making the country vulnerable to fluctuations in the prices of these products. A structural reform program to boost nonmining private development is needed to stimulate exports and growth. It should include reforms to maintain macroeconomic stability, stimulate the formation of human capital and a skilled workforce, and improve the business environment and economic infrastructure to meet private sector requirements. Nominal and real exchange rates have depreciated in recent years. The foreign exchange ratio has deteriorated from 24.2 in 2016 to –11.2 in 2017 and –12.4 in 2018.

Debt is also a challenge for Mauritania. With an external debt–to-GDP ratio of 103.7% in 2018, Mauritania is classified by the International Monetary Fund (IMF) as being at risk of debt overhang. Furthermore, under the IMF's Extended Credit Facility, approved in December 2017, the country is committed to only undertake nonconcessional borrowing on a capped basis and to finance economic infrastructure.

Since 2015, Mauritania has been engaged in a vast economic reform program. Authorities have put a great deal of effort into improving the business climate to promote private investment. Since the sharp drop in iron ore prices in 2014–15, which deepened the fiscal deficit, they have worked to improve the efficiency of public finance management and in May 2018 passed the new organic finance law, regarded as the most important structural reform undertaken as part of the Guidelines for the Reform of the Public Finance Management System in 2012–16. These reforms have been accompanied by major investment in economic infrastructure. Over 2015–17, for the first time in the country's history, domestic investment in sectors such as rural development and industrial development matched foreign investment. This momentum reflects the government's commitment and will to accelerate the attainment of the country's development objectives.



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Mauritius

Macroeconomic performance

The economy continues its steady expansion, with real GDP growth estimated at 4.1% in 2018, up from 3.8% in 2017. Growth was led mainly by construction, financial services, and information and communications technology.

The fiscal deficit widened slightly from 3.4% of GDP in 2017 to an estimated 3.5% in 2018 but is projected to fall back to 3.4% in 2019 due to fiscal consolidation and the ongoing disbursement of a grant from India. Public debt sustainability is regarded as broadly positive, although fiscal consolidation would be required for the country to meet the recently adjusted statutory public debt target of 60% of GDP by December 2021.

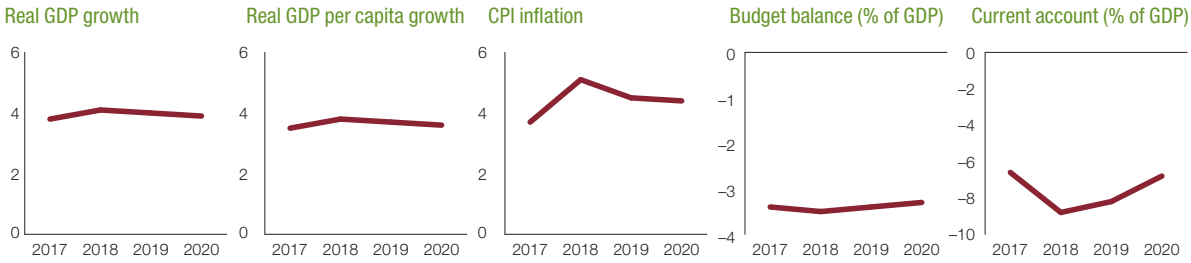
Monetary policy was accommodative in view of the low inflation environment and the need to support domestic activity. Inflation increased from 3.7% in 2017 to an estimated 5.1% in 2018, due largely to food production shortages resulting from losses caused by heavy rainfall. The current account deficit widened from 6.6% of GDP in 2017 to an estimated 8.8% in 2018. International gross reserves stood at 11 months of imports. The main exports are clothing, sugar cane, processed fish, and cut flowers. The export of services also continues to rise, driven by tourism and financial services.

Tailwinds and headwinds

The economic outlook is positive because of favorable external conditions and rising public investment. Real GDP growth is projected to be 4.0% in 2019 and 3.9% in 2020. Growth could even accelerate if the government's public infrastructure program gathers pace and stimulates private investment. The current account deficit is projected to remain high, at 8.2% of GDP in 2019, given increasing commodity prices and large imports for the infrastructure program. The economy's external financing should benefit from continued strengthening of service exports—mainly tourism. Key sectoral drivers of growth are expected to continue performing well, with financial services, food processing, retail and wholesale, and information and communications technology all expected to grow by more than 5%. Furthermore, the economy is diversifying into other higher value added areas such as medical tourism and higher education.

Potential headwinds from increasing global energy and food prices are expected to bring inflationary pressure and constrain the island economy's external position. An economic slowdown in key European trading partners (due to global trade tensions or Brexit) may hinder tourism as well as goods exports. Other possible impediments to growth include a narrow domestic skills base and climate change–related natural hazards.

The country is rapidly developing into a hub for trade, re-export, logistics, and distribution, establishing itself as a launching point for local and international companies seeking opportunities on the continent. Mauritius is also becoming a financial platform or gateway into Africa. In 2016, banks and insurance firms based in Mauritius injected more than $50 million into the Kenyan economy through acquisitions and investments. Mauritian expertise is also rehabilitating and managing sugar industries in Côte d'Ivoire, Madagascar, Mozambique, Tanzania, and Uganda.



Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

Morocco

Macroeconomic performance

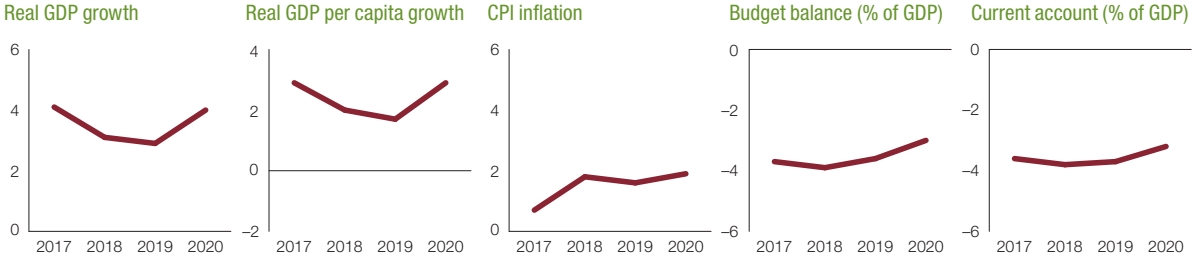
The economy continues to show resilience. Although slowing, real GDP growth was positive at an estimated 3.1% in 2018, down from 4.1% in 2017, reflecting less rainfall. The fiscal deficit, an estimated 3.9% of GDP in 2018, up from 3.7% in 2017, is expected to gradually shrink under fiscal consolidation, tax reform, the rationalization of public expenditure, and more effective collection of tax revenues. The medium-term economic outlook projects a continuing decline in real GDP growth, to 2.9% in 2019, before a rebound to 4.0% in 2020. The projected slowdown in 2019 is attributable to a slight decline in primary sector value added.

Tailwinds and headwinds

The introduction in 2018 of a floating exchange rate regime controlled within a band of ±2.5%, versus the previous ±0.3%, was perceived as a positive sign by investors and an important step toward wide flexibility in the exchange rate regime. In the first eight months of 2018, the dirham rose 1.9% against the euro and slipped 0.9% against the US dollar. Debt remains sustainable and is expected to decline over the medium term. The current account deficit was an estimated 3.8% of GDP in 2018, up slightly from 2017, reflecting primarily a rise in imports of oil and capital goods, while alleviated by tourism receipts and remittances.

Morocco has achieved remarkable economic performance over the past decade. The stock of core infrastructure has grown thanks to an average capital investment rate of 34% during 2008–18, compared with 29.8% in 2007, enhancing the country's attractiveness to foreign direct investment. In agriculture, the main source of income in rural areas, productivity gains are still low despite the Green Morocco Plan aimed at boosting agriculture and stoking industry. The acuteness of water stress affects production and increases the volatility of farm incomes, leading to rural exodus.

Economic diversification into the automotive, aeronautics and electronics industries has been a core objective of the Industrial Acceleration Plan. These diversification efforts are expected to extend the agribusiness and service sectors and stimulate technology transfer and job creation. Its success will depend on, among other factors, the ability to implement human capital development policies that match the needs of the various productive sectors. Agriculture, which contributes substantially to combating rural poverty, has to be smarter and refocus on low–carbon footprint activities that leverage technology and innovation—critically necessary due to water scarcity. The improvement in the business environment must be continued to create real opportunities for boosting the private sector, even though authorities are creating enclaves of excellence around the country through special economic zones. Its overtures to Sub-Saharan Africa also offer Moroccan companies new opportunities. More effective and efficient public spending can create the necessary fiscal space to fund social and territorial development policies, and make growth more inclusive.



Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

Mozambique

Macroeconomic performance

Real GDP growth was an estimated 3.5% in 2018, a dramatic decline from the average of 7% during 2004–15. The decline was due to decreased public investment and a 23% decrease in foreign direct investment in 2015–17.

The fiscal deficit was an estimated 6.7% of GDP in 2018, up from 5.5% in 2017. Since the discovery of hidden debt in 2016, Mozambique has been in default. Major donors suspended aid to the country, so it had to implement fiscal measures to gradually reduce public debt.

Following high inflation and a rapidly depreciating exchange rate during 2016–17, the Bank of Mozambique eased monetary policy, lowering the benchmark lending rate to 18% in August 2018. However, the decrease in inflation from 15.1% in 2017 to an estimated 4.6% in 2018 led to high real interest rates, resulting in a contraction in credit demand by the private sector.

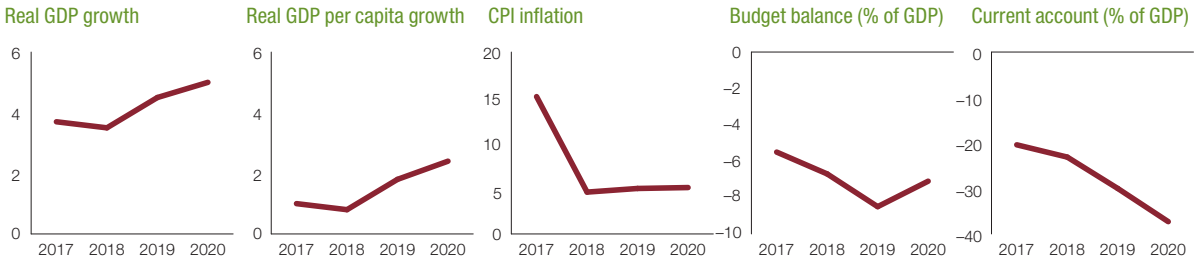
The current account deficit increased slightly to an estimated 23.1% in 2018, from 20.4% in 2017, due mainly to an increased nonmegaproject trade deficit. (Megaprojects include the Mozal aluminum smelter, the Temane gas projects in Inhambane, and the Moma titanium ore and heavy sands project in Nampula.) Nonmegaproject goods imports—80% of total goods imports—grew by an estimated 24% in 2018. Rising prices for key imports such as fuel and food also underlie growing import spending. International reserves are expected to remain at around 7 months of nonmegaproject imports in 2018–19.

Tailwinds and headwinds

Growth is projected to be 4.5% in 2019 and 5.0% in 2020, driven by agriculture, which is continuing to recover from the 2015–16 regional drought, and extractive industries, with coal exports continuing to expand. There are also bright prospects of increased foreign direct investment in gas-related megaprojects in the Rovuma Basin in 2019.

Mozambique is also addressing several of the African Development Bank's High 5s. For "Feed Africa," Mozambique's National Development Strategy aims to increase employment by enhancing productivity and competitiveness in agribusiness and value chain development. For "Industrialize Africa," the government has negotiated the development of an onshore $24 billion liquefied natural gas plant, permitting the creation of downstream value chains and the establishment of an industrial base for fertilizers, gas-to-liquids, and gas-to-power. For "Integrate Africa," Mozambique's growing contribution to the Southern Africa Power Pool could be enhanced with future gas and energy projects. And for "Improve the Quality of Life for the People of Africa," the government will continue to focus on reducing malaria, HIV, and infant and maternal mortality and will increase education spending to 5.9% of GDP in 2018—more than other countries in the region.

Downside risks to Mozambique's economic growth include rising prices for key imports such as fuel and food and economic difficulties in South Africa, Mozambique's second largest export destination. Mozambique's public debt is in distress. Failure to agree on restructuring debt and restoring investor confidence could deepen economic hardship and slow growth. High reliance on borrowing, largely domestic, has not only crowded out private investment but also led to debt distress. Key policy priorities could include an active debt management strategy to restore confidence and measures to stimulate economic growth and employment creation. Finally, Mozambique is prone to natural disasters, such as storms, floods, droughts, and earthquakes.



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Namibia

Macroeconomic performance

After strong growth averaging 5.6% between 2010 and 2016, driven by high public spending, construction of new mines, and favorable commodity prices, the economy has entered a recession. Real GDP growth contracted by 0.9% in 2017 and an estimated 0.1% in 2018, thanks to domestic and external factors, including a sharp reduction in public spending necessitated by falling revenues and weak growth in trading partner economies and subdued household demand.

High public spending amid falling revenue led to a widening of the fiscal deficit from 6.3% of GDP in 2015 to 8.1% in 2016. With increased deficit financing requirements, public debt stock rose from 29.5% of GDP to 42% in 2018, 64% of which is domestic. The surge in domestic borrowing has exerted pressure on the small domestic debt market, with the risk of crowding out private credit. To ensure fiscal and debt sustainability, the government is implementing a fiscal consolidation plan that aims to lower the fiscal deficit to 2.7% of GDP by 2022 and limit public debt to 48% of GDP. The plan also aims to improve spending efficiency and boost growth by creating fiscal space for public investment and promoting private participation in infrastructure through public–private partnerships.

Monetary policy has remained largely accommodative since 2017. The repo rate has been maintained at 6.75% to support growth while keeping inflation low and maintaining parity between the Namibian dollar and the South African rand. Inflation declined from 6.2% in 2017 to an estimated 4.2% in 2018, driven by falling food prices and subdued demand in the economy.

Reliance on primary commodity exports coupled with the high import content in consumption and investment has rendered the economy vulnerable to exogenous shocks. The current account deficit widened to 14% of GDP in 2016, as the terms of trade deteriorated and receipts from the Southern African Customs Union (SACU) fell, but improved to 3.4% in 2017, due to slow growth in imports and higher receipts from SACU. The current account deficit is financed largely through foreign direct investment and other nonportfolio investments.

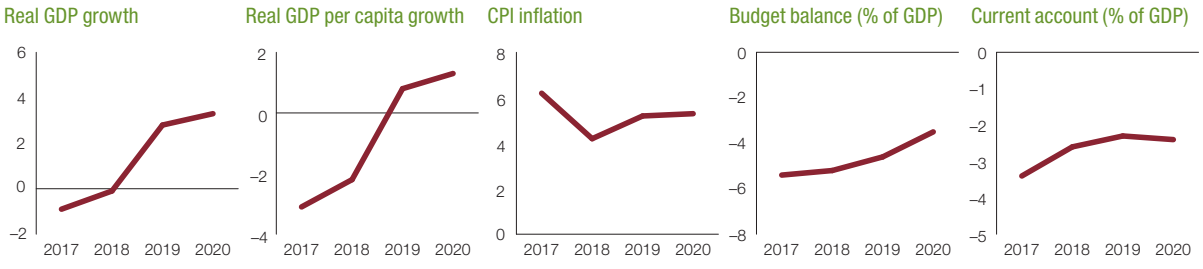
International reserves surged from 3.7 months of imports at the end of 2016 to 4.4 months at the end of September 2018. The highly volatile real effective exchange rate depreciated in 2018, improving the competitiveness of exports.

Tailwinds and headwinds

The medium-term outlook is mixed. Aggregate demand is expected to recover steadily as private activity picks up and new infrastructure projects are implemented as part of the stimulus package. Growth will also be boosted by increased capacity utilization in a new uranium mine as well as improved business confidence as reforms are accelerated.

But growth could remain weak if growth in key trading partners, notably South Africa and Angola, continues to be slow or if international prices of Namibia's commodity exports fall. Uncertainty over land reform and the economic empowerment agenda could also weigh on the growth outlook. The government's assurance that land will not be expropriated without compensation should help ease such concerns.

Going forward, structural reforms to improve competitiveness and spur economic diversification will be crucial in fostering sustainable and job-creating growth. With public debt at a sustainable level, key policy priorities could focus on enhancing domestic revenue mobilization to strengthen the government's fiscal position, providing incentives to shift the economy's structure toward higher value added industries, and advancing the wealth redistribution agenda to address long-standing inequities.



Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

Niger

Macroeconomic performance

Real GDP growth was an estimated 5.2% in 2018, up from 4.9% in 2017, reflecting stronger performance of the agricultural sector. On the demand side, final consumption grew by 4.5% in 2018, and investment, by 11.7% (compared with 2.4% in 2017). The GDP structure remains relatively stable, with agriculture ominating (43.4% of GDP in 2018), followed by services (35%), and industry (14.9%). Despite public finance consolidation, the fiscal deficit stood at an estimated 5.9% of GDP in 2018. Consumer price index inflation was an estimated 4.2% in 2018, reflecting an expansion in credit and money supply in the context of a contraction in net foreign assets.

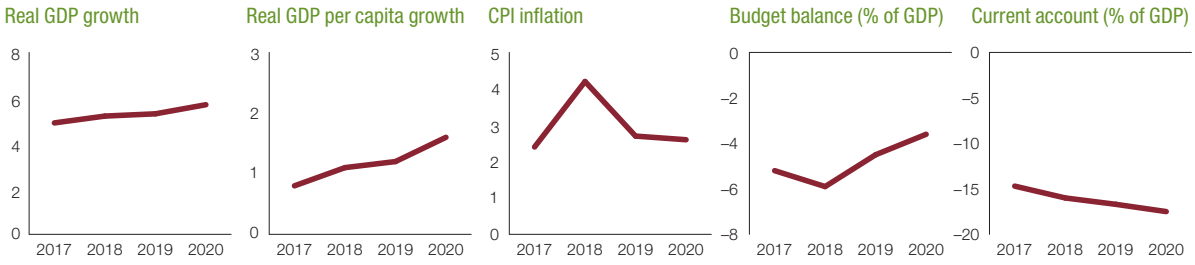
The economic outlook is favorable, with real GDP growth projected at 5.3% in 2019 and 5.7% in 2020. Economic activity should continue to benefit from strong performance in the agricultural sector, underpinned by the expansion of irrigated land and the development of mini-dams. The 2017–2020 Economic and Social Development Plan provides for numerous infrastructure projects, notably the Cotonou–Niamey–Ouagadougou–Abidjan rail loop, a pipeline for exporting crude oil, the Salkadamna power project, and the Kandadji combined hydro and irrigation dam.

Recovery in Nigeria should also be profitable for Niger. The effectiveness of these prospects is also subject to risks related to climate shocks, a decline in the export price of crude oil, possible delays in the pipeline construction project, and the terrorist threat in the Sahel.

Tailwinds and headwinds

Agriculture remains a priority in the country's strategy to strengthen and accelerate economic growth. The implementation of the five-year action plan under the 3N initiative "Nigerians feeding Nigerians" is ongoing, with encouraging results in terms of improved water resources management and increased productivity and value added for agro-sylvo-pastoral and fisheries production. The country has also undertaken numerous reforms aimed at improving the business environment and gained 26 places in four years on the World Bank's Doing Business ranking. Despite the encouraging economic performance, poverty remains high (42.2% of the population in 2017), and access to basic services (health and education) is a major challenge.

As a large landlocked country, Niger is committed to regional integration, especially in the context of the Economic Community of West African States and the West African Economic and Monetary Union. Until early 2011, Niger exported exclusively agricultural and livestock products to these two economic areas. With the export of oil since 2012, the country has diversified its exports and improved its trade balance. Niger has implemented most regional regulations related to trade, including the Common External Tariff and its accompanying measures, and made progress in implementing the World Trade Organization's Trade Facilitation Agreement. Niger has also signed the Continental Free Trade Agreement and is a member of the G5 Sahel subregional organization set up in 2014. Niger leads the group on climate change issues and chairs the Sahel Climate Commission.



Source: African Development Bank statistics; figures for 2018 are estimates; figures for 2019 and 2020 are projections.

Nigeria

Macroeconomic performance

The growing importance of services has bolstered growth in the economy. The sector accounts for about half of GDP, dwarfing the 10% from oil and 22% from agriculture. Real GDP growth was an estimated 1.9% in 2018, reflecting a recovery in services and industry—particularly mining, quarrying, and manufacturing. The recovery benefited from greater availability of foreign exchange. Growth in agriculture was lackluster, due partly to clashes between farmers and herders coupled with flooding in key middle-belt regions and continued insurgency in the northeast.

On the macroeconomic front, the delay by parliament in approving the 2018 budget affected implementation and increased fiscal uncertainty by pushing the bulk of spending to the second half of the year. But thanks to oil revenues, a value added tax on luxury items, and a tax amnesty, the fiscal deficit narrowed in 2018, financed mainly by public debt.

By June 2018, the stock of public debt stood at $73.2 billion, up from $71.0 billion in 2017, representing 17.5% of GDP. Despite the increase, Nigeria remained at moderate risk of debt distress. In November 2018, the government issued a Eurobond of $2.9 billion, which reflects its new debt management strategy of prioritizing foreign debt to mitigate the high financing costs of domestic borrowing. Furthermore, relatively strong oil receipts solidified the current account surplus to an estimated 3.7% and bolstered improvements in the terms of trade by about 13% in 2018 alone.

Real GDP is projected to grow by 2.3% in 2019 and 2.4% in 2020 as implementation of the Economic Recovery and Growth Plan gains pace. However, the slide in oil prices from late 2018 coupled with an output cut imposed by the Organization of the Petroleum Exporting Countries poses a downside risk to the economic outlook. Parliament's approval of the 8.83 trillion naira 2019 "budget of continuity" may also be delayed due to presidential elections scheduled for February 2019.

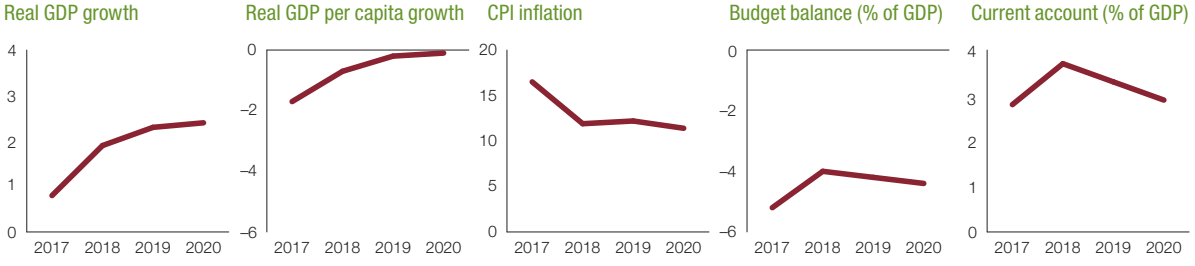
Tailwinds and headwinds

The outlook depends on the pace of implementing the Economic Recovery and Growth Plan, which anchors Nigeria's industrialization by establishing industrial clusters and staple crop processing zones to give firms a competitive edge through access to raw materials, skilled labor, technology, and materials.

The Power Sector Reform Program, if effectively implemented, could attract private investment. It targets 10 gigawatts of operational capacity by 2020. But Nigeria needs to reorient its federal budget, currently dominated by recurrent spending, toward more capital expenditure and accumulating savings to sustain social spending.

The federal government has made strides with institutional and governance reforms, including implementation of the Integrated Financial Management and Information System and the Integrated Payroll and Personnel Information System. The enactment of the Secured Transactions in Movable Assets Act 2017 has institutionalized and widened coverage of collateral to stimulate lending to small and medium enterprises. Although Nigeria has a relatively low debt-to-GDP ratio, there is need for fiscal prudence to avoid a debt trap, especially as global interest rates start to rise. Therefore, contraction of new external debt should balance spending needs with capacity to improve the economy's competitiveness and stimulate growth.

Nigeria accounts for nearly 20% of continental GDP and about 75% of the West Africa economy. Despite this dominance, its exports to rest of Africa are estimated at 12.7%, and only 3.7% of total trade is within the Economic Community of West African States. Nigeria has yet to ratify the Continental Free Trade Agreement, pending the outcome of broad consultations with captains of industry and other stakeholders.



Source: African Development Bank statistics; figures for 2018 are estimates; figures for 2019 and 2020 are projections.

Rwanda

Macroeconomic performance

Real GDP growth reached 6.1% in 2017 and was estimated at 7.2% in 2018, supported by strong growth in services (4.1%) and industry (1.5%), particularly manufacturing. The key drivers of spending in 2018 were household consumption (5.8% of GDP) and investment (2.9%). The fiscal deficit was an estimated 4.3% in 2018, down from 4.8% in 2017, thanks to increased investment (from 23.4% of GDP in 2017 to 25.3% in 2018) and reduced grants, despite strong tax collection driven mainly by improved tax compliance and the introduction of an electronic tax payment system. Public sector debt increased to 41.1% of GDP in 2018 from 35.6% in 2016, but risk of debt distress remains low. With inflation low and the exchange rate relatively stable, monetary policy continued to be accommodative in 2018.

Inflation was estimated at 0.9% in 2018, much below the 8.2% in 2017, thanks to the lower cost of food and nonalcoholic beverages. The exchange rate remained relatively stable throughout 2018. In 2018, the foreign exchange rate pressures on the Rwandan franc remained modest due to continued improvements in the external sector resulting from a 15.8% increase in exports and a 1.4% increase in imports. The currency depreciated by 1.4% against the US dollar in 2017, far below the 9.4% in 2016.

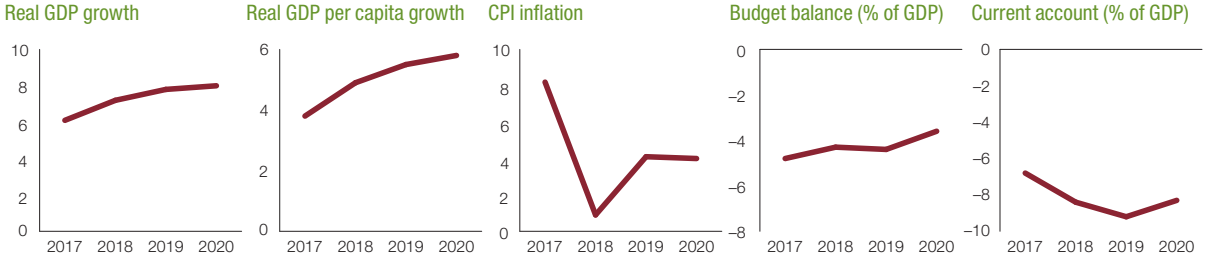
The current account deficit widened to an estimated 8.4% in 2018 from 6.8% in 2017 due partly to a deterioration in the terms of trade to –3.6% in 2018 from 7.7% in 2017. Goods exports increased sharply by 29% and imports by 14.9% between January and May 2018, compared with the same period in 2017.

Tailwinds and headwinds

The economy is projected to grow at 7.8% in 2019 and 8.0% in 2020, supported by export growth resulting from the Made in Rwanda policy, continued public investments such as the Bugesera airport, and the country's strong record of implementing reforms to achieve its long-term development goals. Inflation is projected to edge up to about 4.0% in both 2019 and 2020. Fiscal policy will continue to aim at prudent borrowing and fiscal consolidation to keep debt sustainable. The fiscal deficit is projected to reach 4.4% of GDP in 2019 but to decline to 3.6% in 2020, reflecting prudent borrowing and increased domestic resource mobilization. Rwanda's economy has enjoyed a good governance buildup that has allowed for great strides toward deeply entrenched and respected good governance principles and toward structural transformation facilitated by broad-based growth. The country's bold policy reforms present an opportunity for increased investment and job-creating growth. In terms of social developments, Rwanda has translated its strong growth into reduced poverty and improved equality. The poverty rate fell from 56.7% in 2005/06 to 39.1% in 2013/14, while income inequality, as measured by the Gini coefficient, decreased from 0.52 to 0.45.

Given the drought in 2016 and 2017, Rwanda's high reliance on rain-fed agriculture poses a risk to its economic outlook. Diseases and pests, such as the bronze bug and the fall armyworm in maize, could also reduce agricultural production. Rwanda's suspension from the African Growth and Opportunity Act, following its decision to ban secondhand clothes and shoes, could depress exports and thus growth prospects if the growth momentum in tourism and mining receipts is not sustained. Finally, an oil price increase could raise the country's import bill.

Insecurity and instability in the Great Lakes Region, particularly the civil unrest in neighboring Burundi and the ongoing violence and Ebola outbreak in eastern Democratic Republic of Congo, remain a source of fragility for Rwanda. Increased violence is likely to affect Rwanda's trade because Democratic Republic of Congo and the Great Lakes Region are among the country's major trade partners. Rwanda also needs to improve its savings rate, which is low compared with regional peers—around 13% of GDP, well short of its investment rate of 26%.



Source: African Development Bank statistics; figures for 2018 are estimates; figures for 2019 and 2020 are projections.

São Tomé and Príncipe

Macroeconomic performance

Real GDP growth was an estimated 4.1% in 2018, up from 3.9% in 2017, bolstered by increased foreign direct investment supporting the construction sector in development projects.

The fiscal balance switched to an estimated surplus of 0.3% of GDP in 2018, from a deficit of 2.6% in 2017, driven by increasing revenue and declining total spending, particularly capital spending. Public debt (42.1% of which was foreign debt) was an estimated 51.7% of GDP in 2018. São Tomé and Príncipe was classified as being in debt distress in 2018 because of outstanding external arrears. To promote private credit growth, the central bank reduced the benchmark interest rate to 9% in 2017 and set the minimum reserve requirement at 18%. As a result, private credit increased by 2.2% in 2018 from 2017, to 139.4 million dobras. Inflation was an estimated 6.8% in 2018, up from 5.7% in 2017.

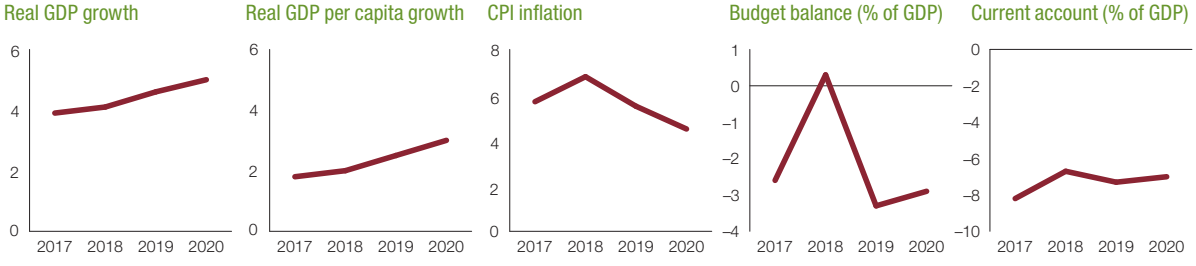
Overdependence on imports for private consumption continues to create imbalances. But the current account deficit narrowed to an estimated 6.7% of GDP in 2018 from 8.2% in 2017. Cocoa beans and coconut accounted for 90.8% of the country's total exports in 2018, with the European Union being the main market. The Netherlands alone accounted for 45.3% of total exports in 2018. Angola is São Tomé and Príncipe's main trading partner in Africa, accounting for about 4% of exports and 91.6% of imports as of June 2018.

Real GDP growth is projected to be 4.6% in 2019 and 5.0% in 2020, thanks to strong performance in the construction, services, and agriculture sectors. Increased public investment, supported mainly by external resources, will also boost growth. The medium-term outlook projects that inflation will decline to 5.5% in 2019 and 4.5% in 2020. The current account deficit is projected to stabilize at around 7% in 2019 and 2020.

Tailwinds and headwinds

Downside risks to the economic outlook include an economic slowdown in Europe, the country's main export market. São Tomé and Príncipe's high rate of nonperforming loans (25% of total loans in 2018) could further weaken the banking sector and curtail credit expansion. The 4.8% increase in wages and salaries granted in 2018 reduced fiscal space and could exacerbate debt vulnerabilities. As an archipelago state, São Tomé and Príncipe is fragile and vulnerable to climate change. Building climate resilience will require additional resources and donor support. The high cost of energy, which is produced largely from fossil fuels, is a major constraint to private development. The government's plans to invest in renewable energy could alleviate this constraint.

São Tomé and Príncipe is a member of the Economic Community of Central African States (ECCAS) and the Community of Portuguese Speaking Countries and is part of the Central Africa configuration in the negotiations for an Economic Partnership Agreement with the European Union. It is currently seeking membership with the World Trade Organization and the Central African Economic and Monetary Community. Despite membership in regional economic communities, São Tomé and Príncipe continues to struggle to reap tangible benefits from effective regional economic integration because of its geographic remoteness from mainland Africa and global markets. The country's limited variety of tradable goods and high transportation costs prevent it from achieving the same degree of competitiveness as its competitors. On the 2016 Africa Regional Integration Index, São Tomé and Príncipe ranked as a top performer in free movement of persons among ECCAS countries. This can be attributed to the removal of visa requirements for some African nationals.



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Senegal

Macroeconomic performance

Economic performance remained strong in 2018, with estimated real GDP growth of 7.0%, down slightly from 7.2% in 2017. The primary sector expanded by 7.8% in 2018, driven by agriculture and related activities. The secondary sector recorded 6.9% growth, driven mainly by mining subsectors, agrofood, and construction. The tertiary sector saw 6.7% growth, reflecting strong performance by the retail segment. On the demand side, real GDP growth was driven by 9.5% growth in gross fixed capital formation, 7.7% growth in intermediate consumption, and 6.7% growth in final consumption.

Fiscal management resulted in a deficit of 3.5% of GDP in 2018, up from 3% in 2017, financed mainly by issuing Eurobonds. The total external debt–to-GDP ratio was 62.9% in 2018, down from 64.2% in 2017, but the risk of debt overhang remains low. Inflation was 1.4% in 2018, up slightly from 2017, reflecting a favorable agricultural season and prudent monetary policy. The current account deficit improved from 7.3% of GDP in 2017 to 6.9% in 2018 due to increased agricultural and fisheries exports and lower imports. The terms of trade improved by 4.1%.

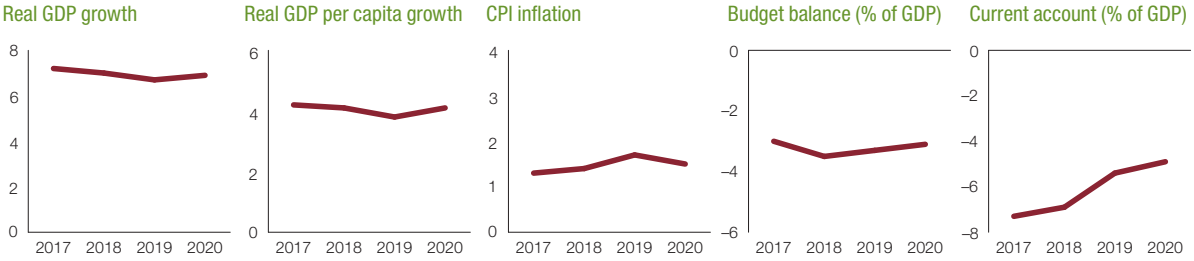
The growth momentum recorded since 2015 is expected to continue in 2019 and 2020 due to continued public investment under the Senegal Emergence Plan. Consolidation efforts could bring the fiscal deficit below 3% of GDP after 2020.

These projections are subject to numerous risks, notably rising oil prices. But Senegal may become an oil- and gas-producing country by 2021. Other risks stem from the accumulation of internal arrears, which could slow construction activity, and the increase in current spending as a result of social demands characteristic of an election year. As a member of the West African Economic and Monetary Union (WAEMU), Senegal enjoys a stable macroeconomic environment but may be vulnerable to deteriorating competitiveness due to its limited flexibility to adjust to external shocks.

Tailwinds and headwinds

As part of the Senegal Emergence Plan, authorities have implemented reforms from the Business Environment and Competitiveness Reform Program. In the agricultural sector, these reforms have focused on simplifying tax procedures and suspending or exempting some taxes. In the energy sector, various reforms and investments have doubled installed capacity in six years, to 1,250 MW in 2018. The energy mix plan has increased production and lowered the price of electricity by 10%. Operationalizing the economic zones and industrial projects has provided companies with facilities that are up to international standards. But to amplify the effects of these reforms, authorities should strengthen the land tenure regime and align the education system to the future needs of the workplace.

In terms of regional integration, Senegal was one of the first to adopt and implement the WAEMU Common External Tariff, it signed the Continental Free Trade Agreement, and it has implemented port facilitation reforms to make the port of Dakar more attractive and secure. In this regard, the country has ratified and is implementing relevant regional regulations. In the same vein, Senegal has constructed roads and bridges to connect to Gambia, Guinea, Guinea-Bissau, Mali, and Mauritania. In 2017, Senegal's exports to Economic Community of West African States members accounted for 39.5% of total exports, and exports to WAEMU members accounted for 30.3%. To further increase trade and reduce the transaction costs related to the movement of people and goods, authorities should develop transport infrastructure, in particular the Dakar–Bamako railway.



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Seychelles

Macroeconomic performance

Real GDP growth was an estimated 3.6% in 2018, down from 5.3% in 2017, due to rising international oil prices, a moratorium on construction, and uncertainty over the Eurozone, on which the country relies for its thriving tourist sector. The service sector—mainly tourism, finance, transport, and communications—led the growth, expanding by an estimated 5.4% in 2018, up from 5.3% in 2017. The primary fiscal deficit was an estimated 0.3% of GDP in 2018, up from a balanced budget in 2017, due mainly to increasing government spending and declining revenue. The country's debt-to-GDP ratio has declined by almost two-thirds from 183% in 2011 to a relatively high 60% estimated for 2018. Authorities plan to reduce the ratio to less than 50% by 2021 through fiscal discipline coupled with an improved debt management strategy.

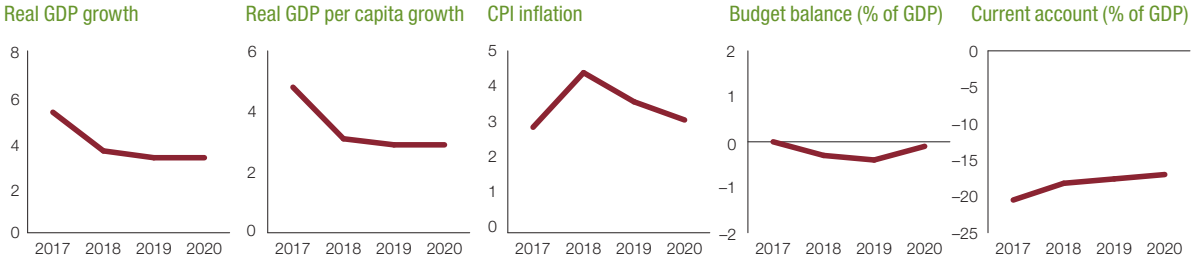
Inflation increased to an estimated 4.4% in 2018 from 2.9% in 2017 due to higher global energy prices and 2017 fiscal measures, which included a higher minimum wage, increased social spending (mainly state pensions), and higher civil service wages (raised through a new "13th month salary"). The exchange rate remained stable in 2018 at 13.9 Seychellois rupees per dollar. Average gross international reserves were estimated at 4 months of imports in 2018.

The current account continued to register a large but declining deficit in 2018. The deficit was an estimated 17.6% of GDP in 2018, down from 20.5% in 2017. The country's main trading partners, Europe and the Middle East (mainly the United Arab Emirates), account for more than 60% of the country's imports and exports.

Tailwinds and headwinds

Economic growth is projected to be 3.3% in 2019 and 2020, with the service sector remaining the primary driver of growth. The medium-term outlook remains positive, thanks to projected vibrant tourism and growing fishery sectors. On the demand side, growth will continue to be driven by robust investment, estimated at 34.6% of GDP in 2019 and 36.1% in 2020. Given the still high debt-to-GDP ratio, internal downward risks include the expansionary fiscal measures in the 2017 budget, which will continue to trigger inflationary pressures. Overdependence on tourism and fisheries makes the economy vulnerable to external shocks. A slowdown in the construction sector, resulting from a moratorium on large hotels and scarcity of construction materials, may also put a brake on growth. The economy enjoys a high-value tourism sector, a large fishing area, emerging financial services and information and technology sectors, an improving regulatory framework for private participation, and a strategic framework for climate change.

External downward risks include deterioration in the terms of trade, rising international fuel prices since late 2016, and uncertain economic performance in the Eurozone—the main source of tourism. The rising trend in international fuel prices is likely to have a negative effect on the balance of payments, inflation, and productivity because the country is an oil importer. In addition, as an island state, Seychelles is also exposed to climatic shocks, requiring additional resources for resilience building.



Source: African Development Bank statistics; figures for 2018 are estimates; figures for 2019 and 2020 are projections.

Sierra Leone

Macroeconomic performance

Real GDP growth slowed to an estimated 3.5% in 2018 from 5.8% in 2017. The decline reflects lower than projected iron ore mining due to the decline of prices since 2014 and the 2017 closure of the main mining company, Shandong Iron and Steel Company.

The fiscal deficit continued to worsen to an estimated 7.7% of GDP in 2018 from 6.8% in 2017, due largely to a shortfall in revenue mobilization and overspending related to elections. The deteriorating fiscal position led to a sharp increase in public debt from 55.9% of GDP in 2016 to 60.8% in 2017. New measures, such as adopting the treasury single account and reducing waivers and exemptions from customs duties, could improve the government's position.

The Bank of Sierra Leone has proactively implemented a tight monetary policy and reduced the accommodation of government financing needs. But internal control weaknesses at the central bank continue to threaten reserve accumulation and macroeconomic stability. The exchange rate has depreciated by more than 30% since 2016, and inflation remained high at an estimated 13.9% in 2018.

The current account deficit worsened to an estimated 16.9% of GDP in 2018 from 13% in 2017, due to increased imports of consumption goods and weak export performance. Most of the country's exports are unprocessed commodities such as gold, diamonds, iron ore, and cashew nuts, while the bulk of imports are rice, petroleum, and machinery. Real GDP growth is projected to increase to 5.6% in 2019 and 5.8% in 2020. The main drivers of economic growth will be increased private agricultural and mining investment amid business climate reforms.

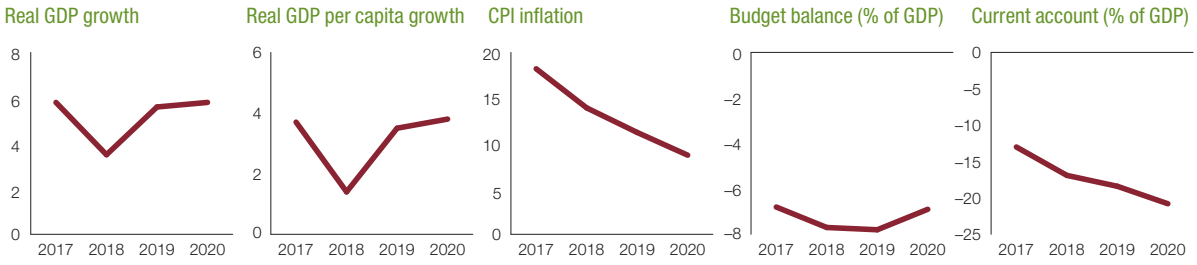
Tailwinds and headwinds

The positive growth outlook is not without macroeconomic imbalances. The fiscal deficit financed partly by the buildup of payment arrears is expected to persist and could pose substantial risks to economic growth by squeezing liquidity and increasing the cost of capital projects. The government envisions adopting more prudent fiscal and monetary policies and has demonstrated strong political will to change for the better.

The deficit is due in part to increased public investments in infrastructure, such as roads and energy, which are expected to boost economic activity in the medium to long term.

Headwinds include macroeconomic imbalances, which are expected to persist, especially the fiscal and current account deficits, which could pose some risks to economic growth. The current account deficit is projected to widen to 18.4% of GDP in 2019 and 20.8% in 2020 due to a sluggish increase in agriculture and mineral exports. Other risks include the increasing debt and commodity price shocks. Dependence on primary commodity exports makes the country extremely vulnerable to external shocks.

The government has initiated several reforms, including the Extractive Industry Revenue Bill, which seeks to improve on the fiscal regime for mining companies, allowing for better government oversight and increased revenue. Two policies for financial sustainability in the energy sector and universal access to electricity and increasing the energy mix were launched in 2018. The country's Roadmap for the National Agricultural Transformation (2018) identifies four enablers to increase rice self-sufficiency, livestock development, and crop diversification: improving the policy environment, promoting women and youth in agriculture, setting up private sector–led mechanization, and sustainably managing biodiversity.



Source: African Development Bank statistics; figures for 2018 are estimates; figures for 2019 and 2020 are projections.

Somalia

Macroeconomic performance

Real GDP growth was an estimated 2.9% in 2018. Supply-side contributors were mainly agriculture, livestock, and financial and telecommunications services. Demand-side contributors were largely government and private consumption, which together constituted about 83% of GDP. The current account deficit hurt growth as it widened to an estimated 7.2% in 2018, driven by rising consumer and capital goods imports, particularly food imports due to persistent droughts; higher oil prices; and Saudi Arabia's ban on Somali livestock imports, following the Rift Valley fever outbreak.

The budget remained balanced in 2018, through enhanced domestic revenue collection and efficient public expenditures. Somalia is classified as being in debt distress, with debt estimated at 65% of GDP in 2017. Monetary policy remained inactive, while foreign exchange market interventions ceased. Inflation remained in the single digits, at an estimated 5.1% in 2018, attributed to higher food prices following adverse weather conditions.

Tailwinds and headwinds

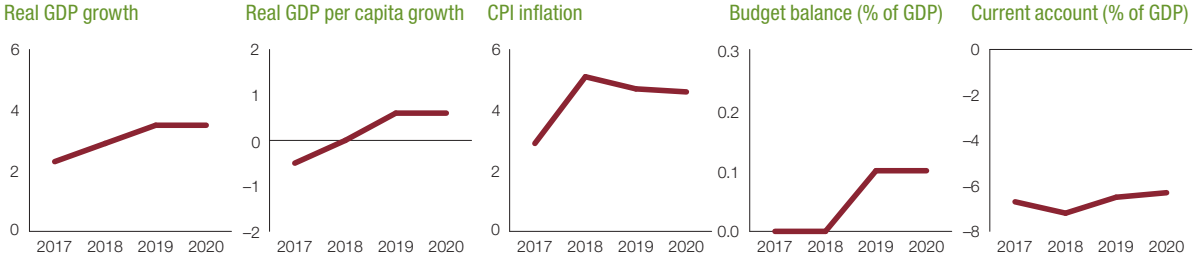
Real GDP growth is projected to be 3.5% in 2019 and 2020. Resolving the debt situation by 2019–20, conditioned on satisfactory performance under the International Monetary Fund Staff Monitoring Program, could also restore investor confidence.

Downside risks include slower agricultural growth due to May 2018 floods, continuing insecurity, and adverse weather shocks to rain-fed agriculture and livestock trade.

Key challenges include infrastructure constraints, weak state institutions and capacity, weak public financial management systems, continued insecurity, limited resilience to environmental extremes, and large arrears to international financial institutions. Somalia lacks the infrastructure to provide basic services, including security, health, water, education, energy, and transport because so much infrastructure has been damaged and destroyed by conflict. The civil war also had a devastating effect on institutions and governance capacity. The public financial management system still faces challenges of transparency, ability, and legitimacy, which has delayed the startup and implementation of projects. Somalia remains insecure due to lack of effective law enforcement mechanisms; high unemployment, especially among young people; and incursions by Al-Shabaab and ISIS insurgents, among others. Floods and droughts have reversed many of the social and development gains made. The country's weak institutional and human capacities pose a challenge to speedy access to debt relief from international financial institutions.

Key opportunities include a vibrant private sector; a diaspora willing to invest in the country; regional integration; import substitution and export promotion; nascent agricultural, agribusiness, and fishing industries; and a young population.

Somalia is endowed with entrepreneurs who have been able to flourish in the conflict-ridden country, and the Somali diaspora remains committed to investing in economic and social reconstruction. Somalia also has the potential to be a regional economic hub due to its strategic geographic location and having the longest coastline in Africa. The country's huge trade deficit is an opportunity for Somalis to produce for domestic and international markets and to reduce dependence on imports. The country is also endowed with huge agricultural and aquaculture production and processing potential. Over 70% of Somalia's population is under age 30 and needs to be well managed to become a potential youth dividend.



Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

South Africa

Macroeconomic performance

Real GDP growth was an estimated 0.7% in 2017/18, down from 1.3% in 2016/17. The agricultural sector grew 17.7% in 2016/17, after contracting 10.2% in 2015/16, to contribute 0.4 percentage point to GDP growth. Manufacturing contracted 0.2% in 2016/17 after growing 0.9% in 2015/16. Growth also slowed in the services sector, with growth in finance, the main subsector, slipping from 2.3% in 2015/16 to 1.9% in 2016/17, contributing 0.4 percentage point to overall growth. Household consumption remains the key driver of growth. Household and government consumption contributed 1.5 percentage point to growth in 2016/17, compared with 0.8 percentage point in 2016.

The fiscal deficit remained high at an estimated 4.0% in 2017/18, down from 4.3% in 2016/17, as the country continued to face revenue shortfalls arising from slow economic growth. To bolster domestic resources, the government introduced new tax policies, including an increase in the value added tax from 14% to 15% on 1 April 2018. Public debt reached an estimated 53.3% of GDP in 2017/18, with domestic debt accounting for over 90% of total public debt.

Inflation was an estimated 4.9% in 2017/18, down from 5.3% in 2016/17, due to lower food prices. In April and May 2018, the value of the rand depreciated against most currencies, while the dollar strengthened considerably. The real effective exchange rate of the rand appreciated by 3.3% from March 2017 to March 2018, resulting in loss of competitiveness. Gross gold and foreign reserves reached $51.1 billion in May 2018, covering about 4.4 months of imports.

Real GDP growth is projected to increase to 1.7% in 2018/19 and 2.0% in 2019/20. The drought has improved in most provinces, and prospects in the agricultural sector are favorable. However, growth in industry and services is expected to remain sluggish.

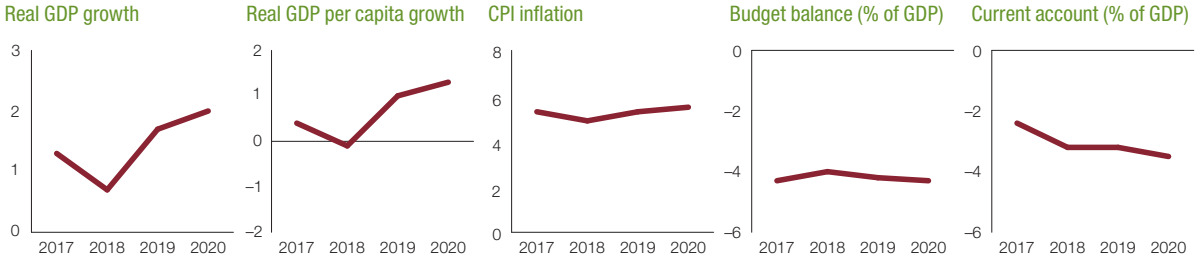
Tailwinds and headwinds

South Africa depends heavily on exports of mineral resources, and although commodity prices increased markedly in the second quarter of 2018, the outlook is on the downside, especially because of expected weakening of global growth due to ongoing trade tensions.

The government recognizes the need to improve the electricity supply. In 2018, South Africa signed long-delayed renewable energy contracts worth 55.92 billion rand with independent renewable power producers. This cleared uncertainty on the energy sector reform introduced in 2011 that permitted private participation in electricity generation. Over 80% of South Africa's electricity comes from coal, while renewable energy accounts for only about 7% of total generation capacity. The government aims to reduce the share of coal in the energy mix to 48% by 2030.

To put in place measures for fair and equitable land reform that will increase agricultural output and build self-sufficiency in food production, the parliament endorsed in December 2018 a constitutional amendment allowing land expropriation without compensation.

While South Africa enjoys well-functioning democratic institutions, the country faces governance challenges in procuring public goods and services and in managing state-owned enterprises. The low competition in goods and services markets and skills shortages are among the key structural bottlenecks hindering growth. Structural reforms in these areas would help reignite growth and foster social inclusion. South Africa's regional integration policy is often seen as inward looking, focusing more on domestic industrial development. It could gain from devising regional integration policies that accommodate the needs of its various neighbors, which would promote regional value chains.



Note: Data are for fiscal years, so 2017 refers to the 2016/17 fiscal year.
Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

South Sudan

Macroeconomic performance

Real GDP contracted by an estimated 3.8% in 2018, following a contraction of 6.3% in 2017, supported by a slight recovery in global oil prices. On the supply side, the oil sector continued to be the main contributor to growth, accounting for about 70% of GDP in 2017, followed by agriculture (10%), manufacturing (7%), and services (6.1%). On the demand side, public consumption was the main contributor, following the 2017 56% increase in public salaries. The current account turned to an estimated deficit of 12.7% of GDP in 2018, from a surplus of 1.7% in 2017, due to a decline in exports, and continued to stymie growth. Income tax increases, high inflation, internal conflicts, disruptions to oil production, a fall in oil prices, and weak agricultural production were the main drivers of the decline in GDP.

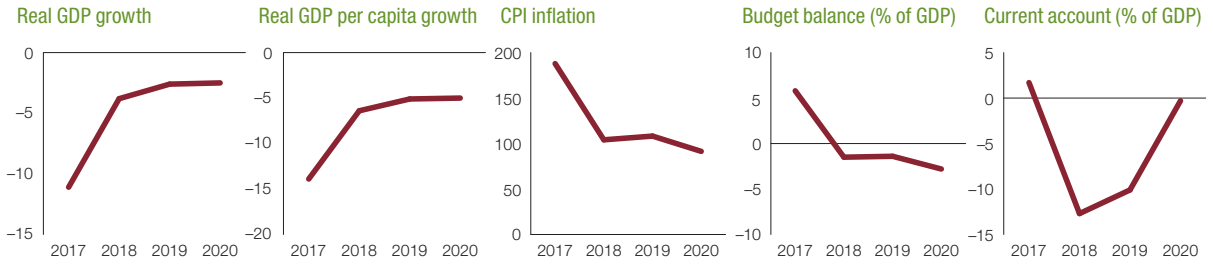
The fiscal deficit was an estimated 1.5% of GDP in 2018, down from a surplus of 5.8% in 2017. Recent debt sustainability analysis puts South Sudan in the debt distress category, with total public debt estimated at 48.5% of GDP in 2018 and public external debt at 32.6% of GDP. Inflation remained high at an estimated 104.1% in 2018, due mainly to uncontrolled growth in the monetary base. The South Sudanese pound depreciated further in 2018, and the economy continued to have severe foreign exchange shortages, leading to an active parallel market.

Tailwinds and headwinds

Further improvements in growth prospects are due mainly to projected increases in global oil prices and oil production. Real GDP is projected to contract further, by 2.6% in 2019 and 2.5% in 2020. The signing of the peace agreement in June 2018 and the opening of four border crossings with Sudan are vital opportunities for reviving the economy. The country's main downside risks are the vulnerability of agriculture to climate change, the high volatility of oil prices, and ongoing conflicts in the Blue Nile, Darfur, and South Kordofan states.

Key challenges include continued internal and external threats to peace, security, and stability; the disputed oil-producing region of Abyei; institutional and human capacity weaknesses; a narrow economic base; and dilapidated infrastructure. Peace, security, and stability are the most pressing challenges for South Sudan. The territorial boundaries of Abyei remain contested and could reignite hostilities between affected people on both sides, with dire social, security, and economic consequences. Institutions and the human resource base remain weak, as the country is in tremendous need of massive financial and technical education services support at all levels. Heavy dependence on the oil sector is a source of economic fragility and vulnerability and underscores the urgent need for economic diversification. And decades of civil war destroyed the country's basic infrastructure and much of its productive capacities.

Key opportunities include abundant natural resources, potential hydropower sites, and regional integration. South Sudan is endowed with abundant natural resources, including a large amount of fertile rain-fed agricultural land that is potentially irrigable, aquatic and forest resources, and mineral resources, including oil. It is also has several potential hydropower sites on the White Nile River that could provide up to 3,000 MW, suiting the country's energy and security needs. And regional integration can act as a major driver for economic development, particularly in the form of investment and imports from neighboring countries and regional blocs and as a market to support economic diversification. The tourism industry has great potential to ensure inclusive growth but lacks investment in infrastructure, human capital, and adequate policy reforms.



Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

Sudan

Macroeconomic performance

Real GDP growth was an estimated 4.1% in 2018, up slightly from 3.3% in 2017. On the supply side, mining (growth of 6.3%), agriculture (3.7%), and manufacturing (1.5%) were the main contributors to growth. On the demand side, private consumption was the main contributor to growth, while the current account deficit, an estimated 2.4% of GDP in 2018, detracted from growth. High inflation and the phasing out of energy subsidies stymied growth. Although unemployment rose to 18% as a result of rapid exchange rate depreciation and persistent inflation, poverty and inequality declined between 2010 and 2015. But limited data impair analysis of how the declines affected structural transformation.

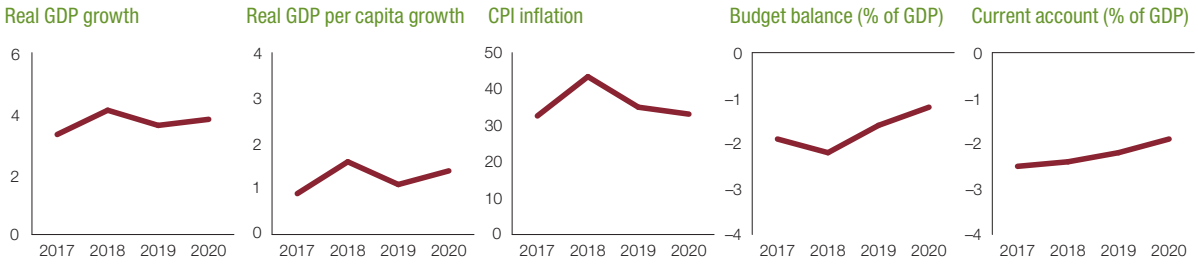
Sudan is in debt distress, with external debt an estimated 62% of GDP in 2018. Lifting of US sanctions is expected to normalize relations with creditors and speed negotiations of debt relief under the Heavily Indebted Poor Country Debt Relief Initiative. Inflation soared to an estimated 43% in 2018, driven by a sharp devaluation of the Sudanese pound and fiscal deficit monetization. Foreign currency scarcity and an overvalued official exchange rate triggered a parallel market emergency.

Tailwinds and headwinds

Real GDP growth is projected to be 3.6% in 2019 and 3.8% in 2020, benefiting from a strong commitment to ongoing macroeconomic policy and structural reforms, including removing tax exemptions, reducing public spending, rationalizing imports while providing incentives to boost exports, a rebound in manufacturing, and high private consumption. Addressing debt distress will also be crucial for realizing the projected economic outlook. The peace agreement signed in September 2018 to end the civil war in South Sudan has encouraged the governments of Sudan and South Sudan to open four border crossings to facilitate the flow of humanitarian and commercial traffic and double oil output production. Downside risks include the continued civil conflicts and insecurity in the Blue Nile, Darfur, and South Kordofan states.

Key challenges include institutional and human capacity weaknesses, high youth unemployment, a high external debt burden, and climate change. Sudan remains a typical transitional state faced with institutional and human resource capacity deficiencies. More than 130,000 young people a year enter the labor market, but only 30,000 positions are available, posing a serious challenge for the country. External debt stock—which increased from $18 billion in 1995 to $53.6 billion in 2016 and to $56 billion in 2018—is unsustainable and thus constrains the country's economic recovery prospects. And Sudan continues to experience prolonged serious environmental degradation caused by low rainfall, overcutting of trees, overcultivation, and overgrazing.

Key opportunities include huge unexploited agricultural potential, an improved national policy environment, and private sector potential. About 63% of Sudan's land area is agricultural land, which is suitable for a wide variety of crop cultivation and animal husbandry. The government's recent economic reforms, coupled with the opportunities arising from the lifting of US sanctions and the improved national policy environment, could create a conducive atmosphere for alignment with both the Sustainable Development Goals and the African Development Bank's High 5s. Sudan also holds huge private investment opportunities in large-scale irrigated agriculture, dairy farming and animal husbandry, forest enterprises involving gum Arabic, and the leather supply chain for regional and global export, with the potential to increase national income and foreign exchange earnings by promoting exports of manufactured and semi-manufactured goods.



Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

eSwatini

Macroeconomic performance

Real GDP contracted an estimated 0.5% in 2018 after 1.9% growth in 2017. Growth was hampered by weak recovery in the raw materials extraction sector, a slowdown in the production sector, and contraction in the services sector. Agriculture has not yet fully recovered from the 2015/16 drought, and mining has declined. Production sector performance was expected to be dampened by decelerating manufacturing resulting from shrinking external demand, notably an underperforming textile industry and the September 2017 European Free Trade Association ban on selected eSwatini exports. The estimated 1.3% service sector contraction was due to anticipated consumer and government spending declines.

eSwatini's fiscal challenges emanate from high public spending and heavy dependence on the volatile and declining Southern Africa Customs Union (SACU) revenue. The fiscal deficit declined to an estimated 7.4% of GDP in 2018 from 7.9% in 2017 and has been financed by domestic borrowing, accumulating domestic arrears, and international reserve withdrawals. Total public debt increased from 19.6% of GDP in June 2017 to 20.8% of GDP in June 2018.

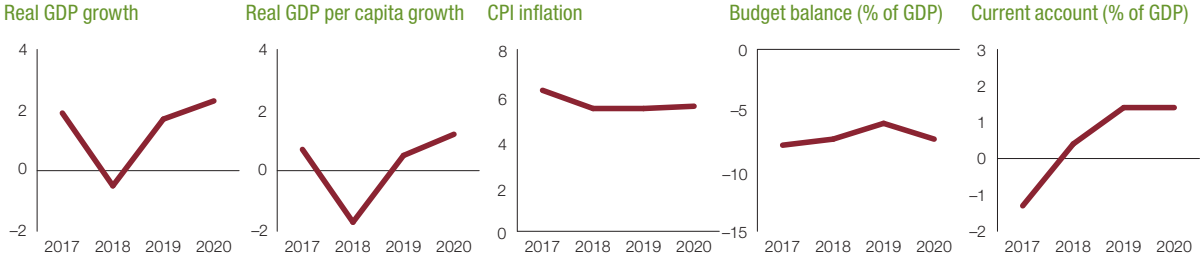
With the eSwatini lilangeni pegged at par to the rand, authorities pursued a restrictive and steady monetary stance, maintaining the discount rate at 6.75% since March 2018. Inflation declined to an estimated 5.4% in 2018 from 6.2% in 2017, and gross official reserves averaged around three months of imports in 2018.

The current account registered a surplus of an estimated 0.4% of GDP in 2018, up from a deficit of 1.3% in 2017, spurred by merchandise trade surpluses and secondary income inflows. The country is overdependent on pulp, sugar, and cotton exports, with about 60% of exports going to South Africa and 80% of imports coming from that country.

Tailwinds and headwinds

The economy faces ongoing fiscal challenges, exacerbated by a weak external position. But real GDP growth is projected to recover modestly to 1.7% in 2019 and 2.3% in 2020, driven by supply-side developments. In 2019, agriculture is projected to fully recover from the drought, construction will benefit from continued expansion (such as the Lower Usuthu Smallholder Irrigation [Phase II] Project), and manufacturing will regain the US African Growth and Opportunity Act market as well as new markets opened by other trade agreements. Improving the business climate and reforming the legal and regulatory framework for infrastructure development present opportunities for enhancing private development and unlocking the economy's potential.

eSwatini faces potential headwinds from persistent fiscal challenges arising from low SACU revenue, a weak external environment, insufficient fiscal consolidation, and a challenging investment climate constraining private development. Growing domestic arrears, if unchecked, will continue to constrain business activity and may increase financial sector vulnerabilities as companies struggle to service their debts. The narrow export base and high market concentration make eSwatini vulnerable to external shocks, particularly those affecting South Africa. Average inflation is projected to be 5.4% in 2019 and 5.5% in 2020.



Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

Tanzania

Macroeconomic performance

Real GDP growth was an estimated 6.7% in 2018, down from 7.1% in 2017. The services sector was the main contributor to GDP (39.3%). Private investment was the main demand-side contributor (63.9%). The external sector stymied economic growth as the current account deficit increased (despite the real depreciation of the Tanzanian shilling), due to a higher volume of imports in 2018 than in 2017. The increase is due largely to increased imports of transport equipment, building and construction materials, industrial raw materials, and petroleum products for large public investment projects, such as the Standard Gauge Railway. The import bill also increased as a result of the rise in the price of key commodities, such as crude oil.

The fiscal deficit increased to an estimated 3.9% of GDP in 2018, due to increased capital spending on infrastructure projects. Public debt increased to an estimated 39.3% of GDP in 2018 from 38.2% in 2017. External debt accounted for about 74.9% of total public debt in 2018. The risk of debt distress remains low because public external debt, at 34.5% of GDP, is mostly concessional.

Monetary policy was more accommodative in 2018 than in 2017. This increased domestic liquidity and reduced lending rates, leading to greater private credit supply. Due to improved food supply, inflation eased to an estimated 3.5% in 2018.

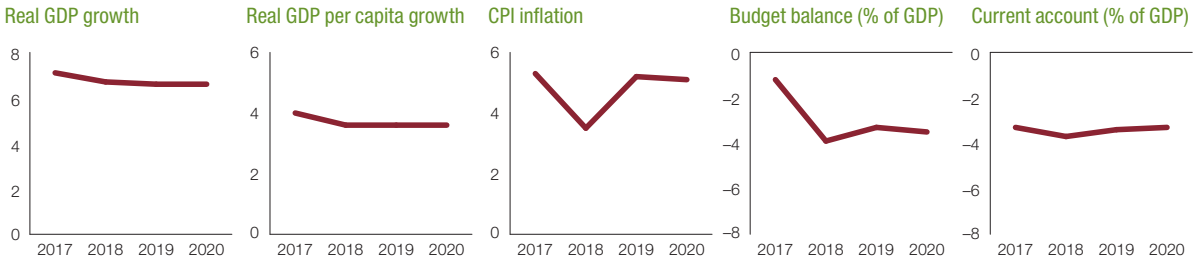
Tailwinds and headwinds

The medium-term outlook is positive, with growth projected at 6.6% in both 2019 and 2020, supported by large infrastructure spending. Headline inflation is projected to marginally increase to 5.2% in 2019 and 5.1% in 2020 due to increased government spending.

But the positive outlook faces several downside risks: growing private sector concerns about economic policy uncertainty and increased domestic arrears that could derail the government's fiscal consolidation and harm the private sector.

Key economic development challenges include slow progress towards inclusive growth, infrastructure bottlenecks, and vulnerability to climate change. Poverty and income inequality remain high despite high economic growth. Infrastructure bottlenecks are most notable in the transport and energy sectors. Reliance on rain-fed agriculture has exposed farmers to income shocks. And inefficient public enterprises present a fiscal risk. One of the development challenges on the social front is youth unemployment, which increased to 7.3% in 2016, compared with 5.7% in 2012.

Key opportunities include peace and political stability, abundant natural resources, a strategic geographic location, and immense development potential for tourism. The Export Zone Processing Agency established in 2008 to accelerate manufacturing exports and help the country achieve structural transformation has helped attract close to $1 billion in foreign direct investment and revive the manufacturing sector into one of the fastest growing in Africa.



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Togo

Macroeconomic performance

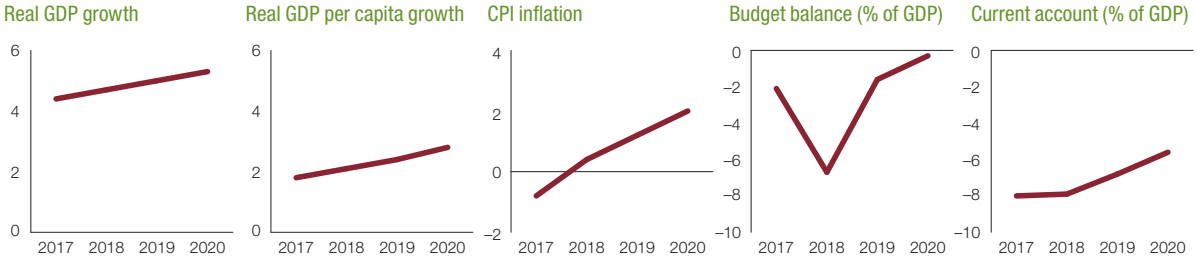
The negative impact of the 2017 political crisis and the severe fiscal adjustment necessitated by the reduction in the debt-to-GDP ratio (from 82% in 2016 to a target of 70% in 2019) held back real GDP growth to an estimated 4.7% in 2018. Primary sector growth was an estimated 5.1%, driven by agriculture (5.1%) and fisheries (6.2%). Secondary sector growth was more muted than in 2017, reflecting lower performance in manufacturing. The political situation is also holding back tertiary sector growth, which was an estimated 4.4% in 2018, down from 7.9% in 2017. On the demand side, economic growth was driven by gross fixed capital formation, contributing 3.8% to growth, and final consumption. Stronger domestic demand resulted in negative net exports. After peaking at 9.6% of GDP in 2016, the fiscal deficit settled at 2.1% in 2017 but climbed to an estimated 6.7% in 2018. Inflation was negative in 2017 and remained low at an estimated 0.4% in 2018.

Real GDP growth is projected to be 5.0% in 2019 and 5.3% in 2020, assuming that the political crisis is resolved and public and private investment recovers. Inflation is projected to remain under control at 1.2% in 2019 and 2.0% in 2020. Along with the anticipated recovery in business activity and capital investment, the fiscal deficit is projected to improve to 1.6% of GDP in 2019. The current account deficit is also projected to continue to improve, from an estimated 7.9% of GDP in 2018 to 6.8% in 2019, thanks to strong exports (phosphates, clinker, and cotton).

Tailwinds and headwinds

The government's key interventions have focused on the agricultural and energy sectors and on public finance. In agriculture, major interventions include developing agro poles and establishing the Agricultural Incentive and Financing Mechanism. In energy, authorities finalized the strategy for universal access to energy by 2025. In public finance, authorities pursued revenue mobilization by strengthening the revenue authority, removing some fiscal exemptions, and streamlining public procurement. A new National Development Plan for 2018–22 was adopted in August 2018.

Togo actively participates in the ongoing regional integration and trade facilitation efforts within the West African Economic and Monetary Union (WAEMU), the Economic Community of West African States (ECOWAS), and the Community of Sahel-Saharan States. It has implemented the WAEMU and ECOWAS Common External Tariff since 1 January 2015. Within ECOWAS, Togo scores high on the regional integration index in environmental protection, regional infrastructure, free movement of people, and financial and macroeconomic integration. The port of Lomé is important infrastructure for regional trade, in particular for transit to neighboring landlocked countries but also some coastal countries: 40% of goods imported through the port are transit goods or destined to be re-exported to other countries in the region. Intra-WAEMU trade accounted for 52% of Togo's exports in 2016.



Source: African Development Bank statistics; figures for 2018 are estimates; figures for 2019 and 2020 are projections.

Tunisia

Macroeconomic performance

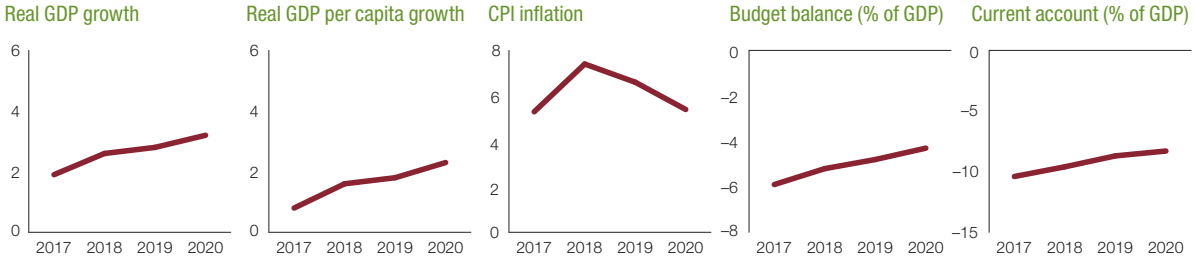
Real GDP growth rose to an estimated 2.6% in 2018 from 1.9% in 2017, spurred by agriculture (8.7% growth) and market services (3.2%). This trend is projected to continue in 2019 and 2020. On the demand side, investment (5% growth) and exports (2.7%) are projected to be the primary drivers of growth.

Tailwinds and headwinds

The budget deficit and the current account deficit both improved in 2018, and this trend is projected to continue in 2019 and 2020. But improvement will be slow because of a high wage bill as well as the structure of the trade deficit linked to import demand, which increased by 16% in the first eight months of 2018 compared with 2017. The dinar depreciated 19% against the US dollar and the euro in 2018. Inflation rose sharply in 2018 to an estimated 7.4% due to exchange rate passthrough, an increase in the value added tax, and higher oil prices but is projected to decline in 2019 after the central bank tightened monetary policy in the second quarter of 2018. The dinar depreciated 19% against the US dollar and the euro in 2018, stressing foreign exchange reserves.

In the medium term, the main challenge will be to reduce unemployment and regional disparities. Some 15.4% of the working-age population is unemployed, including 31% of college graduates. But there are large differences between coastal regions, where most investment and jobs are concentrated, and interior regions. Reducing social and regional disparities will require updating the existing development model and accelerating structural reforms. The role and scope of the government's intervention in the economy need to be re-evaluated, with an emphasis on improving public spending efficiency by prioritizing expenditures likely to benefit the broader economy and the private sector in particular. Although public spending has increased considerably since 2011, the fiscal framework, which relies on borrowing to finance current expenditures instead of capital expenditures, remains largely unchanged. The public debt, the majority of which is external (70%), increased by 71% between 2010 and 2018, raising Tunisia's external vulnerability.

Tunisia has several strengths that can be exploited. In addition to its geographic proximity to Europe, Tunisia also possesses agricultural and agrofood potential, which could spur growth and generate jobs. With an average production of 190,000 tons, Tunisia became the world's second largest olive oil producer in 2017 behind Spain, and growing global demand could absorb double that amount. Tunisia also has substantial phosphate deposits and was the world's fifth largest producer until 2011. It also has gas deposits for domestic consumption. The improving security situation is reopening possibilities for new investment in tourism. Finally, Tunisia has a diversified industrial base (aeronautics, chemical industry, and textiles), but it would need to be upgraded to play a decisive role in the structural transformation of the economy.



Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

Uganda

Macroeconomic performance

Real GDP growth was an estimated 5.3% in 2018, up from 5.0% in 2017. On the supply side, industry (9.7% growth) and services (8.2%) contributed considerably, while agriculture showed slower growth (4.5%). On the demand side, greater investment in public infrastructure was the main contributor to growth, while the current account registered a deficit due to growing imports of capital goods, thereby stymieing growth.

The fiscal deficit widened to an estimated 4.7% in 2018, driven largely by ongoing public infrastructure investments supported by borrowing from both external and domestic sources. The country's debt-to-GDP ratio was estimated at 40.0% in 2018, with external debt at 28.1% of GDP. The 2017 debt sustainability assessment indicated that Uganda is at a low risk of debt distress. Inflation fell to an estimated 3.2% in 2018, due mainly to lower food inflation and prudent monetary policy.

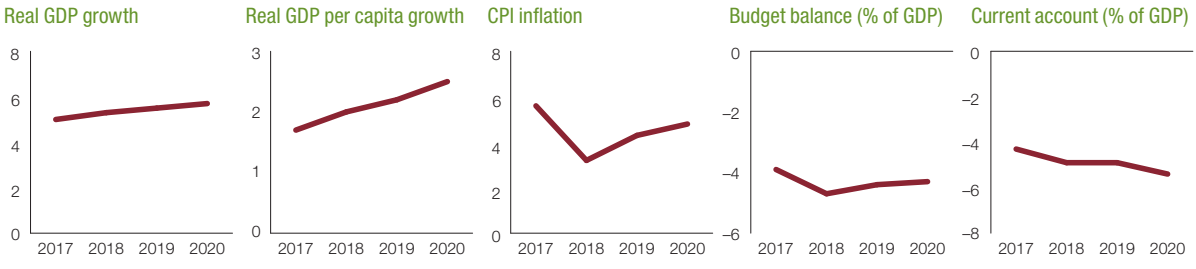
Tailwinds and headwinds

Real GDP growth is projected to improve to 5.5% in 2019 and 5.7% in 2020. Increased infrastructure investment, foreign direct investment in the oil and mining subsectors, and reforms to improve the business environment will drive stronger growth over the short and medium term. The current account deficit is projected to stabilize at 4.9% in 2019 and further weaken to 5.4% in 2020, and the fiscal deficit is projected to further narrow to 4.4% in 2019 and 4.3% in 2020. Headline inflation is projected to increase to 4.3% in 2019 and 4.8% in 2020.

Downside risks include adverse weather shocks, given agriculture's high reliance on rain, and the slow implementation of infrastructure projects. Despite the government's recent large public infrastructure investments, the quantity and quality of transport, water and sanitation, energy, and agriculture infrastructure remain inadequate to meet the country's economic transformation and development objectives. The country continues to face shortages of skilled labor, especially in services and manufacturing, and several business climate challenges that undermine competitiveness: heavy burdens of regulations for registering and obtaining trading licenses and a high administrative burden of taxes.

Weaknesses in public sector management and governance remain. Performance in budget credibility and controls are on a positive trajectory but still at a low levels. Commitment controls are underperforming, contributing to a buildup of arrears, while inadequate financial management controls have led to mischarges of expenditures. Public investment management is affected by weak institutional and human capacities that often lead to project delays. And the country remains highly vulnerable to adverse climate changes, such as droughts.

Agriculture remains a strategic opportunity for spearheading the government's development objectives. Uganda is abundantly endowed with natural resources, including oil, gas, and mineral resources and a natural habitat for diverse wildlife that could support the tourist industry. The country continues to post high economic growth and price stability driven by prudent macroeconomic policies. And its strategic location allows it to be accessible to Central and East African markets, including Common Market for Eastern and Southern Africa members, making it a possible transportation, logistics, and transit hub for regional trade.



Note: Data are for fiscal years, so 2017 refers to the 2016/17 fiscal year.
Source: Data from domestic authorities; figures for 2018 are estimates; figures for 2019 and 2020 are projections by the African Economic Outlook team.

Zambia

Macroeconomic performance

Real GDP growth has continued, at an estimated 4.0% in 2018, compared with 4.1% in 2017. Agriculture output contracted by more than 35% due to a rain shortage in early 2018. Copper production continued to increase by an estimated 4%–4.5% in 2018. Construction also contributed to growth, thanks to public infrastructure projects and investment in commercial buildings and residential housing, towing cement production, which increased at an estimated 10% in 2018.

High capital investment, high debt servicing cost, and a large wage bill have contributed to fiscal deficits, which peaked at 9.3% of GDP in 2015 before declining to 7.8% in 2017 and an estimated 7.1% in 2018, thanks to a fiscal consolidation program. However, the 2018 deficit still missed its target, 6.1% of GDP, due mainly to high capital spending, rising debt servicing, and growing arrears.

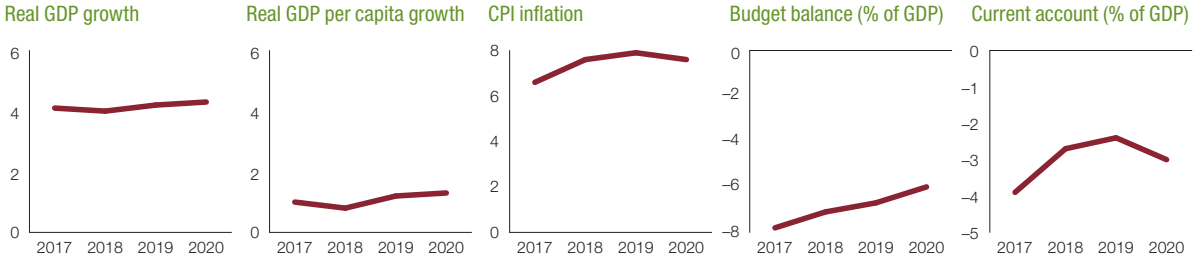
The debt-to-GDP ratio increased from 25% of GDP to 61% between 2012 and 2016, raising concern. In 2018, domestic debt was an estimated 20% of GDP while external debt, including government guarantees, fell to an estimated 39.2% of GDP. High public and publicly guaranteed debt led to Zambia being classified as being at high risk of debt distress in 2017.

Inflation increased to an estimated 7.6% in 2018 from 6.6% in 2017. The relative price stability led the central bank to reduce the policy rate from 15.5% to 9.75% in February 2018. Average lending rates fell from 29.5% in 2016 to 23.7% in September 2018. Gross international reserves continued to fall from $2.4 billion in 2016 to $2.1 billion in 2017 and were an estimated $1.7 billion by the end of 2018, corresponding to 2.5 months of imports.

Tailwinds and headwinds

The medium-term outlook remains positive, with growth projected at 4.2% in 2019 and 4.3% in 2020. Agricultural production declined in 2018 due to poor rain distribution but is expected to rebound in 2019. Mining output is expected to increase by 4%–5% in 2019, benefiting from improvements in electricity generation associated with the replenishment of the Kariba Dam due to good weather conditions. However, lower demand from China associated with escalating trade tensions is expected to further dampen the copper price, which fell by more than 18% in 2018. To raise tax revenue, the government is planning to change the mining tax regime, raising royalties by 1.5 percentage points and removing mineral royalty tax deductions from corporate taxes. On the downside, tax reforms might reduce Zambia's competitiveness in attracting mining companies and could discourage mineral exploration. Another key downside risk to the outlook arises from the slow pace of fiscal consolidation, though a debt default is unlikely in the short term, given the probability of China extending tenure on Zambian debt.

Improving debt sustainability should remain a key priority over the medium term. In addition to strengthening the government's fiscal position, an active debt management strategy would help strengthen confidence in the economy and rebuild some much needed fiscal space. To improve investor confidence in Zambia, the government announced measures aimed at improving debt sustainability and returning to a rating of moderate risk of debt distress. The measures include an indefinite postponement of new infrastructure projects and the cancellation of some contracted loans that are yet to disburse.



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Zimbabwe

Macroeconomic performance

The economy performed better than expected in 2018, expanding by an estimated 3.5%, driven by agriculture, supported by relatively peaceful elections. Cash shortages and the three-tier pricing system coupled with foreign exchange shortages continued to constrain the goods and factor markets.

The fiscal deficit was an estimated 10.7% of GDP in 2018, compared with 12.5% of GDP in 2017, financed mainly through domestic borrowing. In 2018, the government proposed addressing the unsustainable budget deficit with strong fiscal consolidation measures. The fiscal deficit was driven mainly by election-related spending, civil servant salary increases, and transfers to the agricultural sector. Total external debt was an estimated 45.3% of GDP in 2018, down from 53.8% in 2017. The current account deficit was an estimated 3.7% of GDP in 2018, with merchandise imports continuing to exceed exports, putting pressure on the supply of urgently needed foreign exchange and making it critical to diversify exports.

The country's protracted fiscal imbalances have constrained development expenditure and social service provision, undermining poverty reduction efforts. Unemployment pressures have been mounting as employment opportunities continue to dwindle.

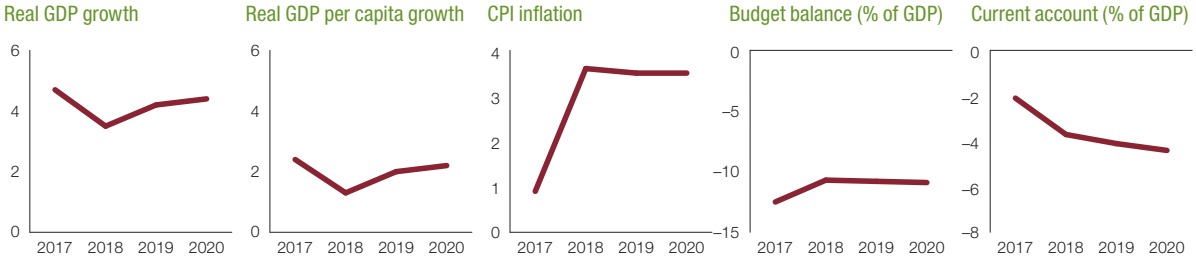
Tailwinds and headwinds

Policy-related macroeconomic instability; lack of funding, land tenure, and investment regulations; high input costs and outdated machinery; inefficient government bureaucracy; and inadequate infrastructure (particularly energy) remain key challenges for private sector development. The country has one of the most youthful populations, with the population ages 15–34 accounting for more than 36% of the total population. However, most young people remain unemployed and resort to informal trading.

Despite the headwinds, the economy is projected to grow by 4.2% in 2019 and 4.4% in 2020. The high and unsustainable debt-to-GDP ratio; the high fiscal deficit; the cash shortages, three-tier pricing, and limited availability of foreign exchange, which continue to constrict economic activity; and the persistent shortage of essential goods, including fuel and consumer goods, remain the major headwinds for any meaningful economic recovery. The agricultural sector and mining are expected to be the main drivers of growth, backed by increased public and private investment.

Zimbabwe has opportunities requiring minimal additional investment to realize medium-term growth targets. In particular, measures are needed to increase transparency in the mining sector, strengthen property rights, reduce expropriation concerns, control corruption, and liberalize the foreign exchange markets. Regeneration of civil society and a renewed engagement with political actors in a positive social contract will accelerate political reform. Given the vast natural resources, relatively good stock of public infrastructure, and comparatively skilled labor force, Zimbabwe has an opportunity to join existing supply chains in Africa through the Continental Free Trade Area. To take advantage of such opportunities, the government has adopted a three-pronged strategy based on agriculture, ecotourism as the green job generator, and special economic zones, growth pillars anchored on enhanced economic and political governance.

The government has adopted and is implementing prudent fiscal policy underpinned by adherence to fiscal rules, as enunciated in the Public Finance Management Act, together with financial rules. The reforms also reprioritize capital expenditure through commitment to increase the budget on capital expenditures from 16% of total budget expenditures in 2018 to over 25% in 2019 and 2020.



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ABBREVIATIONS

AMU	Arab Maghreb Union
ASEAN	Association of Southeast Asian Nations
CEMAC	Central African Economic and Monetary Community
CET	Common external tariff
CFTA	Continental Free Trade Agreement
COMESA	Common Market for Eastern and Southern Africa
EAC	East African Community
ECCAS	Economic Community of Central African States
ECOWAS	Economic Community of West African States
FDI	Foreign direct investment
GDP	Gross domestic product
GTAP	Global Trade Analysis Project
IFC	International Finance Corporation
IGAD	Intergovernmental Authority on Development
KM	Kilometers
Mercosur	Southern Common Market
MFN	Most favored nation
MW	Megawatts
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development
PIAC	Ppresidential investors advisory councils
REC	Regional economic community
SADC	Southern African Development Community
TFA	Trade Facilitation Agreement
WAEMU	West African Economic and Monetary Union
WTO	World Trade Organization

This year's African Economic Outlook from the African Development Bank shows that the continent's general economic performance continues to improve. Gross domestic product reached an estimated 3.5 percent in 2018, about the same as in 2017 and up from 2.1 percent in 2016. Africa's GDP growth is projected to accelerate to 4.0 percent in 2019 and 4.1 percent in 2020.

But even that growth is not fast enough to address persistent fiscal and current account deficits and unsustainable debt. Indeed, countries have to move to a higher growth path and increase the efficiency of growth in generating decent jobs. The 2019 Outlook shows that macroeconomic and employment outcomes are better when industry leads growth.

The special theme this year is regional integration for Africa's economic prosperity—integration not just for trade and economic cooperation but also for the delivery of regional public goods.

New research for this Outlook shows that five trade policy actions could bring Africa's total gains to 4.5 percent of its GDP, or $134 billion a year. First is eliminating all of today's applied bilateral tariffs in Africa. Second is keeping rules of origin simple, flexible, and transparent. Third is removing all nontariff barriers on goods and services trade on a most-favored-nation basis. Fourth is implementing the World Trade Organization's Trade Facilitation Agreement to reduce the time it takes to cross borders and the transaction costs tied to nontariff measures. Fifth is negotiating with other developing countries to reduce by half their tariffs and nontariff barriers on a most-favored-nation basis.

The 2019 Outlook also looks at the gains possible from regional public goods, such as synchronizing financial governance frameworks, pooling power, opening skies to competition, and opening borders to free movements of people, goods, and services.

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