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Sustaining High Growth in Sub-Saharan Africa

Abebe Aemro Selassie
Director, African Department, IMF

London School of Economics and Political Science

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Good evening.

It is a pleasure to be with you all this evening and my thanks to the LSE and International Growth Centre for inviting me to speak.

I would like to take this opportunity to set out the significant strides that have been achieved by many countries across sub-Saharan Africa and then present what we at the IMF believe is required to keep the region moving in the right direction.
It does not feel like very long ago since I was a student here at the LSE. It was the early 1990s and there was a strong sense of change in the air. The Cold War had just ended, governments across sub-Saharan Africa seemed to be toppling one after the other, and Nelson Mandela had just been freed. These political transitions held the promise of creating fundamental change across the region.
And they did.

Some twenty-five years on sub-Saharan Africa is a much-changed place. It goes without saying that poverty remains unbearably high, the fruits of strong growth in some countries have accrued disproportionately to the better off, and far too many people are still impacted by conflict.
But there has also been much progress and transformation. And, I am not talking about skin-deep changes such as shiny new buildings or a better sky line, but fundamental progress that has shifted the opportunity set of a generation.

As Lant Pritchett has noted, the development process occurs across a number of dimensions; political, administrative, economic and social. And Africa has seen progress across each of these dimensions to varying degrees.

On the political front, an increasing number of countries have moved from unconstrained leaders to systems with more checks and balances. In some cases, we are home to some of the world's most boisterous democracies.

Administratively, many countries now have reasonably independent central banks, are able to provide basic services and regulatory and judicial frameworks are developing.
By no means are these political and administrative institutions ideal, but they are no longer as inimical to growth as they used to be.

And playing off this, we've seen many more episodes of sustained growth accelerations, replacing the episodes of boom and bust. Since 1990, three quarters of the countries in the region have registered at least 10 years of uninterrupted growth, and over one-third of the countries have registered 20 years or more of uninterrupted growth.

This has occurred alongside much improved human development outcomes. Over the last 25 years, life expectancy in sub-Saharan Africa has increased from 50 to 60 years, child and maternal mortality rates have halved, and primary school enrolment is up to 80 percent.
It is against this background of strong progress that I would like to make my main point: we are now seeing a deterioration in the macroeconomic health of many countries in the region, and policy makers need to urgently respond to these growing vulnerabilities.

Over 15 years of continuous growth in income per capita in the region came to an end last year. And 12 of 45 countries are expecting per capita incomes to decline this year. These 12 countries are home to about 40 percent of the region's population, or 400 million people.

It is also worrisome that macroeconomic imbalances have emerged in many countries. Perhaps the most concerning manifestation of this is the sharp increase in public debt, which is now above 50 percent of GDP in half of the economies in the region.

Indeed, there are some who are already ringing the alarm bells that we are heading toward another debt crisis in the region. It is often the case that commentary on Africa takes on too much hyperbole and generalisations. So allow me to present a more considered assessment.

Why has debt increased so rapidly?

Median public sector debt in sub-Saharan Africa rose from 34 percent of GDP in 2013 to 48 percent in 2016. Debt accumulation has been particularly high in oil-exporting countries, but debt-to-GDP ratios have also risen in countries that have enjoyed consistently high growth rates, the non-resource-intensive countries.

Importantly, however, part of the debt increase is desirable and central to a broader development strategy to use fiscal space for growth-enhancing investment. There remains a significant infrastructure deficit in sub-Saharan Africa. And in the context of lower starting levels of income and a growing population, convergence will require a significant amount of investment. Moreover, creating room for investment was one of the underlying motivations for the official debt relief process of the mid-2000s which, coupled with strong growth, reduced debt to historically low levels.

What is of concern though is the pace of the increase in public debt and the contribution from adverse macroeconomic developments.

In the oil-exporting countries, for example, public debt has increased, on average, by more than 8 percentage points of GDP per year between 2013 and 2016. This reflects large primary deficits, a growing interest bill and balance sheet effects associated with exchange rate depreciation, against the backdrop of low (and at times negative) economic growth rates.

In the rest of the region, the debt-to-GDP ratio has been increasing at an average rate of about 5 percentage points of GDP per year not withstanding rapid economic growth in many cases. The main drivers have been large primary deficits, valuation effects associated with exchange rate depreciation, and a variety of below the line operations such as the migration of liabilities incurred by state owned enterprises onto the government balance sheet.

As a consequence of the rapid debt buildup, debt servicing costs have risen sharply. The median debt service-to-revenue ratio among sub-Saharan African countries increased from 5 percent in 2013 to nearly double that in 2017. In oil-exporting countries, the debt service-to-revenue ratio is at a staggering 25 percent.

This is diverting much needed resources away from priority sectors such as health and education spending. For example, in Zambia – spending on debt interest alone is over half of what the government spends on education and health. In 2011 it was just 20 percent.

Policy makers are of course well aware of these developments and some countries have started the required policy tightening. But in many other cases adjustment keeps getting delayed.

What is holding back the adjustment?

Having spent some time working for the Government of Ethiopia (at a very junior level, I must add) and worked with many ministers of finance since, I understand first-hand that we are advising countries to take some very difficult decisions in order to reign in debt accumulation.

First, and as I have already noted, the development challenges in the region remain vast creating tremendous spending pressures. There is demand for investment in physical infrastructure such as roads, ports and energy to connect people to markets. There is demand for investment in social services such as education and health to prepare a new generation to compete in the global market. And there is demand for investment in public institutions to create transparent and effective governance structures.

Beyond this, the coalition for fiscal prudence is often small. While the coalition for postponing adjustment until tomorrow can often be overwhelmingly powerful. And even when there is the will, the burden of adjustment must fall on one group or another, and each has a strong case for why it should not be them. This can lead to war-of-attrition type situations that have in the past often been the cause of delayed adjustment in other developing and advanced countries.
Another factor, of course, is that the government's borrowing today are not necessarily the ones that will be repaying tomorrow.

And these domestic factors can be exacerbated by external ones. Take the current low-yield environment on international capital markets which has increased investor appetite for the region's debt instruments. From a broader perspective, this is a positive development as it provides countries with a more diverse set of financing options. But it is also hard to overlook that borrowing costs are being pushed down due to global factors despite worsening fundamentals in some borrowing countries. When low cost financing is flowing in your direction, it is difficult to resist.

In all, the social, political and economic pressures to accelerate broad-based development carries a heavy price-tag and when financing is readily available, we often see adjustment plans postponed.

What are the policy requirements at this juncture?

They say that to a hammer, everything looks like a nail. And perhaps there is perhaps an element of this at work here. But, I have to say that there is need for attending to the macroeconomic health of the region to rise to the top of the policy agenda.

Our advice is always country specific but a key consideration for many countries now is to strike a better balance between much needed investment and debt sustainability.

Importantly, fiscal reforms need to be put in place, and can be designed to attenuate the adverse effects they can have on growth and the most vulnerable segments of society.

Experience with past fiscal consolidations in the region shows that this is best achieved by raising domestic revenues and making careful decisions when it comes to public spending.

For example, reducing inefficient fuel subsidies that we know end up benefiting the better-off and larger firms, and implementing targeted cash transfers for those most in need can help to reduce overall spending and achieve redistribution goals.

I'd like to focus on the critical role that broadening the tax base can play in creating space to scale-up social and other priority spending and strengthening fiscal sustainability.

In the ideal scenario, debt-financed investments would generate growth, a larger tax base and the required revenues to repay debt. Yet, too often countries fail to capture the return on their investment.

At the IMF our policy advice, technical assistance and program engagement seeks to strengthen institutions and policies to help countries achieve their tax potential. On average, we see potential for the region to increase the tax to GDP ratio by 3 to 6 percentage points over the medium-term.

In addition, increasing transparency to identify how public resources are being raised and spent can help to overcome vested interests and contribute toward building sufficient support for raising revenues.

Conclusion: Forces shaping the future

Let me end my remarks by looking forward.

My emphasis today on the importance of tackling the issue of rising public debt head on is because if left unaddressed, it will constrain the region's tremendous growth potential.

And there are a number of factors that have the potential to engender stronger catch-up growth in the coming years.

For one, most countries in sub-Saharan Africa are on the cusp of a demographic transition—the years when the share of young and old in the population declines and those in working age range increases. And this is something that is of truly global consequence. By 2030 or so, half of the annual increase in the global working age population will come from sub-Saharan Africa. Consider how much consumer demand this means. And on the flip side, it is difficult to see how any labor-intensive activity of scale will not require the region's labor force.

Second, the rapid technological change we are seeing should facilitate greater catch-up growth. For example, the growth of Fintech is already transforming traditional forms of banking, and offering financial services to millions of people for the first time; many no doubt, aspiring entrepreneurs.

This offers a huge opportunity for sub-Saharan Africa. But reaping the potential of higher living standards will not happen automatically. And indeed, there are countervailing challenges that need to be overcome—climate change, deepening power sharing, ensuring inclusivity. In particular, closing gender gaps will be essential since about half of the contribution from the growing labor force are women.

My broader point is the following: much of the growth momentum over the last couple of decades has come from reforms that have alleviated constraints to growth; weak institutions, problematic governance, policy uncertainty, and elevated macroeconomic imbalances. Beyond this, there are a range of formidable challenges that I just highlighted. The last thing we need is self-induced macroeconomic policy slippages to complicate development prospects.

I recognize that the required reforms are quite tough and not always popular. But sub-Saharan Africa has overcome much greater challenges in the past from a weaker starting position. This is why I strongly believe that the region can, and will, return to a path of strong growth that will raise living standards for all.

Thank you.

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