AID AFRICA

Ernest Aryeetey and John Page

Framing the Issue

When the global financial crisis hit there was a tendency in most circles to view it as largely an OECD problem. Now, as China, Eastern Europe and the newly industrialized Asian economies show signs of being seriously affected, discussions of how to deal with the crisis have broadened, but there has been relatively little discussion of how the crisis affects African countries and how they should deal with it.

The shift from a financial meltdown to a global recession will hurt Africa, precisely at a time when it had shown signs of sustained growth. Africa was one of the faster growing regions of the world over the last five years, with growth exceeding 5 percent on average. This recovery after nearly 20 years of economic stagnation came on the back of greater integration into the world's commodity markets. With rapid growth in China and India, African exporters gained considerably from significant increases in volume and prices. But beyond good luck, good policies also mattered for growth: Africa's economies were better managed. Macroeconomic policies in particular did much to avoid the growth collapses that had plagued the 1980's and 1990's.

The IMF estimates that growth in Africa in 2009 will be slightly more than 3 percent, about a half of what was expected a year ago. Even this modest growth may prove difficult to sustain in the medium term, unless action is taken both by African governments themselves and by the international community. The G-20 should consider the following economic landscape for Africa when it meets in London and pursue ways to aid Africa as part of its basket of policies.

Policy Considerations

How Has the Global Recession Hurt Africa?

Initially, Africa's economies were not severely affected by the meltdown in global financial markets, largely because their financial systems were not deeply integrated into international financial markets. As the crisis deepened throughout the world, however, and a global recession set in, the impact on African economies became more apparent.

What the crisis and the recession have done is to take away three major sources of recent growth for African economies. Commodity prices and volumes have tumbled and are projected to continue to decline. For example, the price of copper—Zambia's major export—has fallen to less than a third of what it was year ago. In addition to the direct effects of reduced demand, African countries are expected to

suffer reduced private capital flows as the financial crisis in the U.S. and Europe curtails the availability of capital for investment in the region. A number of African countries also depend on remittances to provide major sources of foreign exchange and of spending in poor households. The World Bank projects that these flows will fall substantially with major impacts on the poor.

How Should African Governments Respond to the Crisis?

Economic management in Africa today is vastly different from what it was during the first oil shock of the 1970s. At that time many countries failed to adjust their economic programs to match the resources available. The result was a large number of mismanaged and poorly functioning economies for over a decade. Today African countries realize that the shock to their economies could last longer than the short term. Adjusting budgets to match expected financial resources has become generally accepted across most countries. In Ghana, the newly elected government has prepared a budget that seeks to reduce the deficit from a whopping 14.9 percent of GDP in 2008 to 9.4 percent in 2009.

But maintaining the continent's hard won macroeconomic stability will come at a substantial cost. There is a growing danger that as countries seek to contain their expenditures within limits and ensure macroeconomic stability, they would be doing so at the expense of medium- and longer-term growth and development. Maintaining macroeconomic stability, while sustaining longer-term growth and development, is best done by being creatively selective in public expenditures. Expenditures that enhance productivity must be protected, while those that do not are scaled down. For example building human capital is not a simple matter of maintaining the entire education budget intact. Areas of wastage in the education sector, such as paying the salaries of teachers not present in the classrooms, may be taken out without any negative consequences. Roads that serve only a political purpose may be suspended.

The crisis also presents African governments with an opportunity to strengthen structural reforms. The resource rich economies can use the crisis as an opportunity to put into place better practices in the management of natural resource revenues. Governments can continue and accelerate reforms of the business climate. Institutions affecting agriculture, such as land tenure systems, can be improved. All of these reforms come at little or no fiscal cost but they can position Africa's economies to respond more fully to an eventual global recovery.

Action Items for Global Coordination

The international community has a major role to play in supporting Africa during the crisis through aid and trade. While there are understandable pressures to curtail aid budgets in the OECD, these need to be resisted. For the vast majority of Africa's economies there is no alternative to official development finance: just as their isolation from the global financial system gave them a measure of protection from the financial melt-down it will prevent them from participating in the eventual recovery. Aid has traditionally been pro-cyclical in Africa, rising during good times

and falling during economic contractions. This time the response of the international community needs to be different. OECD governments need to maintain their Gleneagles commitments, and if possible expand them.

The global crisis has also brought a disturbing return to protectionism. The World Bank reports that since the beginning of the financial crisis roughly 78 trade measures have been proposed or implemented, of which 66 involved trade restrictions. Of these, 47 measures were actually implemented, including by 17 of the G-20. These restrictions will limit Africa's prospects for participating in an eventual recovery and should be resisted. Indeed the G-20 should be giving serious thought to expanding and streamlining trade preferences for African products, not restricting their market access.