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THE GREAT RESET:

Relaunching African economies

Emerging stronger: How Africa's policymakers can bolster their economies during and beyond the COVID-19 crisis

Acha Leke

Senior Partner and Chairman, Africa Region, McKinsey & Company

@achaleke

Landry Signé

Senior Fellow, Africa Growth Initiative, Brookings Institution

@LandrySigne

Vera Songwe

Under-Secretary-General, United Nations

Executive Secretary, Economic Commission for Africa

Nonresident Senior Fellow, Africa Growth Initiative, Brookings Institution

@songwevera

"COVID-19 has revealed that globalization has made humanity co-vulnerable, left the majority of society behind, led to the strengthening of value chains that are maximized for individuals and companies rather than optimized for society. The top priority for leaders and policymakers is to weave a policy tapestry that engages and promotes active citizenship, creates an African economy that is resilient and inclusive, by leveraging the African Continental Free Trade Area and optimizing integration and regional trade."

Mrs. Graça Machel, Chair, Mandela Institute for Development Studies (MINDS)

As the world begins to emerge from the economic crisis created by the COVID-19 pandemic, the big question in Africa—beyond how do we protect the health of average citizens—in 2021 is how and when Africa will begin its exit from the first economic recession to hit the continent in a quarter of a century. Africa's economic revival depends on sufficient economic policy response, access to sufficient and affordable financing to recover from the estimated 3 to 5.4 percent contraction in GDP, and strengthened policies for creating jobs. Indeed, Africa's longer-term economic prospects can be safeguarded by making bold and well-informed decisions today, which, in turn, can transform the current crisis into a catalyst for innovation.

Immediate steps for policymakers

African governments have already spent significant amounts of their GDP on domestic stimulus packages—between 1 and 7 percent.[1] (For more on the South African stimulus package in particular, see page 15). However, the funds made available among African nations for response and recovery are less than 1 percent of the amount deployed among the world's richest nations.[2] Indeed, under current conditions, sub-Saharan Africa may likely face a financing gap of about $290 billion.[3]

1 United Nations Economic Commission for Africa. 2020. *Building Forward Together: Financing a Sustainable Recovery for the Future of All.*
2 Ibid.
3 International Monetary Fund. 2020. *Regional Economic Outlook: Sub-Saharan Africa.*

To enable a strong recovery, African policymakers would do well to step up efforts to "stem the bleeding." By investing strongly and promptly to relaunch economies, governments can avoid an even deeper descent, potentially including debt crises, defaults, and a return to pre-COVID-19 economic levels only by 2030.[4]

How might leaders and policymakers pay for it?

Given the serious fiscal constraints that many African governments face, policymakers need to prioritize where and how to intervene as well as find new ways to attract investment and private-sector participation to deliver critical projects and services. Just as important, emerging opportunities in digitization and data analytics are already improving revenue collection. Now might also be the time to use spending reviews to reallocate budgets to high-priority areas, deliver more cost-effective procurement, and reduce fraud.[5] Across Africa, such public-finance reforms could deliver as much as $100 billion a year in new revenues and savings.[6]

Bold efforts to mobilize domestic resources can yield rapid results.

Bold efforts to mobilize domestic resources can yield rapid results. For example, one of the authors worked with a West African country that was able to boost tax and customs revenues by more than 20 percent in just six months. The country rebuilt its customs processes, greatly improving compliance; and it established a debt-collection task force that increased debt recovery from defaulting taxpayers by a factor of five.[7]

That said, African policymakers will also need to redouble their efforts to enlist the global community's support to strengthen liquidity in the short term and restart growth in the longer term. In the next 3 to 6 months, policymakers should seek increased lending from multilateral development banks; these institutions could potentially use their existing balance sheets to release an additional $100 billion in lending to Africa. Global institutions can also set up a Liquidity and Sustainability Facility (LSF) that would lower governments' borrowing costs by ensuring that their short-term debt obligations can be met. Such measures would pave the way for the global community to assist African policymakers in restarting and reimagining sustainable growth—for example, by introducing innovative financing tools such as bonds linked to the pursuit of the Sustainable Development Goals.[8]

Policies for supporting MSMEs must be central to the recovery

At the same time, policymakers must continue to support businesses—both smaller enterprises and larger firms—that have been disrupted by the crisis. Arguably, the greatest priority must be to bolster the micro-, small-, and medium-sized enterprises (MSMEs) that are key to African commerce and account for 83 percent of private-sector employment in Africa.[9] Such businesses, which number between 85 million to 95 million, are especially vulnerable to COVID-19 mitigation measures given they are often characterized by person-to-person contact. By just May 2020, 75 percent saw their revenue decline by over 30 percent.[10]

There are several steps that governments can take to provide financial support to MSMEs. One option is to assist MSMEs through larger firms in their value chains, which might include upstream

[4] Jakkie Cilliers et al., "Impact of COVID-19 in Africa: A Scenario Analysis to 2030," *Institute for Security Studies, Frederick S. Pardee Center for International Futures, and Gordon Institute of Business Science*, July 2020.

[5] Rima Assi, David Fine, and Kevin Sneader. 2020. *The Great Balancing Act: Managing the Coming $30 Trillion Deficit While Restoring Economic Growth*. McKinsey & Company.

[6] Yaw Agyenim-Boateng et al. 2019. *Unlocking Africa's $100 Billion Public-Finance Opportunity*. McKinsey & Company.

[7] Ibid.

[8] United Nations Economic Commission for Africa. 2020. *Building Forward Together: Financing a Sustainable Recovery for the Future of All*.

[9] Findings from a recent collaborative study between AUDA-NEPAD (the African Union Development Agency), Ecobank, and McKinsey & Company (unpublished).

[10] AUDA-NEPAD. 2020. *Supporting African MSMEs Through and Post the COVID-19 Crisis*. Workshop Document 26.

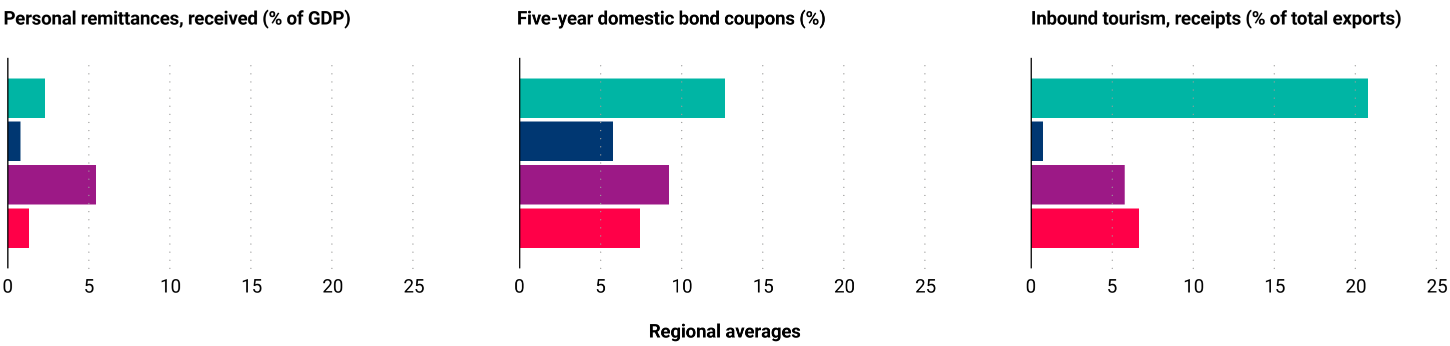
suppliers and downstream buyers. Governments can provide easier liquidity and working-capital terms to these larger players, and they can make such support conditional upon these firms' providing favorable financial terms to MSMEs. Governments can also consider providing risk guarantees or first-loss mechanisms while requiring banks to on-lend under the chosen set of criteria and guidelines. In order to encourage banks to lend to MSMEs.

To bolster large firms, governments can consider two approaches. First, in a few situations, countries may designate certain sectors as "strategic" and develop support packages—potentially including short-term loans, payroll support, and debt-to-equity swaps. In Nigeria, for example, the government has designated key agricultural value chains and the cement industry as strategic; in addition their broader economic relevance, those sectors are particularly important in the country's drive to substitute imports. In addition, governments can help a broader set of companies conserve cash and survive the crisis. Options in this regard include lowering the liquidity or capital-ratio requirements of banks assisting companies in raising capital through avenues such as private-equity financing, as well as deferring payments due by companies to public-sector entities. Governments might require companies to maintain a minimum wage or payroll to qualify for such support.[11]

FIGURE 1.1

EXPOSURE TO SHOCKS BY SUB-SAHARAN AFRICAN REGION

The economies of sub-Saharan Africa depend on tourism and domestic bond markets, both of which are volatile. The pandemic has caused tourism to plummet and bond coupons to soar, creating harmful effects for those economies in which tourism and bonds play a particularly important role. Their importance, however, varies by sub-Saharan African region. Whereas tourism constitutes more than 20 percent of exports in East Africa, it constitutes just 0.7 percent of Central African exports. Five-year bond coupons vary from as high as 12.8 percent in East Africa to 5.8 percent in Central Africa.



Visual Key

- East Africa
- Central Africa
- West Africa
- Southern Africa

Source

World Bank. 2020. *World Development Indicators*. Domestic sovereign bond data for African public entities from 01/01/2010 to 01/01/2018. *Bloomberg LP*. Accessed on November 15, 2020.

Understanding Africa's economic challenges in and beyond the crisis

Finance will continue to be one of the greatest needs for African businesses; indeed, only 5 percent of MSMEs across the continent feel they have received adequate support from lenders.[12] Provided governments navigate Africa's fiscal challenges with skill and determination, they can continue offering suitable financial support to small enterprises; in addition to indirect support through value chains and banks, such assistance might include loans, debt forgiveness, low interest rates, assistance with payments to suppliers, and reduction in utility costs. At the same time, policymakers must not lose sight of the region's informal sector, as 84 percent of African MSMEs are unregistered. Policymakers can take advantage of the opportunity created by the crisis to convince larger numbers of informal

[11] Kartik Jayaram et al. 2020. *Finding Africa's Path: Shaping Bold Solutions to Save Lives and Livelihoods in the COVID-19 Crisis*. McKinsey & Company.
[12] Findings from a recent collaborative study between AUDA-NEPAD (the African Union Development Agency), Ecobank, and McKinsey & Company (unpublished).

enterprises to register, and thus gain better access to finance and markets. Moreover, to promote registration, governments could shape bold campaigns and attractive packages, potentially including multi-year tax holidays and capacity building for MSMEs.

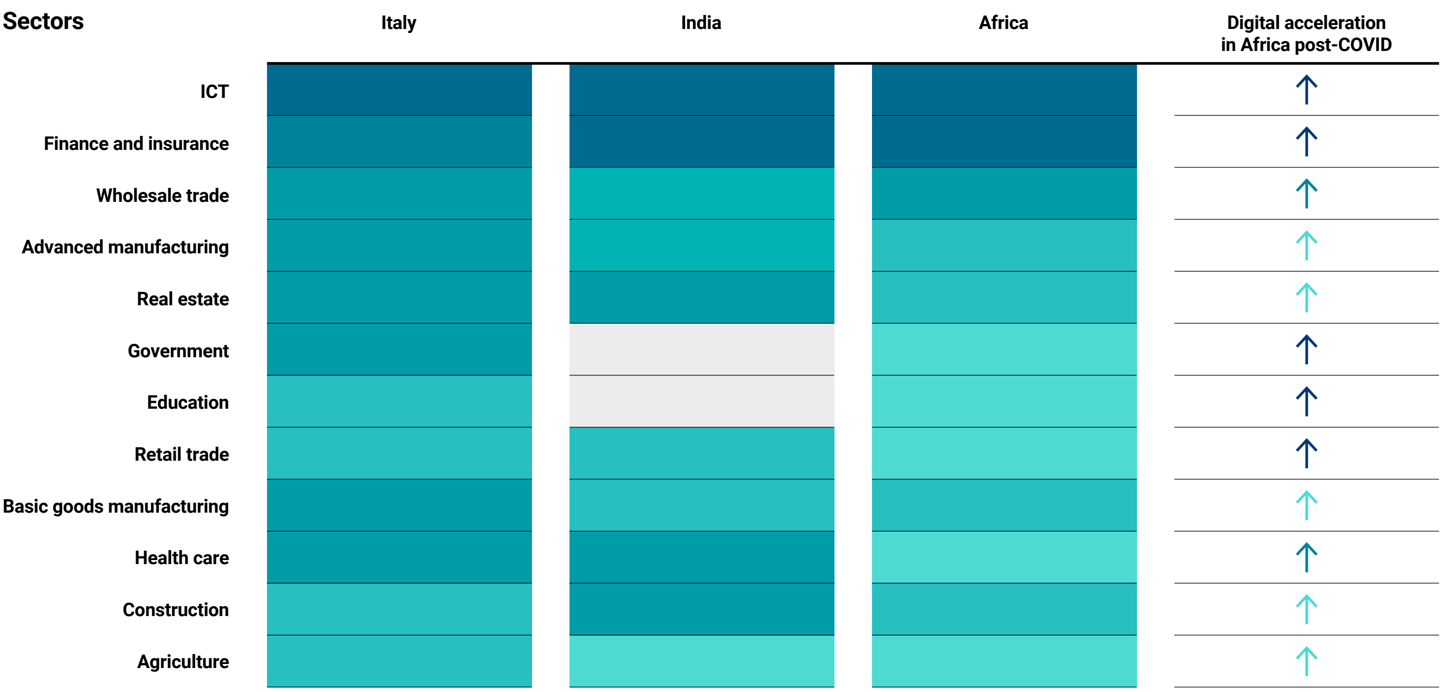
Governments will also need to make careful decisions about which sectors to prioritize. Instead of attempting to resuscitate all hard-hit sectors, governments would do well to prioritize sectors that can offer services and goods with long-term prospects—and that have true potential for value-creation and employment at scale.

Moreover, mitigating the economic impact of COVID-19 across the continent will require tracking and forecasting the social and political changes that the pandemic has caused, especially as COVID-19 crisis has exacerbated economic hardship and may push up to 40 million Africans into extreme poverty. Policymakers will also need to focus on enabling businesses to respond effectively to these new conditions. In doing so, they would do well to focus on new and existing industries that enjoy high economic potential and a competitive advantage, rather than those that face falling demand, or have been overtaken by businesses enjoying more favorable conditions in other regions.

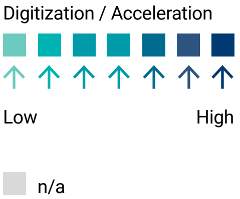
FIGURE 1.2

THE COVID-19 CRISIS HAS CREATED THE OPPORTUNITY FOR ACCELERATION IN DIGITIZATION

Africa continues to lag behind the rest of the world in digitization, and the COVID-19 crisis has laid bare the extent to which the region is behind. Now, the necessity for remote work will contribute to the acceleration of digitization across sectors.



Visual Key



Source

Kartik Jayaram et al. 2020. *Reopening and Reimagining Africa*. McKinsey & Company.

Technology and the African Continental Free Trade Agreement already show promise for supporting the bounce back

Digital transformation is arguably Africa's biggest opportunity arising from the crisis. During the pandemic, the continent has accelerated its adoption of ICTs: lockdown conditions have pushed many sectors to raise their online presence and expand their range of digital services, with developments that would ordinarily take years compressed into several months. Significant opportunities remain for digital acceleration in key sectors, particularly government, education, retail trade, and finance (see Figure 1.1).

Thus, COVID-19 has revealed, more acutely than ever, that leaders should prioritize scaling up investments in the physical and technological infrastructure needed to bring Africa more securely into the digital age and boost the training infrastructure needed to equip the workforce with basic and advanced digital skills, from mobile transactions to graphic design and coding.[13] Leaders can encourage digital practices on the small-scale too in order to encourage widespread usage of digital tools: For example, Kenya and Rwanda have lowered transaction charges in digital payments, thus boosting adoption.[14] Ethiopia recently approved the e-Transactions proclamation, granting legal status to electronic messages and documents.[15]

The African Continental Free Trade Area (AfCFTA), which also holds promise for accelerating the region's economies through economic integration and a shift in focus toward high-productivity industrial activities commenced trading on January 1, 2021. With the increased ease of intra-African trade, African businesses will be empowered to transform continent-wide needs into opportunities for entrepreneurship. (For more on the AfCFTA, see page 63).

Good, transparent governance cannot be neglected

In this time of crisis, effective and efficient policy implementation at all levels is more important than ever. Governments will need to ensure that support programs are relevant, and that their costs do not outweigh their benefits. Such programs must be accessible, speedily implemented, and scalable. They must be run transparently, under appropriate rules, and managed without conflicts of interest.[16] A key step to improve governance will be to forge a stronger social contract between citizens and the public sector across Africa[17]—around service delivery, transparency, and social protections. (For more on efforts to improve governance in the region, see Chapter 6). A number of African countries have already committed themselves to enhanced governance over COVID-19-related spending: For example, Cameroon, the Central African Republic, Chad, Kenya, São Tomé and Príncipe, South Africa, and Uganda have all undertaken independent audits of such spending and published the related procurement contracts.[18]

Conclusion

The path to more robust and resilient African economies will be a challenging one, calling for boldness, imagination, and tenacious implementation on the part of policymakers. Indeed, a sustained recovery will demand extraordinary effort from public-sector leaders to reimagine policies and practices in rapidly changing circumstances. African governments would do well to focus on profound challenges such as lack of financing—including among informal businesses—and to support promising sectors in order to kickstart and sustain an economic revival. Moreover, leaders should focus on policies and decisions that can have long-lasting impacts, especially around technological adoption and effective implemention of the AfCFTA.

13 Kartik Jayaram et al. 2020. *Reopening and Reimagining Africa*. McKinsey & Company.
14 World Bank Group. 2020. *Africa's Pulse: Charting the Road to Recovery*.
15 Ibid.
16 AUDA-NEPAD. 2020. *Supporting African MSMEs Through and Post the COVID-19 Crisis*. Workshop Document 26.
17 Kartik Jayaram et al. 2020. *Reopening and Reimagining Africa*. McKinsey & Company.
18 International Monetary Fund. 2020. *Regional Economic Outlook: Sub-Saharan Africa*.

VIEWPOINT

Debt sustainability and financing for development: A key post-COVID challenge

Brahima S. Coulibaly

Vice President, Global Economy and Development, Brookings Institution

@BSangafowaCoul

One of the key challenges and priorities for policymakers in 2021 will undoubtedly be sovereign debt sustainability and the broader issue of financing for development. To be sure, even prior to the COVID-19 pandemic, sovereign debt across sub-Saharan Africa had been increasing due to growing financing needs against the backdrop of insufficient domestic resource mobilization. The 2008-2009 global financial crisis resulted in ultra-low global interest rates and facilitated access to capital markets for many countries that took advantage of investor reach for yield to issue sovereign debt on international capital markets. The debt build up accelerated significantly following the severe 2014 oil price shock, and an estimated one-third of countries in sub-Saharan Africa were either in or at risk of debt distress even before the onset of the COVID pandemic.[19]

Soon, more countries will either be in or at high risk of debt distress.

The COVID-19 pandemic is the most severe and widespread shock that African countries have experienced in 30 years. The collapse in economic activity has dried up revenues for public expenditures, precisely at a time when more spending is needed to combat the pandemic and to shore up economies. Accordingly, debt levels further rose significantly, and, soon, more countries will either be in or at high risk of debt distress. Now, the International Monetary Fund estimates that the region will need an additional $345 billion through 2023.[20]

To help combat the pandemic, African countries received financial support from several institutions, including the multilateral and regional financial institutions as well as development agencies. Early in 2020, the G-20 announced a Debt Service Standstill Initiative (DSSI) to suspend sovereign debt repayments through the end of that year for the least developed countries in the world, including several African countries. The DSSI was a well-intentioned initiative, as debt service payments had already been rising significantly for African countries due to both rising debt levels and higher shares of costlier private sector debt. However, its implementation fell short of expectations: As of the summer of 2020, the DSSI helped mobilize only $4 billion, significantly below the target of $12 billion for all participating countries.[21] Furthermore, the impact of the debt freeze initiative has been rather limited due to the absence of creditor participation, including that of the private sector.

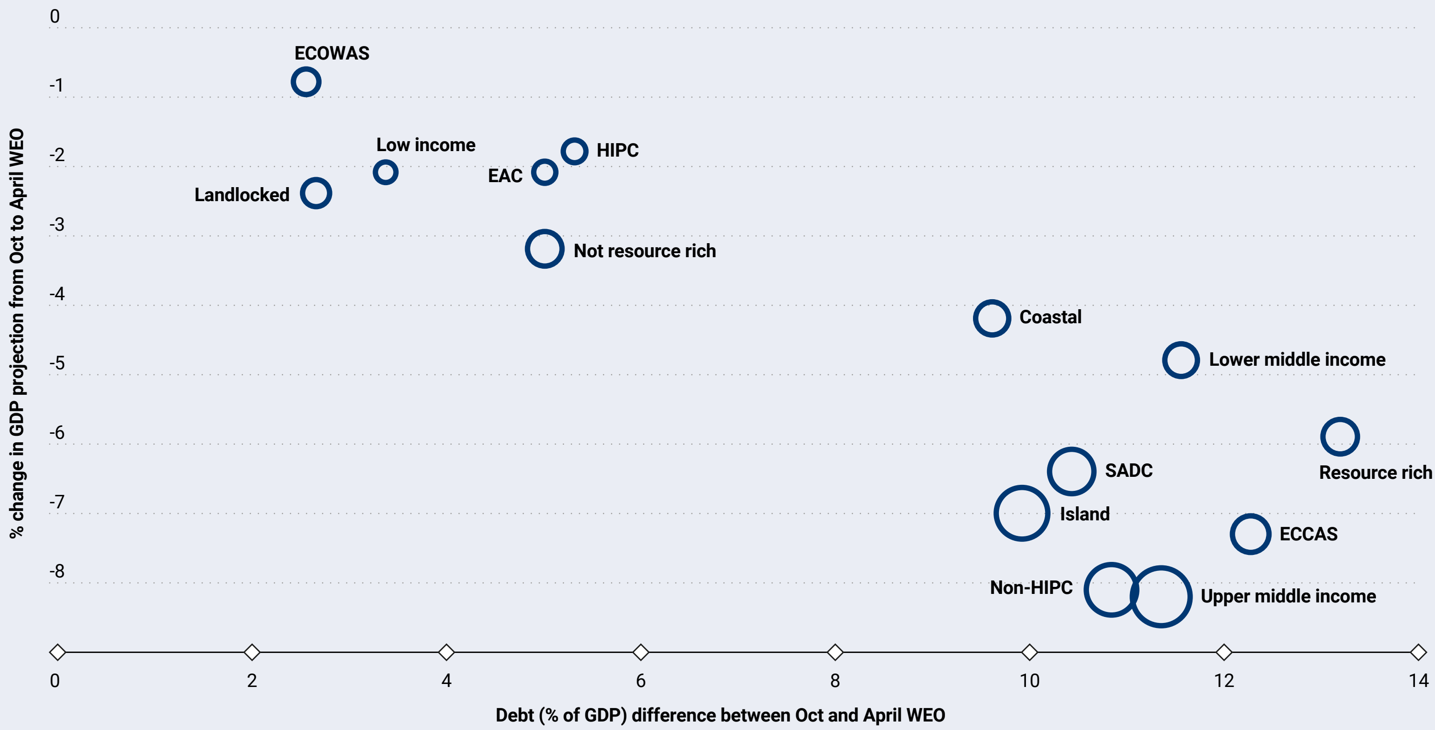
[19] Based on debt sustainability analysis of the International Monetary (see IMF, "Macroeconomic Developments and Prospects in Low-Income Countries," *IMF Policy Paper* (March 2018).

[20] Kristalina Georgieva. 2020. "Opening Remarks at Mobilizing with Africa II High-Level Virtual Event."

[21] Concerns about sovereign credit downgrades and loss of hard-fought-for access to capital markets are among the key factors behind the shortfall in uptake of the DSSI.

FIGURE 1.3
IMPACT OF COVID-19 ON DEBT AND GDP

Of the 38 countries in sub-Saharan Africa eligible for relief under the G-20's Debt Service Suspension Initiative (DSSI), more than 80 percent (31) have participated to some degree. The high participation reflects the fiscal challenges faced by the countries in the fight against the pandemic and its impact on the economies. Some eligible countries, however, have been hesitant to defer payments on all eligible debt because of concerns about sovereign downgrades. The G-20 should work on a solution that would address this concern and boost the uptake.



Visual Key

The size of the circles varies by GDP per capita (real 2019 USD).

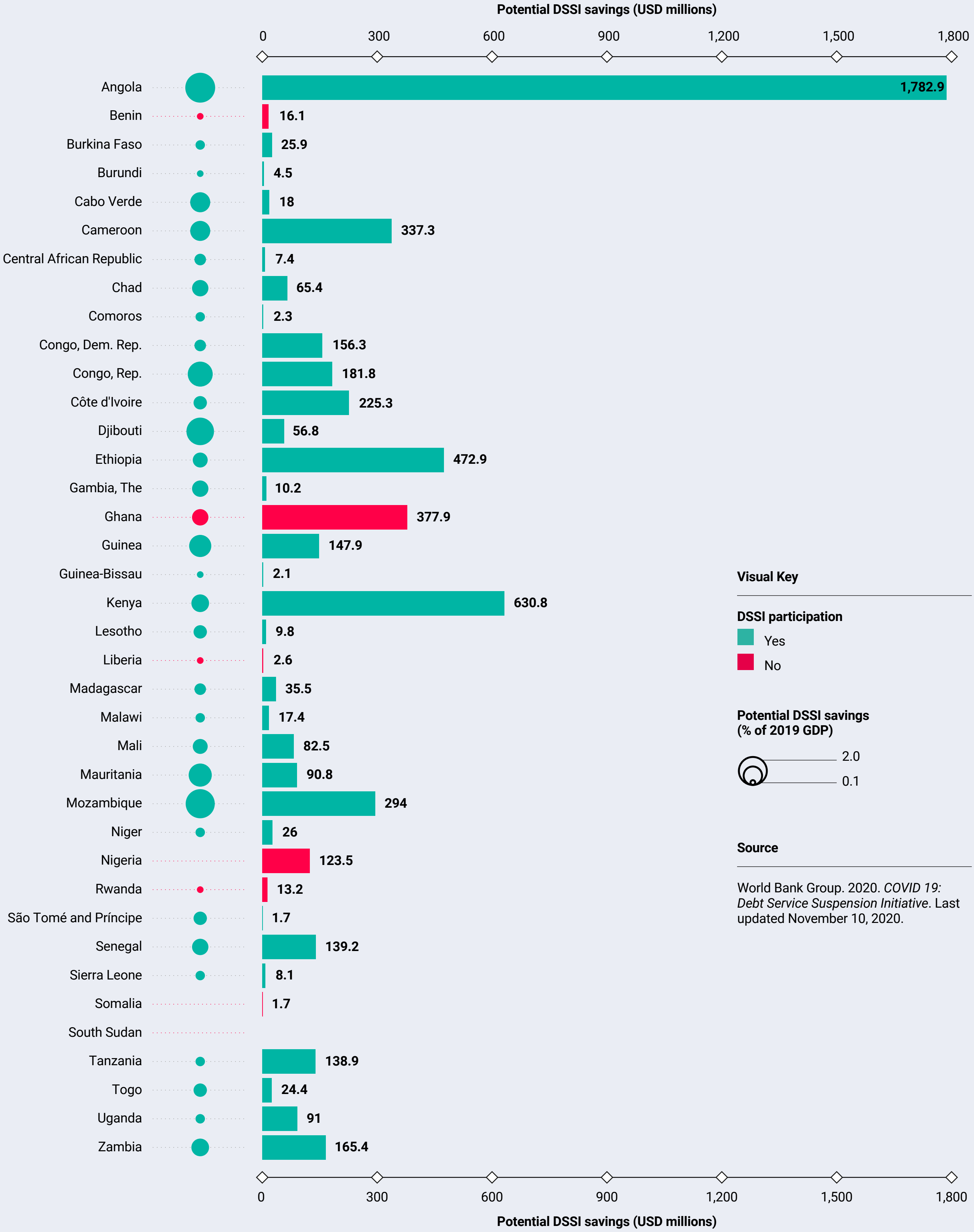
Source

International Monetary Fund (2020). World Economic Outlook. Accessed on August 30, 2020.

In the scramble to finance development agendas in a difficult post-COVID environment, effective management of sovereign debt—as well as efficiency in domestic resource mobilization and in public spending—have become imperative. The international community should continue to support these efforts and work on a comprehensive framework for orderly sovereign debt restructuring, which is an important gap in the global financial system, as debt restructuring will likely be inevitable for several countries in the coming years.

FIGURE 1.4
DEBT SERVICE SUSPENSION INITIATIVE PARTICIPATION AND POTENTIAL SAVINGS

Of the 38 countries in sub-Saharan Africa eligible for relief under the G-20's Debt Service Suspension Initiative (DSSI), only nine have yet to participate in some form. Eligible countries have been hesitant to participate for fear that participation will convey distress to holders of private debt and credit rating agencies. Because debt forgiveness does not feature in DSSI, policymakers of eligible countries also worry that participation sacrifices long-term debt sustainability for short-term financial flexibility.



Source

World Bank Group. 2020. *COVID 19: Debt Service Suspension Initiative*. Last updated November 10, 2020.

VIEWPOINT

Recipe for a green recovery: Carbon taxes

Gunnar Köhlin

Director, Environment for Development, University of Gothenburg

@GunnarKohlin
@EfD_initiative

Ira Dorband

Researcher, Mercator Research Institute on Global Commons and Climate Change

@i_dorband

Jan Christoph Steckel

Head of working group "Climate and Development" (CaD) Mercator Research Institute on Global Commons and Climate Change

@jan_c_steckel

Thomas Sterner

Professor of Environmental Economics, Department of Economics, University of Gothenburg, University Fellow Resources for the Future

As Africa looks to recover from the economic devastation created by the COVID-19 pandemic, the time is right to prioritize green transformations in that recovery. Indeed, as Milton Friedman said—and the African Development Bank emphasized in its COVID-19 Rapid Response Facility document—a crisis is needed to appreciate when "the politically impossible becomes the politically inevitable."[22] If Friedman is right, we should not waste this crisis, since the world, including Africa, needs drastic change.

Three things are needed from African leaders to successfully accomplish the daunting twin tasks of economic recovery and green transformation: 1) generation of funds for investments in sustainable solutions; 2) creation of incentives that ensure that all actors contribute to building an inclusive green economy, and 3) establishment of human capital in institutions tailored to implement those transformations.[23]

Given the complexity of this challenge, leaders must enact policies that both raise funds and provide the right incentives for green growth, preferably alongside short-term poverty alleviation.[24] Pigouvian taxes—taxes that correct the market failure that stems from actors not paying the full cost of their actions on others (e.g., carbon taxes)—on polluting activities do that. There are several compelling arguments for implementing such policies in Africa now.

First, carbon pricing (reduced subsidies) can raise substantial revenues. Fossil fuel subsidies in Africa amounted to $36.5 billion in 2019.[25] Since the pandemic has contributed to reductions in global oil prices, policymakers have room to implement reforms without significantly increasing prices compared to pre-COVID-19 levels. For many countries, a $75 per ton carbon tax—the level of carbon tax needed to contain global warming to below 2°C—would increase pump prices by less than the recent collapse in global oil prices—17 U.S. cents per liter.[26] Given the current oil consumption in Africa of about 4 million barrels per day, this policy would open up about $40 billion per year for investing elsewhere, most notably in a recovery and sustainability program. Green transformations of the transport and energy sectors are possible today, but demand large up-front investments.

The tax base for upstream carbon pricing on fossil fuels is broad and includes the informal sector. While being administratively easier and harder to evade compared to other taxes, implementation of such a tax is still sensitive to public acceptance and, at times, meets popular resistance.[27] At first glance, such a tax could seem to hurt the poor, but, if leaders invest the resulting revenues in pro-poor policies, the impact of the tax is more than offset by the resulting gains in other areas. For Africa, Figure 1.5

22 African Development Bank. 2020. COVID-19 *Rapid Response Facility, Abidjan*.

23 Note that these recommendations are compatible with the much more elaborate analysis of Hepburn et al (2020) on the relationship between recovery packages and climate change. Hepburn, C., O'Callaghan, B., Stern, N., Stiglitz, J. and Zenghelis, D. 2020. *Will COVID-19 fiscal recovery packages accelerate or retard progress on climate change?* Oxford Review of Economic Policy 36(S1): 359-381.

24 UNEP. 2020. *Building a Greener Recovery: Lessons from the Great Recession*. United Nations Environment Programme, Geneva.

25 IEA. 2020. *Energy Subsidies*. Accessed October 2020.

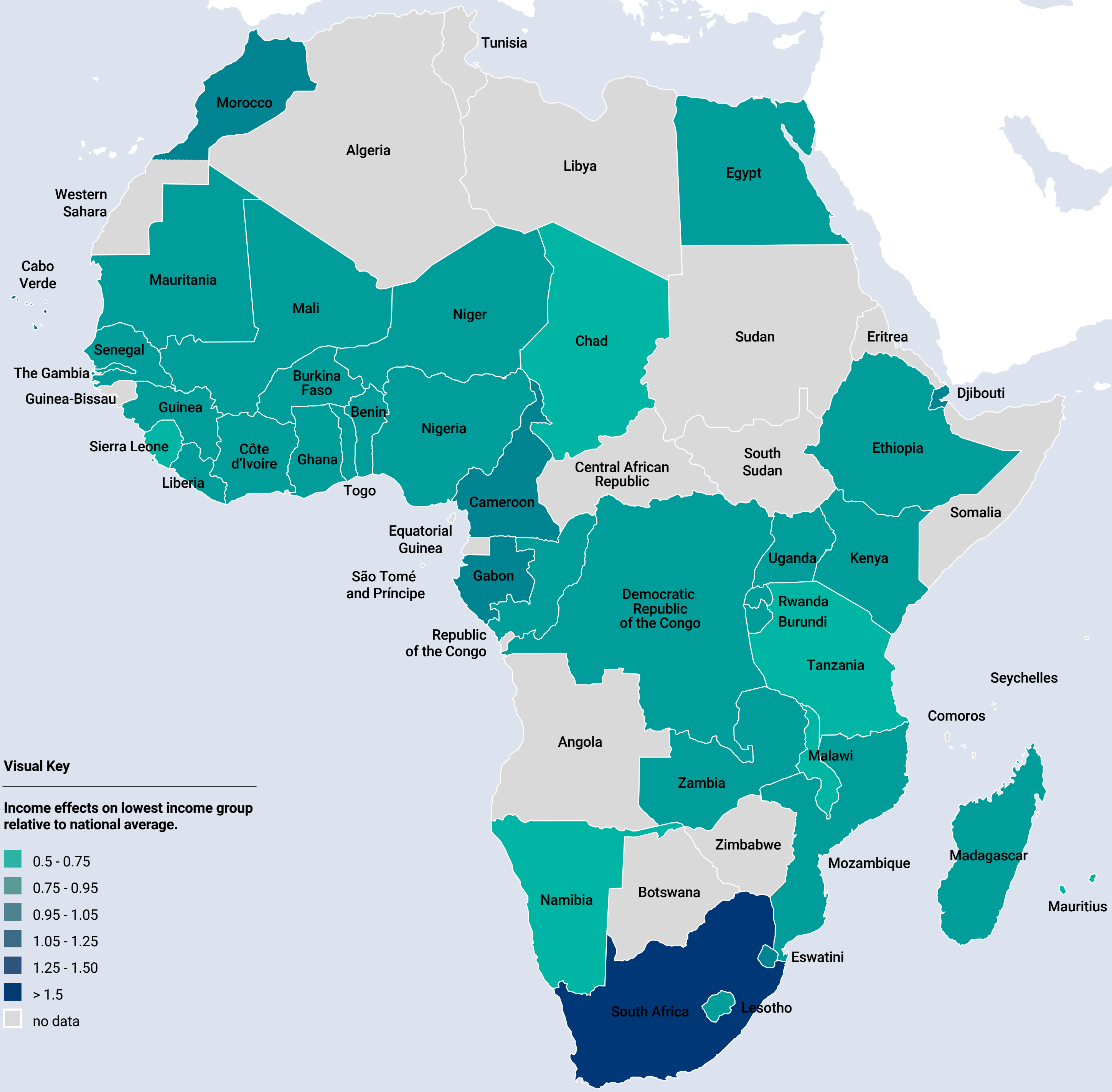
26 International Monetary Fund. 2020. Greening the recovery, *IMF Special Series on COVID-19.*

27 The most notable African case being the riots in Nigeria in 2012 that forced President Goodluck Jonathan to reverse gasoline subsidy cuts. These arguments are elaborated on in the 2015 World Bank report "Decarbonizing Development."

FIGURE 1.5

INCOME EFFECT OF A CARBON TAX ON THE LOWEST INCOME GROUP RELATIVE TO THE NATIONAL AVERAGE

Carbon taxes reduce income inequality as low-income households pay relatively less than richer ones. Indeed, carbon taxes are progressive if, relative to their income, poor taxpayers bear a relatively lower tax burden than richer taxpayers. The figure below shows the tax incidence for the lowest income group compared to the national average. A ratio below 1 indicates that a carbon tax is progressive.



Source

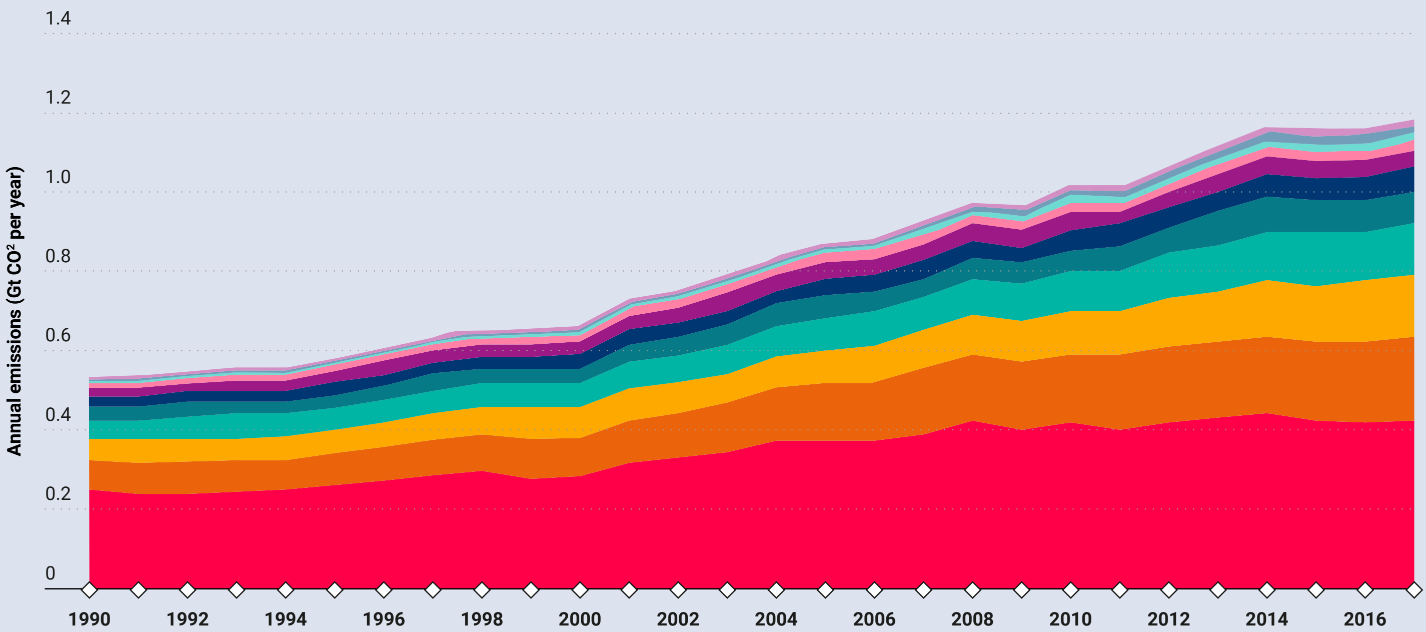
Dorband, I.I., Jakob, M., Kalkhul, M., & Steckel, J. C. 2019. *Poverty and distributional effects of carbon pricing in low- and middle-income countries – a global comparative analysis*. World Development, Volume 115: 246-257.

shows that the consumption incidence (before redistribution) of a carbon tax would actually be progressive[28] in all countries except South Africa. In fact, globally, for countries with per capita incomes below $15,000 per year, carbon pricing has, on average, *progressive* income effects, reducing income inequality, largely because of the small proportion of transport and modern fuels in the consumption basket of the poorest people in the poorest countries.[29] Moreover, the distributional impact can be made even more pro-poor in the allocation of the tax returns.

By getting the prices right and taxing the negative environmental impacts, policymakers can create strong incentives toward a low-carbon economy. As African economies look to recover from the negative shocks of the pandemic and grow fast, a price on carbon is essential for that growth to not also lead to rapidly growing greenhouse gas emissions, which are on the rise anyway (Figure 1.6). While population and GDP growth underpin these increases, the increased carbon intensity in the transport sector has been a main driver, and investments in new coal-fired power generation can drive future emissions.[30] Getting prices right is therefore essential, since they affect production and consumption choices of all stakeholders, particularly those in industry, transport, and, of course, energy.

FIGURE 1.6
TOP-10 CARBON EMITTING COUNTRIES IN AFRICA, 1990-2017

Carbon emissions are already on the rise in Africa, driven primarily by only a few countries.



Visual Key

- Kenya
- Angola
- Sudan
- Tunisa
- Libya
- Morocco
- Nigeria
- Algeria
- Rest of Africa
- Egypt
- South Africa

Source

Ayompe, L.M., S.J. Davis, & B.N Egoh. 2020. *Trends and drivers of African fossil fuel CO2 emissions 1990-2017*. Environmental Research Letters in press.

In sum, a carbon tax is the obvious choice for an African policymaker in the wake of the COVID-19 pandemic. It can raise much-needed substantial revenues for progressive recovery packages with a broad tax base. It has short-term balance-of-payment benefits and incentivizes long-term green investments. It is, therefore, the perfect post-COVID, inclusive, green-growth policy.

28 Carbon taxes are progressive if, relative to their income, poor taxpayers bear a relatively lower tax burden than richer taxpayers.

29 Dorband, I.I., Jakob, M., Kalkhul, M., & Steckel, J. C. 2019. *Poverty and distributional effects of carbon pricing in low- and middle-income countries – a global comparative analysis*. World Development, Volume 115: 246-257.

30 Steckel, J.C., J. Hilaire, M. Jakob, O. Edenhofer. 2020. *Coal and carbonization in sub-Saharan Africa*. Nature Climate Change, 10(1), 83-88.

VIEWPOINT

From stimulus to debt: The case of South Africa

Gracelin Baskaran

Senior Research Fellow, Development Policy Research Unit, University of Cape Town

@gracebaskaran

Haroon Bhorat

Professor of Economics and Director, Development Policy Research Unit, University of Cape Town

@haroonbhorat

The COVID-19 pandemic has seen the widespread use of expansionary fiscal policies which, in terms of scale, is simply unprecedented. An estimated eye-watering $12 trillion of discretionary fiscal support has been provided globally during the pandemic. Such expenditure has come in the form of support to the unemployed, small businesses, and struggling sectors in an effort to save livelihoods and keep economies buoyant. Crucially, though, for many countries in sub-Saharan Africa, these fiscal stimuli packages have deepened their debt challenges. (For more on rising debt in the region under COVID, see page 9).

South Africa is one such example. Although the country's pre-pandemic forecast for debt-to-GDP ratio for 2020 was already high at 65.6 percent, supporting the economy through the pandemic required the government to breach the spending ceiling and expand its borrowing—raising the forecasted debt-to-GDP ratio to 80.5 percent for 2020. The strain of higher debt can significantly damage a country's long-run growth prospects: Indeed, a study by the World Bank[31] found that in emerging markets, the loss of annual real growth is 0.02 percentage points for each percentage point over a 64 percent debt-to-GDP ratio.

So, after we recover from the health crisis, how do we recover from the economic damage? Stimulating economic recovery requires at least three key responses: strengthening confidence in South Africa's ability to adhere to a fiscal consolidation path; improving the efficiency of expenditures; and, finally, strengthening revenue mobilization.

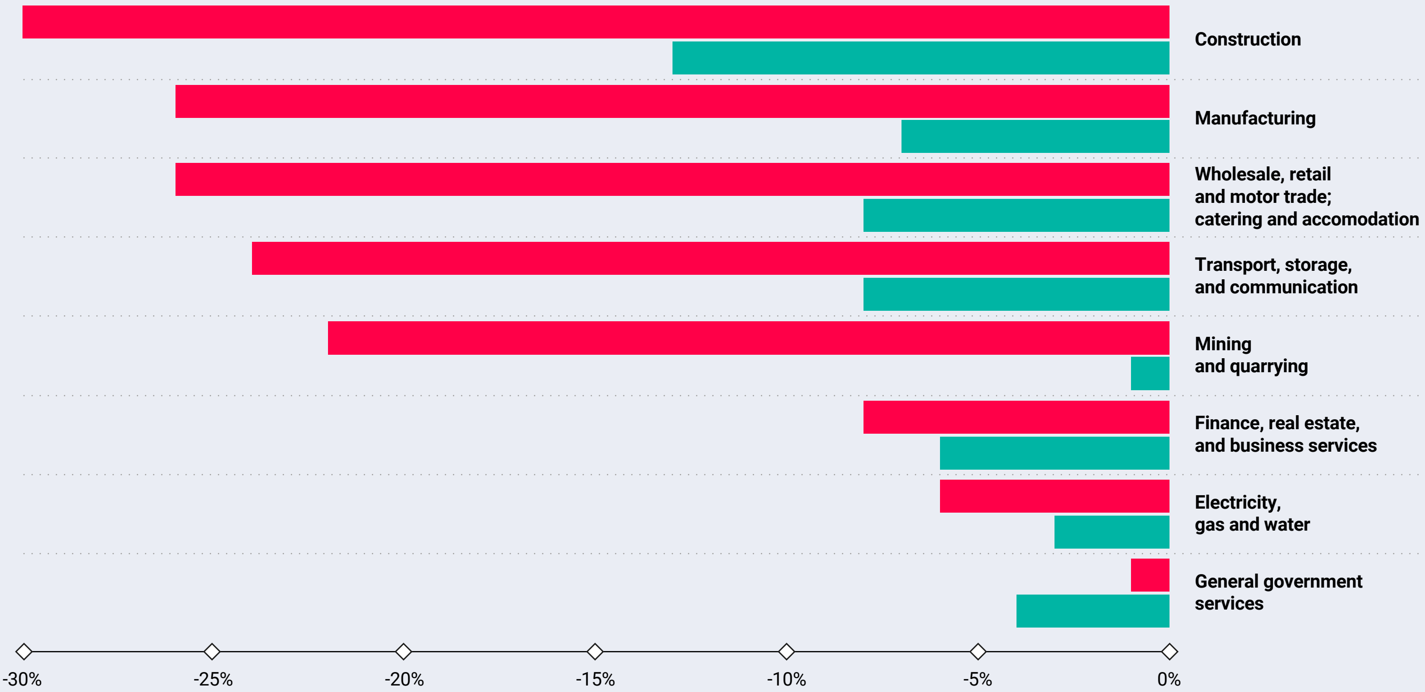
First, South Africa must restore confidence in its proposed fiscal consolidation path. Earlier this year, Moody's downgrading left South Africa without an investment grade rating for the first time since the advent of its democracy. This move put pressure on domestic capital markets and reduced confidence in the South African economy, manifested in higher bond yields, exchange rate depreciation, and by extension, increased borrowing costs. As a result, the fiscal consolidation path presented in the most recent budget for 2020/2021 has been met with skepticism from the market. Indeed, the President's Economic Advisory Council noted that the fiscal consolidation path suggested by the government is neither desirable nor believable. South African authorities therefore must pursue and ultimately deliver on the proposed structural reforms of reducing the public wage bill in order to signal that they are serious about fiscal consolidation.

Second, critically, leaders must improve the efficiency of existing expenditure. Despite a rate of investment above the long-term rate, owing largely to significant public investment in state-owned enterprises, the efficiency of investment has deteriorated significantly. In fact, the average incremental capital output ratio (ICOR, which explains the relationship between the value of investments and the consequent increase in gross domestic product), was four times higher[32] between 2012

[31] Carlos A. Primo Braga and Gallina A. Vincelette. 2011. *Sovereign Debt and the Financial Crisis: Will This Time Be Different?* World Bank Group.
[32] The higher the ICOR, the lower the productivity of capital.

FIGURE 1.7
Q2 CHANGE IN GDP AND EMPLOYMENT, SOUTH AFRICA

While the pandemic caused many South African industries—both in their output and employment—to shrink from Q1 to Q2, the economy's different sectors were not hit evenly. For example, among the hardest hit was construction, where employment shrank by 13 percent and output shrunk by more than 30 percent. Mining, on the other hand, saw an sharp drop in output, but a much smaller decrease in employment.



Visual Key

GDP
Employment

Source

"Gross Domestic Product (GDP), 2nd Quarter 2020," *Statistics South Africa*, September 8, 2020.

and 2017 than the average between 2000 and 2010. And, when looking at the top 100 emerging and developing markets, South Africa's ICOR now lags behind 82 percent of its peers, suggesting a growth in wastage, corruption, and inefficiency in spending by the fiscus.

Finally, the country must strengthen its revenue mobilization. Given the year of economic hardship for firms and households, it is not feasible to raise taxes. Even before the crisis, tax revenue shortfalls were a recurrent theme in South Africa. The National Treasury's Budget Review 2020 noted that, although there have been large tax increases over the last five years, the gap between projected and collected revenue has continued to expand. Improving the efficiency of tax collection by building the capacity of the South African Revenue Service and strengthening policies to reduce fiscal leakages is, thus, key.

Although these broad policy recommendations have been explored in the South African context, they are central to stimulating growth across sub-Saharan Africa. While positive results from several vaccines have lifted hopes for an end to the pandemic, the economic recovery will be much longer and the transition from expansionary policies to fiscal consolidation is more important than ever.

VIEWPOINT

Keep remittances flowing to Africa

Remittances—money sent by migrants to families back home—provide a financial lifeline to millions of households. Remittance flows to low- and middle-income countries reached $550 billion in 2019, surpassing foreign direct investment and official development aid. These are only recorded flows; the true size—including those through informal channels—is even larger.

Remittance flows to sub-Saharan Africa were recorded to be $48 billion in 2019[33] (Figure 1.8), but the true total is likely to be significantly larger. Nigeria alone received about half of total remittance flows to sub-Saharan Africa (Figure 1.9, first panel). In general, the economies of smaller, poorer, and fragile countries are more dependent on remittances: Controlling for the size of the economy, the top recipient countries in the region in 2019 included South Sudan (35 percent of GDP), Lesotho (21 percent of GDP) and The Gambia (15 percent of GDP) (Figure 1.9, second panel). While data are not available for Somalia, the country is also known to be highly dependent on remittances as a source of income and external financing.

Impacts of the COVID-19 crisis

Remittance flows to sub-Saharan Africa are projected to decline by 8.8 percent, to $44 billion in 2020, followed by a further decline of 5.8 percent, to $41 billion in 2021. The COVID-19 pandemic has hit remittances providers in a variety of ways: Sub-Saharan migrant workers, especially those in high-income OECD countries, have lost jobs or seen their incomes plummet, reducing their ability to send money home. Weak oil prices have affected outward remittances from the Gulf Cooperation Council countries[34] to Africa. Currency exchange rates also affect remittance flows: When source currencies (e.g., the euro) depreciate against the U.S. dollar, the value of remittances in U.S. dollar terms declines; when the currency of the recipient country (e.g., the Nigerian naira) depreciates, migrants may send more money home to take advantage of cheaper prices. In Africa, many countries still practice various forms of currency control, resulting in a divergence between the parallel and the market exchange rate and a diversion of flows to informal, unrecorded channels.

The decline in remittances is worrisome for the region where almost 40 percent of the population live in extreme poverty, and millions rely on remittances to put food on the table and have children stay in school. Thus, government efforts are needed to support households experiencing hardships, and international efforts are needed to keep remittances flowing to Africa.

Dilip Ratha

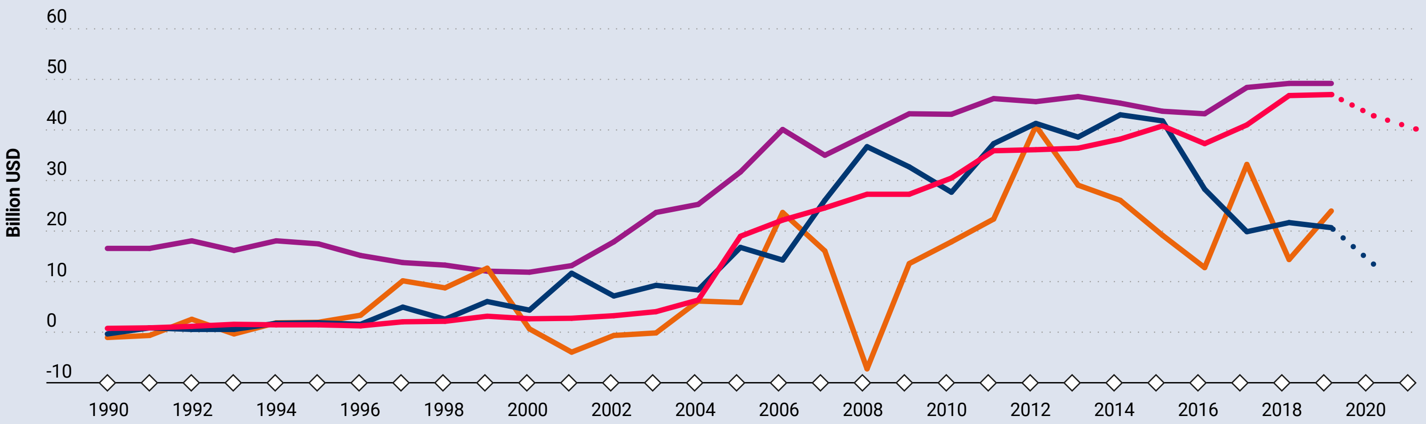
Lead Economist, Migration and Remittances
Head, KNOMAD, World Bank

@DilipRatha

[33] Dilip Ratha et al. 2020. *Phase II: COVID-19 Crisis Through a Migration Lens*. World Bank Group. Migration and Development Brief 33.
[34] Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

FIGURE 1.8
REMITTANCES ARE A LARGE AND STABLE SOURCE OF EXTERNAL FINANCING IN SUB-SAHARAN AFRICA

Remittance flows to sub-Saharan Africa were recorded to be $48 billion in 2019, larger than foreign direct investment (FDI) and comparable in size to official development assistance (ODA). However, like with other sources of financing, the COVID-19 pandemic has and is expected to continue to lower this important financing sources significantly.



Visual Key

- ODA
- Remittances
- Portfolio debt & equity flows
- FDI

Note

Dotted line indicates projection.

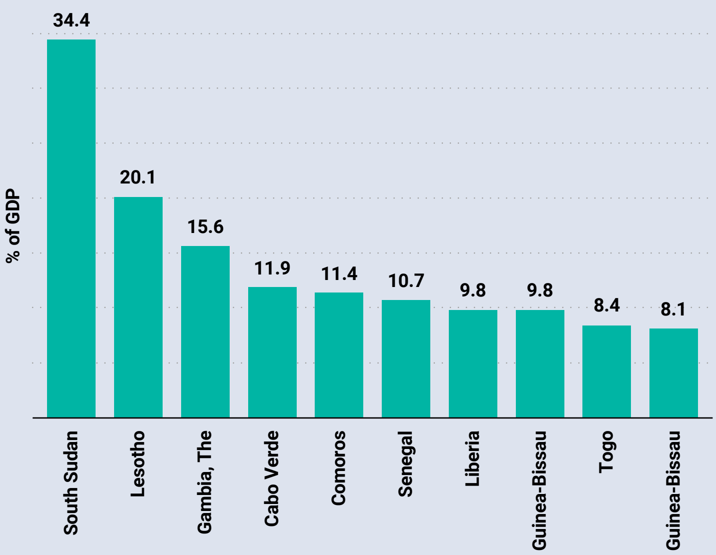
Source

Knomad. "Phase II: COVID-19 Crisis through a Migration Lens." October 2020.

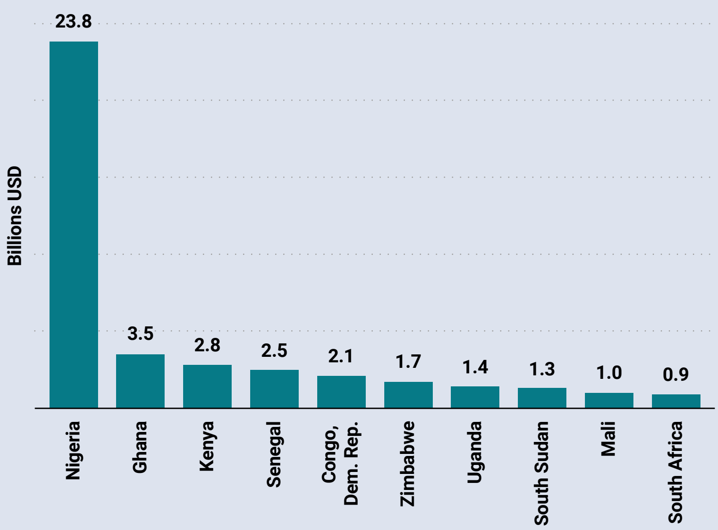
FIGURE 1.9
TOP RECIPIENTS OF REMITTANCES IN SUB-SAHARAN AFRICA, 2019

Remittances play an important role in many sub-Saharan African economies. For example, at $1.3 billion, this source of financing accounted for over 34 percent of South Sudan's GDP in 2019.

Top-10 remittance destinations (by % of GDP), 2019



Top-10 remittance destinations (by absolute amounts), 2019



Source

Dilip Ratha et al. 2020. *Phase II: COVID-19 Crisis Through a Migration Lens*. World Bank Group. Migration and Development Brief 33.

Future of migration and remittances in Africa

The pandemic has significantly dampened new migration flows worldwide due to widespread travel restrictions, fear of the virus, and weak job prospects. In many host countries, employment levels for foreign workers have fallen, invariably more so than for native-born workers. A significant number of unemployed migrant workers are returning to their countries of origin, which are now facing the challenge of accommodating hundreds of thousands (if not millions) of returnees, including through the provision of health care, housing, jobs, and financial support.

While trying to impose travel and visa restrictions, host countries must not impose irreversible restrictions that could constrain businesses from hiring essential workers (including foreign workers) during the recovery phase.

In the long run, migration flows from Africa are expected to increase significantly, driven by income gaps, the rapidly growing working-age population, and climate change. Notably, the average income in high-income OECD countries is over 50 times the average income in low-income countries. At recent (pre-COVID-19) growth rates, it would take over a hundred years to close that gap; the pandemic is likely to worsen it.

Remittance flows to sub-Saharan Africa are projected to decline by 8.8 percent, to $44 billion in 2020, followed by a further decline of 5.8 percent, to $41 billion in 2021.

What can be done?

A key lever for facilitating remittance flows during the crisis is reducing the cost of sending money: The fees paid to remittance service providers to send money to Africa average nearly 9 percent—the highest rate in the world and three times the Sustainable Development Goal target for remittance costs (3 percent). The cost of international remittances within Africa—intra-regional migration and remittances are large there—is even higher than the cost of remittances from the United States or Europe. Digital remittance channels, which have gained popularity during the crisis, also have high fees that have increased in recent months.

Lowering the burden of sending remittances can maximize this important flow of financing for development. Policymakers must work to make sure remittance service providers do not face difficulties in partnering with correspondent banks. Indeed, opening access of money transfer operators (MTOs) to partnerships with national post offices, national banks, and telecommunications companies could help remove entry barriers and increase competition in remittance markets. And these remittance channels can also be used to mobilize diaspora investments through diaspora bonds and bond financing through securitization of future flows of remittances. The global community should consider creating a non-profit remittance platform to provide a one-stop solution to keep remittances flowing and leverage them for development financing for the benefit of millions of poor people in Africa and the rest of the world.

VIEWPOINT

Threats to job creation: Tourism and COVID-19

John Page

Nonresident Senior Fellow, Africa Growth Initiative, Brookings Institution

Sub-Saharan Africa's services-led economic growth has been under increasing strain due to COVID-19. Beyond the threats to health and livelihoods the pandemic has thrown a wrench into some of the most promising sectors for economic growth in the region—including its "industries without smokestacks" (IWOSS).[35]

For the past few years, as part of a project on creating jobs for the region's burgeoning youth population, the Brookings Africa Growth Initiative has been examining how services subsectors that mimic traditional manufacturing—in that they are tradable, have high value-added per worker, have the capacity for learning and productivity growth—can absorb large numbers of low- to moderately skilled labor.

One of the key industries without smokestacks is tourism. Its decline in the face of this unprecedented global pandemic may tell a cautionary tale for tourism-dependent economies in Africa and elsewhere. Indeed, under COVID-19, the economic outlook is particularly uncertain for African countries with contact-intensive sectors such as tourism, hospitality, entertainment, and transportation.

Tourism is an important driver of economic growth around the world. In 2014, the industry provided an estimated 277 million jobs and accounted for about 9.8 percent of global GDP.[36] Blessed with beaches, cultural sites, and abundant wildlife, prior to the pandemic, Africa had the second-fasting growing tourism sector in the world. In fact, tourism represents about 8.5 percent of Africa's GDP and employs around 24 million people.[37]

With the COVID-19 pandemic, the number of international tourist arrivals has decreased sharply. From April to June 2020, the number of international tourists arriving in Africa fell by 98 percent, compared to that same period the year before. While some countries have had a partial resumption of passenger traffic, demand is not expected to reach its pre-COVID levels before 2023.[38] Moreover, the pandemic has severely affected sectors where women's employment is disproportionately high, such as hotels and restaurants.[39]

As a result, tourism-dependent economies are estimated by the African Development Bank to experience sharp declines in growth in 2020. Mauritius (-14.9 percent), Seychelles (-12 percent), and Cabo Verde (-6.6 percent) will be especially hard hit but are expected to recover in 2021. Exchange rate volatility is particularly severe in those economies too.

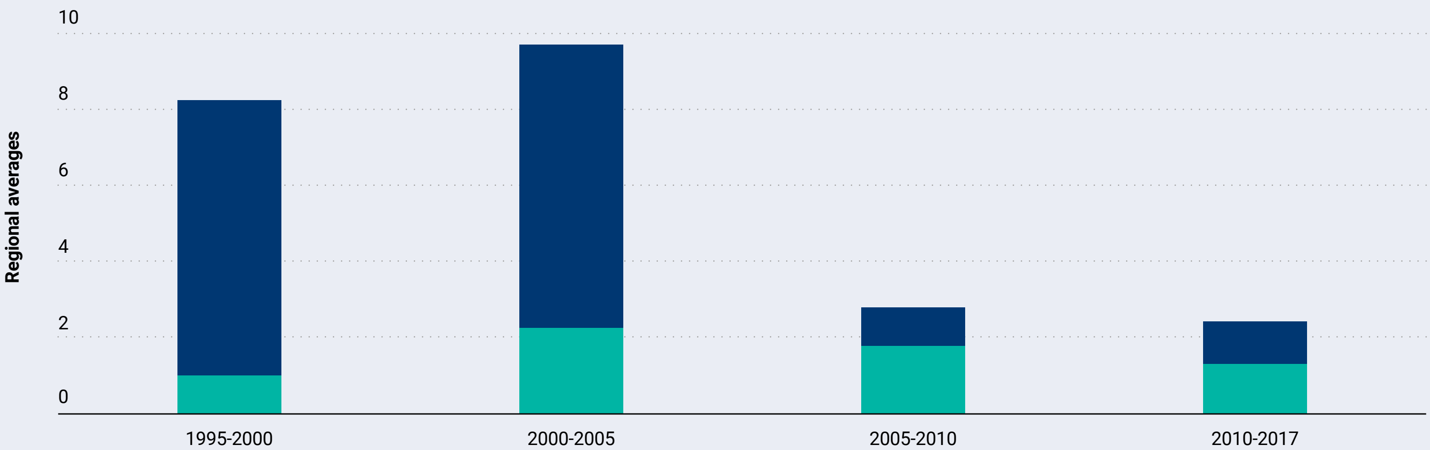
The pandemic will have far-reaching implications for productive employment, especially for low-skilled youth, in such roles as cooks, waitrons, and front office staff.

35 Richard Newfarmer, John Page, and Finn Tarp. 2018. *Industries Without Smokestacks: Rethinking African Industrialization*. Oxford: Oxford University Press.
36 Daly, Jack and Gary Gereffi. 2018. "Tourism Global Value Chains and Africa." In *Industries Without Smokestacks: Rethinking African Industrialization*, edited by Richard Newfarmer, John Page, and Finn Tarp, 68-89. Oxford: Oxford University Press.
37 African Development Bank. 2020. *African Economic Outlook, 2020*.
38 Ibid.
39 Ibid.

Between 2010 and 2018, the average share of employment in travel and tourism in total employment in Ethiopia was 8.4 percent. Kenya's tourism sector—pre-pandemic—employed about 1 million workers, accounting for 9.2 percent of total workers. In Rwanda, tourism employs more than 3 percent of the labor force, including low-skilled workers. Ten million tourists visited South Africa in 2017—by far the most in sub-Saharan Africa. In 2018, there were an estimated 849,000 formal private sector jobs in tourism there, representing 5 percent of total employment. In Uganda, tourism firms employ a high share of youth in their total work force (47.5 percent).

FIGURE 1.10
VALUE-ADDED GROWTH DECOMPOSITION FOR TOURISM IN AFRICA, 1995-2017

From 1995 to 2005, tourism value added grew rapidly, driven mostly by increased employment in the sector rather than improved productivity. Growth, however, was markedly different from 2005 to 2017: not only was growth in tourism value added much weaker, it also was driven more by gains in productivity rather than employment.



Visual Key

- Productivity
- Employment

Source

Coulibaly, Brahima, Dhruv Gandhi, and Ahmadou Aly Mbaye. 2019. *Job Creation for youth in Africa: Assessing the potential of industries without smokestacks.* The Brookings Institution.

What is needed to put Africa's tourism-dependent economies back on their feet? The global recovery of travel and tourism will depend on progress in the development of COVID-19 vaccines and on their widespread availability—an area where global public action can play a role. More than half of all advanced market commitments for COVID-19 vaccines have been made by high-income countries. Addressing the challenge of universal accessibility for low-income countries will require collaboration among governments, the private sector, and global health agencies. The COVAX initiative, a cost-sharing global alliance of more than 170 countries for COVID-19 treatment, is a welcome development. (For more on vaccine distribution in sub-Saharan Africa, see page 29).

Governments of tourism-dependent economies can also take policy actions to reduce the impact of unexpected shocks, such as COVID-19. Policymakers can implement sound macroeconomic management using appropriate monetary, fiscal, and financial policies. Where volatility is a concern, countries should allow exchange rates to adjust in an orderly manner.

Africa's tourism sector can weather this shock. The continent will continue to offer beaches, culture, and wildlife. With appropriate vaccines and policies, tourism will continue to create productive jobs.