Sub-Saharan African countries continue to grow at a steady pace

The region’s decade-long economic expansion appears sustainable

For newly resource-rich countries, strong governance will be key to harnessing resource wealth for development

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This document was produced by the Office of the Chief Economist for the Africa region
Summary

- Global economic activity has slowed significantly in recent months, weighed down by policy uncertainty.
- Despite difficult global conditions, growth in Sub-Saharan Africa has remained largely on track. However, the region’s economic prospects are vulnerable to heightened downside risks.
- Because Africa’s growth recovery since 2000—the longest expansion since independence—was based on improved macroeconomic policies and political stability, the prospects of sustained growth are strong.
- Discoveries of minerals are bringing the prospect of large revenues for newly resource-rich countries. The challenge for these countries will be to strengthen mineral governance so as to avoid the pitfalls of resource wealth.

Section 1: Recent Trends and Prospects

- High-income country growth remains under pressure, although financial market conditions have eased.
- African countries continued to post steady growth, supported by resilient domestic demand, strong commodity prices, and an accommodative policy environment.

RECENT TRENDS IN THE GLOBAL ECONOMY

Economic activity slowed in the second quarter, amid difficult global conditions. An escalation of financial market tensions in Europe in May and weaker growth in some of the larger developing countries significantly impacted global economic activity as weaker consumer and business confidence translated to higher precautionary savings and weaker spending. Reflecting this weakness, global industrial production contracted for the first time since May 2009. The deepest contraction occurred in the Eurozone, the epicenter of the current crisis. Among developing countries, the expansion in industrial output still remains well below its ten-year average of 7.5 percent (3m/3m, seasonally adjusted annualized rate).

The slowdown in real-side activity has led to a slump in global trade. Global trade flows contracted at a pace of 4.5 percent (3m/3m, saar) between May and July. The sharpest contraction in import demand was in the Euro Area (-15.3 percent in July), where unemployment rates continue to hit record highs. Developing country trade has also fallen. Weak import demand from developing countries reflects not only spillovers from the Euro Area crisis, but also ongoing slowdown in the domestic economies of some large developing countries including Argentina, Brazil, China, and India.

Conditions in global financial markets have eased significantly since July, supported by recent policy decisions of major central banks. Among these are, the European Central Bank’s announcement to “do whatever it takes to save the euro” and the upholding of the European Stability Mechanism by the German Constitutional court; as well as policy interventions such as the unlimited bond buying programs announced by the ECB (Outright Monetary Transactions), the US Federal Reserve’s QE3 program and the Bank of Japan’s expanded Asset Purchase Program. Borrowing costs have come down—for example, developing country bond spreads have eased by some 80 basis points to go below their long term average of 310 bps. Indeed, gross capital flows to developing countries, which fell by about 30 and 40 percent in May-June, have since recovered to their April levels. The recent monetary policy stimulus has also supported a pick-up in precious mineral prices. But financial markets remain vulnerable to changing market perceptions and implementation of policies.
Though activity is likely to pick-up by the fourth quarter, global GDP is expected to grow at a relatively weak pace of 2.3 percent in 2012, with high-income countries expanding at 1.2 percent and developing countries at 5.1 percent. Baseline projections call for a slow strengthening of global activity, but prospects for 2013 are fragile, particularly in high-income economies. Global growth is projected to rise to 2.6 percent in 2013, with growth in high-income and developing countries edging up to 1.5 percent and 5.6 percent respectively. Financial markets, though improved, are still nervous and sentiment is vulnerable to bad news. Should conditions in Europe deteriorate markedly, the global economy could return to recession-like conditions. However, given recent policy interventions, this is most likely a tail event. Outside the Euro Area, risk of the so-called fiscal cliff in the United States also threatens to derail an already fragile global economy. Under current legislation this would impose a sharp 5 percent drag to US GDP in 2013, with negative implications for developing regions with strong trade and investment ties to the United States. The indirect impacts through weaker confidence and implications on global financial and commodity markets could be even more significant.

RECENT DEVELOPMENTS IN SUB-SAHARAN AFRICA

Despite setbacks in the global economy, growth in Sub-Saharan Africa has remained largely on track. An accommodative policy environment, still strong commodity prices, and domestic demand have continued to support economic activity. Relatively resilient domestic demand and robust export growth in countries with new mineral discoveries in recent years are expected to underpin economic growth for the remainder of the year. The region is projected to grow by 4.8 percent in 2012, broadly unchanged from the 4.9 percent growth rate of 2011 (Figure 1). Excluding South Africa, the region’s largest economy, growth is forecast at 6 percent, making it one of the fastest growing developing regions. Indeed, a third of countries in the region will be growing at or above 6 percent. A number of the fastest growing economies in the region are buoyed by new mineral exports—iron ore in Sierra Leone and uranium and oil in Niger—a return to peace—Côte D’Ivoire—and robust growth in the non-minerals sector—Ethiopia (Figure 2).

Sub-Saharan African trade has been impacted by developments in the global economy. The region’s exports rebounded nicely in the first quarter of the year, growing at an annualized pace of 32 percent, up from the -11 percent pace recorded in the last quarter of 2011 (Figure 3). However, exports have not been immune from
the recent bout of market volatility stemming from the Euro Area crisis, as well as the economic slowdown that is occurring in some of the largest developing economies, in particular China, which remains an important market for the region’s metal and mineral exporters. Although more recent data is lagging across countries in the region, where data is available there is evidence of the slowdown. For instance, in South Africa, the most globally integrated economy in the region, export growth on a seasonally adjusted annualized basis was down by around 32 percent in the three months leading to June. Similarly, export growth in both Kenya and Botswana contracted at -2 percent and -20 percent respectively in June.

Trends in services trade, particularly tourism (an important driver of growth in countries such as Kenya, Mauritius, and Seychelles), have mirrored developments in the global economy. According to the UN World Tourism Organization, tourism arrivals to the region were up some 7 percent in the first four months of 2012. The continued growth of tourist arrivals to destinations in the region has benefitted from the ongoing diversification of source countries. In Kenya tourist arrivals (via air travel) increased by 8.8 percent (y/y) in the two months ending in June compared with the same period last year. In Mauritius, visitors from Europe, which accounts for two-thirds of arrivals, dropped 6 percent in the first six months 2012, but this was partly offset by an increase of 16.7 percent in visitors from Asia (visitors from China increased some 59 percent). The pace of expansion of tourism arrivals in the second half of 2012 is likely to be constrained by weak global conditions, as well as increased piracy and terrorism threats on and off the East Coast of Africa.

Investments to the region have been weakened by the global slowdown. After reaching an estimated $42.4 billion in 2011, private capital flows to the region are expected to fall to $36.6 billion in 2012 (Figure 4). However, given the still relatively high levels of commodity prices and the ongoing resource prospecting and exploration in the region (particularly in East and West Africa), foreign direct investment flows to the region in 2012 are expected to remain resilient, steadying at around $31 billion (compared to $32.5 billion in 2011). Other private capital flows, which are of a shorter term duration and, thereby, more susceptible to changing market sentiments, are estimated to be lower by some $4.2 billion (i.e. from $11.7 billion in 2011 to $7.5 billion in 2012). For instance, a recent survey showed that as a result of the ongoing deleveraging in the Euro Area some 75 percent of external banks that conducted business in the region decreased available credit or liquidity (e.g. trade finance) and became more selective with customers in the region.
As financial market conditions have improved, investor interest in the region has strengthened. Indeed, in September Zambia joined the growing list of African countries (Ghana, Senegal, Nigeria, Namibia) that for the first time in recent years are tapping international capital markets. Zambia’s maiden 10-year $750 million Eurobond was oversubscribed and was issued at a 5.625 percent yield, lower than yields in some high-spread Euro Area economies. Further, South Africa’s maiden inclusion in the Citi World Government Bond Index (WGBI) is supporting an increase in foreign investor participation in South Africa’s domestic bond market, thereby, helping to fund its increasing current account deficit and keep a lid on inflation.

Consumer spending most likely held up during the recent escalation of financial market tensions. Data on consumer sentiment and retail spending across countries is largely unavailable, but in South Africa and Nigeria, where retail sales data is available, we observe that on a quarter-on-quarter basis, retail trade volumes were up by some 8.6 percent in both South Africa and Nigeria, for the three months ending in June. Using monthly passenger car import data as a proxy for the strength of consumer durable goods, we observe that on a year-on-year basis the growth in the dollar value of imports of durable consumer goods held steady at 18 percent in the three months ending in May (when the Euro Area crisis escalated), similar to that recorded in the previous month. Nonetheless the performance across the region was varied with import demand of durables expanding across some 80 percent of countries and contracting in the remaining countries. Where consumer durables contracted, this was more likely due to domestic challenges rather than from spillovers related to the Euro Area situation: Malawi where the sharp devaluation of the Kwacha significantly increased import costs; Sudan which was impacted by South Sudan’s decision to put on hold the production and exports of oil; and Central African Republic where conflict continues to disrupt economic activity.

Consumer spending in aggregate appears to have at least held steady through May for most countries and in June for the two largest economies in the region. This is all the more important as consumer spending accounts for some 60 percent of GDP in Sub-Saharan Africa. In part, the resilience of consumer spending was supported by wage increases, improved access to credit, steady remittance flows (projected to reach $24 billion in 2012 from $22 billion in 2011), and falling inflation and interest rates in a number countries (Kenya, Uganda, South Africa). Inflation has trended down as food and fuel price pressures have eased, providing scope for flexibility in monetary policy.

Government spending is supportive of growth. Helped by relatively moderate debt-to-GDP ratios averaging some 40 percent in the region, government spending has been expansionary in recent years. Indeed, real government consumption is expected to rise by an average of 4.8 percent in 2012, consistent with the estimated real GDP growth in the region, showing that both government and private sector spending (consumption and investment) will remain important drivers of GDP growth in the region. Nonetheless, rising fiscal deficits in some countries could compromise future growth prospects due to the risk of macro instability. To the extent that government spending is instrumental in relieving binding constraints in infrastructure provision as well as human capital sectors, the ongoing stimulatory fiscal policy will be supportive not only of the current growth trajectory but also the long-run competitiveness and productive capacities in these economies. However, a continuation of generally accommodative policies since the 2008-09 global crisis means that in many countries fiscal policy space to counter severe external shocks may be constrained. Some countries such as Botswana and Nigeria are moving to rebuild fiscal policy space.
**MEDIUM-TERM OUTLOOK FOR SUB-SAHARAN AFRICA**

Looking forward, recent policy interventions in high-income countries will likely contribute to stabilizing the situation in Q4 2012 and bolster global demand in 2013. Domestic demand in the region should continue to remain relatively resilient compared to support from external demand. As a result, growth in Sub-Saharan Africa is expected to see an uptick to 5.2 percent in 2013. Excluding South Africa, growth is expected to reach 6.2 percent in 2013.

With demand from both high-income and developing countries expected to come in weaker than previously thought, the demand for Sub-Saharan African exports of goods and services will be weaker in the remainder of 2012 and in 2013, although a pick up is expected thereafter. Nonetheless, for some of the countries for which new mineral discoveries have been made in recent years export growth is still expected to remain robust (Mozambique and Sierra Leone).

Although commodity prices have tapered off somewhat in recent months, compared to their earlier highs, they still remain elevated and are thus expected to support economic activity in the resource-rich sector. Domestic demand, which has remained a resilient pillar of growth in Sub-Saharan Africa in recent years, is expected to continue in that trajectory over the medium term. The strength in domestic demand will be supported by ongoing investments to improve productive capacity, particularly in tackling infrastructural barriers (which has benefitted from new sources of capital), rising incomes, favorable demographic dynamics, higher remittance flows (rising to $27 billion by 2014), lower interest rates in some countries (for example, South Africa and Kenya) and the rise in foreign direct investment. Indeed, foreign direct investment to the region, supported by a growing middle-income and still high commodity prices is projected to pick up steadily to a record high of over $48 billion by 2014.

Nonetheless, risks to these forecasts remain tilted on the downside, as the global economy remains fragile, and weaker growth in China could further curtail growth in the resource-dependent economies in the region.

A fragile global recovery presents a key risk. While the slow strengthening of global activity in the baseline remains the most likely scenario, prospects are fragile particularly in high-income economies. A sharp deterioration in these countries could have severe global implications. Indeed, GDP in Sub-Saharan Africa could fall by up to 3.5 percentage points relative to baseline were there to be a marked escalation of financial market tensions that shut off some larger Euro Area economies from refinancing their debt. However, given recent policy interventions, this is most likely a tail event. A credit squeeze in some of the periphery Euro Area economies could pull GDP growth down by 0.8 percentage points. Risk of the so-called fiscal cliff in the United States also threatens to derail an already fragile global economy. Though other developing regions with stronger trade and investment ties to the United States will likely be harder hit (e.g., East Asia and Latin America and the Caribbean), the effects on Sub-Saharan Africa will not be insignificant, with an estimated direct impact of a reduction of 0.3 percentage points from the baseline forecast. The indirect impacts through weaker confidence and implications on global financial and commodity markets could be even more significant.

Trade and investment flows will be the main channels through which weaker global economy will impact the region. Trade impacts of a weaker global economy are likely to be most severe for regional exporters of oil, other minerals, and agro-industrial raw materials (e.g. cotton) as sales (prices and volumes) of these commodities tend to more sensitive to the global business cycle. Food exporters will be less hard hit because food tends to remain stable even as global activity rises or recedes. Smaller economies like Swaziland, Seychelles Cape-Verde, and Gambia would be exposed to a sharp decline in global tourism.
Tighter financial conditions in the wake of a Euro Area crisis or rattled market confidence from a fiscal cliff situation in the US would likely affect short-term capital flows to the more financially integrated economies like South Africa, and to a lesser extent Nigeria and Kenya. If the crisis endures then FDI inflows, upon which much of the region relies, are also likely to be impacted.

Developments in commodity prices remain a source of concern as well. Should China not succeed in engineering the soft-landing scenario of the baseline, demand for and prices of major metals and minerals could decline significantly. Over the past decade, Sub-Saharan African exports to China have increased from 5 percent to some 19.3 percent in 2010, with oil (Sudan, Angola, Republic of Congo) and metal and mineral exporters (Zambia, Mauritania, Democratic Republic of Congo) among the countries whose exports are heavily dependent on Chinese demand (Figure 5). Another commodity price risk is on the supply-side shocks to oil (triggered by a possible escalation in geopolitical tensions), which could lead to a surge in oil prices. This development would likely hit hard the oil importers in the region, putting pressure on their currencies and potentially reversing the lower inflationary trends observed in 2012; although for oil exporters the price shock would be to their benefit.

While external risks are most prominent, a number of domestic challenges could also cause outturns to sour. Disruptions to productive activity from political unrest are important potential downside risks, as investment, merchandise trade and tourism receipts, all important growth drivers, are likely to suffer. The 6 percent contraction in output in Cote d’Ivoire in 2011 was due to the civil unrest there, and in 2012 there has been new political unrest in Mali.

Another downside risk stems from adverse weather conditions. With the agricultural sector accounting for about 20 percent to 40 percent of GDP in most Sub-Sahara African countries (and an even higher share of employment), and with much of the sector dependent on good rains, the impact of poor rainfall on GDP growth in the region can be significant. However, the effects of poor rainfall are not limited to the agricultural sectors. They also have implications for the services and industrial sector, as these sectors depend on the generation of power from hydroelectric sources. Already in 2012, poor rains are forecast for the eastern Horn of Africa as well as the Sahelian zone, affecting parts of Mauritania, Mali and Niger.

**FOOD INSECURITY**

The recent spikes in international food and grain prices (Figure 6) could have negative implications for Sub-Saharan Africa. An unprecedented hot and dry summer in the United States, Russia and Eastern Europe led to reduced yields on both maize and wheat production worldwide. As a result, the World Bank Food Price Index soared by 10 percent in July compared to a month earlier. Over the same period, prices of maize increased by almost 25 percent (Figure 7) and wheat prices surged by around 30 percent.
While it is still unclear what the implications of these spikes could be for the region, the high proportion of expenditures on food, high rates of malnutrition and the recurrent crisis and insecurity—particularly in the Sahel region—are enough reason for increased concern and monitoring. A recent report by the FAO and USAID’s Famine Early Warning System Network (FEWSNET), lists14 countries which are particularly vulnerable to the recent food price increase. In most of these countries, maize and wheat provide 20 percent or more of the average household’s caloric intake (Table 1).

Additionally, the presence of Desert Locusts and ongoing conflict in the Sahel region of West Africa further undermines the region’s food security. Countries like Mali and Niger are already suffering from infestation from these locusts and there is potential for the swarm to move to neighboring countries such as Mauritania and Chad, further amplifying food scarcity in a region already food insecure from population displacement due to conflict (see April issue of the Pulse).

The impact of this latest food price increase in local markets across Africa is difficult to determine as current trends show significant variation in domestic prices across the region. In West and Central Africa, prices of cereals are still at record high levels owing to low production in 2011. However, better rains in 2012 have caused prices in the coastal countries to decline. Wheat prices in Mauritania rose by 12 percent in July, reflecting the sharp increase in global prices that month. Further, the price of domestic and imported rice rose by about 50 and 40 percent above prices of a year ago, respectively.

Prices in East Africa, though high, have started to ease on account of the new cereal harvest reaching markets. In Sudan, prices of sorghum and millet declined in August but are still twice as high as a year ago as trade flows were interrupted by conflict and demand from neighbors increased. Similarly, in neighboring South Sudan, cereal prices declined by 10-15 percent due to increased imports.
from Ethiopia and Uganda. Still, prices remain between 30 and 80 percent higher than last year. Kenya continues to show modest decline in all monitored food staples, while price changes for the month of August in Ethiopia and Uganda have been mixed. In Ethiopia, teff prices are more than 50 percent above a year ago and in Uganda both banana and cassava (national staples) remained between 29 and 17 percent above last year’s prices, respectively.

Prices in Southern Africa are in line with seasonal trends. However, in Zimbabwe, the price of maize is 48 and 68 percent higher in the cities of Harare and Bulawayo, respectively. Maize prices in Malawi are on the rise due to poor harvests and a high rate of inflation.

IS AFRICA’S ECONOMIC RECOVERY SUSTAINABLE?

Since 2000, Africa has seen more than a decade of economic growth, the longest expansion in over 50 years. During this period, two very different development experiences have unfolded in tandem.

Two competing narratives describe the economies of Sub-Saharan Africa over the last fifteen years. On the one hand, GDP growth has been relatively rapid, averaging 5 percent a year until the 2008-9 global economic crisis; since 2010, growth has resumed and is expected to increase to over 5 percent in 2013. Moreover, growth was widespread: 22 non-oil countries averaged 4 percent growth or higher for the decade 1998-2008. Africa has been attracting private capital flows which, now exceed foreign aid. The poverty rate has been falling faster than one percentage point a year and for the first time, between 2005 and 2008, the absolute number of people living on $1.25 a day fell (by 9 million). Child mortality has also been declining, and even though a large number of African countries are unlikely to meet the MDGs, about half the “off-track” countries are within 11 percent of the trajectory to reach the goals.

On the other hand, Africa’s growth has largely followed commodity prices, and African exports are highly concentrated in primary commodities. Manufacturing’s share of GDP is the same as in the 1970s. With the exception of Mauritius, no African country has achieved structural transformation. Despite overall poverty reduction, some rapidly growing countries such as Burkina Faso, Mozambique and Tanzania have reduced poverty only slightly. The absolute levels of human development are the lowest in the world. Indicators of service delivery are appalling: teachers in public primary schools in Tanzania are absent 23 percent of the time; public doctors in Senegal spend a total of 29 minutes a day seeing patients. Such systems are unlikely to be able to deliver at the scale required by Africa’s population boom. Finally, Africa’s civil wars may have ended, but political instability is widespread: this year alone saw coups d’état in Guinea-Bissau and Mali, violence on the border between South Sudan and Sudan, as well as in eastern Congo. And on any worldwide indicator of corruption, Africa scores the lowest.

How can these seemingly contradictory narratives be reconciled? Devarajan and Fengler (2012) contend that the growth success is mainly due to reforms in economic policies, necessitated by misguided policies of the past. Meanwhile, the development challenges—lack of structural transformation, weak human capital and poor governance—reflect government failures that are difficult to overcome because they are deeply political.

In the half century since independence, the African continent experienced highly uneven economic and social performance. Starting from a similar position to most Asian economies—and in many cases even better—Africa experienced three distinct growth episodes (Figure 8): Post independence sluggish growth (1960-1975), Two lost decades (1976-1999) and the “catch up” (since 2000).
The initial poverty reduction strategy for Africa post independence seemed simple. Experts believed that Africa just needed transfers of financial resources to close its development gap. Investments in roads, schools and clinics did not materialize into higher standards of living and growth. Moreover with the discovery of natural resources—particularly oil—across the continent, Africa’s exports were highly dependent on commodities. The combination of high and volatile commodity prices and low levels of human development and infrastructure, a lack of competitiveness and weak mobilization of revenues resulted in Africa’s debt crisis beginning in the late 1970s. What followed were two decades of social and economic decline.

By the early 1990s, it became clear that Africa’s economic model was not sustainable. Development partners found that aid-financed projects were not productive in a setting where economic policies were distorted. This led to a new era of development thinking, characterized by “Structural Adjustment Programs (SAPs).” The problems with the adjustment programs were not in substance but in process. African governments often had little incentive to fully implement SAPs as it would have hurt their own political interests and because these policies were imposed from outside, they could be more easily rejected.

Since the late 1990s, Africa has been catching up. Despite the global financial crisis of 2008/09 Africa has grown at 4.7 percent between 2000 and 2009. Excluding South Africa, which still represents a third of Africa’s economy and experienced sluggish growth of 2.1 percent, the continent’s average growth rate was 6 percent. This robust growth performance has resulted in the first overall reversal in the poverty rate since the 1970s from 58 percent in 1999 to 47.5 percent in 2008. Growth and poverty reduction was almost universal across types of countries and sub-regions: commodity exporters have been growing as did commodity importers, landlocked and coastal countries.

More than a decade of strong growth has propelled part of Africa to what the World Bank classifies as “middle income”, or $1,000 per capita income. Out of Africa’s 48 countries, there are already 21 states with 400 million people which have officially achieved Middle Income status (even though half of them are still below US$ 2000) (Figure 9). Ten countries representing another 200 million people today would reach MIC-status by 2025 if current growth trends continue or with some modest growth and stabilization (Comoros, Zimbabwe). Another seven countries (70 million people) could reach MIC-status if they accelerate their economic performance and achieved seven percent of uninterrupted growth (Sierra Leone needs to grow even faster which is possible with the recent expansion in mining). Only ten African countries (230 million people) almost certainly will not reach Middle Income by 2025. Most of them are fragile and conflict affected states.

A conjuncture of four interrelated factors explain Africa’s “growth recovery” since 2000, which has become the most sustained expansion since independence and which was not significantly interrupted by the global financial crisis: policy, demography, geography, and technology. However, policy performance remains uneven across countries and policy areas. Demographic
pressures, urbanization and technological change also bring a number of new challenges which African governments will need to address to sustain the current growth momentum.

The improvement in economic fortunes has been associated with better policies. Over the last decade Africa has improved its economic and social policies. These reforms occurred mostly because of two main shifts in the region: the lessons learned from the painful debt crisis and subsequent HIPC/PRSPs-process which provided debt relief and supported home-grown reform agendas and the end of the cold war that opened up political space in Africa. Even though it did not yet achieve a transformation in governance, the opening provided voice to many segments of society which had been marginalized. Together with rapid population growth and urbanization, the demands for better social and economic policies have been growing.

Africa’s economic fortunes also improved at a time when the possibility of a demographic dividend started to emerge. Across the world, demographic dividends are associated with better development results. Since independence, Africa’s population grew rapidly from a very low base of below 250 million to 900 million people today. Africa is adding 27 million new people every year and will continue to grow at this speed until 2050. Fertility is expected to come down gradually which will be compensated by people living longer and a larger number of young families (which have fewer children). As a result the most rapidly growing group in Africa are “working adults” (age 16-64) growing by 19 million each year; children (age 0-14) will only continue to grow by 4 million annually. The dependency ratio will keep improving for the next decades and reach a relationship of two working adults per dependent by 2050 (Figure 10).

With rapid population growth Africa is also urbanizing rapidly, with deep implications for social and economic opportunities. No country has ever reached high income with low urbanization. Today, 41 percent of Africans live in cities, with an additional one percent every two years. By 2033, Africa – like the rest of the world – will be a majority urban continent. Urbanization and development go together. With a large urban consumer base, firms and customers benefit from scale economies.
The mobile revolution is the most visible sign of Africa’s emergence. In 2000, Africans were hardly connected. South Africa and a few wealthy individuals had phone connections, and there were no affordable cell phones. Within a decade cell phones have become ubiquitous with the exception of a few countries.

However, as earlier stated, Africa faces some deep development challenges—in growth, poverty reduction, structural transformation, human development and governance—that at best call into question the gains of the last fifteen years and at worst could undermine them.

**Slow-growing countries.** A significant number of African countries have been growing much more slowly than the regional average. One group is the so-called “fragile states”, countries where conflict or governance has deteriorated so much that the state is unable to perform its basic functions. Of the 33 fragile states in the world, 20 are in Africa. If we take out the oil-exporting countries (whose growth is essentially a function of world oil prices), the remaining African fragile states have experienced much slower per-capita growth than their non-fragile counterparts. That fragile states grow more slowly is not surprising, inasmuch as these countries suffer from political violence, insecurity and high levels of corruption. Perhaps more surprising is the persistence of fragility: A combination of these features of fragile states coupled with a minimum level of consumption for poor people results in the possibility that the economy gets “stuck” in a low-level equilibrium trap (Andriamihaja et al., 2012).

**Fast growth, slow poverty reduction.** Even among Africa’s fast-growing countries, a disturbing number are not seeing rapid poverty reduction. For example, despite years of significant oil revenues, the central African countries have some of the lowest human development indicators in the world. The tragedy is that these countries have not been able to use their oil revenues to significantly improve the welfare of their poor citizens. Perhaps the reason is that oil revenues (unlike tax revenues) go directly from oil companies to the government, without passing through the hands of the citizens (see section II).

**Slow structural transformation.** Even among countries that have achieved both rapid growth and poverty reduction—Ghana, Rwanda, and Ethiopia are examples—there has been remarkably little structural transformation. The share of manufacturing in GDP or employment is still quite low, and scarcely higher than it was before the growth phase. Yet labor-intensive manufacturing growth is probably the best way for Africa to absorb the 7-10 million young people entering the labor force each year.

**Infrastructure.** There are many reasons why competitive manufacturing has not taken off in Africa, but most of them revolve around the high costs of production on the continent. A major factor behind these high costs is Africa’s infrastructure deficit. For example, African exporters face some of the highest transport costs in the world, especially in trying to ship goods from landlocked countries to the ports. But a study by Raballand and Teravaninthorn (2010) shows that vehicle operating costs along the four main transport corridors are no higher than in France. Yet, transport prices are among the highest in the world. The difference between transport prices and vehicle operating costs are the profits accruing to trucking companies, some of which are of the order of 100 percent.

**Business climate.** In addition to infrastructure, a host of other factors serve to drive up the cost of doing business in Africa. The World Bank’s Doing Business indicators rank African countries lowest among all regions of the world. While there has been progress recently—last year, 36 out of 46 African countries reformed business regulations, and Rwanda and Sao Tome and
Principe are among the world's leading reformers—the fact remains that the costs of starting and running a business in Africa are, on average, the highest in the world.

**Informal sector.** Most Africans work in smallholder farms and household enterprises, what is often called the informal sector. In fact, for those low-income countries where there are data, the private wage employment sector has been creating jobs at a faster rate than GDP has been growing. But that growth is from such a low base that it does not come close to absorbing the 7-10 million of new entrants into the labor force every year. Instead, most young people will end up working where their parents do, in smallholder farms and household enterprises.

**Weak human capital.** As mentioned earlier, despite a decade and a half of economic growth, some poverty reduction and improvement in human capital indicators, Africa still has the lowest levels of human capital in the world. The weak human capital base is distressing because considerable resources—from donors and African taxpayers—have gone into the health and education sectors. At least three factors contribute to this ineffective public spending and weak link between access and quality. First, resources allocated to addressing the problems of poor people do not always reach the front-line service provider. Secondly, even when resources get to the school or clinic, the provider is often not there. Teacher absenteeism rates in Uganda and Tanzania were about 27 and 23 percent, respectively (World Bank, Bold and Svensson). Third, even when present, the quality of the service is exceedingly poor.

**Government failure.** All of the problems described so far—from slow growth to poverty-insensitive growth to infrastructure deficits to restrictive business regulations to poor service delivery—have at their root a government failure that is standing in the way of pro-poor reforms. Whether it is the fact that losers are concentrated while winners are diffuse, or that clientelistic politics alter incentives facing politicians, the system is in an equilibrium that has no intrinsic force for change.

In light of these deep government failures, are Africa's recent economic growth and poverty reduction sustainable? While nothing is certain in this world, two factors provide support for cautious optimism. First, the success of prudent macroeconomic policies in delivering a long period of growth has generated political support for these and other reforms. This clearly demonstrates that consensus is possible around overcoming government failures in other important policy areas.

Second, the combination of democratization, demographic change, rapid urbanization, increasing levels of education and the almost complete connectedness of the continent through the cell phone have substantially altered Africa's policymaking processes. Today, there are many more reformers inside and outside government in African societies. At the same time, there is more political space to voice alternative views and challenge government policies. Greater debate and consultation make it easier to develop a domestic consensus around reforms. In addition, the telecommunications revolution is enabling poor people to know what is going on and is greatly lowering the costs of mobilizing collective action, thereby, making governments more careful about perpetuating anti-poor policies.

Despite this cautious optimism about Africa's overall prospects, there is one group of countries where the challenge of sustained, pro-poor growth is particularly large: Africa's mineral exporters.
Section II: Mineral Governance

Minerals are a major source of income in Africa’s resource-rich countries: Economic rents from oil and mining average around 28 percent of GDP, and natural resources make up over 77 percent of total export earnings and 42 percent of government revenues.

Recent mineral discoveries in several countries hold the prospect of large resource rents for these countries as well.

The challenge for the newly resource-rich countries will be to harness natural resource wealth for growth and development and improve on the performance of traditional mineral exporters.

Strong mineral governance—quality of public institutions, checks and balances on politicians and powerful interest groups, effectiveness of the state in providing public goods, and the regulatory environment for economic activity—will be key to avoiding the pitfalls of resource wealth and fostering economic growth.

HOW RESOURCE DEPENDENT ARE AFRICAN ECONOMIES?

SIZE OF THE NATURAL RESOURCE SECTOR

The economic size of the extractive sector—oil, gas and mining—is large in many African countries, and this sector is a major source of income in these countries. Its economic importance also means that the sector is central to the economic development of these countries. Economic rents from minerals (oil, gas and mining) in Sub-Saharan Africa were over $169 billion in 2010, out of a world total of $2.43 trillion.¹ In the two largest oil producers, Nigeria and Angola, the combined size of these rents was over $100 billion, and in four other countries rents were over $5 billion a piece (Figure 11).

Resource rents are large in comparison to the size of the economy. In 2010, 18 countries had mineral rents larger than 5 percent of GDP (Figure 12).² These countries are benefiting from high prices for their resources, new investment and new discoveries. Natural resource rents in the extractive sector average around 28 percent of GDP. Rents are higher in resource-rich oil countries: 34 percent of GDP compared to 21 percent of GDP in non-oil resource-rich countries. Oil-rich Republic of Congo has the highest size of rent relative to GDP (62 percent), and Mauritania leads the resource-rich mineral countries with 54 percent of GDP. Of course, there is much variation in the size of these rents across the region: for example six countries have rents that are less than 10 percent of GDP, four countries have rents between 10 to 20 percent of GDP, and the remaining eight countries have rents greater than 20 percent of GDP.

¹ Resource rent is the difference between revenue and cost of extraction.
² For purposes of this analysis, Angola, Cameroon, Chad, Republic of Congo, Cote d’Ivoire, Equatorial Guinea, Gabon, Nigeria, and Sudan (pre-independence of South Sudan) are classified as resource-rich oil countries and Botswana, Democratic Republic of Congo, Ghana, Guinea, Mali, Mauritania, Mozambique, Namibia, and Zambia are classified as resource-rich non-oil countries.
The oil-rich economies tend to be less diversified and, therefore, more dependent on the extractive sector than other mineral-rich countries. For example, mining value added accounted for an average of 42 percent of GDP in oil-rich countries and only 16 percent in non-oil mineral-rich countries in 2010. There are, nonetheless, some variations within oil-rich countries, with Equatorial Guinea having the highest dependency at 92 percent and Cameroon one of the lowest at 11 percent of GDP (Figure 13).

The dependence of government revenues and export earnings on natural resources is likewise large in resource-abundant countries, and has been increasing. Government revenues from natural resources—a combination of tax and non-tax payments, including royalties and profit sharing—accounted, on average, for 45 percent of total general government revenues in resource-rich countries in 2011 (Figure 14). The average for oil-rich countries was much higher at 60 percent of total general government revenue. At 77 percent of total merchandise exports (2011), the contribution of natural resources to export earnings is likewise very high (Figure 15).

The economic importance of natural resources is likely to persist in the near and medium term in several established oil and mineral producers, thanks to the sizeable stock of resource wealth and the prospects of continued, high commodity prices. According to Paul Collier⁴ (2012), current African resource reserves may be underestimated given the fact that less investment

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⁢ Other minerals excludes oil and gas but includes bauxite, copper, iron ore, gold, lead, nickel, phosphates, silver, tin, and zinc. Diamond resource is not included and therefore Botswana, Namibia, and Sierra Leone are underestimated.

⁴ “Managing natural resources to ensure prosperity in Africa.” Speech at UONGOZI Institute in Dar es Salam Tanzania in February 28, 2012. Africa has currently $23,000 per square km worth of subsoil assets compared to Europe’s $125,000.
in exploration has taken place on the continent compared to other regions. The region’s established oil producers represent less than 10 percent of the share of global reserves as well as annual production. Nigeria, the largest regional producer, can keep supplying at 2011 levels for another 41 years, while Angola, the second largest producer in the region, has about 21 years remaining at current production levels before its known reserves are depleted (Figure 16). Given the size of these reserves, it is likely that the dependence on oil resources in these countries is likely to continue in the near to medium term. Production in newly oil-rich countries such as Ghana and Uganda could also last for several years.

African countries share in global reserves and annual production of nonfuel minerals is sizeable as well. In 2010, Guinea alone represented over 8 percent of total world bauxite production; Zambia and the Democratic Republic Congo have a combined share of 6.7 percent of the total world copper production; and Ghana and Mali together account for 5.8 percent of the total world gold production.

There has been a recent spate of mineral discoveries in Africa, thanks to advances in technology and increased investor interest. New discoveries of oil, gas and other minerals in the region hold the promise of substantially augmenting countries’ resource income. Ghana’s Jubilee oil field, which was discovered in 2007, came on line in December 2010. When it reaches peak production in 2013, Jubilee will produce 120,000 barrels of oil per day. Other discoveries are moving forward towards development and these could take total production to 200,000 barrels per day by 2020. Uganda’s fields in the Lake Albert Rift basin discovered in 2006, if developed for export, could produce 150,000 barrels per day or more. Both countries could generate over $2 billion in annual government revenues in the 2020 timeframe even at conservative world oil prices of $80/barrel.
Recent findings of natural gas in Mozambique (estimated at 124 trillion cubic feet) and Tanzania (estimated at 28 trillion cubic feet) could yield $10 billion and $2 billion in annual government revenues, respectively, when market demand is sufficient to allow development of all discovered reserves. This could be two decades hence. Also, Mozambique just had its first year of new coal production in the Tete province, which is projected to reach 100 million metric tons in a decade. This is estimated to add another $2 billion to fiscal revenues by 2020. In Sierra Leone, mining of the Tonkolili deposits, which are estimated at 10.5 billion tons of iron ore, is boosting the country’s output and exports—GDP is projected to grow by 25 percent in 2012 compared to around 5 percent in 2011.

**ECONOMIC PERFORMANCE AND THE RESOURCE CURSE**

**ARE NATURAL RESOURCES BAD FOR GROWTH?**

An issue that has dogged the development prospects of resource-rich countries is whether resource wealth is bad for growth and development. The argument is that developing countries with resource wealth often grow more slowly than their non-resource-rich counterparts—the so-called resource curse. The resource curse literature has identified four economic channels through which resource abundance hurts a country’s growth. The foremost channel is declining terms of trade—namely, that commodity exporters face a secular decline in the relative price of their products. The second is the phenomenon of “Dutch Disease,” where a boom in the resource sector lowers the competitiveness of the manufacturing and non-resource export sector through an appreciation of the exchange rate and through an increased demand for labor and capital, which pushes up production costs in the economy. The third channel is volatility in international commodity markets and associated large fluctuations in prices, with this volatility transmitted to fiscal and external balances and with implications for macroeconomic management. And lastly, the weak backward and forward linkages of the resource sector with other parts of the economy. Empirical studies in the 1980s and 1990s found evidence that suggested a negative effect of resource wealth on economic growth. Sachs and Warner (1995) covering 97 countries over 1971-89 found that natural resource exporters grew at appreciably lower rates than other countries, even when controlling for other factors influencing growth.

More recent work, embodying better data and methodology, suggests that there is little evidence to support the notion of a resource curse. Lederman and Maloney (2009) argue that the data (net resource exports instead of resource exports) do not support the stylized fact of slow growth in resource-rich countries. Instead, the evidence points to heterogeneity in countries’ growth performance: some resource-rich countries perform poorly compared to non-resource-rich countries, others do not. This and other studies also find that the standard channels through which the resource curse operate may not exist or these channels are applicable to other sectors as well. For example, prices of individual commodities do not show signs of a declining long-run term, thanks to the sustained strong demand for commodities from fast-growing emerging markets.

The global economic importance of Africa in oil & other minerals will persist in the near and medium term.
and the relative scarcity of natural resources. Consequently, empirical results do not link the terms-of-trade effect as a main channel for the resource curse. Also, empirical evidence does not find that a boom in the resource sector has systematically created labor and capital shortages in other sectors, thereby, pushing up production costs in those sectors.

A larger issue for resource-rich countries, however, is why governments in these countries have not undertaken appropriate policies to transform resource wealth into sustainable development. With increasing recognition of the centrality of institutions—economic, legal, political and social—for development, the debate on transforming resource rents to riches has turned to understanding how institutions and natural resources interact and how institutions and governance can explain policy failure.

ECONOMIC PERFORMANCE OF AFRICA’S RESOURCE-RICH COUNTRIES

A comparison of the growth performance of resource-rich and non-resource-rich countries between 1980-2010 yields mixed results. Weak output growth in the 1980s led to a virtual stagnation in per capita GDP growth rate for both sets of countries (Figure 17). There was an uptick in growth in the second-half of the 1990s, but not for oil exporters. Overall, resource-rich countries were not able to harness resource wealth for growth in these two decades. The pattern that emerges in 2000-10 is markedly different: growth is higher in all groups, with oil-rich countries leading. The most recent data do not find evidence of stagnation and slow growth in resource-rich countries. On the contrary, it shows that these countries have benefited from a better policy environment and rising commodity prices. The latest growth performance of resource-rich countries coincides with the natural resource price boom that began in the early 2000s. For example, the average annual percentage change in crude oil price was -2.9 in 1980-1989, 2.1 in 1990-1999, and 17.5 in 2000-10.

Along with the magnitude, the quality of growth in oil-rich countries has improved. From volatile and negative growth rates in 1980-1999, oil-rich countries achieved positive and sustained growth in the last decade. While the countries exhibited very similar growth as a group from 1980 to 1999, more recent periods have seen greater divergence. Angola and Equatorial Guinea have emerged as fast-growing countries with annual average growth rates above 7 percent. Cameroon, Sudan, and Nigeria have followed with average growth rates of 3-6 percent. By contrast, Cote d’Ivoire and Chad are either at levels not much different from earlier periods or are worse off.

Established oil and mineral producers have seen little diversification and structural transformation of their economies. In fact, mining value added as a percentage of GDP has actually increased in most resource-rich African countries. In Chad, Equatorial Guinea, and Sudan this share has ballooned from less than 1 percent in 1980 to 44, 92, and 15 percent, respectively in 2010. This increase is driven by both new discoveries and investment in the mining sector. The exceptions are Namibia and Zambia, where the share of mining value added in GDP has declined from 38 and 19 percent in 1980 to 15 and 7 percent, respectively in 2010.
Revenues from resources provide governments with an opportunity to invest for development. In order to have a lasting impact on sustainable development, mineral resource revenues would need to be saved and invested in building human capital and other form of assets to compensate for the depletion of these resources. The issue is whether mineral-rich countries have made effective use of natural resource windfalls. The conventional measure of savings—national net saving—fails to adequately measure how well these countries have done in terms of building total wealth, and a more appropriate measure, called “genuine savings,” is needed. As an approximation, consider an adjustment to net savings that deducts the extraction of minerals and environmental depletion and adds investment in human capital. Using this concept of adjusted saving, how well are these countries doing in terms of building total wealth? While all the resource-rich countries have positive national net saving, the same cannot be said about genuine savings (Figure 18). For example oil-rich Angola and Sudan have both negative genuine saving, indicating that, despite their large inflows of resource windfalls, they are far from being able to build other productive capital. On a positive note, Botswana, Ghana and Namibia have genuine savings that are larger than conventional savings.

The ramping up of public investment in resource-rich countries has drawn added scrutiny to the quality of investment. According to the Public Management Index, which measures (on a scale of 0-4, with 4 the highest) the quality of the public investment process across the stages of project appraisal, selection, implementation and evaluation, the region’s resource-rich countries post fairly low scores: most countries fall within a score of 1-2. Non-oil mineral-rich countries do better than the oil-rich countries in terms of the efficiency of investment decisions from project appraisal to implementation. Better management of public investment is likely to lead to better returns on investment and outcomes. The scope for strengthening this capacity remains large in these countries.

Performance on poverty and inequality is likewise mixed. Although resource-rich countries have seen a strengthening of economic growth over the past decade...
or so, poverty rates have fallen slowly. Some countries such as Angola, Republic of Congo and Gabon have actually witnessed an increase in the percent of the population living in extreme poverty. Overall, the decline in poverty rates in resource-rich countries has generally lagged that of the region’s non-resource rich countries. Income distribution remains highly unequal in most countries in the region. Data for 1998-2008 for 12 resource-rich countries show that the share of the poorest 20 percent of the population in income is only about 6 percent, comparable to that for non-resource-rich countries. To a large extent, the benefits of growth have not reached the poorest segments of society (Figure 19).

These countries generally perform weakly on human development outcomes as well. Thus, even though more than half of the 18 resource-rich countries have middle-income status, resource-rich countries often do not have better outcomes on education and health than the regional average. Indeed, many of the resource-rich countries score at the bottom of the Human Development Index. The Democratic Republic of Congo has the lowest rank at 187, closely followed by Mozambique and Chad at 184 and 183 respectively. Nigeria and Zambia are among the resource-rich countries that are in the lowest quintile by rank.

WHY MINERAL GOVERNANCE MATTERS

As the role of institutions in economic development is recognized, there is an increased focus on quality of institutions and governance. Institutions—the formal and informal rules of the game—provide incentives that motivate (or discourage) certain kinds of activities. For example, institutions may promote corruption and rent-seeking, favor powerful interests groups or elites at the expense of the collective welfare, or foster investment and competition. Clearly, the quality of institutions matters. Governance refers to key aspects of institutions such as the process of policymaking, the checks and balances on politicians and powerful interest groups, the effectiveness of the state in providing public goods, and the regulatory environment for economic activity (Acemoglu, 2008).

The standard dimensions of governance are well-known: rule of law, transparency, lack of corruption, accountability, voice and participation, and effective government. Governance has implications for policymaking. Weak governance environments will likely lead to suboptimal policies for resource extraction and for collection and allocation of resource rents. For example, without the rule of law, mineral extraction becomes a “winner-take-all” scramble of resources, as experienced with diamonds in Central African Republic. In turn, this could lead to conflict and prolonged stagnation. Large rents amplify the importance of generation, allocation and distribution of rents, all areas for which governance matters. Increasingly, the political economy context is viewed as being important to determining outcomes. Less political inclusiveness, i.e. inclusiveness of diverse groups and views, will result in less collectively oriented outcomes and will benefit political and economic elite interests.

Transparency and accountability—two key pillars of governance—are hugely important in resource-rich countries. With large resource windfalls, limited technical capacity, and weak checks and balances, the scope for inefficiency, corruption and elite capture of rents is likely to be rampant. Transparency provides information on important aspects of resource management—from exploration to extraction to collection of rents and to distribution of these rents. Availability of such information raises citizens’ awareness of size of resource wealth and who is benefiting from it. It also allows citizens to monitor the actions and performance of their public officials, and it facilitates debate and consensus-building on how to manage resource wealth. Transparency is also central to building accountability of policymakers and for supporting checks and balances. Transparency and accountability, in turn, provide a foundation for building citizens’ confidence and trust in their government.
For resource-rich countries, a useful approach is to identify and address the governance challenges and constraints that are most closely linked to transforming resource wealth into development progress. A value chain approach for natural resource management shows how rents flow through the value chain, the relationship between the state, firms, and society along the chain, and how decisions are made (Alba, 2009 and Barma et al, 2012). The three key areas of natural resource management embodied in this approach are: (i) extraction – transparency regarding terms of contracts; (ii) taxation – efficiency in tax collection; and (iii) investment of resource rents – careful prioritization of public investment (Figure 20). By introducing the political economy dimension into the value chain, the governance, institutional and capacity issues that have a bearing on transforming resource riches to development progress can be analyzed. In short, one can gain an understanding of how resource management is determined by the political context and what type of institutional solutions are needed to address the political economy problem.

GOVERNANCE IN AFRICAN COUNTRIES

The World Governance indicators provide some measure of how well African countries do along various dimensions of governance. These indicators show that oil-rich countries systematically perform worse than other country groups in terms of voice and accountability, political stability, rule of law, and the control of corruption (Figures 21 and 22). This pattern has persisted over time. In the areas of rule of law and control of corruption, oil-rich countries are much more homogenous than in political stability and voice and accountability. Among this group, Chad and Sudan are the worst performers, and they have seen little improvement in their governance indicators scores during 2000-10. The overall much stronger performance of non-oil mineral-rich countries on these dimensions of governance is largely due to Botswana and Namibia.
The overall results on quality of governance are not surprising. In rentier states, where governments are heavily dependent on resource rents for revenues, and not on direct taxation of citizens, the accountability chain between citizens and governments can be weak. Also, natural resources abundance can be associated with weak checks and balances because the generation of large rents motivates political elites and powerful private actors/groups to capture these rents for the benefit of a few over the common economic interest.

International norms and standards that promote transparency in the natural resource sector can help to strengthen governance in this sector. A case in point is the Extractive Industries Transparency Initiative (EITI), a multi-stakeholder initiative comprising governments, companies, civil society groups, investors and international organizations, which is focused on improving transparency and accountability in the extractives sector. The EITI provides an internationally-recognized framework for public disclosure by mining companies and governments of what they pay and what they earn respectively. The initiative, which is voluntary, leaves implementation to countries that sign on to the initiative. The Publish What You Pay initiative, which requires mandatory disclosure of payments, has supported the EITI. These mechanisms are helping to support advancements in transparency in the region. Out of 36 countries that are now part of EITI, 19 are African: Eight countries—Central African Republic, Ghana, Liberia, Mali, Niger, Nigeria, and, most recently, Zambia—are compliant with all requirements of the EITI. The recently passed rule requiring U.S.-listed oil, gas and mining companies to publish at the project-level payments to government will provide added transparency.

Some have argued (Moss 2011 and Devarajan et al, 2011) that a possible way to strengthen the accountability chain and reduce leakages and inefficiencies in the provision of services is to provide direct cash transfer of oil rents to citizens (Box 1).

**BOX 1**

**Direct distribution of oil revenues: A policy option in resource-rich countries of Africa?**

Oil-rich countries do not need much external financing and also rely less on revenue raised by taxing their citizens. As a result, these countries can be stuck in a vicious circle of low accountability of government and weak monitoring of public spending that leads to poor service delivery and increased poverty, which in the end maintains low taxes. Providing direct cash transfer to citizens or a universal cash transfer is a possible way of reducing leakages and inefficiencies in the provision of public services (Moss 2011 and Devarajan et al. 2011).

A direct cash transfer of oil revenues, i.e. akin to a dividend, has the obvious benefit of increasing citizens’ disposable income. An added benefit is that it increases citizens’ knowledge of the amount of oil resources (which are often not publicly known), which in turn increases their interest in monitoring the distribution, use and management of these resources. Moreover, if this income is taxed, it would provide citizens with a greater incentive to hold their governments accountable for management of these taxes. Strengthening the demand side of accountability, in turn, could have the desired effect of making resource dependent governments responsive to their citizens’ needs.

Thus, transferring resource revenues as dividends directly to citizens is one possible way to improve transparency of resource revenue management because it creates an incentive to tax, improves accountability, and is good for national cohesion and good for the poor. Of course, care needs to be exercised in setting the tax rate. In a simple model of public and private decision-making, Devarajan et al. (2011) show that once the tax rate passes a certain threshold, citizens’ disposable income is reduced to a level where they lose interest in monitoring public investments. Hence accountability will decrease. Another additional benefit of a uniform and universal cash transfer is the potential for it to strengthen national unity. In countries where ethnic, religious or tribal tensions exist, a universal direct transfer to all citizens could be an additional source of national identity and pride.

The feasibility of, or constraints to, such a cash transfer scheme will depend on both technical—lack of skilled staff, identification of beneficiaries, mechanisms for transferring funds—and political economy issues (patronage politics of major infrastructure projects). First, the political will to redistribute oil revenues and set up a taxation scheme should be relatively high for such a program to be effective. Second, there remains a risk that the government misappropriates some of the redistributed funds. And finally, creating a taxation scheme can induce transaction costs, which might be too high in the country.
Natural resource funds are becoming more widespread in Africa. Resource-rich countries are establishing funds to manage resource windfalls in the context of both volatility and exhaustibility of revenues. The broad economic goals of these funds are to: (i) insulate government budgets and spending from commodity price swings and support spending in the event of adverse shocks; (ii) invest in priority projects to facilitate growth; and (iii) save for the future, transferring wealth across generations or time. A key reason for the increase in these funds is to also reduce the scope for corruption by reducing the size of the rents country elites have to fight over.

While natural resource funds can in theory minimize some of the risks associated with the resource curse, their success depends on the type of rules for their management and the implementation of these rules. Studies show that good governance is central to the effectiveness of these funds in meeting their goals (Dixon and Monk, 2011 and Humphreys and Sandbu, 2012). In designing funds in countries with weak governance, it is important to understand the political incentives of policy makers and to incorporate institutional arrangements—such as withdrawal rules, representation in decision-making, and transparency—that overcome the political economy problem.

Over half of the 18 countries that we identify as resource-rich in Sub-Saharan Africa have natural resource funds: Angola, Botswana, Cameroon, Republic of Congo, Democratic Republic of Congo, Equatorial Guinea, Gabon, Ghana, Mauritania, and Nigeria. The goals of the funds vary. For example, Botswana’s Pula Fund is explicitly for intergenerational saving and public investment, while Mauritania’s resource fund is for macroeconomic stabilization. Little is known about the governance, particularly the fiscal rules and accountability mechanisms, of many of the funds in the region. For example, only Botswana, Gabon and Sudan publish at least yearly information on fund assets and transactions.

Source: Revenue Watch Institute, 2010; and Sovereign Wealth Institute, 2012.
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