



## ECA POLICY BRIEF

### Macroeconomic policies to promote economic recovery in Africa<sup>1</sup>

#### Summary

As has been the case in other parts of the world, the COVID-19 pandemic has disrupted lives and livelihoods across Africa and has had a significant negative impact on African economies. Projections by the Economic Commission for Africa (ECA) indicate that the real gross domestic product (GDP) of Africa will contract by between 1.8 and 5.4 per cent in 2020. African Governments, with the support of development partners, have therefore mobilized resources and implemented measures to cushion households and businesses from the adverse impact of the pandemic. This policy brief provides an overview of the economic impact of the COVID-19 pandemic and of how fiscal stimulus packages could facilitate the continent's economic recovery. The findings suggest that Africa will require financial assistance of at least \$100 billion in 2020 to avert a recession. Specifically, findings have revealed that: (a) the financial stimulus announced by African Governments, which total approximately \$104.5 billion, equivalent to some 4 per cent of the continent's GDP in 2019, could enhance GDP growth by up to 6.7 percentage points; (b) delaying the roll

out of stimulus packages by a year could cost the continent as much as 3.8 percentage points in lost GDP by 2021; (c) strong economic governance will help ensure that resources are used efficiently; and (d) although stimulus packages will at first exacerbate debt burdens, the rate of increase in the continent's debt-to-GDP ratio will slow as stimulus packages promote GDP growth.

Policy measures to mitigate the adverse impact of the pandemic and strengthen economic recovery should include measures to: enhance countries' health-care systems; facilitate the mobilization of domestic resources; prioritize the use of concessional financing; encourage the use of innovative lending tools, such as the proposed liquidity and sustainability facility; strengthen governance and ensure implementation of the recommendations of the ECA and African Union High Level Panel on Illicit Financial Flows; leverage innovative financing for development mechanisms; strengthen the African Continental Free Trade Area; and encourage countries to invest in digital technologies.

#### Introduction

In addition to its debilitating health-related repercussions, the COVID-19 pandemic is now having a significant impact on both advanced and developing economies, with long term implications in terms of debt distress, rising unemployment and poverty levels, deepening inequality and social unrest. Lockdowns, imposed by governments around the world, have resulted in significant slowdowns in nearly all economic sectors, putting pressure on both

<sup>1</sup> This policy brief was prepared by the Macroeconomic Analysis Section led by Hopestone Kayiska Chavula, Officer-in-Charge of the Section, in the Macroeconomics and Governance Division of the Economic Commission for Africa (ECA) under the overall guidance of Bartholomew Armah, Director of the Division.

domestic and global value chains. In a recent study, ECA found that, on average, businesses in Africa were operating at only 43 per cent of their capacity during the early stages of the COVID-19 pandemic, and calculated that a month-long full lockdown across Africa, imposed to halt the diffusion of the virus, could cost the continent some 2.5 per cent of annual GDP.<sup>2</sup>

The pandemic has significantly reduced incomes and exacerbated unemployment. Furthermore, the International Labour Organization (ILO) has estimated that global hours worked could have dropped by 10.7 per cent in the second quarter of 2020, equivalent to a loss of 305 million full-time jobs.<sup>3</sup> The corresponding figure for Africa is estimated to be 9.5 per cent, which is equivalent to a loss of nearly 40 million full-time jobs. The impact of the pandemic on unemployment and underemployment is projected to be higher than the impact observed during the global financial crisis of 2008–2009. The full extent of job losses will, however, depend on how quickly the global economy recovers from the pandemic.

In line with the above projections and developments, real GDP in Africa may contract by as much as 5.4 per cent in 2020 as a result of decreasing economic activity, weakened trade, disruptions in supply chains, a dip in development financing, a decline in overall demand and a slump in key global commodity prices, including the price of oil.<sup>4</sup>

The global fiscal response to the crisis has been huge and includes a fiscal stimulus by advanced economies of over \$9 trillion. Notwithstanding their relatively limited tools and fiscal space, African Governments have also spared no effort in responding to the pandemic. They

have enacted a range of fiscal and other policy measures, including lockdowns, social distancing mandates, tax breaks, interest rate cuts and fiscal stimulus packages totaling some \$104.5 billion, with almost \$44 billion of that amount mobilized from African countries' domestic reserves. South Africa and Egypt have earmarked the most resources to address the negative repercussions of the pandemic, authorizing fiscal stimulus packages of \$26 billion, and \$6 billion, respectively. The present policy brief, which draws on a recent report by ECA entitled "Macroeconomic policies for early recovery",<sup>5</sup> summarizes available data and sets out a number of policy recommendations for consideration by African decision makers that could facilitate the continent's economic recovery.

## Impact of fiscal stimulus measures on growth

The Africa-wide macroeconomic model developed by ECA was used to formulate optimistic, less optimistic and pessimistic scenarios with regard to the impact of fiscal stimulus measures on the continent. The optimistic scenario envisages a 20 per cent decline in employment in 2020, in addition to a 10 per cent decline in external demand, a decline in government revenue of some 15 per cent, a 5 per cent reduction in non-oil commodity prices and an average oil price of \$40 a barrel. The less optimistic scenario envisages a 30 per cent decline in employment, a 12.5 per cent decline in external demand, a decline in government revenue of approximately 20 per cent, a 10 per cent reduction in non-oil commodity prices and an average oil price of \$35 a barrel. The pessimistic scenario envisages a 40 per cent decline in employment in 2020, a 17.5 per cent decline in external demand, a 15 per cent reduction in non-oil commodity prices and an average oil price of \$30 a barrel.

Findings by ECA suggest that the continent requires a fiscal stimulus package of at least \$100 billion in 2020 to avert a recession. The effectiveness of that stimulus will depend on the timeliness of disbursements, the severity of the pandemic and the capacity of existing governance mechanisms to minimize financial leakages and ensure that financial assistance reaches its intended beneficiaries. The

2 ECA, COVID-19: Lockdown exit strategies for Africa (Addis Ababa, May 2020). Available at: [www.uneca.org/sites/default/files/uploaded-documents/Global-Debate-Africa-COVID-19-Lockdown-Exit-Strategies/eca\\_analysis\\_-\\_covid-19\\_lockdown\\_exit\\_strategies\\_for\\_africa.pdf](http://www.uneca.org/sites/default/files/uploaded-documents/Global-Debate-Africa-COVID-19-Lockdown-Exit-Strategies/eca_analysis_-_covid-19_lockdown_exit_strategies_for_africa.pdf). (accessed on 23 November 2020).

3 ILO, ILO Monitor: COVID-19 and the world of work, 4th ed. (Geneva, 27 May 2020). Available at: [www.ilo.org/global/topics/coronavirus/impacts-and-responses/WCMS\\_745963/lang-en/index.htm](http://www.ilo.org/global/topics/coronavirus/impacts-and-responses/WCMS_745963/lang-en/index.htm) (accessed on 23 November 2020).

4 ECA, Macroeconomic impact of COVID-19 on Africa: evidence from the Africa-wide aggregate macroeconomic model (forthcoming).

5 ECA, Macroeconomic policies for early recovery in Africa (forthcoming).

findings also reveal that, although stimulus packages will increase debt burdens in the short term, those debt burdens will diminish as growth picks up in the medium term.

### The growth effects of the stimulus

In the optimistic scenario, financial stimulus measures will facilitate real GDP growth in Africa of 2.8 per cent in 2020. This is 4.6 percentage points higher than the baseline no-stimulus growth rate of -1.8 per cent, and is equivalent to a \$128.1 billion increase in real GDP. Alternatively, the stimulus can be seen as generating a 22.5 per cent return on investment.

In the less optimistic scenario, the financial stimulus will promote real GDP growth of 2.3 per cent in 2020, an improvement of 5.6 percentage points relative to the baseline no-stimulus growth rate of -3.3 per cent. The additional growth generated by the stimulus translates into \$156.3 billion in real GDP, which is some 50 per cent more than the overall cost of the stimulus measures, namely \$104.5 billion. In effect, the stimulus generates a 50 per cent return on investment.

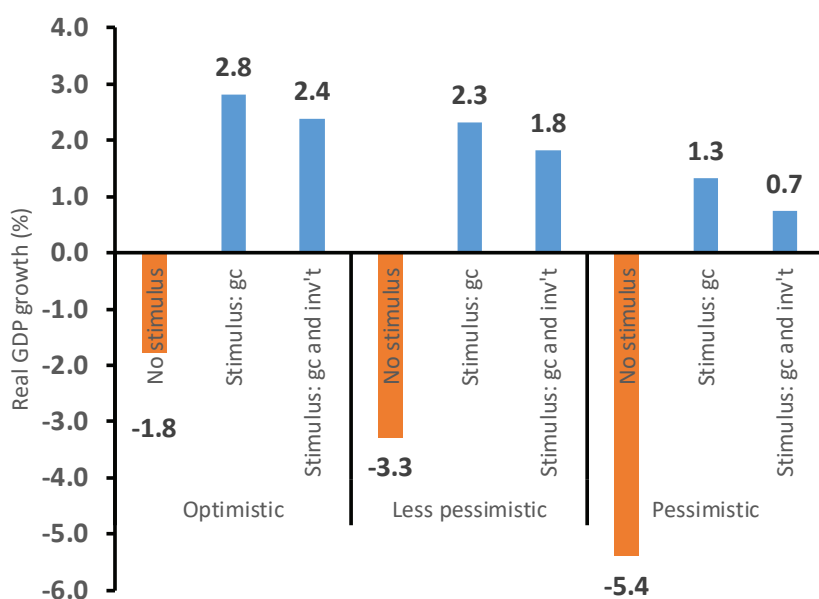
In the pessimistic scenario, the continent will experience a contraction in GDP of some 5.4 per cent in 2020 without the adoption of stimulus measures. The financial stimulus offsets that contraction, however, and actually leads to positive growth in GDP of 1.3 per cent in 2020, thereby averting a recession and generating approximately \$188.5 billion in GDP, which is some 80 per cent more than the overall cost of stimulus measures. In effect, the stimulus generates an 80 per cent return on investment.

The three scenarios are illustrated in figure I, below.

### The growth benefits of timely interventions

Although the size of stimulus packages are important, timely fiscal responses magnify their impact on growth and can have positive spillover effects on health expenditure and outcomes. As illustrated in figure II, delaying the disbursement and use of the fiscal stimulus by until 2021 could cost the continent 3.8 percentage points in lost GDP growth in 2020–2021. That loss, equivalent to some \$100 billion in GDP, is almost equal to the cost of the entire stimulus package and would therefore render it ineffective.

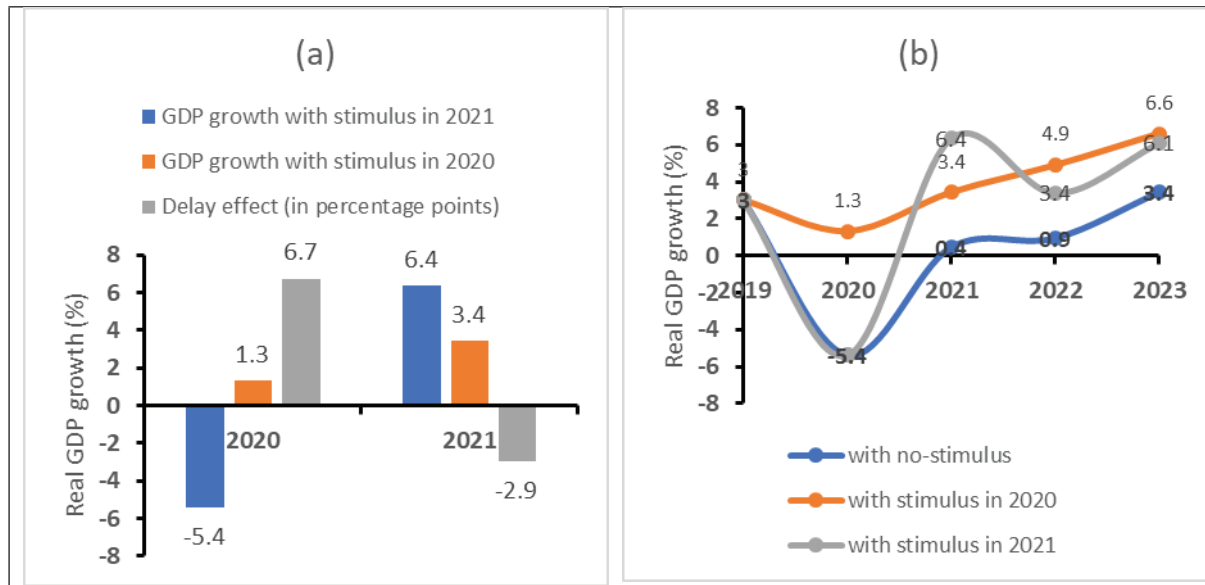
**Figure I: Real GDP growth in Africa with and without the implementation of financial stimulus measures, 2020 (optimistic, less optimistic and pessimistic scenarios)**



Notes: gc=government consumption; inv't=investment.

Source: ECA, Macroeconomic impact of COVID-19 on Africa: evidence from the Africa-wide aggregate macroeconomic model (forthcoming).

**Figure II: Impact on real GDP of a delay in the implementation of fiscal stimulus measures until 2021**



**Source:** ECA, Macroeconomic impact of COVID-19 on Africa: evidence from the Africa-wide aggregate macroeconomic model (forthcoming).

### The growth effects of good governance

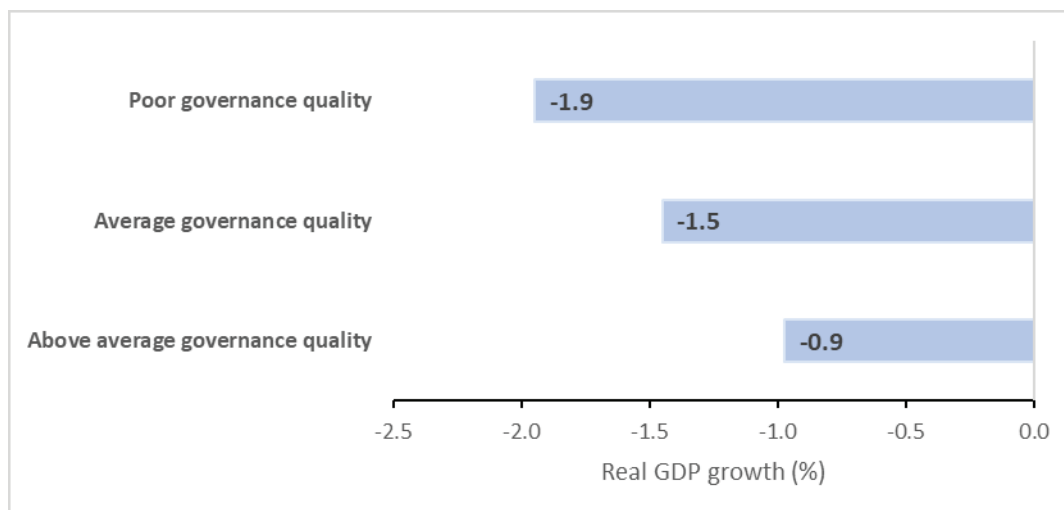
As many financial oversight mechanisms in Africa remain weak, it is safe to assume that not all of the \$104.5 billion stimulus package will reach its intended beneficiaries. The impact of fiscal stimulus measures on growth is therefore likely to vary depending on the strength or weakness of a country’s governance architecture. As illustrated in figure III, even in countries with relatively strong governance mechanisms, real GDP growth is likely to be 0.9

percentage points lower than it would be in the absence of corruption. In countries with particularly poor governance mechanisms, growth may decline by as much as 1.9 percentage points.

### Impact of policy responses

In the short term, a fiscal stimulus is likely to increase the fiscal deficit and debt levels. Those effects are, however, offset by an increase in real GDP growth. The initial increase in many countries’ deficit-to-GDP

**Figure III: Corruption-related reductions in real GDP (per cent), in countries with poor, average and above average governance**



**Source:** ECA, Macroeconomic impact of COVID-19 on Africa: evidence from the Africa-wide aggregate macroeconomic model (forthcoming).

ratio reflects increasing government spending, while subsequent increases result largely from increased debt service payments, assuming there is no debt standstill. In the medium to long term, however, those higher expenditure outlays are partly offset by an increase in real GDP growth rates.

Stimulus packages are likely to cause a slight deterioration in the continent's current account balance between 2020 and 2024, primarily because of rising imports and declining exports, remittances and foreign investment. The projected increase in imports is attributed to increased domestic demand fueled by the stimulus. On the other hand, the decline in export growth and financial flows is driven by a fall in external demand exacerbated by lockdown measures and related declines in economic activity in key export destinations, including China, European Union countries and the United States of America. A deterioration in a country's trade deficit will eventually exert pressure on its foreign reserves, leading to a depreciation in its currency and fueling domestic inflation.

## Policy recommendations for economic recovery

To facilitate the economic recovery of the continent, African policymakers should inter alia: invest in health-care systems; facilitate the mobilization of domestic resources; prioritize the use of concessional financing; encourage the use of innovative financing mechanisms in order to reduce borrowing costs and increase the scope of development financing; strengthen governance systems; promote implementation of the recommendations of the ECA and African Union High Level Panel on Illicit Financial Flows; leverage innovative financing for development mechanisms; strengthen the African Continental Free Trade Area; and promote investment in digital technologies.

### Invest in health-care systems

The COVID-19 pandemic has drawn attention to weaknesses in the continent's health-care infrastructure and services. Africa manufactures about 2 per cent of medicines used on the continent. The majority of Africans, and particularly the poor, rely on under-funded public health facilities while a minority enjoys access to well-funded, high quality private health-care services. Furthermore, no African country has fulfilled the commitment made by African

States in 2001 to allocate at least 15 per cent of their national budgets to health care.

### Prioritize the use of concessional financing and strengthen governance systems

The debt implications of the stimulus will depend on the financial resources allocated, the costs associated with mobilizing those resources and the governance architecture that underpins their use. It is therefore imperative that the duration and eligibility criteria of the Debt Service Suspension Initiative be revisited to broaden participation and the scope of that Initiative. It is also vital to engage credit rating agencies and private lenders in the Initiative in order to address credit downgrade concerns and maximize its debt relief impact, particularly as approximately one-third of the external debt of African countries is owed to private sector lenders.

Furthermore, strengthening governance systems regulating the use of stimulus funds and engagement with civil society and local communities will be instrumental in ensuring that resources are used effectively.

### Strengthen domestic resource mobilization and promote implementation of the recommendations of the ECA and African Union High Level Panel on Illicit Financial Flows

With declining foreign direct investment, increased capital outflows and plummeting remittances, domestic resource mobilization will become increasingly important in the continent's development financing landscape. However, tax collection as a share of GDP remains very low, with many countries recording tax collection ratios of less than 10 per cent. The experiences of Rwanda and South Africa suggest that reforming tax administration systems, using digitization and eliminating harmful tax provisions can lead to significant increases in tax revenue in Africa.

Implementing the recommendations of the ECA and African Union High Level Panel on Illicit Financial Flows is also crucial, particularly as illicit financial flows are estimated to cost the continent between \$50 billion and \$148 billion in lost revenues each year.

## **Encourage the use of innovative financing mechanisms in order to reduce borrowing costs and increase the scope of development financing**

African economies should identify and advocate for the mobilization of additional resources through innovative financing mechanisms, including: a new allocation of special drawing rights (SDRs) and the voluntary redistribution of SDRs from developed countries that are currently not using them to vulnerable and least developed countries; the proposed liquidity and sustainability facility, the creation of which would lower the cost of commercial financing to frontier and emerging markets through credit enhancements by Organization for Economic Cooperation and Development (OECD) countries; state-contingent debt instruments, such as GDP-linked bonds that could be used to hedge against external shocks; and debt and central bank currency swaps.

## **Strengthen the African Continental Free Trade Area**

The African Continental Free Trade Area is expected to spur structural transformation and strengthen

trade and economic development in Africa. By uniting its 55 fragmented economies into one continental economy, the Area will create a vast internal market and foster economic and industrial development across the continent.

## **Promote investment in digital technologies**

The COVID-19 pandemic has highlighted the important role of digital technologies in ensuring business continuity in an era of crisis. In an era of social distancing, digitization promises to sustain economic activity and promote job creation in areas such as e-commerce, e-health service delivery and e-learning. For this to happen, an enabling environment must be created to foster collaboration among private sector stakeholders and governments in order to increase Africans' access to affordable and reliable technology.

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