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AN ANALYSIS OF ISSUES SHAPING AFRICA'S ECONOMIC FUTURE

Executive Summary

TACKLING INEQUALITY TO REVITALIZE GROWTH AND REDUCE POVERTY IN AFRICA

THIS REPORT WAS PRODUCED BY THE OFFICE OF THE CHIEF ECONOMIST FOR THE AFRICA REGION

WORLD BANK GROUP

Executive Summary

GROWTH IS SET TO BOUNCE BACK IN SUB-SAHARAN AFRICA, BUT THE RECOVERY IS STILL FRAGILE

- After bottoming out at 2.6 percent in 2023, economic growth in Sub-Saharan Africa is expected to reach 3.4 percent in 2024 and 3.8 percent in 2025. The recovery is primarily driven by greater private consumption growth as declining inflation boosts the purchasing power of household incomes. Investment growth will be subdued as interest rates are likely to remain high while fiscal consolidation constrains government consumption growth. The contribution of the global economy to Africa's growth will remain modest. Expectations of monetary policy rate cuts in large global economies may stimulate investment growth in 2025.

Lower inflation is supporting the economic rebound in the region

- Inflation is cooling in most Sub-Saharan African economies but remains high. The median inflation in the region is projected to fall from 7.1 percent in 2023 to 5.1 percent in 2024 and 5 percent in 2025–26. The normalization of global supply chains, steady decline of commodity prices, and impacts of monetary tightening and fiscal consolidation are contributing to a lower rate of inflation in the region.
- Although inflation is receding in most countries in 2024, it remains high compared to pre-pandemic levels: inflation is projected to decrease in about 80 percent of African countries compared with 2023, but it is still higher than pre-pandemic levels in 32 of 37 countries. Moreover, 14 countries in the region still exhibit persistently high levels of inflation (two or more digits) this year—with a median inflation rate that has dropped modestly from 25.9 percent in 2023 to 24.8 percent in 2024.
- This mixed picture requires different monetary policy responses. A pause in monetary policy tightening might be warranted in countries with declining inflation that are close to or within the target range, while a combination of monetary tightening and fiscal consolidation will be essential for those countries with elevated inflation. Fiscal prudence is particularly recommended to avoid a resurgence of inflation in the many Sub-Saharan African countries that are holding elections this year.

The contribution of global drivers of growth remains subdued and uncertain

- The global engine of growth is slowly reactivating. In the second half of 2023, global activity remained resilient as stronger private and government spending sustained aggregate demand despite tight financial conditions. Greater labor force participation, the normalization of supply chains, and falling energy and commodity prices contributed to global economic activity amid uncertainties arising from geopolitical tensions and geoeconomic fragmentation. Still, headwinds to growth in advanced economies lie ahead this year. Global policy rates remain elevated, leading to tight credit markets—which could dampen private investment. Moreover, continued growth of household consumption may be restricted by a gradual depletion of the stock of excess savings that accrued during the COVID-19 pandemic. In China, subdued consumer sentiment, the risk of entrenched deflation, and persistent strains in the property sector limit the prospects for a return to the growth levels of the early 2010s.

Fiscal balances are improving but at a moderate pace

- Fiscal balances continue to improve, thanks to the fiscal consolidation measures underway in several Sub-Saharan African countries (for instance, Ghana, Kenya, and Nigeria). Debt restructuring negotiations provide an additional incentive for prudent fiscal management in Ghana and Zambia. The median fiscal deficit in the region is projected to decline modestly from 3.8 percent of gross domestic product (GDP) in 2023 to 3.5 percent of GDP in 2024. Although the fiscal balance is expected to improve in most countries in the region (31 of 46), their deficits still remain large: the median fiscal deficit of these 31 countries is projected to narrow from 4.8 percent of GDP in 2023 to 3.8 percent of GDP in 2024. Furthermore, the number of countries with large deficits (exceeding 3 percent of GDP) has dropped modestly, from a peak of 34 in 2022 to 27 in 2024. The vulnerability of African governments' fiscal positions to global shocks remains a challenge. Transformative policy actions to build fiscal buffers are essential to prevent and/or cope with future shocks.

Growing debt service obligations are creating liquidity problems and crowding out development spending

- Public debt in Sub-Saharan Africa is expected to decline from 61 percent of GDP in 2023 to 57 percent of GDP in 2024. However, the risk of debt distress remains high. More than half of the African governments grapple with external liquidity problems, face unsustainable debt burdens, or are actively seeking to restructure or reprofile their debts. Public debt service obligations have surged as governments in the region are exposed to market financing and non–Paris Club government loans. External borrowing is more expensive than it was prior to the pandemic despite sovereign spreads gradually declining from their peak in May 2023. For instance, the coupon of the new Eurobond issued by Kenya this February is 9.75 percent, compared to the 6.875 percent of the Eurobond maturing in 2024.

Growth headwinds are compounded by escalating conflict and violence

- Increased conflict and violence in the region will continue to weigh on economic activity. Although confined to small economies so far, military coups and the risk of coup contagion significantly impact international investor sentiment and the perception of risk toward the entire region. Tensions in West Africa have escalated with the decisions of Burkina Faso, Mali, and Niger to leave the Economic Community of West African States and Senegal's decision to delay elections. In Sudan, the resolution of the conflict between the Sudanese Armed Forces and the Rapid Support Forces through mediation may prove difficult. In Ethiopia, security remains uncertain as bouts of violence continue in the Amhara and Oromia regions.
- Persistent conflict and organized violence may disrupt production and access to food staples in several countries (Burkina Faso, Mali, Niger, and Somalia, among others). Food security problems are amplified by climatic shocks—as frequent droughts and floods are lashing Eastern and Southern Africa (Ethiopia, Kenya, Mozambique, Somalia, and Zambia). Disruptions of rainfall patterns, along with the black pod disease, are threatening cocoa production and the livelihoods of farmers in Côte d'Ivoire and Ghana. Moreover, factors like soil degradation, pests, and market fluctuations exacerbate the difficulties faced by agricultural communities. With an estimated 105 million people in the region potentially experiencing severe food insecurity as of March 2024, urgent and comprehensive agricultural interventions and support are imperative.

Renewed urgency around revitalizing growth is critical

- The pace of economic expansion in the region remains slow and insufficient to have a significant effect on poverty reduction. Growth per capita in Sub-Saharan Africa is set to accelerate from a modest 0.1 percent in 2023 to 0.9 percent in 2024 and 1.3 percent in 2025. However, the projected boost in economic activity remains well below the long-term growth rate. Indeed, the region has remained stuck in a low-growth trap over the past decade: if the region's growth rate maintained the pace of 2000–14 over 2015–26, real output per capita would be about one-third higher than its level at current growth rates.

TACKLING STRUCTURAL INEQUALITY TO REVITALIZE GROWTH AND ACCELERATE POVERTY REDUCTION

- Most countries in the region have been unable to sustain growth over the long term. Over the past six decades, the evolution of real GDP per capita can be characterized by long-term swings. Moreover, growth is volatile and unstable compared to that in advanced economies and other developing countries—particularly non-African upper-middle-income countries. This variability is especially troublesome when measured against the region's low average growth rate. Overall, countries in the region are unable to sustain longer expansions. In fact, Sub-Saharan Africa has shorter and weaker expansions relative to the rest of the world. Existing evidence suggests that the more egalitarian societies tend to sustain growth for a longer period of time.
- Economic growth reduces poverty in Sub-Saharan Africa less than in other regions, as measured by the growth elasticity of poverty. Per capita GDP growth of 1 percent is associated with poverty reduction of only 1 percent in the region, compared to 2.5 percent in the rest of the world. The low growth elasticity of poverty prevails even after controlling for initial differences in poverty, income levels, and inequality. Meanwhile, the limited poverty reduction in Sub-Saharan Africa since 2000 has been driven primarily by growth as opposed to distributional changes in income, making the limited impact of growth on poverty reduction especially concerning.
- High inequality in the region is largely structural and not simply the result of differences in individual talents or effort. Structural differences lead to accumulating disparities at three distinct stages. First, these disparities arise when people build their productive capacities, including in access to schooling and other basic services (the *pre-market* stage). Second, when people engage in productive activities, poorly functioning markets, distortions, and frictions can systematically limit certain groups' access to productive income-generating opportunities (the *in-market* stage). This limits market competition, increases the misallocation of resources, and undermines structural transformation and firm growth. Third, disparities can be exacerbated or redressed through taxes, social transfers, and subsidies (the *post-market* stage). Importantly, these stages are interconnected, with spillovers occurring from one stage to the other. For example, inequality in access to quality education will be compounded by labor market distortions or lack of competition, which could then be exacerbated by regressive taxes.
- Access to basic services remains highly unequal despite significant improvements in coverage over recent decades. Critically, inequality in access to services is heavily influenced by the circumstances into which a child is born, suggesting that structural inequalities are prevalent early in the pre-market stage. On average, a child's location accounts for around half of the structural inequality at the pre-market stage, especially in resource rich countries. Such pre-market structural inequalities are strong drivers of limited intergenerational mobility.

- Market imperfections and institutional distortions have the power to limit productivity and earnings. Firms and farms face pervasive credit constraints, with only about one in 10 firms with fewer than 19 workers relying on bank financing. Instead, most own-account workers and household enterprises rely on their own resources, resources from family and friends, or informal sources to start up their businesses. Similarly, access to product markets is constrained, which prevents firms and farms from scaling up their production. In particular, the lack of connectivity and market integration means that markets are segmented, allowing firms or farms with market power to capture benefits, contributing to income inequality. For instance, trade costs, including costs of transportation, are four to five times higher in Ethiopia and Nigeria than in the United States. Finally, frictions in the labor market prevent workers from accessing productive opportunities.
- Although taxes, transfers, and subsidies reduce inequality, they may not reduce poverty. The combined effect of taxes, transfers, and subsidies leads to a greater reduction in inequality in Sub-Saharan Africa than in non-African countries with comparable levels of income. However, the level of inequality after this fiscal effort is still higher than the pre-fiscal level of inequality in other regions. The poor often pay more in taxes than they receive in benefits, even if taxes are higher for the rich. Taxation policy tends to increase poverty rates in most African countries for which fiscal incidence analysis is available. Poorly targeted subsidies and limited social assistance do not compensate poor African households for the indirect taxes they pay, even after accounting for the fact that low-income households largely purchase goods in informal markets.

POLICY RESPONSES

Domestic resource mobilization and support from the international community can play a role in alleviating the region's funding squeeze

- The ability of African countries to finance their development and reprofile their debt is constrained by limited access to costlier external funding. Amid high levels of external debt repayments, as a result of high debt levels and elevated borrowing costs, some countries in the region may face temporary external liquidity pressures in 2024 and 2025. Increased domestic resource mobilization is critical to win back the country's policy space, channeling resources toward pro-growth public spending and addressing debt rollover risks. Strengthening tax administration, broadening the tax base, and improving the efficiency of public spending are essential. The international community can also play a role by providing more concessional financing to facilitate the implementation of structural reforms and supporting external debt management.

Tackling structural inequalities to foster growth and poverty reduction

- Structural inequalities in Sub-Saharan Africa require multisectoral actions—particularly policies to create a level playing field and enhance the productive capacity of the disadvantaged. Investments in human capital (foundational learning and nutrition) and strengthened local capacity for service delivery to underserved populations and regions can build people's capacity to seize market opportunities. Removing size-dependent distortions, improving justice service delivery, and boosting market access can support fairer and more thriving marketplaces. Implementing regional trade agreements, such as the African Continental Free Trade Area, and investing in more efficient and affordable transportation corridors present a unique opportunity to expand markets.
- Domestic revenue mobilization efforts can also be designed to protect the poor—through taxation of high-net-worth individuals via income and property taxes. Taxation of land and property can provide effective mechanisms to support local governments in the region. Digital technologies can help to broaden the coverage of property taxes. This would require digital record keeping that maximizes interoperability, facilitates updating of records, and allows regulatory oversight; transparency through public access to registry data; and integrated workflows to support record updating and tax enforcement. Eliminating value-added tax exemptions and reforming utilities (that is, addressing energy subsidies and reviewing water tariffs), which largely benefit high-income households, could also yield revenue—although they might be accompanied by mitigating measures to minimize the impact on the poor.
- Overall, the special focus of this issue of *Africa's Pulse* suggests that fiscal policy alone is insufficient to revitalize growth and accelerate poverty reduction. Policies to build assets and use them efficiently are critical for fostering inclusive growth.

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