

Unlocking Africa's Potential: Key Insights from the AfDB 2024 African Economic Outlook Report

OLANIWUN AJAYI (UK) LLP NEWSLETTER

INTRODUCTION

The African continent is a vibrant tapestry of 54 countries that is home to over 1.3 billion people across five regions: North, West, East, Central, and Southern Africa. Boasting the youngest population globally, Africa offers a vast labour force and consumer market. The continent's economy is abundant in natural resources, including significant deposits of minerals, oil, and natural gas, and it is witnessing rapid growth in the technology and innovation sectors.

In May 2024, the AfDB launched the African Economic Outlook 2024 with the theme: *Driving Africa's Transformation: The Reform of the Global Financial Architecture*. This newsletter explores some of the key themes from the AfDB report and provides insights into the implications for law and policy on the African continent.



Overcoming Challenges and Moving Ahead with Cautious Optimism

Despite global challenges that tested economies worldwide, African economies have shown considerable resilience. Although there was a lag in growth, there is cautious optimism for a rebound. High food and energy prices, weak global demand, and climate change impacts have contributed to slower growth.

Inflation and liquidity issues from pandemic-related policies have particularly made traditional monetary tools less effective. Additionally, most African currencies depreciated against the US dollar in 2023 due to various factors, including market corrections and debt restructuring.

The report notes that the average fiscal deficit increased slightly from 4.9 percent of GDP in 2022 to 5 percent in 2023 while average current account deficit is projected to widen from an estimated 1.7 percent of GDP in 2023 to 2 percent of GDP in 2024 and 2025.

Significantly, external financial flows to Africa, made up of foreign direct investment (FDI), official development assistance (ODA), portfolio investment and remittances, declined by 19.4 percent in 2022 to US\$ 174.9 billion from US\$ 217.1 billion in 2021. Although public debt is recorded to have declined with the average public debt ratio stabilizing at around 63.5 percent between 2021–23 from 64 percent in 2020, the ratio remains high in many countries where public finances have been volatile. By implication, resources channelled to debt service have eroded fiscal gains with tight pressure and constraints on governments' capacity to invest in transformational sectors and human capital development.



Real GDP growth of 3.7 percent is projected for 2024 and 4.3 percent in 2025.

Looking ahead, a real GDP growth of 3.7% is projected for 2024 and 4.3% in 2025, positioning Africa as the second fastest-growing region after Asia. The report significantly highlights the heterogeneous growth outlook across Africa's regions and economic groupings, including non-resource intensive economies, tourism-dependent economies, oil exporting countries and other (non-oil) resource-intensive economies. This reflects crucial differences in the structure of Africa's economies, commodity dependence, and the domestic policy responses deployed to mitigate the impact of shocks experienced since 2021.

The report notes that the forward-looking projections are based on the expectation that most of the factors that adversely affected African economies in the previous year will diminish.

In the same breadth, the AfDB cautions that while the economic outlook in Africa is promising, it must be carefully balanced against existing risks, uncertainties, and geopolitical tensions within the continent. Some

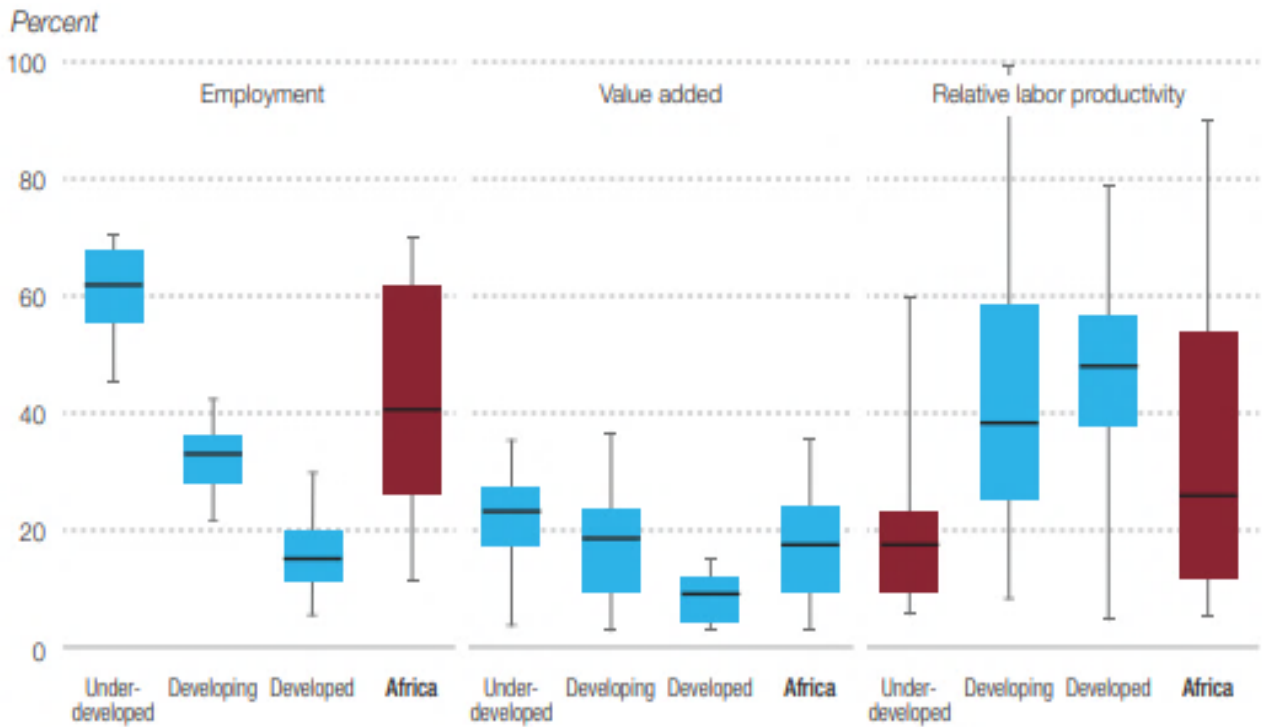
identified potential risks include a protracted gridlock in global trade and investment; higher commodity prices; increased regional conflicts and political instability; climate shocks; and persistent inflationary pressures in many African countries with far-reaching implications on private sector activity in countries with higher domestic borrowing costs.

Manufacturing and Beneficiation: Key to Africa's Structural Development



The 2024 AFDB report highlights the need for structural transformation in Africa, emphasizing the transition from low productivity, labour-intensive activities to higher productivity, skill-intensive sectors. Currently, many African countries are in the early stages of this transformation, with significant labour productivity gaps between agricultural and non-agricultural sectors.

Based on contribution to their sectoral employment, close to half (25) of African countries can be considered as structurally underdeveloped, with the agricultural sector accounting for a median of 61.9% of total employment in 2021. Africa's vast natural resources are underutilized and undervalued, leading to a significant underestimation of the continent's true wealth despite its rich assets. To drive economic transformation, expanding manufacturing capacity, diversifying agriculture, and enhancing mineral beneficiation are crucial.



Agricultural Employment, Value Added, And Relative Labor Productivity by Stages of Structural Transformation in Africa, 2021. (Source: AFDB Economic Outlook Report 2024)

The report also underscores the potential of a services-led growth model. With services becoming increasingly significant in Africa’s international trade, this approach offers unique opportunities- the scale and size of service firms, the high productivity potential of service firms regardless of their size, and the reduced reliance on physical capital in the services sector- when considered against the fact that trade numbers on the continent increased in value by more than fourfold between 2000 and 2022, from US\$66.4 billion to US\$269.4 billion.

The report advances the concurrent support for non-tradable services which are generally more labor intensive and less capital intensive and tradable services such as tourism, business, and finance, and ICTs.

Africa is currently focused on non-tradable services, but the strategic exploitation of tradable services can pull in foreign exchange revenues needed to finance transformation, improve public infrastructure and strengthen government functions.





But for Africa to strongly position itself for structural transformation, two conditions are crucial. First, institutions matter and only countries with well-defined and functioning institutions that invest in productivity-enhancing soft and hard infrastructure can transform their economies. Secondly, Africa will need to close the huge annual financing gap of about US\$402 billion by 2030 to fast-track its structural transformation and catch up with high-performing developing countries from other regions.

To achieve this, countries must look towards mobilizing additional domestic resources by leveraging new investment in its huge pool of critical and rare earth natural resources and improving its tax collection system while ensuring efficiency in public spending.

But, as the report highlights, there still exists a snag to the full realization of development financing objectives in Africa. Many African countries deal with limited fiscal latitude and low tax capacity, while the private sector across the continent tends to be highly risk-averse with minimal participation in critical sectors. Thus, domestic resources alone will be insufficient for addressing the financing gaps that hinder structural transformation in many African nations.

Global Financial Architecture Reform Essential for Financing Africa's Structural Transformation

The report identifies limitations in the current global development financing architecture. While multilateral financial institutions have supported Africa's recovery, they

have not delivered resources at the scale needed for structural transformation. The governance structures of these institutions need adaptation to enhance equity and access for African countries.

Notwithstanding their strategic position in leading global and regional efforts to mobilize and allocate resources at scale, available evidence suggest that the current governance structures (shareholding models and weighted voting systems) of multilateral development banks and other global financial institutions such as the World Bank, IMF, AfDB, and other regional development banks, can be better adapted to deliver equity and inclusion in relation to access and availability of financing for Africa's structural transformation.

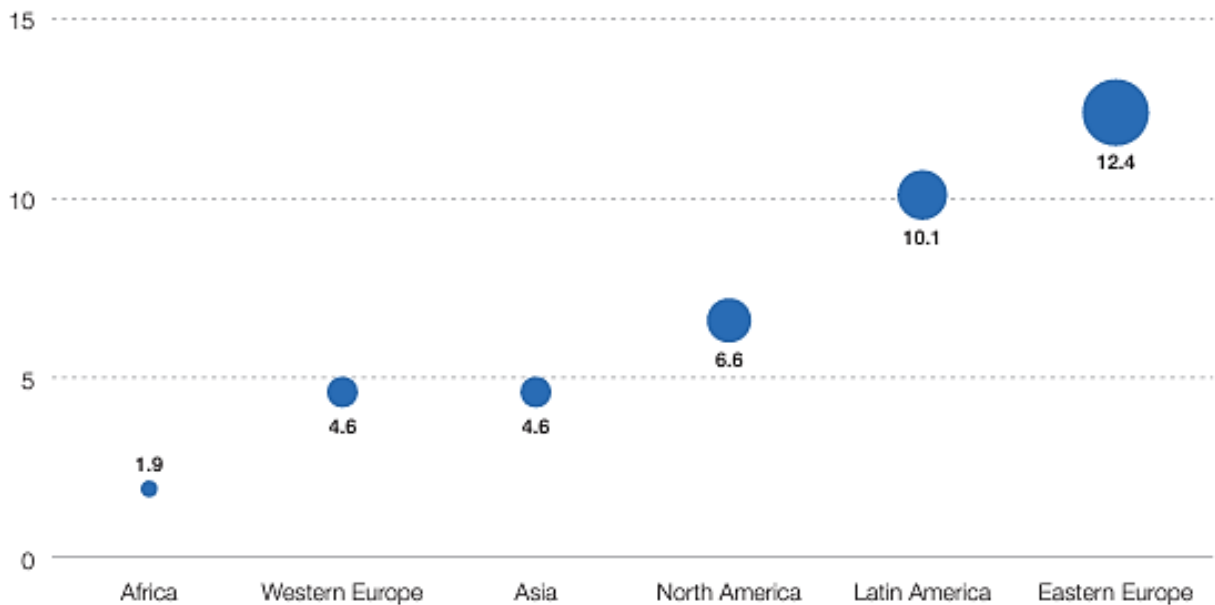


The current global financial architecture and system of multilateralism is not delivering enough resources in a timely manner and scale to meet national and global development goals in Africa.

The current structure also makes access to development finance for African countries very expensive and complex. African countries face high borrowing costs in international capital markets, attributed to perceived risks by international investors. It has been estimated that African countries are paying about 500 percent more in interest costs when borrowing in international capital markets than when borrowing from the World Bank or other multilateral development banks such as the African Development Bank.

This high- risk premium paid by African countries is largely attributable to a perception of risk by international investors originating from subjective credit ratings based on asymmetric information about African market conditions. On the contrary, evidence shows that Africa has the lowest risk of default on infrastructure when compared to other regions.

Default rate (percent)



Regional Comparison of Default Rates on Infrastructure and Other Projects (Source: Moody's Analytics, 2020)

The risk misperception of Africa is inimical to the continent's financial priorities; since countries are compelled to spend a significant share of their revenue on debt repayments, instead of investing in the delivery of health, education and social protection initiatives.



POLICY RECOMMENDATIONS

The report highlighted a broad-based mix of reform proposals for the short, medium and long terms.

- In the short term, monetary policy and exchange rate adjustments are crucial; and adjustments should be adapted in a manner that accounts for the prevailing inflation levels and exchange rate policy across countries. In addition, promoting local production and diversifying import sources are important actions to address rising food prices. An efficient use of borrowed resources and the strengthening of debt management capacity are also identified as beneficial in reducing

the burden of public debt.

- In the medium to long term, focus must be placed on scaling up domestic resource mobilization through improved debt management and combating illicit financial flows. Creating an enabling environment to attract and scale up external financial flows is crucial for domestically resourced funding. Additionally, reforming the GFA must be done in ways that ensure that the instruments of global financial governance are more nimble, inclusive, and responsive. Reforms must be deliberately fashioned out to enhance Africa's access to emergency financing.

OUR THOUGHTS

The AfDB report's findings and recommendations have significant implications for law and policy. Key areas of focus include:



Inflation Management

It will be important to adapt legal frameworks to support innovative monetary policies and enhanced regulatory oversight to manage inflation, in alignment with the calls to achieve faster disinflation.



Currency Stabilization

The report proposes flexible and situation-based adjustments to exchange rates as a mechanism for addressing exchange rate pressures on the continent. Thus, robust foreign exchange regulations, transparent debt restructuring frameworks, and enhanced fiscal responsibility constitute critical elements of currency stabilization tools.



Attracting Investments

Consistent with policy options aimed at promoting local production, diversifying import sources and diversifying direct and portfolio investments, it is appropriate for authorities to review investment protection laws, streamline regulatory processes, and develop public-private partnership (PPP) frameworks to attract foreign investment and other external financial flows which complement domestic resources.



Structural Transformation

At the heart of the report is the acceleration of structural transformation, and African countries will need to

strengthen support for sustainable industrialization and services-led growth through industrial policy formulations, intellectual property rights, and adaptive labour laws.



Financing Solutions

To address the financing gaps in the continent, African governments will need to complement the mobilization of domestic resources with improved tax administration and efficient public spending, as well as push for reforms to the global financial architecture towards more sustainable and equitable access to financing.



Institutional Strengthening

Since responsible institutions are crucial to achieving structural transformation, governments will need to enhance governance and institutional frameworks, including anti-corruption laws, decentralization policies, and judicial reforms to ensure transparency, accountability, and effective management of domestic economies across the continent.

For More Information, Please Contact :



Gabriel Onagoruwa
Partner & Chair,
Finance and Project Development
gonagoruwa@olaniwunajayi.net



Oluebube Nsofor
Associate
onsofor@olaniwunajayi.net