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Capital Flows and The Future of Work

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Abbreviations

CEMAC	Economic and Monetary Community of Central Africa
ELA	emergency liquidity assistance
EMs	emerging markets
EMEs	emerging market economies
FDI	foreign direct investment
GDP	gross domestic product
GPS	global positioning system
ICRG	*International Country Risk Guide*
MDGs	Millennium Development Goals
MFIs	microfinance institutions
MSMEs	medium-sized enterprises
NPLs	nonperforming loans
ODA	official development aid
PFM	public financial management
REO	*Regional Economic Outlook* (IMF)
SDGs	Sustainable Development Goals
SOEs	state-owned enterprises
SSA	Sub-Saharan Africa
TFP	total factor productivity
UN	United Nations
UNHCR	United Nations High Commissioner for Refugees
UNOCHA	United Nations Office for the Coordination of Humanitarian Affairs
US	United States
VAR	vector autoregression
VAT	value-added tax
VIX	CBOE Volatility Index
WAEMU	West African Economic and Monetary Union
WEO	*World Economic Outlook* (IMF)

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The following conventions are used in this publication:

- In tables, a blank cell indicates "not applicable," ellipsis points (. . .) indicate "not available," and 0 or 0.0 indicates "zero" or "negligible." Minor discrepancies between sums of constituent figures and totals are due to rounding.
- An en dash (–) between years or months (for example, 2009–10 or January–June) indicates the years or months covered, including the beginning and ending years or months; a slash or virgule (/) between years or months (for example, 2005/06) indicates a fiscal or financial year, as does the abbreviation FY (for example, FY2006).
- "Billion" means a thousand million; "trillion" means a thousand billion.
- "Basis points" refer to hundredths of 1 percentage point (for example, 25 basis points are equivalent to ¼ of 1 percentage point).

Executive Summary

RECOVERY AND RISING RISKS

The macroeconomic outlook for sub-Saharan Africa continues to strengthen. Growth is expected to increase from 2.7 percent in 2017 to 3.1 percent in 2018, reflecting domestic policy adjustments and a supportive external environment, including continued steady growth in the global economy, higher commodity prices, and accommodative external financing conditions. Inflation is abating; and fiscal imbalances are being contained in many countries. Over the medium term, and on current policies, growth is expected to accelerate to about 4 percent, too low to create the number of jobs needed to absorb anticipated new entrants into labor markets.

However, there are concerns on the quality of the fiscal adjustment, and underlying vulnerabilities have yet to be decisively addressed.

- More progress on domestic revenue mobilization is needed to ensure debt sustainability and create fiscal space for much needed investment and development spending. The fiscal adjustment thus far largely reflects the oil price rebound for oil exporters coupled with sharp cuts in capital spending in several countries. With few exceptions, there has been relatively little progress in strengthening domestic revenue mobilization; many countries have delayed adjusting domestic fuel prices in response to the recent oil price increase, resulting in the re-emergence of energy subsidies; domestic arrears remain large, contributing to a buildup in nonperforming loans (NPLs); and, beyond the central government, state-owned enterprises (SOEs) are becoming a major fiscal risk in some countries.

- Financial sector vulnerabilities remain elevated with high NPLs weighing on banks' balance sheets and constraining credit to the private sector.

- On the external side, financial inflows were strong in the first half of 2018 with record issuances of Eurobonds but the recent turbulence in emerging markets has led to some increase in spreads. Reserve buffers have though, generally not been rebuilt and, in half of the countries in the region, remain below levels considered adequate.

The outlook is surrounded by significant downside risks. The global economy is entering a period of unusually elevated policy uncertainty; growth is already slowing in most advanced economies and could slow more sharply in the event trade tensions escalate; while spikes in commodity prices and populist pressures in the run-up to elections in several countries could derail consolidation efforts.

Shielding the recovery and creating enough jobs for the region to harness fully its demographic dividend would require strong, sustainable, and inclusive growth. Achieving this in turn would require policies to strengthen resilience and facilitate the reallocation of labor and capital into more productive sectors to lift incomes faster. These policies include steady fiscal consolidation to reduce debt vulnerabilities; advancing revenue mobilization; enhancing the efficiency of expenditures, in particular to address the re-emergence of wasteful energy subsidies; allowing greater exchange rate flexibility where institutional setups permit and barring balance sheets vulnerabilities; addressing growing financial sector weaknesses in a timely manner; and pursuing policies to foster private investment and enhance potential growth.

CAPITAL FLOWS IN SUB-SAHARAN AFRICA: CAUSES AND CONSEQUENCES

Cross-border capital flows to sub-Saharan Africa from nonofficial sources have increased sharply since the global financial crisis. Scaled by economic size, net capital flows to sub-Saharan Africa were higher than those to emerging market economies in recent years. Much of this increase has been driven by nonresident inflows—particularly portfolio flows. Empirical analysis shows that global factors, notably, United States interest rates, global risk aversion, and commodity prices, are important drivers of capital flows to sub-Saharan Africa. However, strong domestic fundamentals can help to mitigate the risks associated with volatile capital flows. The analysis also suggests that the domestic impact of capital flows depends on the type of flow. In general, portfolio flows tend to be more prone to moving the real exchange rate and output above trend, and to fuel credit growth—vulnerabilities that tend to raise the likelihood of a financial crisis. While, at least historically, portfolio flows have not been strongly associated with either domestic investment or growth, they do seem to boost public consumption (including social spending). By contrast, inward foreign direct investment appears to directly spur domestic investment, and in turn support economic growth. These findings indicate a complex relationship between external finance, domestic macroeconomic stability, and investment and economic growth in the region. Policymakers need to be prudent and ensure that the borrowed resources are used effectively, enhance productivity, and promote sustainable economic growth. Vigilance is also warranted against the buildup of macroeconomic and financial imbalances.

FUTURE OF WORK IN SUB-SAHARAN AFRICA

The current wave of technological advances is set to shake up the landscape for jobs across the world. Against this backdrop, how can sub Saharan Africa create the 20 million jobs per year needed over the next two decades to absorb its growing workforce? This chapter focuses on how the current wave of technological innovation—the Fourth Industrial Revolution—will impact sub-Saharan Africa's comparative advantage and the nature of work within countries in the region. It draws on formal economic models but also on scenario analysis, which allow consideration of how the course of global economic integration and the impact of climate change could shape economic opportunities and thus the future of work in sub-Saharan Africa. The overarching policy challenge is to support the new and emerging sectors that drive growth. If successful, sub-Saharan Africa can create jobs for its young and growing population and make progress toward meeting the Sustainable Development Goals. Development strategies must adapt to the demands and prospects of the Fourth Industrial Revolution. Integration and connectivity are the key pillars of successful growth policies. This includes traditional and digital infrastructure, an education system that keeps pace with changing skill requirements, smart urbanization, safety nets for a volatile labor market, and trade integration.