Africa: the Next Growth Miracle?

Stefan Dercon
Oxford University
DFID

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Outline

• The miracle described
• Why may this fail?
• Opportunities and challenges for success
• Epilogue
The Miracle Described

PART 1

Average Annual GDP per capita Growth

Source: IMF World Economic Outlook
In sum

• There is growth
• Not just in oil exporters
• And improvement in human development outcomes

• But with clear heterogeneity. E.g. consider Radelet’s emerging economies

Source: ‘Emerging Africa; How 17 Countries are Leading the Way’, Steven Radelet, Centre for Global Development, 2010
Why did it happen?

Source: IMF World Economic Outlook
More than a little help from commodity prices...

Net Barter Terms of Trade (2000=100)

Source: World Bank World Development Indicators
Rate of convergence to the best practice frontier for Doing Business, 2005-2012

Georgia – Best performer

China and India

Source: Data provided by the World Bank, produced for Doing Business Survey 2012

The China-Africa Growth Coupling

Almost an absolute correlation after 1999 – Coincided with China's New Africa Policy

No correlation in growth trends between China and SSA prior to 1996

African growth tracked downwards - China’s aid-related investment spend was cut back from Q4 2007

Africa's growth is tracking the V-shaped recovery of China since Q1 2009

Africa's growth has been robust on back of strong resource demand from the PRC

1999-2008: Growth correlation of 0.91593721

Source: IMF, EIU; Frontier Advisory analysis
Why did it happen?

- Commodity prices
- Much better investment environment due to macroeconomic stability and general stability
- Rise of trade and involvement of emerging powers, not least China

- Highest growth in natural resource rich economies, not just relative price effect but also extraction climate 'better'
Why may this fail?

PART 2

How sustainable is the success...

• First, round up the usual suspects
• Then identify the actual risks and challenges…
Population bomb...

Rapid population growth will take place in Asia and Africa ... But it will peak near that time...

... but the path to modern population structure comes with a golden opportunity of low dependency ratios....

Stage 1: High death rates, high births, high dependency

Stage 2: Falling death rates, high births, high dependency

Stage 3: Low death rates, falling births, low dependency

Stage 4: Low death rates, low births, high dependency

Many African countries entering into stage 3

Source: Populationpyramids.net, note that this slide borrows ideas from Hans Rosling’s TED talk and publicly available demographic transition presentations.
Many countries will experience a golden opportunity of low dependency ratios...


Primary Education

Source: World Bank World Development Indicators
Population bomb...

may actually be part of a more immediate opportunity...

of the lowest dependency ratio and largest working age population ever...

healthier and better educated than ever...

Climate Change Bomb...
Climate effects are harshest in developing countries (1)

Map of likely future water scarcities

Western Europe and most of North America will be largely unaffected by water scarcity.

But Africa and Western and Southern Asia will be hit by either physical or 'economic' water scarcity – the inability to access available water.

Climate effects are harshest in developing countries (2)

Climate effects on agricultural productivity are hardest in developing countries (including Latin America and South-East Asia) though also affecting North America and Australia.
**Climate Change Bomb...**

is real, but will hit after 2030, not likely much earlier....

and an important force for resilience will be development....

so making development more urgent...

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**But there is a failing economic transformation.....**

• E.g. share of employment in agriculture
  SS Africa 68% versus Asia 53%
And an early acceleration of African urbanization without growth

By 2030 more people in both Africa and Asia are projected to live in urban than rural areas.

Formal Employment

Source: World Bank Jobs Databank
... waged jobs are not keeping pace

Job creation in Ghana 1998-2006

<table>
<thead>
<tr>
<th>Earnings Characteristic</th>
<th>Trend (% of total jobs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Sector / State High</td>
<td>Downward</td>
</tr>
<tr>
<td>Large Firm Wage High</td>
<td>Downward</td>
</tr>
<tr>
<td>Other wage High</td>
<td>Downward</td>
</tr>
<tr>
<td>Small Firm Wage Low</td>
<td>Upwards (doubles)</td>
</tr>
<tr>
<td>Farmer Very low</td>
<td>Upwards</td>
</tr>
<tr>
<td>Medium Firm Wage Moderate</td>
<td>Downward</td>
</tr>
<tr>
<td>Self Employed without employees Low / Moderate</td>
<td>Downward</td>
</tr>
<tr>
<td>Family Employment No data (likely low)</td>
<td>Constant</td>
</tr>
</tbody>
</table>

Source: Nsowah-Nuamah, Teal, Awoonor-Williams (2010)

So real issue is growth without transformation - key risk 1: jobless growth

- Fast growth
- Partly driven by natural resources
- In relatively urbanising settings
- No growth in manufacturing or sectors with formal job creation
- Risking to turn demographic dividend into trouble…
Natural resource curse?

Is it a problem that the growth today has a strong component from extraction of natural resources?

• It is relatively jobless
• It has incentives to perpetuate this
  – Dutch Disease?
  – Incentives for governance and emergence of non-extractive institutions

The Dominance of Institutions

• The X-factor is institutions, the hard to measure, “set of economic and political rules, created and enforced by state and citizens, which determine economic, social and political incentives, which in turn determine economic and other development outcomes” (Daron Acemoglu and Jim Robinson, “Why do Nations Fail”)
The Dominance of Institutions

- Inclusive political institutions (with sufficient centrality of power but with clear constraints on this power) lead to inclusive economic institutions that promote growth and are sustainable.

- Extractive political institutions (with power in small elite with few constraints) lead to economic institutions with no or unsustainable growth and development.

- In resource rich environments: no incentive to build up state capacity or tax-raising powers, no process that requires inclusion to keep power.
Any progress?

• Some say: YES.
  – from 4 to 24 democracies in Africa (Radelet – using Polity IV and Freedom House index)
  – progress everywhere on doing business
• Other say: no
  – Above interprets institutions are rules and not the enforcement of rules
  – Pritchett: when limited contract enforcement, **deals** environment, not rules

In poor ‘institutional’ settings, deals dominate....

• Open versus closed deals (identity of agents matter or not)
• Ordered versus unordered deals (predictable, once deal is done it stays done versus not)

<table>
<thead>
<tr>
<th></th>
<th>OPEN</th>
<th>CLOSED</th>
</tr>
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<tbody>
<tr>
<td>ORDERED</td>
<td>Functioning economy, with much petty corruption</td>
<td>Oligarchs, Cronyism</td>
</tr>
<tr>
<td>UNORDERED</td>
<td>Informal sector</td>
<td>Fragile states</td>
</tr>
</tbody>
</table>
Natural resource deals ...
... relatively easy even in fragile environment

– Natural resource extraction: high return in short run, limited capital, no lags, heavily localised, high value per tonne, limited skills of labour force – easily protected
– Compared to
  – manufacturing: capital intensity, scale matters, lags, long horizon, labour force skills
  – Commercial agriculture: scale matters, lags, long horizon, low value per tonne

Key risk 2: institutional incentives

• Natural resources offer few incentives for state to build up its capacity
• While even in fragility it can thrive

How to change horizon from short-run to long-run?
… is more than just saving large part of natural resource rents
… is also about what to do with it today
.... Collier: investing in investing
How to do this? ... there is the rub...

• Policy makers that need to act against their own incentives
• Using aid to support this process, with aid suffering from the same incentives
• Leading to isomorphic mimicry:
  – Building institutions and organizations that look like the real thing
  – But just look like the real thing and no more…

Opportunities and Challenges

PART 3
The two key risks are also massive opportunities

- Jobless growth but also
  - demographic dividend, and
  - gradual rise of education and skill levels in Africa
- Natural resources curse
  - but also unique historical opportunity for Africa

Huge natural resource rents on offer...

In 2010, the two largest oil producers: Nigeria & Angola, had a combined total rent of over $100 bn—almost 60% of total rents from the region that year

Source: WDI 2012.
Note: Includes oil, natural gas, and other minerals (excludes diamonds and timber).
Massive reserves....

**Figure 16: Ratio of reserves to annual production in years, selected oil-rich countries**

- Nigeria: 41 years
- Gabon: 41 years
- Sudan: 41 years
- Chad: 36 years
- Angola: 21 years
- Equatorial Guinea: 14 years
- Congo, Rep.: 18 years
- Other Africa (incl. new discoveries): 27 years


The global economic importance of Africa in oil & other minerals will persist in the near end medium term

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Expectation on continuing discoveries....

- Recent discoveries in e.g. Ghana (oil), Tanzania (natural gas), Uganda (oil), Ethiopia (diamonds), Mozambique (natural gas)

- Under-surveyed continent...
With large increases in demand offering hope and expectation for unprecedented rents...

- Managed well, increased global demand is a positive for resource-rich countries
- Tax revenues can be collected, and domestic accountability strengthened
- Revenues can be reinvested and used to diversify growth and create jobs
- Public services, infrastructure, can all be improved

Managed poorly, wasted resources,
- Incentives for poor governance and conflict
- Booming underemployed youth
- Borrowing against future returns that won’t materialize

Source: McKinsey & Company, Resource Revolution, Meeting the world’s energy materials, food and water needs, November 2011
The other main present and future opportunity

The future is:

The opportunities offered by new technologies and communications
The future is:

The opportunities offered by new technologies and communications

Of course, communications and technology offer new opportunities and brings down costs. But it is no substitute for actual investment

The opportunities offered by new technologies and communications
The future is:

Mandarin…

China in Africa is viewed with suspicion

• It goes for ‘deals’, not following rules
• It has clear self-interest, not aid in mind
• Upsets the donor-recipient relationship
• Is exploitative…
China in Africa needs to be understood from China

- State-interest is commercial interest and vice-versa
- Aid is commercial as there is no other interest than Chinese development
  - Aid size to Africa?
- Consistent with commercial interest in fuelling its growth
  - Tied aid
- The fact that it does not follow our rules does not mean it ‘vicious’
- More used to ‘fragile’ institutional environments…

<table>
<thead>
<tr>
<th>China in Africa needs to be understood from China (2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• It is also looking for FDI opportunities to balance its own restructuring away from labour-intensity</td>
</tr>
<tr>
<td>• Workers’ paradise built on workers’ exploitation</td>
</tr>
<tr>
<td>- Labour as a natural resource (Lewis model)</td>
</tr>
<tr>
<td>- That is getting exhausted (“middle income trap”)</td>
</tr>
<tr>
<td>• Incentives against labour-intensity of production</td>
</tr>
<tr>
<td>• Encouragement of movement out of S-Eastern China into West, other Asian countries and Africa</td>
</tr>
<tr>
<td>• CADF – $5 billion, managed by CDB – tied credit/equity stakes</td>
</tr>
</tbody>
</table>
The prize for Africa: job creating growth

Is Africa ready to grab that opportunity?

The pieces that need to get into place

– the demographic dividend (education, health, ….)
– natural resource rents for transformative infrastructure, social protection, absolute poverty alleviation, etc
– an investment climate that will make Chinese, other foreign and local investors willing to part with their cash for the long-run
– basic costs structures to make investment profitable
Due in part to cost-disadvantages: against China, for example

- **Green Zone**: Investors engage if risks to investment do not outweigh benefits of low wage compared to value-added.
- **Amber Zone**: Investment likely to be less profitable than in China – compensating benefits must be offered to attract investors.
- **Red Zone**: Value-added < min wage.


Opportunity: Cost-profiles are changing...

Real wages in China are rising fast

But in most DFID LICs they are more stable

Real Wages 2000-2009, Selected Economies

Data also suggests that since the 1990s, wages are growing faster than productivity in China – meaning that it is becoming more expensive to produce labour-intensive goods there.

Source: ILO, Key Indicators of the Labour Market database (2012); converted to US$
Rate of convergence to the best practice frontier for Doing Business, 2005-2012

China and India

Georgia – Best performer

Source: Data provided by the World Bank, produced for Doing Business Survey 2012

And Chinese business are looking

FDI projects, Ethiopia

<table>
<thead>
<tr>
<th>Country</th>
<th>Total Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>93</td>
</tr>
<tr>
<td>India</td>
<td>39</td>
</tr>
<tr>
<td>S-Arabia</td>
<td>27</td>
</tr>
<tr>
<td>Britain</td>
<td>18</td>
</tr>
<tr>
<td>US</td>
<td>12</td>
</tr>
</tbody>
</table>

FDI projects, Ghana

<table>
<thead>
<tr>
<th>Country</th>
<th>Total new Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>167</td>
</tr>
<tr>
<td>India</td>
<td>129</td>
</tr>
<tr>
<td>Nigeria</td>
<td>91</td>
</tr>
<tr>
<td>UK</td>
<td>57</td>
</tr>
<tr>
<td>US</td>
<td>40</td>
</tr>
<tr>
<td>South Africa</td>
<td>17</td>
</tr>
</tbody>
</table>
The pieces that need to get into place
- the demographic dividend (education, health, ...)
- contribution from aid undeniable
- natural resource rents for transformative infrastructure, social protection, absolute poverty alleviation, etc.

And
China’s and other EP businesses as the key investors with jobs to relocate to create jobs in Africa

with their cash for the long run – Some signs

What does this mean for aid?

**PART 4**
Financial Flows into Developing Countries

-1.0%
-0.5%
0.0%
0.5%
1.0%
1.5%
2.0%
2.5%
3.0%
3.5%
4.0%
4.5%

1970 ... flows
Foreign direct investment,
net inflows
Workers' remittances and
compensation of
employees, received

Aid is becoming increasingly irrelevant....

Source: IMF World Economic Outlook 2009
Where and How we offer it, What For is much more important

The Role of Aid?

– the demographic dividend (education, health, ....) yes, contribution from aid undeniable
– natural resource rents for transformative infrastructure, social protection, absolute poverty alleviation, etc not quite
– Basic costs structures to make investment profitable hopeful signs
– The investment climate that will make Chinese, other foreign and local investors willing to part with their cash for the long-run some signs
The Motors: Resource wealth, trade and investment

Huge challenges

An **economic agenda** with potentially huge benefits for Africa

– Requiring work on global system to make it work
  – Huge benefits for economic rivals
  – Can we allow Chinese firm to gain via Africa from AGOA?

A **political institutional agenda** with few levers and fraught with bad experiences

– How much do we know what works? Can we? Should we?
So what do we have?

– a global crisis in the OECD
– huge liquidity outside OECD with much investment in non-productive sectors in Africa
– Africa booming fuelled by commodities
– huge liquidity outside OECD with much investment in non-productive sectors in Africa
– exciting signs of progress on human development
– a developmental state with rhetoric on poverty
Are we back in 1977

Average Annual GDP per capita Growth

Source: World Bank World Development Indicators
A warning from history... Haven’t we been here?

Hotel Intercontinental
Cote d’Ivoire

Ujamaa Tanzania

Unique historical opportunities are ... unique

• Africa and the world can waste its natural resources or allow them to be wasted
• We can waste the demographic dividend
• We can waste the opportunity to grab a part of the world’s production

Cost would be huge:
Macroeconomic collapse, fragility, debt
Let us not go back to

1986