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Africa: a new growth model is needed[1]

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For Africa to reach its full growth potential, a higher investment rate and more diversified FDI across sectors are key in shaping a more balanced and resilient growth model, less focused on just a few pockets of growth (such as extractive industries and trade hubs). This new pattern should prioritize agriculture, further diversification of export revenues and more inclusive finance to gradually attract a larger share of the rural activity into the formal sector.

Raising investment levels is a challenge

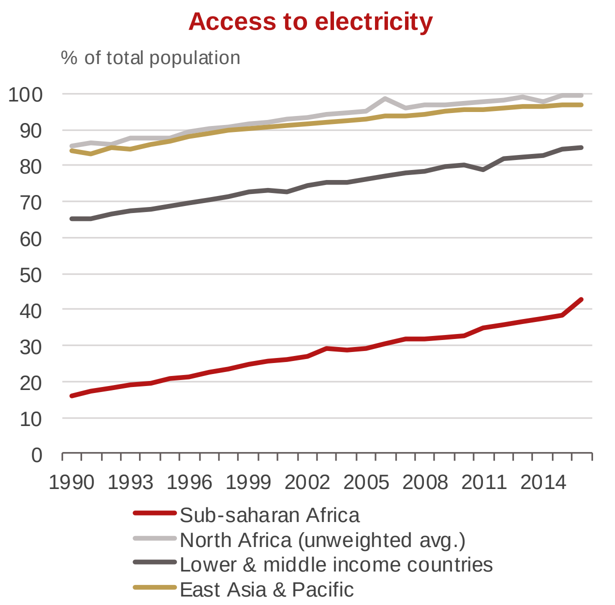
As explained in our prev/isous Risk&Opportunities issue (No. 2; “Africa is more integrated in global financial flows”), despite an increasing trade and financial integration with the rest of the world since the beginning of the 2000’s, Africa’s performance in terms of GDP per capita has been lacklustre. It seems that, among other factors, raising investment rates will be key to increase the region’s overall growth potential. However this task is a difficult one, as the continent remains constrained by low levels of domestic savings. Most institutions foresee that external financing needs will remain important in Africa over the coming years. According to Oxford Analytica, Africa is expected to register an average aggregated balance of payments deficit of 5.1% of GDP in the next 10 years. This would represent more than USD 100bn to finance every year. The African Development Bank recently estimated the continent’s infrastructure needs at USD 130–170bn a year[2], with an annual financing gap in the range of USD 68–108bn.

[1] A first first version of this article was published as a SUERF policy note (https://www.suerf.org/policynotes/4065/africa-needs-investments-beyond-its-pockets-of-growth).

[2] The Africa Development Bank released this new estimate in their African Economic Outlook 2018. Investment needs were estimated on subsectors, with targets to be achieved by 2025:

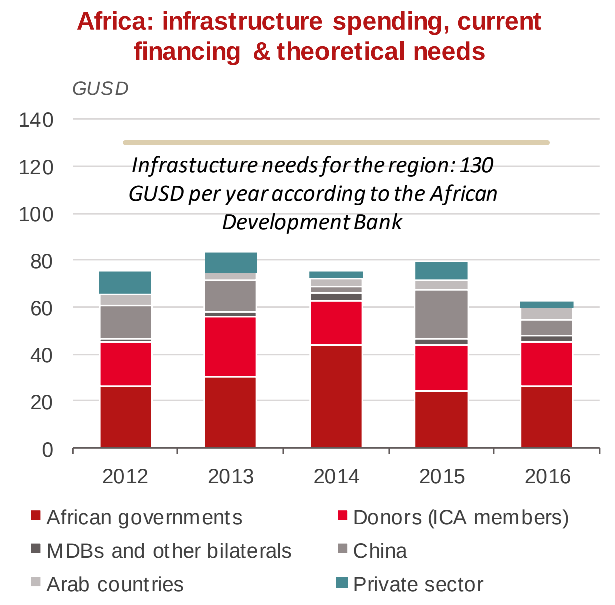
- *Power: 100% urban electrification; 95% rural electrification*
- *Water supply and sanitation: 100% access in urban area;100% access in rural area*
- *Information and communication technology: Mobile universal coverage; 50% of population within 25 km of a fiber backbone; Fiber to home/premises internet penetration rate (10%)*
- *Road and other transport sectors: 80% preservation; 20%development*

Chart 1



Source: SG Economics and Sector Research

Chart 2



Source: SG Economics and Sector Research

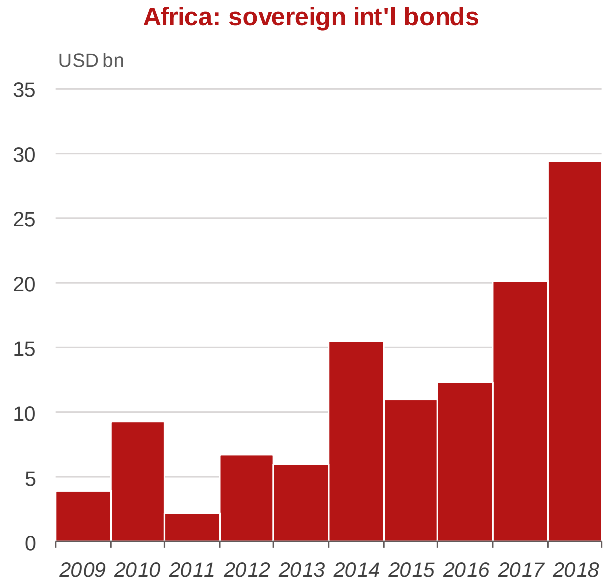
In addition to the level of investment, composition will be key. Africa has financed its growth in the last decade with higher debt flows, but productive investment is lagging. The share of portfolio flows in total investment flows has increased. Portfolio inflows to Africa were near zero in net terms until 2009; they now account for around a third of total flows. With the low development of equity markets (except in South Africa) these flows essentially mirror the issuance of international debt bonds, adding a new component to the external solvency constraint in the region. Solvency ratios have worsened on average since the early 2010's after the debt cancellations under MDRI and HIPC initiatives. Higher reliance on more costly resources such as bonds and commercial credits has increased debt services, in particular in low and middle-income countries of Sub-Saharan Africa.

Sub-saharan Africa (excl. high income)	2010	2011	2012	2013	2014	2015	2016	2017
Total external debt stock to exports (%)	70.8	65	74.5	79.5	89.3	119.7	138.9	138.6
Debt service to exports (%)	3.9	4.1	5.3	6.3	6.9	7.9	11.9	10.4
Private creditors (% of long-term, public external debt)	33%	35%	41%	40%	42%	42%	40%	42%

Source: World Bank, SG Economics and Sector Research

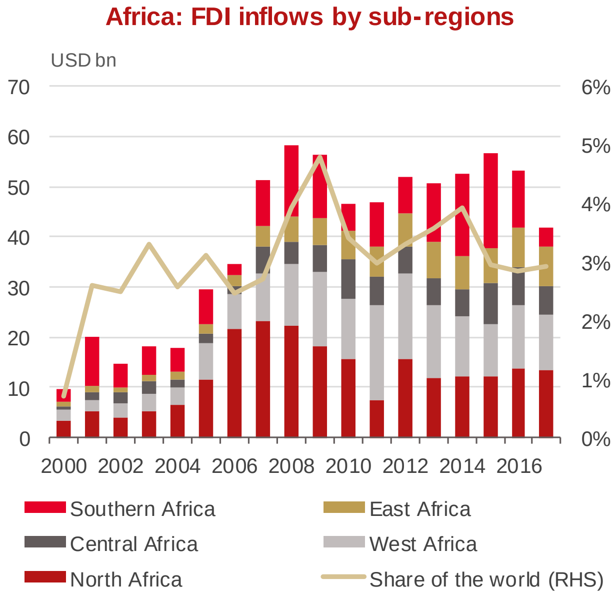
While increasing during the first phase of the "Africa growth story" between 2004 and 2008, FDI flows have remained broadly stable since, hovering around USD 40 to 50bn per year according to UNCTAD statistics, and accounting for around two-thirds of total investment flows since 2010. Africa accounts for approximately 3% to 4% of the world's total FDI, fairly much the same share as in 2001, and broadly comparable with Africa's share of the world GDP. This could be viewed an underperformance as the region should theoretically be able to attract a bigger share of total FDI, considering its infrastructure needs, its globally improving macroeconomic performance, or the fact that rates on return on FDI tend to be higher than in other emerging or developed markets.

Chart 3



Source: SG Economics and Sector Research

Chart 4



Source: SG Economics and Sector Research

The picture is also mixed when analysing the recipient sectors. The share of manufacturing in greenfield projects (greenfield projects account for the lion's share of FDI in Africa, while M&A deals remain marginal) has been decreasing over the past years, from 41% in 2010-11 to only 23% in 2016-17. On a more optimistic side, the share of "infrastructure" investments – defined as the combination of electricity, gas, water and construction subsections – has increased strongly, and they account now for more than 40% of greenfield projects.

Announced greenfield FDI projects by industry	Avg. 2016-17	Avg. 2014-15	Avg. 2012-13	Avg. 2010-11
Primary	8%	24%	13%	25%
Manufacturing	23%	30%	35%	41%
Services	69%	46%	52%	34%
o/w electricity, gas and water	*30%*	*16%*	*18%*	*9%*
o/w construction	*13%*	*11%*	*7%*	*6%*

Sources: UNCTAD, SG Economics and Sector Research

Reasons for the stagnating levels of FDI are difficult to list. However, most studies point towards institutional quality as a key "pull factor" for FDI. While many countries have made real progress in terms of economic and political governance, the region continues to lag behind other emerging regions in most international rankings (World Bank's "Governance Indicators" or "Ease of Doing Business"; World Economic Forum's "Global Competitiveness Report"). Investors continue to perceive Africa as the riskiest region in the world, with rates of return potentially not high enough to compensate for this risk. There are however growing differences between countries. Non-resources countries display on average improving economic and political governance indicators, while this is not true on average for "rentier" countries.

Ease of Doing Business rankings, 2019	Average ranking	Min	Max
OECD	29	1	72
Eastern Europe Central Asia	53	6	126
East Asia	94	2	178
Latin America	112	54	188
Middle East & North Africa	112	11	187
South Asia	123	77	176
Sub-Saharan Africa	141	20	190

Source: World Bank, SG Economics and Sector Research

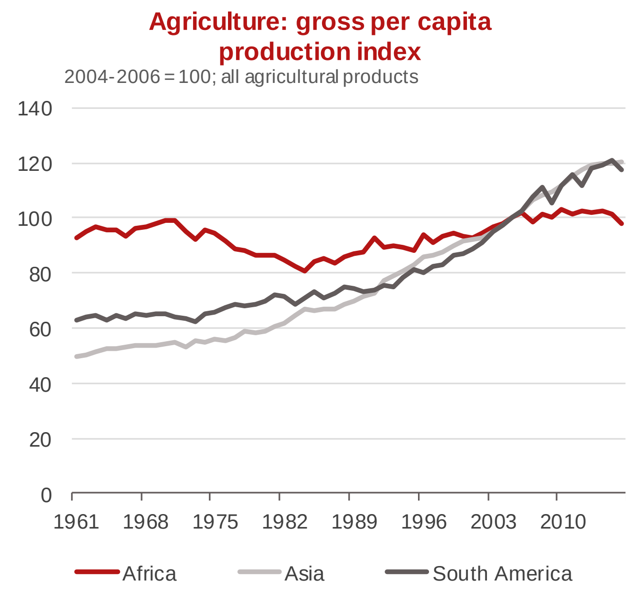
Overall, underperformance in terms of levels and sectoral allocation of FDI seems to have contributed at least partly to poor productivity performance for the continent, highlighting some key question marks on Africa's "growth story".

Africa has yet to register a green revolution

Africa's transformation process differs from other regional transformations in several ways. Many people continue to live in rural areas and depend on agriculture. The industrial sector is still underdeveloped, especially manufacturing industry, and structural change out of agricultural employment remains limited. Lessons from the experiences of other emerging economies point that the role of agriculture as a catalyst for broader economic transformation remains crucial.

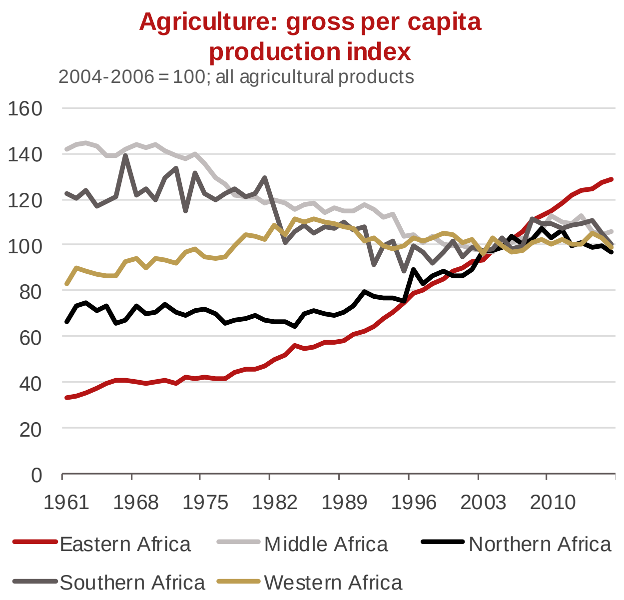
Despite a strong potential, with the continent hosting 60% of the world's uncultivated arable land, progress in terms of agricultural output has been extremely slow. Much of the sector remains stuck into "subsistence farming" with small farms, unsecure land rights, lack of storage facilities and a poor ability to market crops. On average for the continent, gross agriculture output per capita levels have remained broadly stable since the days of independence. One exception is East Africa, which has more successfully developed export-oriented crops, besides a large traditional subsistence farming sector. This lack of comprehensive green revolution in the continent explains the need to massively import food for the large cities. It does also explain the high "hunger" levels. The World Bank estimates the "food deficit" in Sub-Saharan Africa at around 130 kilo calories per person per day, twice the level in East Asia.

Chart 5



Source: SG Economics and Sector Research

Chart 6



Source: SG Economics and Sector Research

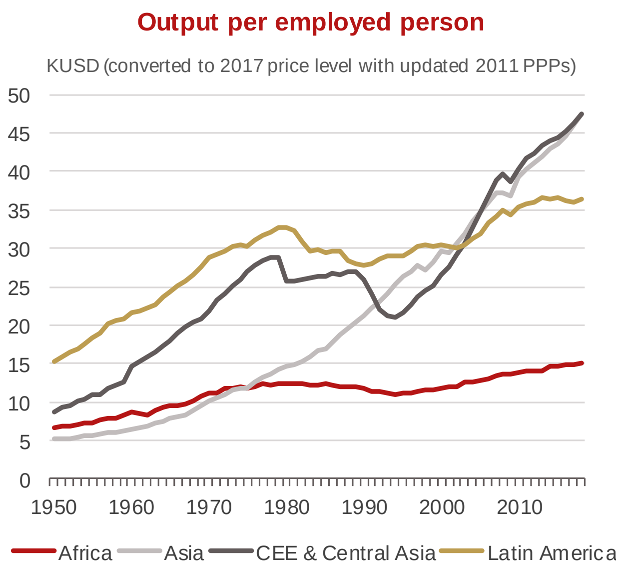
NB 1: Per caput index obtained by dividing "Production Index" numbers by index of population, or directly from per caput production.

With scarce data available on productivity levels across regions and periods, it nevertheless seems that African productivity has not progressed as it should have during times of high growth, pointing also towards "pockets" of growth not evenly distributed within countries. Available studies (such "Globalization, Structural Change, and Productivity Growth, with an Update on Africa" by M. McMillan, D. Rodrick and I. Verduzco-Gallo) suggest that labour productivity growth in Africa has evolved much more slowly than in other emerging regions.

	Labor productivity growth 1990–2005 (unweighted averages)
Latin America	1,35
Africa	**0,86**
Asia	3,87
Hing income countries	1,46

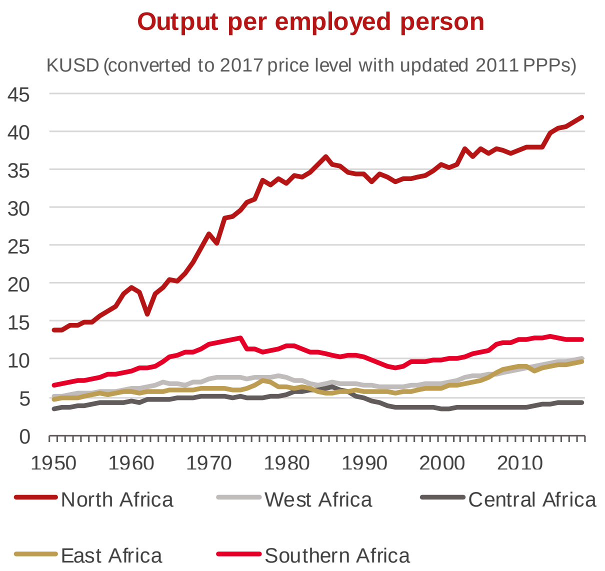
Source: "Globalization, Structural Change, and Productivity Growth, with an Update on Africa" by M. McMillan, D. Rodrick and I. Verduzco-Gallo

Chart 7



Source: SG Economics and Sector Research

Chart 8



Source: SG Economics and Sector Research

NB 2: Real GDP is expressed in 2016 PPP $ […]. The 2016 PPPs are based on the World Bank-international comparison project (ICP) 2011 round, updated using the change in the national GDP deflator, relative to the US GDP deflator.

NB 3: Estimates of labour productivity based on GDP per person employed are available for all countries in the database. While this is a relatively robust measure, it does not correct for part-time jobs as it merely counts people who are employed. Hence, GDP per person employed is somewhat underestimated in countries with a higher share of part-time workers, which are mostly OECD countries.

The same trend can be seen in the level of output per employed person as estimated by the Conference Board, where Africa now clearly lags other regions. The only sub-region registering a significant increase in this productivity proxy is North Africa, where the share of manufacturing in the economy has remained stable over the past three decades, around 15 to 20% of GDP. In Sub-Saharan Africa, the share of manufacturing industry has decreased from close to 18% in 1990 to less than 10% currently. This could be one among many other factors, such as education and health issues, that have been weighing on the evolution of productivity.

Africa needs more export-oriented investment and more inclusive finance

Recovery of economic activity through the continent is likely to continue in the coming years. A combination of greater economic diversification, ongoing sub-regional integration, new hydrocarbon production coming on line and more favourable business environments will offer tailwinds. However, the high sensitivity to commodity price, the rapidly growing population and the rising external debt burden and will also continue to pose persistent challenges.

Africa needs to attract more FDI to further diversify its export revenues and to enhance its productivity levels. Building resilient energy infrastructure, establishing manufacturing hubs, redesigning urban development and broadening the ability to raise fiscal revenues are recognized priorities to achieve these goals. Otherwise, the external balance of payment constraint is likely to bite again sooner or later.

Beyond this agenda, the need to develop policies and new business models to better integrate the very large informal sector, especially in agriculture, is a parallel priority of equal importance and urgency. With the slow demographic transition, rural communities will continue to grow significantly, even if their share in the total population is declining. This will further adjourn the prospect of reaching a “Lewis point” in the development trajectory. The Lewis turning point, named after the development economist and Nobel prize laureate Arthur Lewis, is when surplus rural labour is reduced to zero, pulling upwards agricultural and unskilled industrial real wages. For the years ahead in Sub-Saharan Africa, a large segment of the population could remain trapped in the rural communities with informal and low productivity activity if polices, new business models, and more inclusive finance fail to attract gradually this population in the formal sector.

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