Africa's Growth Story

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Introduction

The past two decades saw sub-Saharan Africa emerge as one of the fastest growing economic regions in the world. Most African countries recorded economic growth in excess of 6 percent per annum over the past 15 years. This strong performance followed two decades of economic stagnation in most sub-Saharan African countries, characterized in many of them by political instability, economic mismanagement and an unsustainable external debt. The "Africa rising" narrative suggested that the continent was on its way to self-sustaining growth, the kind of growth that the East Asian "tigers" and western countries experienced during the times that they were rising, and the kind of growth that led to a massive reduction in poverty in China within a generation. This optimism about Africa's growth seems to have quickly given way to a wave of pessimism. Economic growth in the last few years has slowed down sharply in several countries in the region due to a number of factors. The current wave of pessimism makes one to wonder if the Africa rising story is coming to an end.

The Growth Story

Africa's growth history is characterized by wide swings. Since 1960, the continent has experienced two periods of growth: first between 1961 and 1975 and a second from 1995 to 2014, interspaced with stagnation (Zamfir, 2016). The causes of the economic stagnation were clustered around three key factors: geographical conditions, the legacy of slave trade, and colonization. The assumption is that one of these initial factors led African countries on an institutional path that was not propitious to development. At the end of the colonial era, the continent's resources and relative stability led to favorable comparisons of its development prospects with south-east Asia. Africa indeed experienced sustained growth in the 1960s and 1970s (above 5 percent in many cases), but this growth ended abruptly with the 1979 oil crisis. Rising oil prices and high interest rates for sovereign debt sealed the fate of many African countries. In response to these economic challenges, a number of measures, including agricultural liberalization, privatization of state-owned enterprises, opening up to international trade, external debt reduction (including debt cancellation), and the pursuance of sound macroeconomic policies were taken which eventually renewed growth.

The turn of the millennium saw Africa entering a period of sustained and impressive growth, with some of its countries among the fastest growing economies in the world. According to the McKinsey Global Institute (2010), Africa's real GDP growth rose by 4.9 percent per year from 2000 through 2008, more than twice its pace in the 1980s and '90s. Between 1995 and 2011, GDP growth across the continent averaged about 4.3 percent a year, some 3 percentage points higher than in the previous two decades. The continent's total GDP of US$1.6 trillion in 2008 was roughly equal to that of Russia or Brazil and the continent was among the world's growing economies. Indeed, over the decade ending 2011, and according to the Economist Magazine (April 2013), six of the world's ten fastest-growing countries were African, and in eight of the ten years, Africa grew faster than East Asia, including Japan. Africa was the world's fastest growing continent in 2013.

Labor productivity rose, on average, by 2.7 percent a year since the Economist Magazine labelled Africa "the hopeless continent" in 2000. Trade between Africa and the rest of the world increased by 200 percent between 2000 and 2011, driven by increased demand from China, which became Africa's biggest trading partner. Inflation dropped from 22 percent in the 1990s to 8 percent in the decade ending 2011, while foreign debts declined by a quarter and budget deficits by two-thirds, according to the Economist Magazine (2011; 2013). The continent proved resilient in the aftermath of the 2008-2009 financial crisis due to good fiscal management and low economic interconnectivity with the rest of the world.

The rapid growth in Africa occurred alongside a decline of conflicts, improved institutional and regulatory quality, and the emergence of increasingly accountable and democratic governance (Ernest and Young, 2013). The growth was also associated with declining inequalities in several countries, a growing labor force and improvements in key social indicators.

According to the United Nations (2013), out of a total of 35 countries for which data was available, 19 countries (54.3 percent) experienced a decline in inequality during the period 1990-2012, while 13 countries (37.1 percent) experienced an increase, compared to corresponding figures of 58 percent and 32.3 percent, respectively, in Asia. And during the decade ending 2013, real income per person in the continent increased by more than 30 percent, whereas in the previous two decades, it shrunk by nearly 10 percent.

A genuine middle class also emerged, and according to the Standard Bank, some 60 million African households had incomes greater than US$3,000 at market exchange rates and the number was expected to reach 100 million by 2015, almost the same as India (The Economist, 2011; 2013). The declining inequality, a rising middle class and urban growth contributed to a vibrant consumer market and created strong demand for modern goods and services, particularly information and communication technologies, clothing, and automobiles.

Africa also benefited from China's rapid growth and its search for "cheap" natural resources to fuel the country's infrastructure-led economic growth (Ackerman, 2015). China's arrival helped stimulate direct investment in Africa's infrastructure and boosted the continent's manufacturing sector. Other non-western countries, including Brazil, Turkey, Malaysia and India followed China's lead, and the continent was about to break into the global market for light manufacturing and services. Cross-border commerce, long suppressed by political rivalry, was growing as tariffs and barriers to trade were dismantled. Nigerian, Kenyan and South African companies were moving faster across borders, tapping into neighboring growth markets.

Africa also attracted a large inflow of foreign direct Investment (FDI) in the period leading to 2012 which contributed significantly to the region's growth. The sources of foreign direct investment to the continent were more diverse in the post-2011 period than in the decade before and came from OECD countries which accounted for 64 percent of the total USD178 billion FDI stock in the region in 2012 and emerging countries such as Brazil, Russia, India, China South Africa (BRICS) which increased their share of FDI in Africa from 8 percent in 2009 to 12 percent in 2012, equivalent to US$67.7 billion.

It must be mentioned that the rapid growth rates experienced in Africa over the last two decades were however not universal across the continent. They varied widely, with about half the countries in the region experiencing remarkable growth and others growing slowly.

What were the Drivers of Africa's Impressive Growth?

There has been much debate about what exactly spurred Africa's impressive growth since the turn of the millennium. Many attributed Africa's impressive growth to rising commodity prices on the world market. Truly, Africa benefited greatly from the surge in commodity prices in the post-2000 period, the commodity boom explains only a part of Africa's growth story. About a quarter of Africa's impressive economic expansion in the decade after 2000 came from higher revenues from natural resources. The rest came from other sectors, including wholesale and retail trade, transportation, telecommunication, and manufacturing.

The emergence of democratic and accountable governments, which led to an improved political and economic environment was a major contributory factor to the economic rise of the continent. The number of conflicts in sub-Saharan Africa declined since 2000, and political stability and democratic governance improved in many countries. With democracy came better governance, including more political freedoms, less violence, greater adherence to the rule of law, stronger public institutions, a better business environment, and less corruption. Although, the new democracies are far from perfect, the differences in the quality of governance show significant improvement.

Improvement in macroeconomic management and the business climate also played a major role in Africa growth. Macroeconomic management since the late 1980s became much more effective, with more flexible exchange rates, lower inflation, smaller budget deficits, and higher levels of foreign exchange reserves. Strong state control gave way to more market-oriented economic systems. Many African governments removed distortions that hindered growth, which led to more open trade, greater choice for farmers in buying inputs and selling their products, less red tape, and a drop in the cost of doing business. Africa's external debt also fell since 2002 after a series of initiatives, including the Heavily Indebted Poor Countries (HIPC) arrangement and the 2005 Multilateral Debt Relief Initiative (MDRI) which saw the debt of some 30 African countries cut by about US$100 billion.

A new generation of policymakers, activists and business leaders also emerged from the ranks of government institutions, civil society organizations, and private businesses, setting up businesses, working as local representatives of multinational corporations, leading local NGOs and activist groups, and taking an increasing role in political leadership and management of the economy.

Perhaps more important, African countries' relationships with their development partners became much healthier. Country-led poverty reduction strategies replaced structural adjustment programs at the center of policymaking, providing a stronger basis for international financial flows to bolster future development efforts. Sub-Saharan Africa witnessed a significant increase in the volume of international financial flows (including private capital flows, official development assistance and remittances to the region) from US$20 billion in 1990 to above US$120 billion in 2012.

During much of the past two decades, world economic conditions were generally favorable. Trade expanded rapidly and with that came access to new technologies and ideas, alongside bigger markets. Interest rates were also low, making borrowing for infrastructure projects far more affordable. And from 2002 through 2014, rising commodity prices helped buoyed economic activity in much of the region. African countries' relationships with their development partners also became much healthier. Country-led poverty reduction strategies replaced structural adjustment programs at the center of policymaking, providing a stronger basis for international financial flows to bolster future development efforts. Foreign aid played an important role and helped accelerate growth of many African countries and consolidated democracy in others, especially since the mid-1990s.

The Growth Outlook

Over the past few years and with the aftermath of the 2008 financial crisis, the global economy has been struggling, and many countries are confronting some of their most difficult challenges in a decade or more. Growth in sub-Saharan Africa slowed from 5.1 percent in 2014 to an estimated 3.4 percent in 2015. The World Bank projected that growth will remain subdued at 2.5 percent in 2016, as commodity prices were expected to remain low, global activity was anticipated to be weak, financial conditions were tightening, and many countries in eastern and southern Africa were facing severe drought. Growth is expected to pick up gradually in 2017, driven by domestic demand. Subdued commodity prices will affect mostly the less diversified oil exporting countries as they are not likely to experience any significant pickup in consumption growth. Growth was, in fact, to slow further for the region's oil exporters in 2016 to 2.3 percent, from as high as 6 percent in 2014. Investment growth was expected to slow in many sub-Saharan African countries as governments and investors were expected to cut or delay capital expenditures in a context of fiscal consolidation (World Bank, June 2016).

The IMF also made similar forecasts. According to the Fund, the pace of economic expansion in the region declined to 3.5 percent in 2015, the slowest in 15 years, and it was projected to slow further to 3.0 percent in 2016, well below the 6 percent or so observed over the past decade, and barely above the continent's population growth. And indeed, GDP per capita growth was projected to be under 1.0 percent for two years in a row for the first time since the late 1990s.

A confluence of domestic and external factors is exerting severe strain on many countries, leading to a significant slowdown of growth around the world. Perhaps most important is the drop in China's growth to about 6 percent, well below the pace of recent years. China's trade with sub-Saharan Africa exploded from less than $20 billion in 2003 to more than $170 billion in 2013. The changing economic situation in the world and especially the slowdown of the Chinese economy have had significant effects on investments in Africa. China's weakened growth and the country's efforts to put greater emphasis on its domestic economy have led to a sharp slowdown in trade with Africa and a significant contraction in some countries, especially Angola, the Republic of Congo, Equatorial Guinea, South Africa, and Zambia.

The sharp decline in world commodity prices has also impacted significantly on many sub-Saharan African economies. Prices of corn, copper, and cotton have all fallen by more than 20 percent since 2013. Iron ore and oil prices have also dropped more than 50 percent. These declines have had wide-ranging implications for many sub-Saharan African countries, in terms of export earnings, budget revenues, investment, employment, exchange rates, and foreign exchange reserves. The effects are particularly large in the oil producers such as Angola, Republic of Congo, and Nigeria, among others, and in countries that export iron ore (Liberia, Sierra Leone, South Africa), copper (Republic of Congo, South Africa, Zambia), and diamonds (Botswana, Namibia, South Africa). South Africa has been hit by falling export prices and growth is now only about 1.0 percent. Oil exporters such as Nigeria and Angola are confronted with widening fiscal and trade imbalances. Liberia and Zambia also have been hit hard.

Countries across the region also face several other long term challenges, including backlogs in infrastructure, especially power, roads, and water. A World Bank study in 2009 estimated that sub-Saharan Africa's infrastructure needs are about US$93 billion a year. Recently, the IMF estimated that budget spending on infrastructure by sub-Saharan African countries reached about US$51.4 billion (IMF, 2014), implying a financing gap of about US$41.6 billion. World Bank researchers estimate that infrastructure deficiencies in Africa reduces growth by more than 2 percentage points a year.

Climate change also presents a serious challenge to many parts of the African continent. Temperatures in sub-Saharan Africa are expected to rise between 1.5 and 3 degrees Celsius by 2050, and weather patterns, temperatures, and rainfall are expected to be more erratic. These will have a dampening effect on output and labor productivity in agriculture, putting millions of people at risk of food insecurity. The drought is likely to dampen growth in a number of countries, including Ethiopia, Malawi, and Zambia.

Long-Term Growth Prospects

A confluence of factors continue to pose serious headwinds for sub-Saharan Africa, but this does not mean that the region's growth momentum has stalled. Dealing effectively with these challenges will determine the direction and sustainability of the region's growth.

More broadly, Africa's long-term growth prospects are strong, propelled by both external trends in the global economy and internal changes in the continent's economies. Although the future outlook for many countries in the region remains difficult and clouded by risks, the underlying domestic drivers of growth over the past decade or so still persist.

Africa's agriculture, for instance, holds enormous potential across the value chain. With about 60 percent of the world's uncultivated arable land surface and forests resources covering 23 percent of its land area, the growth potential of the continent's agricultural sector is enormous (Sy, 2014). Most of Africa's labor force also works in agriculture: about 60 percent of the continent's jobs are related to agriculture. The growth potential of the agricultural sector is vital because as many studies have shown, in sub-Saharan Africa, growth in agriculture and services is more effective in reducing poverty than growth in industry. But there are significant obstacles to the agricultural sector's development. The issue of land ownership rights is a major impediment to agricultural development. Lack of capital to invest in seeds, fertilizers, machinery and equipment, and irrigation is also a major growth impediment to the continent's agricultural sector. African governments have to establish more favorable environments for private investment in downstream agricultural processing to help expand job creation, accelerate long-term growth, reduce poverty, and minimize vulnerability to price volatility.

The continent also boasts of abundant riches, including 10 percent of the world's oil reserve, 75 per cent of global platinum deposits, 50 per cent of diamonds, 50 per cent of chromium, 40 per cent of gold and 20 percent of uranium (UN-ECA, 2014). In addition, more than 30 African countries are oil and gas producers, and significant new oil and gas discoveries are creating business opportunities for investors. Africa (excluding North Africa) is considered the "new frontier" for global oil and gas, with such countries as

Cameroon, Equatorial Guinea, Ghana, Kenya, and Republic of the Congo, United Republic of Tanzania, and Uganda emerging as potentially major new producers of oil. The emergence of new oil and gas producers offers investment opportunities for exploration, production and related services, as well as in infrastructure development.

Africa's demographic dividend will be one of the major drivers of the continent's future growth. According to studies by African Center for Economic Transformation, sub-Saharan Africa's population is projected to increase from 965 million in 2016 to 2.1 billion in 2050. The continent also has the youngest population, with four in 10 people under the age of 15. This means that by 2050, sub-Saharan Africa will have a larger and younger workforce than China or India, indicating a fast-growing consumer base. Although urban populations will grow quickly, posing major challenges to job creation, infrastructure, education, health, and agricultural production, history shows that population growth is not necessarily a constraint on growth, so the demographic changes will also provide ample opportunities. Indeed, larger urban populations, a growing share of working-age people, and increased female labor force participation all present opportunities to expand labor intensive manufacturing and services activities especially when accompanied by investment in infrastructure and education. It is estimated, for instance, that the demographic dividend could account for 11-15 percent of Africa's GDP growth between 2011 and 2030.

The business environment in the continent is rapidly improving with many African countries ranked among the world's best. Seventeen out of the 50 economies that made the greatest improvement in their regulatory environment for business in 2013 were from Africa. Remarkably, eight of these countries were ranked ahead of China, 11 were ahead of Russia, 16 were ranked ahead of Brazil, and 17 were ranked ahead of India. Up to 2014, African countries constituted half of the 20 top global frontier markets that America and European multinational corporations were most interested in investing in. Asia and the Middle East each had three countries in this ranking, while Latin America had two. Nigeria topped the list of the global frontier markets, while Angola, Ethiopia, Ghana and Kenya were in the top 10.

Reaping the Long-Term Growth Prospects

Africa's growth surge cannot be sustained without strong education and health systems. Increases in school enrollment and completion rates, especially for girls, will be good first steps. But school quality is undermined by outdated curricula, inadequate facilities, weak teacher training, insufficient local control, teacher absenteeism, and poor teacher pay. The future calls for dramatic improvement in quality of education to equip students—especially girls—with the skills they need to be productive workers. Similarly, health systems remain weak, underfunded, and overburdened. Robust efforts are needed to improve access to health facilities, train health service providers, bolster the delivery of basic health services, and strengthen health systems more broadly.

Ensuring greater income equality will also help significantly in this regard as it will increase low-income households' ability to invest in education and physical capital and also help reduce sociopolitical instability and poor governance which discourage private investment. A handful of well-designed and targeted policy interventions to open up opportunities for low-income households and women will help alleviate inequalities and unleash the region's growth potential.

To reap the continent's long-term growth prospects, African countries must move aggressively to diversify their economies away from dependence on few primary commodity exports that exposes them to external shocks. Although, Africa is a resource-rich continent and most countries are endowed with natural resources, it is known that natural resources have not brought fortunes to many resource-rich countries in the region. This is partly because the linkage between the extractive sectors with the rest of the economy has remained low and resource-rich countries have usually failed to diversify their economies, engendering the concept of 'resource curse' that is afflicting many of them. Managing the exploitation of natural resources to have a positive effect on growth requires appropriate governance and fiscal regimes that ensure that resource rents are not misappropriated, are widely shared, and that governments are accountable and transparent in their resource allocation. For natural resource exporters, a robust and prompt shift in policy response is needed given the likelihood of an extended period of sharply lower commodity prices.

A long-term decline in commodity prices would undoubtedly affect the continent's growth prospects. But commodity-led growth in the continent is not as reversible as it used to be. African countries need to boost productivity and increase export volumes. Fortunately, buyers of Africa's commodities now are more diversified. A generation ago, Brazil, Russia, India and China accounted for just 1.0 percent of African trade. Today, they make up 20 percent, and by 2030 the rate is expected to be 50 percent. This means that if Brazil, Russia, India and China continue to grow, Africa will probably grow too. Besides, trade barriers in the continent are being dismantled, and despite the dearth of good roads, intra-African trade, by some measure, has gone up from 6 percent a decade ago to 13 percent of the total volume. But a lot more is needed.

As many commentators have observed, to reap Africa's strong growth potential, a significant policy reset is required in many areas. To begin with, there is the need for adroit macroeconomic management. Currently, widening trade deficits are putting pressure on foreign exchange reserves and currencies, tempting policymakers to try to artificially hold exchange rates stable. At the same time, budget deficits are widening, and with borrowing options limited, closing the gaps requires difficult choices. At the core will be the ability to mobilize domestic resources and increase tax revenues, which will allow countries to control deficits while financing critical investments in roads, power, schools, and clinics. In some countries, it might make sense to augment domestic revenue with borrowing, especially for priority infrastructure projects. But the burden of debt is accelerating, interest rates are rising, and spreads on sovereign bond issues in Africa are climbing quickly—putting the brakes on further borrowing (Sayeh, 2016). Strong fiscal consolidation will therefore be needed in many countries in the region.

Although strong macroeconomic policy reforms are required in many African countries, self-sustaining growth begins to occur when an economy undergoes a structural transformation from relying less on agriculture to relying more on industry. That is, self-sustaining growth is underpinned by large-scale industrialization, and this is the historical lesson of the East Asian tigers, China and even the West. Unfortunately, the situation in Africa points to the opposite direction. African labor has moved out of agriculture in large numbers, but the beneficiary has not been manufacturing but services. Meanwhile, the services sector tends not to be as productive as the manufacturing sector and is unlikely to be an engine of sustained productivity growth in the long-term. Africa's growth acceleration in recent years has thus not been associated with economic structural transformation. In general, the agricultural sector is still the employer of the majority of the labor force but representing a small share of the continent's GDP. Not only that but also productivity in the agriculture sector is still relatively low, underscoring the fragility of the continent's recent growth.

Weak infrastructure in sub-Saharan Africa is also a key factor limiting agricultural growth, industrialization, trade integration, and poverty reduction. It also contributes significantly to the cost of doing business in the region. Africa's transport infrastructure development has been inadequate, with the share of paved roads remaining low and a few rail developments. The region is also experiencing power crisis. Transport costs for merchandise exports are among the highest in the world, and an often unreliable electricity supply hinders economic activities and industrialization. According to the African Development Bank (2009), the poor state of infrastructure in sub-Saharan Africa cuts economic growth by 2.0 percent every year and reduces productivity by 40 percent. The continent needs roads, ports, airports, railways, energy production capacities and ICT infrastructure.

A strong policy agenda for building and maintaining infrastructure in sub-Saharan Africa is required to support high and sustainable growth. Investments in power, roads, and water, in particular, will be critical. While power supply in the region will need to grow substantially to meet unsatisfied demand, a significant share of the increment could be met from hydropower, thereby mitigating the climate change impact. A growing number of overseas and local companies see this as an opportunity to invest in the continent infrastructure to help meet the demand. Currently, African governments and private sources combined are investing about US$72 billion a year in new infrastructure across the continent. Africa's private infrastructure investment accounts for 13 percent of the emerging market total, up from 7 percent in 2000. However, the continent still faces huge backlogs in infrastructure, particularly in the provision of power, water, and transportation that will require at least US$46 billion more spending per year (MGI, 2010). Financing these investments will require a deft combination of prudent borrowing mixed with higher domestic revenue.

Since the 2008-09 global financial crisis, foreign direct investment has been replaced by remittances as the largest external source of funds. Reducing the cost of remittances and developing financial instruments to channel such flows into development programs and projects would go a long way in supporting the growth of the continent. Foreign aid has also helped support the surge of progress, and continued assistance will help mitigate the impacts of the current slowdown. Larger and longer-term commitments are required, especially for better-governed countries that have shown strong commitment to progress.

Continued long-term progress in Africa also requires building institutions of good governance and deepening democracy. The move during the past two decades away from authoritarian rule is remarkable, but it remains incomplete. Better checks and balances on power through more effective legislative and judicial structures, increased transparency and accountability, and strengthening the voice of the people are what it takes to sustain progress.

To unleash and sustain the continent's growth potential, African governments must move to implement the vision for a truly integrated continent in response to the region's need for a new and interconnected future. This will ensure that the regional integration agenda for the continent moves beyond the narrow focus on trade to include productive integration, free movement of people, regional infrastructure, and financial and macroeconomic integration. Such a fully integrated continent will ensure increased production and productivity, development of regional and global value chains, faster delivery of goods and lower transaction costs. Free cross-border movement will provide a powerful boost to economic growth and skills development, and support competitiveness. Free flow of capital will lead to investment increases and efficient allocation of finance, while better financial integration will promote knowledge and technology transfer as well as greater innovation (Lopes, 2016).

Conclusion

Africa's growth acceleration in the past two decades resulted partly from high commodity prices and low interest rates. Underpinning the continent's growth surge were also significant changes and improvements in the macroeconomic environment, political stability, institutional reforms and human development. The recent slowdown in growth presents major challenges that will not be easy for some African countries to overcome. In some countries, especially those reliant on a few commodity exports, the slowdown could be quite significant. But, for many countries in the region, the underlying drivers of growth over the past two decades still persist and so there is hope that strong growth will resume, albeit with a few pauses along the way. There is however the need for African countries to strengthen their resilience against external shocks. Managing the growth slowdown will also require right policies, strong leadership, difficult choices, and forceful action.

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