WHAT’S FUELING THE AFRICAN GROWTH?

A few decades ago, when Africa was crumbling under the burden of debt, economic forecasts were very pessimistic. But the vigorous growth of African economies has proven them wrong. Where does the African growth come from? What are its specificities? What does Africa need to be able to race with other great emerging countries?

ParisTech Review – We often speak of Africa as if it were a single entity. Are we perhaps mistaken by the word?

Lionel Zinsou – It would obviously be absurd to reduce to a single model all 54 African countries: they cover a wide range of economic specializations and levels of development. Nevertheless, the idea of an African unity is far from being absurd and we should be aware of the fact that this claim comes from the Africans themselves. It is expressed under several forms: recognition within international institutions, representation at the G20 (the seat of South Africa, in this regard, is very important), lobbying in favor of a permanent membership within the Security Council of the United Nations… The increasing role played by the African Union should also be taken into account. The AU headquarters and the UN Economic Commission for Africa are both located at Addis–Ababa, which plays the role of capital of the continent.

This unity claim responds to a significant trend of economic integration. African countries increasingly trade between themselves, and not only goods: foreign direct investment inside the continent is also very dynamic. For example, South Africans invest in telecom, gold mining, agribusiness. They also create financial firms, especially regarding private equity. Morocco invests in banking and transport. Egypt is turned towards Sudan and East Africa. These transborder financial flows reflect the emergence of regional powers, capable of exporting capital. Obviously, there are also many signs of differences in matters of development.

Are these differences of rhythm signs of different growth regimes? More broadly speaking, what are the factors behind the economic takeoff of the continent?

Growth patterns vary from one country to another and this forces us to consider the complexity of the causes of growth: several variables can be identified to explain the current dynamism of Africa. These can combine differently according to the countries that are examined. Let’s try to get a clearer picture.

The rise in relative prices of minerals and agricultural raw materials (food, cotton) is often put forward. It is true that there is a scarcity trend for a number of these materials, whose prices tend to rise. It should be known, however, that this increase is uneven: it is low for cotton, a little stronger for coffee and cocoa, real but volatile for hydrocarbons and finally, strong for rare earths and metals.

But what seems equally important is that at the same time, there has been a decline in the price of manufactured goods, which are still mostly imported. This double movement is quite interesting: compared with ten years ago, for a given quantity of cotton or diamonds, you can now buy more machine tools, agricultural equipment and equipment to develop infrastructures… As a whole, the continent has had a trade surplus for many years. The double movement of rising prices for local products and decreasing prices for imported products results in a significant effect in terms of purchasing power which economists call “terms of trade”.

The second major variable is that, over the past fifteen years, there have been positive cash flows. This is more pronounced in Morocco, less in Benin, but it is a movement that affects the whole continent and that is fundamental to my eyes. From 1960s to the 1980s, we witnessed, on the contrary, high capital outflows. Today, it is the exact opposite.

Could you elaborate on the nature of these capital flows?

Debt reduction, to start with. While many highly indebted countries spent a substantial part of their income to pay interests, debt reduction has drastically reduced these outflows of capital.

This deleveraging has taken two forms. The cancellation of debt, first: the HIPC (“Heavily Indebted Poor Countries”) cancelled part of their debt in exchange for the development of social services. This has been a true revolution. It is also a much wiser way to manage development aid: when working with direct aids to support projects that must be managed over the long–term, for one billion of aid that is paid, only 400 million will be used in the field. Whereas if we cancel the debt, one billion equals to one billion.

Second form: loan repayment. Countries such as Angola, Algeria and Nigeria have repaid their debt. Within a decade – without neglecting the impact of African GDP growth – the average public debt has decreased from 125% of the GDP to 25%. Such a deleveraging of the economy gives the possibility to re-borrow, but in smarter, cheaper ways; or for example, invest in projects that stimulate economic growth and not only pay for operating expenses.

Apart from debt reduction, capital inflows also play a great role. For example, the flow of funds from the diaspora is very important. In Morocco, this represents 15% of GDP, for example. In Cape Verde, it is more than a half! If we consider the weighted figures, Nigeria and Sudan are the two countries that benefit the most from these inflows. Altogether, the diaspora brings 50 to 60 billion per year, an amount equivalent to the total of the official development aid.

Finally, there is the foreign direct investment. I mentioned earlier the investment of African countries in other African countries. But of course there are inflows from outside the continent: Europe, America, Asia… The big emerging economies have drawn the global focus on the interests of Africa. Brazilian funds can be found everywhere in Angola and Mozambique. China has mainly invested in natural resource sectors and infrastructure. India has completed the largest transaction ever made in Africa: the purchase of the Kuwaiti Zain African telephone network by Bharti. There would be many other examples to give out… Even great traditional investors – Europe and the U.S. – are starting to regain interest. We are now in a phase of emulation and acceleration.

A fact very few people know of: if you take the whole continent, it has a current account surplus, which is partly due to the trade surplus, and partly to the excess of capital flows.

This can help accumulate reserves – Africa is clearly following the footsteps of China. Did you know for example that the accumulated assets of the African Central Banks represent $500 billion, more than the EU's central banks? These assets, it is true, are concentrated in very few institutions: namely, the Central Bank of Nigeria, of Algeria and of Libya.

It is easy to understand how this context can trigger economic growth, which reached 5% per year for the entire continent. But more specifically, what fuels this growth?

Most of the growth is fueled by productivity gains due to technology. The increasing purchasing power that I mentioned earlier enables to import productivity, by incorporating technology in the production of goods and services. This is particularly the case for telecommunications, but also for agricultural production. In agricultural production, productivity sometimes jumps from 1 to 10. In Benin, for instance, cotton productivity per hectare varies from 600 kg to 3 tons (with an average of 700 kg). You can see what is made possible by injecting capital and integrating technology! If we take a look at the market of milk production, within the same animal species, production can vary from ½ liter to 15 liters per day, a difference of one to 30. We can confidently expect 30 to 40 years of economic growth, simply from the increase of agricultural productivity.

The development of services is also a source of growth. Africa it is not only about cassava, oil and rare earths: it is about all this, but also about transports, trade, tourism, telecommunications, etc. Agricultural production and mining contribute very little to the GDP.

Accelerated banking should also be mentioned. It allows to bring more activities into the formal economy, but also to develop credit and therefore, investment.

And what about demographics?

It has become a positive factor. The African situation looks very similar to the Chinese one fifty years ago, despite a certainly different demographic future. Africa is the only continent that can rely today on such a considerable – and almost completely young – labor force.

A small distinction should however be made: although the population contributes in stimulating the growth, the integration of the youth into the labor market is often difficult. This reason for it is very simple: African growth is highly intensive in terms of capital. Water, agriculture, energy, infrastructure are the most capital intensive activities and they are precisely on the agenda. If you take the agricultural upstream, for example, for every dollar of revenue, you need to invest two dollars of capital. However, if you consider the food processing industry, you need to invest half a dollar for one dollar of revenue. The manufacturing industry has a coefficient of capital four times lower than the primary sector. This capital intensive growth, while the continent has little capital and capitalists, also explains why African growth is around 5% and not 7.5%, as in India or China, where growth is more labor intensive.

But, as you were telling us, there is capital.

Yes, but it still needs to be distributed properly. On this side, considerable efforts need to be made. The reserves of the Central Banks that I mentioned earlier mainly consist in U.S. Bonds. This is certainly not the best way to finance an economy…

African countries suffer today from an underdeveloped financial system. To give you an average number: in today's world, the financial assets of the economic agents (stocks, bonds and liabilities of banks) are roughly four times the global GDP. In Africa, they are about one time the GDP. This gives you an idea of what remains to be done: building an appropriate financial system in order to finance the economy properly is crucial issue.

What are the most advanced countries? Are there any African "lions", the same way there were Asian "dragons" or "tigers"?

It's a little too early to see who will be leading the race, while growth rates are still relatively undifferentiated. It is also difficult to say whether social tensions will disrupt the growth models: Tunisia and Egypt were not protected from the "Arab Revolution" by their 7% growth. However, we can see rapid progress in Anglophone and Lusophone Africa. The historical role of leaders is also highly discriminating. Morocco in North Africa, Ghana in West Africa, Mauritius in the Indian Ocean, Botswana in Southern Africa… are getting ahead.

What are the four or five largest companies in Africa?

As everywhere in the world, they are the big oil companies of large producing states (Sonatrach in Algeria or Sonangol in Angola) or mining companies (De Beers, OCP in Morocco). More recently, two groups of South African Telecoms (MTN and Vodacom) joined the top ten; and even a major retailer (Shopsite); the next groups are from the construction and supply sectors. The needs and consumption of the new African middle class – young, modern and solvent – have made their way into these rankings. They will certainly dethrone raw materials exportations.

We haven't talked about the industry. You say that the Africa economy is largely based on services. But what about the secondary sector?

Here again, we need to make distinctions. Tunisia, Morocco, Egypt, South Africa are industrialized countries. Egypt, for example, exports fertilizers, cables, textiles, electronic components, etc. But on the whole, the continent is hardly industrialized. This reflects several problems.

The first concerns the fragmentation of the domestic markets. There are 54 countries within Africa and many markets are tiny. This is why regional integration is essential, and it is also one of the reasons why East Africa goes a little faster now: it integrates faster and better than West Africa.

The question of scale is fundamental. This is proven by a simple examination of facts. Consider the industries that don't rely on scale issues, like the food industry: they grow at breakneck speed. Breweries are also a good example: the size of local markets is sufficient. They even allowed world booms. If you take South African Breweries (SAB–Miller), for example, they are no 2 in China, n°.2 in the U.S. and no 1 in Australia, well positioned everywhere else… In contrast, the textile industry, for instance, depends very much on the scale and suffered during the recent years.

Second factor: the relative weakness of solvent domestic demand. Take the example of the automotive industry. Today, annual sales across the continent reach hardly two million vehicles, a market comparable to France, but concerning one billion people over 30 million km². This demand is too low to help the development of an industry (as was done recently in Malaysia, for example). But some signs of change have appeared: the Renault plant in Tangier is one of these signs that show the emergence of a sector where the price of specific offer is well-adapted to the purchasing power of consumers. A new range of consumer goods and services (e.g. telephony) is starting to emerge, specially designed for the continent by investors from emerging countries. Demand will quickly increase from two to four million vehicles a year.

Should we expect to see Africa replace China as the "workshop of the world"?

Probably not, at least not right away. The game has changed. For a long time, Africa has supplied raw materials to Europe. Today it has other clients, starting with China, India or Korea… that have taken the place of Europe as workshop of the world. In the medium term, Africa will become its own supplier and its own client: it will produce first of all for itself.

It already has an endogenous growth: the crises that stroke its main trading partner, the European Union, in 2012 and again in 2013, didn't have much negative impact on the African economy. Capital is needed to fuel the domestic and endogenous growth: it is thus crucial to establish a supply structure. Progress is being made. And where capital markets are more efficient – in South Africa, Nigeria, Morocco, Ghana – growth is stronger.

To summarize: improving the terms of trade is an essential parameter of growth and Africa now enjoys a favorable position regarding its exports. But more importantly, there is what economists call the "invisibles" i.e. the financial flows. Their existence and efficiency are the bedrock upon which economic players can take advantage of this favorable position. Without capital, without financial markets, without investment, without capitalists, without the generation of young entrepreneurs – among other assets of modern Africa – the rising price of oil or palm oil would simply inflate revenues and fuel corruption and predation.

Finally, there is the labor factor: demographics are a big chance when combined with productivity gains, through training and technical progress. To increase the purchasing power, what you need first is productivity… This brings us back to the central question of funding, which is necessary in order to incorporate technology and increase productivity.

In developed countries, the solvency of demand was also made possible by the development of the welfare state, which released households from a number of concerns and contributed to the growth of consumption. Is it not a possible path for Africa?

Certainly. And beyond the security provided by the welfare state, there is the question of redistribution and transfers, which can boost consumption and fuel growth. But the question only arises in the most advanced African countries, mainly in the North and the South of the continent. Elsewhere, we see a very different problem: the inefficiency of government. The issue is not to develop the welfare state – at least not yet. The first step is to build a state, a state capable of raising taxes: today, there is still very little income tax or VAT across the continent. Instead of modern taxes, it is mostly tariffs that allow government revenues. This is definitely an obstacle to development. African goverments can only take an average of 20% of their GDP, against 40% for developed countries. So their first emergency is to build a state. The issue of redistribution will only come in a second phase.

Source : http://www.paristechreview.com/2013/03/20/african-growth/