

## Chapter 1

# **Africa's integration into the global economy**

This chapter analyses the overall development trajectory in Africa and its position in the global economy since 1990. It first addresses the determinants, components and dynamics of growth in gross domestic product and their impact on job creation and inequality. The analysis then proposes five reasons why Africa needs better growth patterns in light of its Agenda 2063 development targets. The second part of the chapter looks at growth avenues that regional and global markets present to African economies. The chapter presents the policy challenges to boost domestic competitiveness, further develop domestic markets and unlock investments.

# BRIEFING

Between 2000 and 2016, Africa experienced strong economic growth rates (averaging 4.6% annually), higher than Latin America and the Caribbean (2.8%) yet lower than developing Asia (7.2%). These resulted from high commodity prices, improved macroeconomic management and strategies to diversify growth. Many countries have invested strongly in public infrastructure; some have also diversified their trade partnerships, in particular with China, India and other emerging partners.

Despite this, Africa would benefit from improving its economic growth patterns for several reasons:

- African countries need to strengthen the drivers of **long-term growth**. Growth has been highly volatile, and only three African countries are forecasted to meet Agenda 2063's growth target of 7% a year during the 2016-20 period.
- Growth has not created enough jobs, and quality jobs remain scarce. If current trends persist, the share of **vulnerable employment** in Africa is projected to remain at 66% in 2022, far above the target of 41% by 2023.
- Africa's recent growth has not improved **well-being** as much as has growth in the rest of the world.
- Reducing **inequality** is essential to make growth more inclusive and resilient. If Africa lowered its current Gini coefficient to that of developing Asia, growth between 1990 and 2016 could have potentially reduced the number of poor people by an additional 130 million.

Both global and regional markets offer new avenues for better growth. Export diversification can help Africa benefit more from **integration into the global economy**. Deepening regional integration, particularly increasing intra-African trade in intermediate goods, can also help. **Domestic demand in Africa** offers new opportunities for local companies, such as entrepreneurs and small and medium-sized enterprises. African governments can do more to help them catch up with global productivity, especially through building industrial linkages and developing local capacity. To mobilise more financial resources for countries' development, African governments can improve tax policies and revenue collection, enhance the effectiveness of public spending and promote better financial intermediation to channel savings towards investment in local economies.

# Africa's integration into the global economy

## Growth

Since 2000, Africa's GDP has tripled

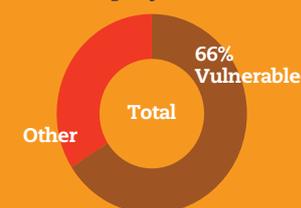


## Trade

Africa has diversified its trade partnerships



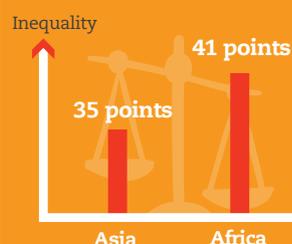
## Employment



Agenda 2063's target for vulnerable employment of **41%** by 2023 is still far away

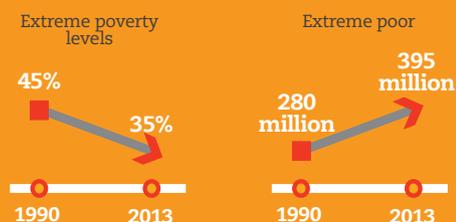
## Inequality

Africa's Gini coefficient average



## Poverty

Extreme poverty levels decreased, but more people are living on USD 1.90 a day or less



## Policy options for better growth

Deepening regional integration could boost Africa's GDP by 1%, total employment by 1.2% and intra-African trade by 33%



Helping African producers tap fast-growing domestic markets



Unlocking private finance for productive investment



### Basic indicators: Africa in the global economy

Table 1.1. Basic indicators for Africa, Asia and LAC, 2017

	Africa	Asia	LAC
Population (thousands)	1 202	4 011	620
Land area (thousands of km <sup>2</sup> )	30 143	25 071	20 412
Population density (pop./km <sup>2</sup> )	39.9	160.0	30.4
GDP, PPP (USD billion)	6 377	45 114	9 783
GDP per capita, PPP (USD)	5 305	11 246	15 785

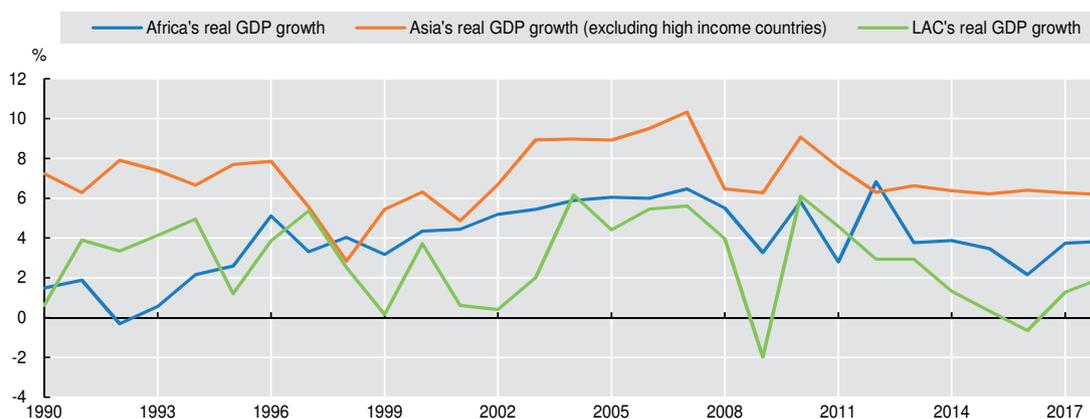
Source: Authors' calculations based on data from UNDESA (2017), *World Population Prospects: The 2017 Revision* (database), World Bank (2017a), *World Development Indicators* (database), and IMF (2018), *World Economic Outlook* (database).

Table 1.2. Foreign and domestic financial flows and tax revenues to Africa (current USD, billion), 2010-16

		2010	2011	2012	2013	2014	2015	2016	
Foreign	Private	Inward foreign direct investment	46	45	55	62	64	49	59
		Portfolio investments	28	26	42	32	31	20	13
		Remittances	53	60	64	64	68	65	62
Public	Official development assistance (net total, all donors)	47	52	52	57	54	51	50	
		<b>Total foreign flows</b>	<b>175</b>	<b>182</b>	<b>214</b>	<b>215</b>	<b>217</b>	<b>185</b>	<b>185</b>
<b>Domestic tax revenues</b>		<b>332</b>	<b>407</b>	<b>421</b>	<b>418</b>	<b>412</b>	<b>343</b>	<b>312</b>	

Sources: Authors' calculations based on IMF (2018), *World Economic Outlook* (database), OECD-DAC (2017), *International Development Statistics* (database), and World Bank (2017a), *World Development Indicators* (database).

Figure 1.1. Real economic growth in Africa, Asia and LAC, 1990-2018

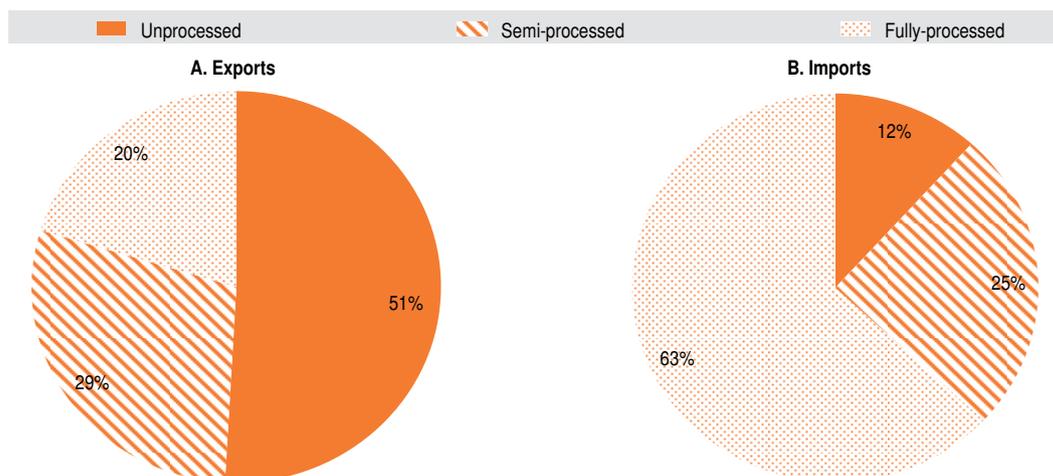


Note: (p) = projections.

Source: Authors' calculations based on IMF (2018), *World Economic Outlook Database*.

StatLink <http://dx.doi.org/10.1787/888933782411>

Figure 1.2. Trade composition in Africa, 2016



Source: Authors' calculations based on United Nations Statistics Division (2017), *UNCOMTRADE* (database).

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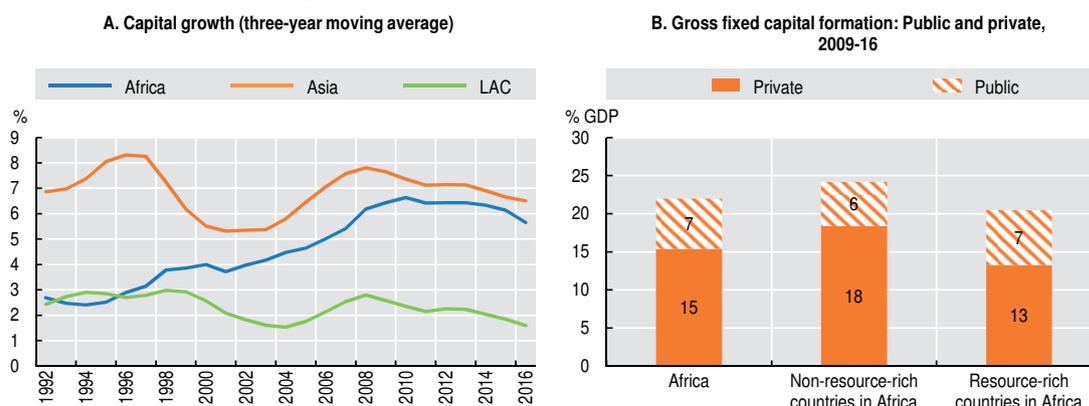
## Five reasons why Africa needs better growth patterns

### Growth remains volatile, despite a strong process of capital accumulation and new trade partners

The African continent has experienced strong growth since 2000, leading to a so-called “rising Africa”. From a historical perspective, Africa’s growth performance has much improved compared to the 1990s when its per capita growth was negative. Between 2000 and 2008, Africa’s growth rebounded at about 5.5% and per capita growth at 3.1%. This aggregate performance is better than that of LAC at 3.6% but lower than Asia’s average of 8.0% for the same period. The number of African countries with GDP growth rates above their population growth also substantially increased. This growth performance benefited from favourable commodity prices, improved macroeconomic management and debt-relief, but also from growth diversification strategies in some countries (see Box 1.2).

Many African countries have invested strongly in public infrastructure, leading to a process of capital accumulation across the continent. Whereas capital stock in Africa grew roughly by only 2.5% in the early 1990s,<sup>1</sup> capital accumulation quickly accelerated in the early 2000s and reached 6.6% in 2009, a level similar to Asia’s capital expansion (Figure 1.3, Panel A). The capital ratio per worker in Africa has increased steadily and attained a similar growth rate to LAC, even after adjusting for Africa’s rapid labour expansion. This acceleration reflects the low starting point in many African countries. The average gross fixed capital formation was 22% of GDP for the whole continent (Figure 1.3, Panel B). For 16 African countries, it was over 30% of GDP. While private sector accounts for the majority of investment, public investment also amounted to 7% of GDP per year. During this period, many African governments invested in projects to fill the large infrastructure gap and boost aggregate demands in relation to the global economic crisis.

Figure 1.3. Capital growth in Africa, Asia and LAC, 1992-2016, and gross fixed capital formation in Africa, 2009-16



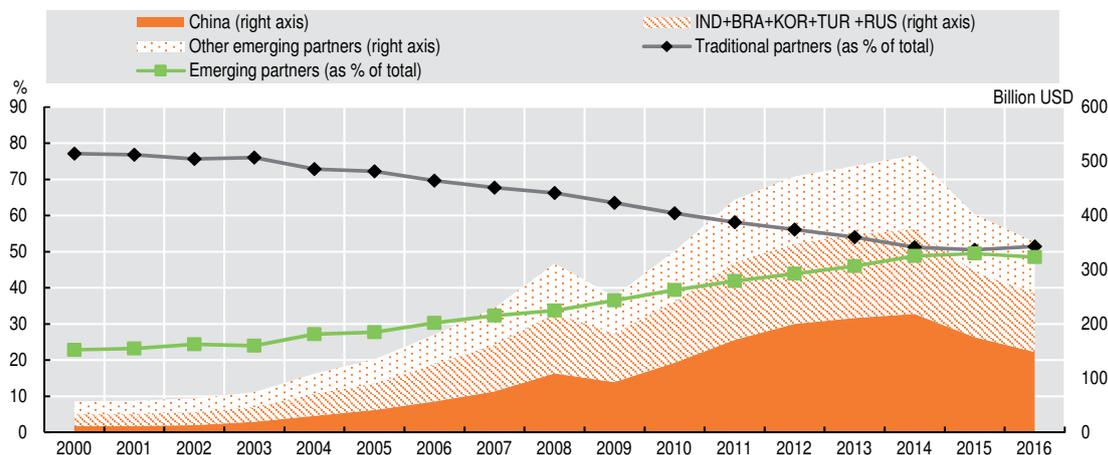
Note: The gross fixed capital formation comprises the total net value of acquisitions of fixed assets during the accounting period, plus variations in the valuation of non-produced assets (e.g. subsoil assets). Resource-rich countries are defined as those with at least five years between 2006 and 2015 for which resource rents excluding forest rents were at least 10% of GDP.

Sources: Panel A: Authors' calculations based on data from The Conference Board (2017), *Total Economy* (database), Panel B: World Bank (2017a), *World Development Indicators* (database); IMF (2018), *World Economic Outlook* (database). StatLink  <http://dx.doi.org/10.1787/888933782449>

Countries have also diversified their trade partnerships. Between 2000 and 2016, Africa tripled its trade with the rest of the world, from USD 276 billion to USD 806 billion. Trade flows with emerging partners like China and India expanded significantly (Figure 1.4). As a result, Africa’s trade shifted from traditional to emerging trade partners. This holds both for African exports and imports. Trade with emerging economies accounted for 51%

of Africa's exports and 46% of Africa's imports in 2016. Nevertheless, expanding trade relations has not diversified the continent's export basket.

Figure 1.4. Distribution of Africa's trade, 2000-16



Note: India (IND), Brazil (BRA), Korea (KOR), Turkey (TUR), and Russia (RUS). Trade is the sum of Africa's exports and imports. Africa's emerging partners are those defined by OECD et al. (2011).

Source: Authors' calculations based on UN Statistics Division (2017), UN COMTRADE (database).

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Sustaining growth over a long period is challenging for most African economies. Individual growth trajectories from 1970 to the mid-2000s reveal that growth spells tend to be shorter in African and Latin American countries than elsewhere (see Berg, Ostry and Zettelmeyer, 2012, for details). Recent data shows that growth volatility remains widespread:

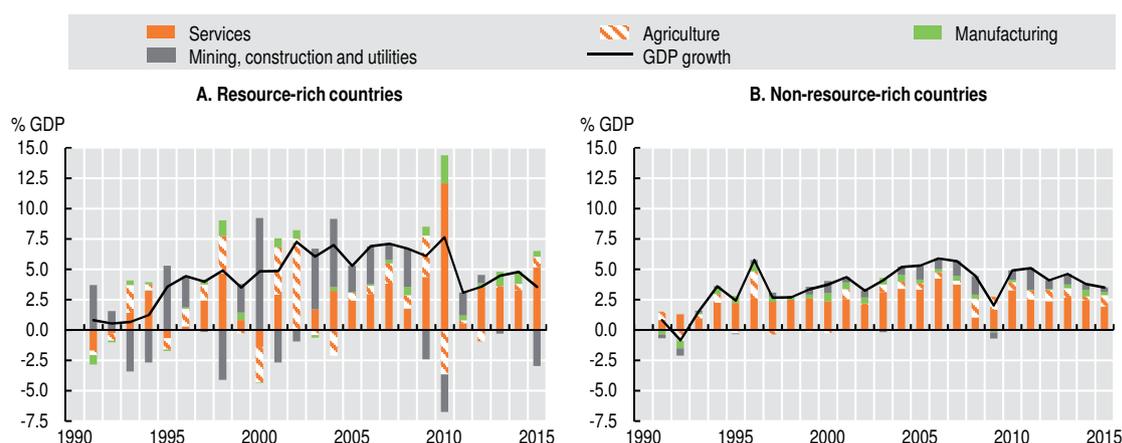
- Africa's growth experienced a dip in 2008/09. In net-importing countries, a sharp increase in oil and food prices seriously affected household purchasing power and countries' current account balances, demonstrating Africa's vulnerability to external commodity shocks.
- Africa's growth experienced a second low point in 2010 largely related to the Arab Spring. This revealed, among other things, that prior growth did not create enough jobs and was not inclusive.
- In 2016, the continent's GDP growth dropped temporarily as unfavourable commodity prices again hit many large economies that are based on natural resources. GDP growth is expected to recover slowly and reach 2.8% in 2018, in part due to Africa's resilient domestic demand and a recovery in oil prices.

The volatility of growth varies widely across countries, depending on the structures of their exports and production. The standard deviation of annual growth between 2000 and 2017 is significantly higher for resource-rich African countries, at 9.0 points, than for non-resource-rich African countries (3.2 points), developing Asian countries (4.1 points) and developing LAC countries (2.6 points). This comparison between resource-rich and non-resource-rich countries is instructive:

- The resource-rich countries have enjoyed stronger terms of trade and have average growth since 2000 at more than 6% a year due to high commodity prices, especially for fuel (petroleum, natural gas and coal) and metals (Figure 1.5, Panel A). However, the high concentration of export earnings from only few natural resources has led to unstable government revenues. It has deterred governments from committing to long-term public investment and from sustaining social spending. As commodities prices dropped sharply between 2012 and 2016 (57% for fuel and almost a third for metals and minerals), domestic revenues in resource-rich countries decreased by 44%. The slump in commodity prices reduced the continent's growth to 2.2% in 2016.

- By contrast, non-resource-rich countries have registered more stable growth at about 4% a year since 2000. Between 2000 and 2015, the services sector contributed about 3 percentage points a year to annual GDP growth, compared to 1.1 percentage points for industry and 0.6 percentage points for agriculture (Figure 1.5, Panel B). A number of countries, such as Ethiopia, Kenya and Rwanda, have successfully boosted growth through public investment (mostly in large infrastructure projects) and buoyant services. In addition, net oil importers have benefited from lower fuel prices in recent years, hence reducing their import bills. The second half of this chapter will elaborate on the drivers of growth across African countries.

Figure 1.5. Sectors driving the annual growth in Africa: Resource-rich versus non-resource-rich countries, 1990-2016



Note: Resource-rich countries are defined as those with at least five years between 2006 and 2015 during which resource rents excluding forest rents were at least 10% of GDP. For the resource-rich countries, the peak in the contribution of services in 2010 is in part due to the “rebasings” effect of Nigeria’s GDP. The rebasing happened in 2015, but the GDP series of country was readjusted back to 2010.

Source: Authors’ calculations based on IMF (2018), *World Economic Outlook* (database).  
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Under a business-as-usual scenario, Africa is unlikely to meet the targets set in the first ten-year implementation plan of the African Union’s Agenda 2063. In the first half of the plan (2013-17), Africa’s real GDP grew at 3.4% a year. For the next five-year period (2018-22), Africa’s real GDP growth is projected at 3.9%. Africa is lagging behind its 7% a year target by more than 3 percentage points annually. Achieving high growth rates has proven difficult for all countries worldwide since the 2009 global crisis (Table 1.3).

Table 1.3. Growth rates for African countries, other developing countries and high-income countries, 2000-20

		Number of countries in each growth category			
		2000-05	2006-10	2011-15	2016-20 (p)
African countries	Growth above 7%	9	9	6	3
	Growth of 0-7%	38	41	43	48
	Negative growth	5	2	3	3
Other developing countries	Growth above 7%	15	14	10	6
	Growth of 0-7%	63	64	65	73
	Negative growth	2	4	6	2
High-income countries	Growth above 7%	6	1	1	0
	Growth of 0-7%	46	43	43	51
	Negative growth	0	8	8	1

Note: (p) : projections.

Source: Authors’ calculations based on IMF (2018), *World Economic Outlook* (database).

African countries need to strengthen the drivers of long-term growth. The contribution of labour to growth has not increased much over time, and total factor productivity (TFP) gains have remained small and volatile. Despite the process of strong capital accumulation between 2009 and 2016, Africa experienced virtually no growth in TFP (Figure 1.6). This situation is better than in LAC, where TFP growth was negative during the same period. But Africa lags behind Asia, where TFP contributed 1 percentage point to annual growth. Slow TFP growth is a source of concern as long-term growth depends on sustained improvement in productivity. The vulnerability of African economies to external shocks and climatic conditions such as droughts is one of the main factors explaining the volatility of TFP. In agriculture-based economies, for example, higher agricultural commodity prices, rather than agricultural productivity growth, have been the driving force for TFP gains (IMF, 2016a).

Figure 1.6. Contribution of total factor productivity, labour, and capital to GDP growth in Africa, Asia and LAC, 1990-2016



Note: TFP stands for total factor productivity, measured as the variation in GDP not explained by the contribution of labour and capital to GDP.

Source: Authors' calculations based on data from The Conference Board (2017), *Total Economy* (database).

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While public investments can help jump-start growth, sustaining it over a long period depends on a set of country-specific policy factors. The literature suggests that a number of factors can sustain growth (e.g. Berg, Ostry and Zettelmeyer, 2012). Prolonging growth episodes depends on the stability of macroeconomic environments (such as inflation rates), higher financial development (proxied by the ratio of private credit to GDP) and more equal income distribution. Political competition and the strength of policy-making institutions also help countries enjoy longer growth spells. Countries' capacity to manage external shocks – such as changes in interest rates and in the terms of trade – plays a crucial role in increasing the probability of growth episodes, while decreasing the probability of growth reversals. Many African countries have improved their macroeconomic management, their regulatory frameworks and the quality of public institutions. However, further steps are needed to reduce vulnerability and to achieve stronger and less volatile growth that translates into higher levels of well-being.

### Recent GDP growth has not increased well-being

Despite Africa's strong growth performance since 2000, the correlation between the continent's GDP per capita and well-being indicators appears weaker than the world average. In Africa, like in the rest of the world, gross national income per capita and gross secondary school enrolment rates correlate relatively strongly with GDP per capita. However, outcomes related to other dimensions of well-being, such as years of schooling, health status and

housing conditions, have a much weaker association with GDP per capita in Africa than the world average (Table 1.4). Results are similar for several dimensions of subjective well-being, including satisfaction with standards of living and with health coverage availability. Dimensions related to public governance – satisfaction with educational systems and perceived corruption – are also sources of concern. Compared to other countries with similar levels of income per capita, many African countries seem less able to transform resource flows into positive outcomes for the well-being of their citizens.

It is possible that, in a number of African countries, policies have not been effective enough in improving well-being. This may be the case where indicators of well-being weakly correlate with GDP per capita (Box 1.1). Resource-rich countries lag behind non-resource-rich countries in a number of well-being dimensions (Christiansen, Schindler and Tressel, 2013: 9-10). One hypothesis is that the dependence on resources makes their growth too volatile and less conducive to an increase in well-being.

### Box 1.1. The correlation between GDP per capita and selected well-being indicators in Africa and the world

Development is often considered synonymous with economic growth, and yet GDP growth is only one indicator of development among many. Human development fails when aggregate increases in productivity and material wealth do not produce meaningful gains in the overall well-being of a country's population. Economic growth is only a means to an end: the sustainable and equitable improvement of people's lives. Going beyond macroeconomic metrics and monitoring well-being across the many different areas that matter for citizens are necessary to comprehensively assess the quality of life within a country.

The OECD measures well-being in non-OECD countries by looking at well-being outcomes in two broad areas: material conditions and quality of life (see Boarini, Kolev and McGregor, 2014). Material conditions encompass various consumption possibilities, work, housing conditions and infrastructure. Quality of life comprises health status, education and skills, social connections, empowerment and participation, vulnerability and life evaluations, and feelings and meaning – which are the main aspects of subjective well-being.

Table 1.4. Correlation between well-being indicators and GDP per capita in Africa and the world

Variables	Correlation		Variables	Correlation	
	All countries	Africa (average)		All countries	Africa (average)
Gross national income per capita	0.9969	0.9966	Having someone to count on in an emergency	0.4825	0.2951
Vulnerable employment	0.7860	0.7212	Satisfaction with water quality	0.4586	0.1961
Education and skills: gross enrolment ratio (secondary school)	0.7504	0.7932	Satisfaction with roads	0.4376	0.3033
Expected years of schooling	0.7085	0.4876	Lack of money for shelter	0.4209	0.3213
Access to improved sanitation	0.7139	0.4763	Having no health problem	0.4008	0.2196
Child mortality ratio	0.6861	0.4138	Satisfaction with standard of living	0.3916	0.2502
Life satisfaction	0.6707	0.4871	Satisfaction with health coverage availability	0.3621	0.1092
Life expectancy	0.6689	0.2186	Dissatisfaction with household income	0.2750	0.3614
Lack of money for food	0.6361	0.3574	Change in forest land cover	0.2432	0.0826
Adult literacy	0.6256	0.4234	Satisfaction with educational system	0.2395	0.0525
Maternal mortality ratio	0.6038	0.4139	Sense of safety when walking alone at night	0.1424	0.0005
Health coverage	0.5851	0.3207	Perceived widespread corruption	0.1193	0.0484
Perceived Corruption Index	0.5522	0.148			

Note: The correlation between variables is calculated using the R square.

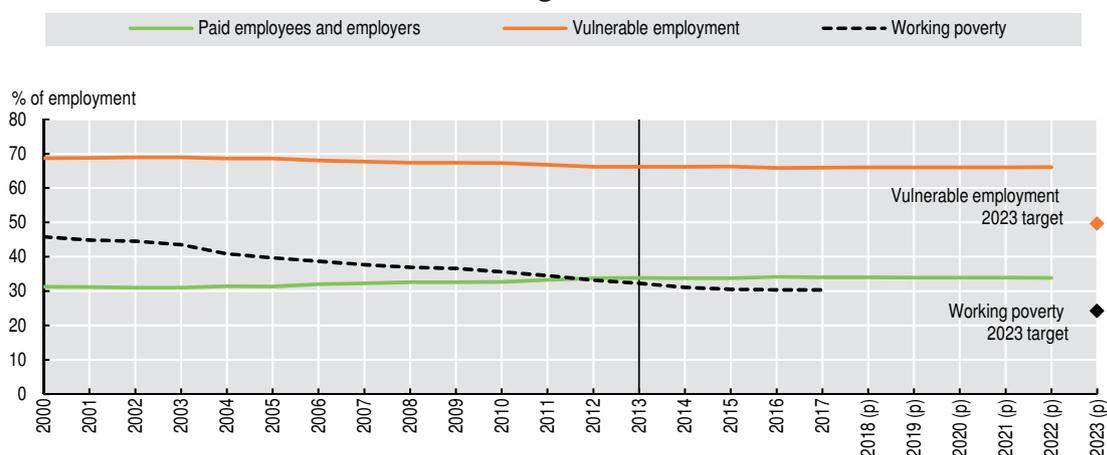
Source: Authors' calculations based on World Bank (2017a), *World Development Indicators* (database), and Gallup (2017), *Gallup World Poll*.

## The continent needs to generate more quality jobs for its large labour force

Quality jobs remain scarce across the continent. Relatively high growth since 2000 has not created enough quality jobs, and the share of vulnerable employment remains stubbornly high. According to International Labour Organization data, 34% of Africa's workers had wage-paying jobs or were employers in 2017, and 66% were in vulnerable employment as own-account or family workers (Figure 1.7). While the unemployment rate stood at only 7.2% of the labour force in 2017, 30% of the workers remained poor despite working.

The continent also has one of the highest rates of informality outside the agricultural sector. The rates range from 34% of employed people in South Africa to 90.6% in Benin (ILO, 2018). The income level for informal workers is often highly vulnerable to various economic shocks, and the social protection system covers few informal workers.

Figure 1.7. **Employment status for Africans, 1990-2022, and the 2023 targets of Agenda 2063**



Note: (p) : projections.

Source: Authors' calculations based on the ILO (2017), ILOSTAT.

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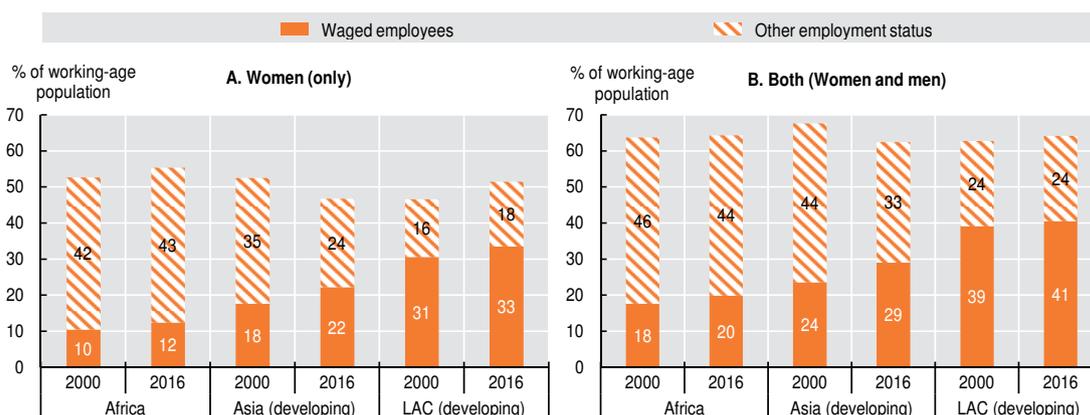
If current trends continue, Africa will not meet the quality employment targets set out in the first ten-year implementation plan of Agenda 2063.

- The most challenging target relates to vulnerable employment. The share of vulnerable employment has fallen by only 2 percent points since 2000, and is projected to persist at 66% in 2022 (Figure 1.7). If this trend continues, Africa would not make any progress on its target of reducing the vulnerable employment rate by 25 percentage points, from 66% in 2013 to 41% in 2023.
- The share of workers living on less than USD 1.90 (purchasing power parity [PPP]) a day decreased from 46% in 2000 to 30% in 2017. However, such progress may not suffice to meet the 2023 target of reducing the share of the working poor to 24%. If the working poverty rate follows the average trend between 2000 and 2017 and declines by 0.91 percentage points a year, working poverty will decrease to 25%.

Despite general progress, workplace disparities between men and women continue to worsen in many countries. African countries have made much progress in increasing educational attainment for women since 2000. However, only 12% of Africa's working age women were on wage-paying employment in 2016 (Figure 1.8). Other developing countries have much better rates: 22% in Asia and 33% in LAC. In 2016, 75% of Africa's female workers remained in vulnerable employment, and almost 35% were working poor

(ILO, 2018). Inequalities are also found in relation to females' participation in the labour force, in entrepreneurship opportunities and in access to economic assets (UNDP, 2016). The gender pay gap in the non-agricultural sector stands at 30% (UNDP, 2017: 4).

Figure 1.8. **Waged employees as a percentage of the working-age population in Africa, Asia and LAC, 2000 and 2016**



Source: Authors' calculations based on the ILO (2017), ILOSTAT (KILM database).

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Young people suffer from underemployment and a lack of wage-paying jobs. About 42% of the working youth live on less than USD 1.90 a day (PPP). In low-income African countries, only 17% of the working youth (7% of all youth) are full-time employees (AfDB/OECD/UNDP/UNECA, 2012). The lack of wage-paying jobs is challenging for governments, as the majority of African countries face extremely rapid demographic and urban growth. Middle-income countries in Africa face a similar dearth of quality jobs, as many young people remain out of the labour market. In North Africa for example, 26.1% of young people between the ages of 15 and 24 are not in education, employment or training (NEET), the second highest rate globally (ILO, 2018). In that region, youth make up more than 34% of the total unemployed population while representing only about 15% of the labour force. In South Africa, the share of youth in NEET has stayed consistently high, at over 30%, every year for which data is available since 2012.

### Further alleviating poverty requires reducing income inequality

All in all, the continent has made good progress in fighting extreme poverty since 2000. Africa's share of the population living on USD 1.90 a day or less declined from an average of 49% in the 1990s to 36% in the 2009-16 period.

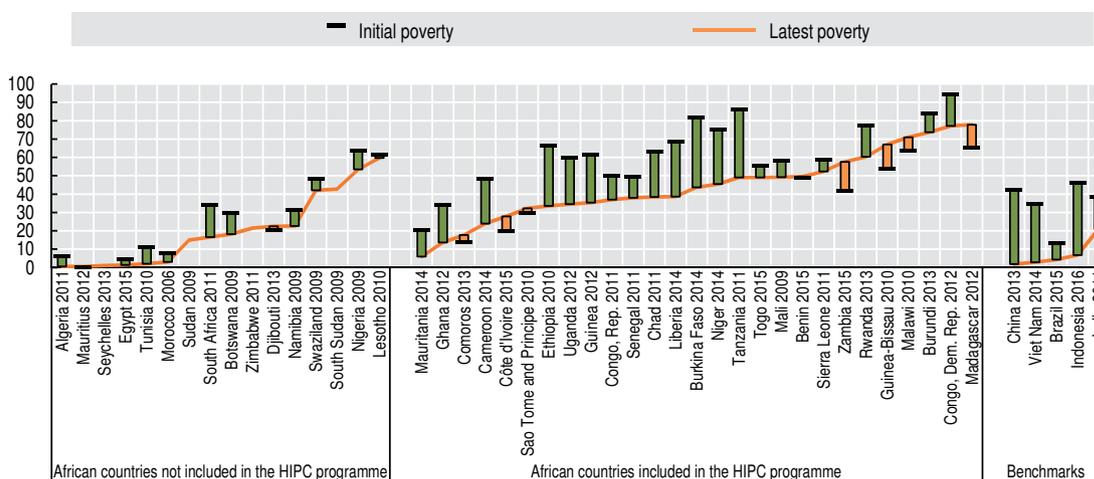
- Six countries – Algeria, Egypt, Mauritius, Morocco, Seychelles and Tunisia – have almost eliminated extreme poverty (Figure 1.9). In Morocco, for example, the national initiative for human development (INDH), launched in 2005, has successfully helped vulnerable groups by encouraging income-generating activities and social protection measures such as health coverage. By end-2015, about 8.5 million people belonging to the poor or the most vulnerable households in Morocco had access to free or partly-free health care in public hospitals through the RAMED insurance launched in 2008 (see OECD, 2017a: 163). The government also provides a 24-month exemption of social security contributions for the long-term unemployed who take part in the Idmaj training programme.
- In six other countries – Burkina Faso, Chad, Guinea, Liberia, Niger and Tanzania – the annual pace of poverty reduction since 2000 was similar to China's between 1996 and 2013.

- Overall, non-resource-rich countries in Africa have been notably successful in reducing poverty rates, from 57% to 37%. However, most of these countries have benefited from debt relief programmes which may no longer be available in the future (see note for Figure 1.9).

Many African governments need to further reduce poverty for four reasons:

1. Although the proportion of poor people has decreased, their absolute number has increased due to rapid population growth in the poorest segments of society. The number of people living on less than USD 1.90 a day increased by 105 million between 1990 and 2013, from 280 million to 395 million. Resource-rich countries accounted for 65% of this increase (68 million people).
2. About half the countries (27) still have poverty rates above 25%. Resource-rich African countries have managed to decrease poverty rates by only 5 percentage points, from 41 % to 36 % despite strong growth since 2000. This is disappointing, because resource-rich countries in other world regions such as Asia and LAC have been much more successful at reducing poverty. In LAC, for example, the poverty headcount ratio fell from 14% to 5% between 1990 and 2013.
3. Debt relief from the Heavily Indebted Poor Countries (HIPC)<sup>2</sup> and multilateral debt relief initiatives helped 30 African countries increase their social spending between 1998 and 2012. As they are completing the HIPC programmes, the countries will need to find new approaches for financing poverty reduction programmes.
4. About 45% of the population earn USD 1.90-5.50 a day and remain poor or vulnerable to falling back into poverty. Further efforts to boost their income and social protection are essential to move this group firmly out of poverty.

Figure 1.9. Poverty reduction in 42 African countries, Brazil, China, India, Indonesia and Viet Nam



Note: Heavily Indebted Poor Countries (HIPC). The year indicates the latest survey year for calculating the poverty rate.

Source: World Bank (2017b), PovcalNet (database).

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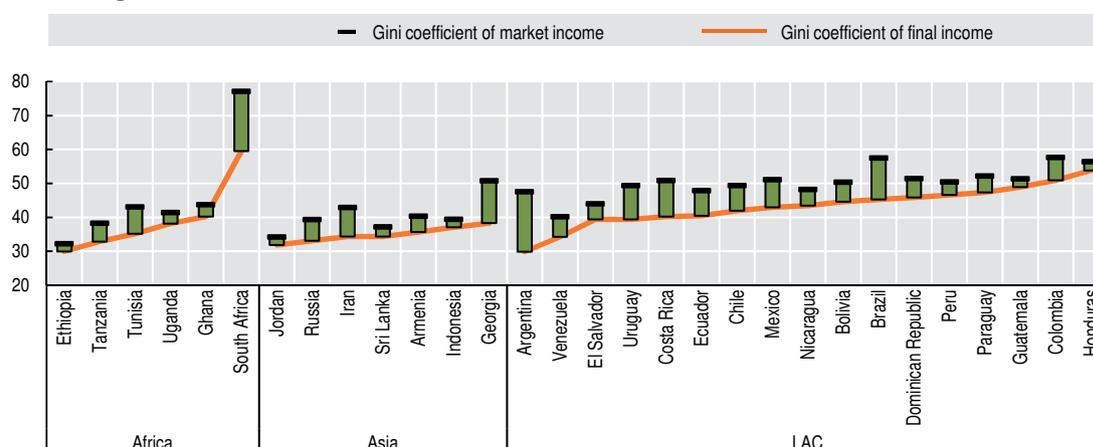
Reducing income inequality can help reduce poverty faster. The unweighted Gini coefficient<sup>3</sup> for Africa averages 41 points, which is higher than Asia's unweighted average of 35 points. Several econometric analyses show that reducing income inequalities in Africa would enable growth to reduce much more poverty (see Christiansen, Schindler and Tressel, 2013: 13; Thorbecke and Ouyang, 2017: Table 3). Our estimations based on the PovcalNet database (World Bank, 2017) show that lowering Africa's current Gini level to Asia's average

(35 points) would decrease its poverty headcount by about 2 percentage points for each percentage point of GDP growth. This compares to the actual decrease of 1.5 percentage points observed between 1990 and 2016. Such a decrease of inequality would reduce the number of poor people by 130 million, from 394 million in 2016 to 264 million.

Several African governments have managed to reduce inequality by using fiscal policies and reforms, however lower growth prospects in the short term may put budgetary pressure on these programmes. South Africa in particular has developed a progressive tax and social protection system that reduced its Gini coefficient from 77 to 60. South Africa has the highest reduction in Gini coefficients among a sample of 29 developing countries in the Commitment to Equity Database (Figure 1.10). Other African countries in the sample, namely Ethiopia, Ghana, Tanzania, Tunisia and Uganda, have also succeeded to reduce their Gini coefficients, though to a lesser extent. The decline in the number of conflicts has also helped to reduce inequality.

However, a high concentration of land and of physical and human capital (often due to historical legacies) limits the impact of redistributive policies. In many countries, weak governance of taxation and low social spending contribute to a limited redistributive capacity of the state, to biased public policies that favour politically-connected regions, and to ethnic and gender inequalities (UNDP, 2017).

Figure 1.10. Gini coefficients of market and final income in selected countries

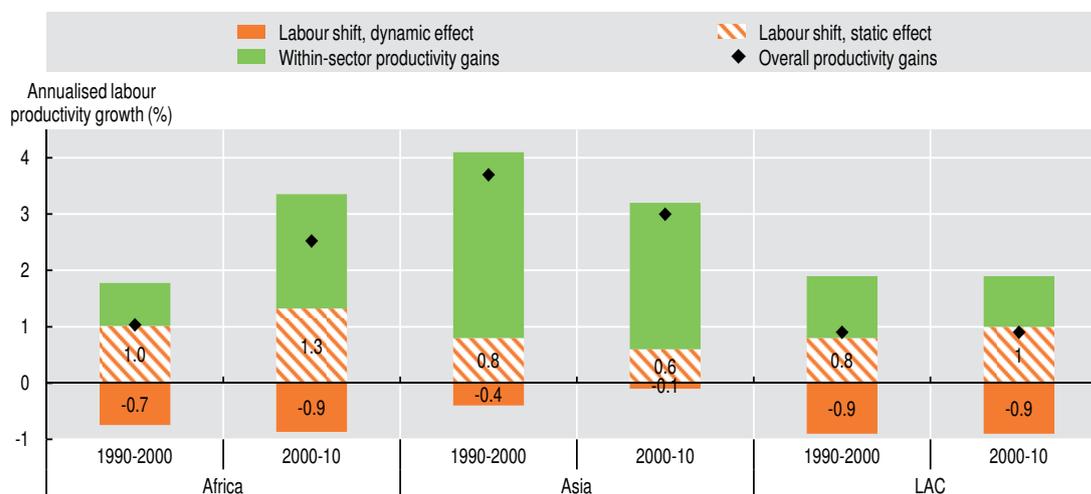


Source: CEQ Institute (2018), Commitment to Equity Institute Data Center on Fiscal Redistribution.<sup>4</sup>  
StatLink <http://dx.doi.org/10.1787/888933782582>

### If business continues as usual, structural transformation may be hard to sustain

Since 2000, Africa has experienced positive structural transformation as labour has moved from less productive activities to more productive ones. In a sample of 13 African countries where data is available, the sectoral shift of labour contributed 0.5 percentage points per year to labour productivity growth between 2000 and 2010, the same contribution as in Asia (Figure 1.11). Services like wholesale and retail trade, restaurants, and hotels absorbed the most surplus agricultural workers. Their share in total employment almost doubled in two decades, reaching 20.1% in 2010, up from 11.4% in 1990. An increase in natural resource rents and remittances boosted the demand for domestic consumption of non-tradable goods and services. In addition, opening up to private investment and competition helped expand activities with higher productivity levels such as telecommunications and banking services. As a result, overall labour productivity in Africa increased by 2.5% a year between 2000 and 2010, compared to 1% one decade earlier.<sup>5</sup>

Figure 1.11. Decomposition of labour productivity growth in 31 developing countries in Africa, Asia and LAC, 1990-2010



Note: African countries include Botswana, Egypt, Ethiopia, Ghana, Kenya, Malawi, Mauritius, Morocco, Nigeria, Senegal, South Africa, Tanzania and Zambia. Asia includes 11 countries, and LAC includes 9 countries. The overall effect of the sectoral shift of labour is the sum of static and dynamic effects.

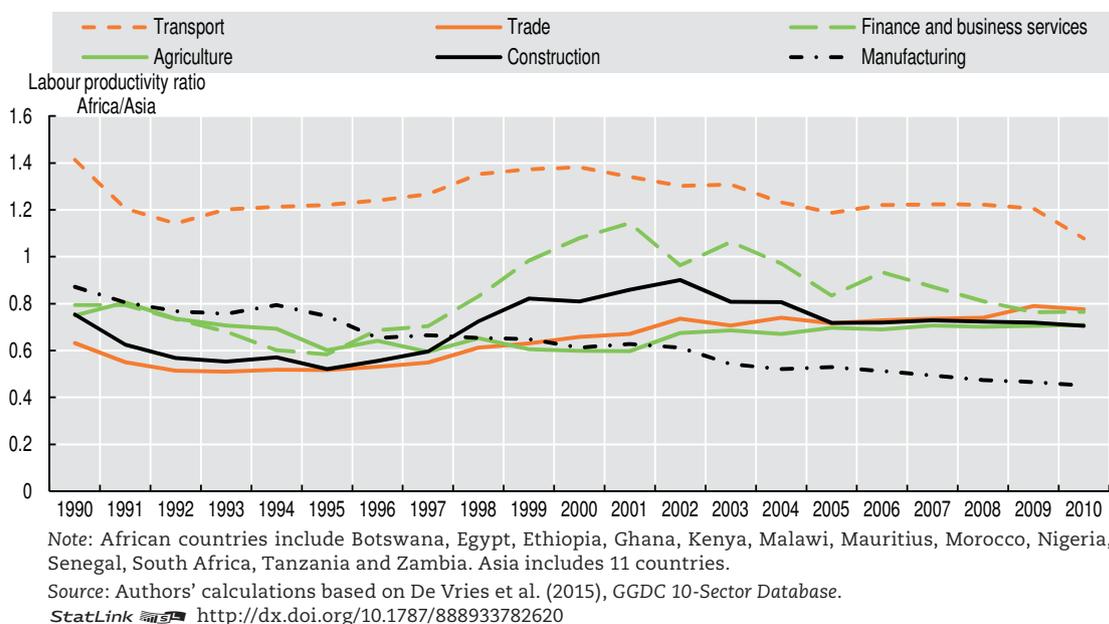
Source: Authors' calculations based on De Vries et al. (2015), *GGDC 10-Sector Database*.  
StatLink <http://dx.doi.org/10.1787/888933782601>

However, this process is reaching its limits as Africa's labour is moving into activities where productivity levels are declining. As more and more workers move into sectors experiencing declining productivity, the overall productivity gains from labour reallocation diminish over time. The decline in productivity of the labour-absorbing sectors reduced annual labour productivity growth by 0.9 percentage points annually between 2000 and 2010 (Figure 1.11). With the exception of South Africa (where the effect is negligible), this effect is observed in all other 12 African countries where data is available. The variations are significant, ranging from -0.6 percentage points in Nigeria to -2.2 percentage points in Botswana. Such "dynamic losses" during a structural transformation resemble those experienced by LAC, but not by Asia (De Vries, Timmer and de Vries, 2015).

African firms' productivity tends to lag behind that of their global competitors in many sectors. The Africa-to-Asia ratio of labour productivity has decreased since 2000 (Figure 1.12). This has been obvious in agriculture, as well as in market services such as transports, financial activities, construction and manufacturing. The next section will use firm-level data on 11 manufacturing activities to explain the factors contributing to this negative TFP differential for African firms.

In terms of the employment outlook, service-led development is a challenging opportunity for most African countries due to higher skill requirements. The services sector plays an increasingly important role in Africa's development. Recently, legal, financial and business services have been increasingly traded across African countries. If this trend continues, more services may become tradable and even expand to foreign markets thanks to new technologies, improved infrastructure and lower barriers to trade. However, most of the new generation of tradable services require high skill levels, which may not yet be accessible to the majority of Africa's labour force. Skill requirements are even greater in services than in many segments of manufacturing. Today the services sector as a whole absorbs a significant share of entrepreneurs and wage employment, but its productivity levels are low and employment is often vulnerable or informal. Many service firms in African countries need support to comply with the quality and other standards required to gain access to exports markets (ECA, 2017).

Figure 1.12. Africa/Asia ratios of labour productivity in services, construction and manufacturing, 1990-2010



## Regional and global markets offer Africa opportunities for growth but require new policies

This section analyses new growth avenues that regional and global markets present to African economies. To take advantage of the many opportunities they offer, African governments need to adapt their strategies to a new economic reality. Technological change, global value chains, and evolving trade and investment agreements are reshaping opportunities for integration into regional and global markets. Governments will need to be innovative in mobilising domestic savings and external financial inflows.

### Better integration into global economy can increase growth, employment and equality

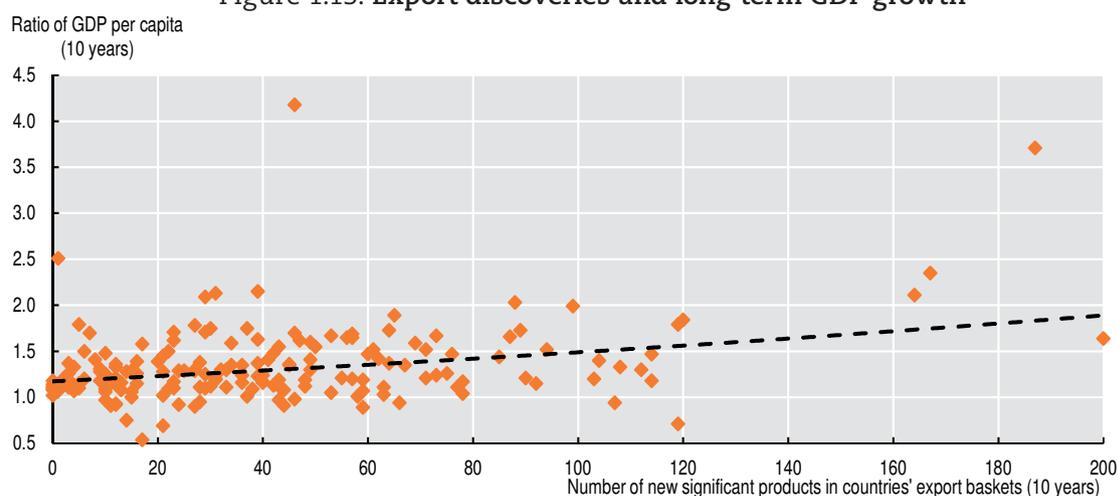
The continent can build on its current level of global integration to achieve better growth, employment and equality. This chapter's first section highlighted that Africa's growth is high but volatile and does not translate into sufficient development outcomes. The present section shows that upgrading the quality of existing products, expanding exports products and improving access to capital goods and inputs can provide ways to sustain growth, increase job quality and reduce inequality. In this process, intra-African trade will be an important lever for policy action.

The challenge for most African countries is not to further integrate into the global economy but how to integrate in a better way. Africa is already open to international trade and connected to global value chains (GVCs). Imports and exports of goods and services represented about 50% of Africa's GDP in 2015-16, which is similar to Asia, and higher than in the LAC region (44%). Integration into GVCs is also higher in Africa than in LAC and South Asia. GVC participation have increased since the 1990s (AfDB/OECD/UNDP, 2014).

Diversifying exports can increase and sustain economic growth. The majority of Africa's exports are unprocessed commodities (Figure 1.2). More diversified export baskets are associated with higher economic growth rates (Figure 1.13). Introducing new

products to export markets strongly correlates with cumulative long-term growth of GDP per capita (Klinger and Lederman, 2004; Rieländer and Traoré, 2016). More diverse product baskets lead to more stable export earnings over the longer run, reducing macroeconomic uncertainty and encouraging more investment in the economy (Ghosh and Ostry, 1994; Bleaney and Greenaway, 2001). Moreover, developing the capabilities to export more sophisticated products tends to help countries recover from stagnation periods and to prolong growth spells (Hausmann, Pritchett and Rodrik, 2005; Berg, Ostry and Zettelmeyer, 2012). Upgrading to more sophisticated export products builds countries' capacity to move to other export baskets, leading to higher growth in the context of adverse shocks.

Figure 1.13. Export discoveries and long-term GDP growth



Source: Trade indicators are calculated based on UN Statistics Division (2017), UN COMTRADE (database). GDP per capita figures are calculated based on World Bank (2017a), World Development Indicators (database).

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Concentrating exports on few products also influences inequality outcomes and job quality across the continent. Improving a country's ability to produce and export more complex goods is likely to help it generate and distribute more wealth across society. Currently, the majority of African countries export few fully-processed products, as shown by their positions in Figure 1.14, Panel A. Diversifying into products with larger spill-overs and a strong influence on other sectors can help create formal jobs and encourage local informal firms to formalise. Figure 1.14, Panel B shows the negative correlations between export complexity and the share of vulnerable employment. In contrast, concentrating exports on few products can lead to spatial inequalities, especially where the export industries are concentrated in a specific place, as is the case of mining.

Facilitating access to imports of high quality – both capital and intermediate inputs – can help diversify Africa's exports. Africa has steadily increased its imports of capital and intermediate goods, from 7% of GDP in 1990-99 to 9% in 2009-14 (Figure 1.15, Panel A). However, many firms, especially SMEs, face difficulties in getting import licenses, according to firm-level surveys. A systematic review of tariffs in the East African Economic Community also shows that many intermediate goods are misclassified and face higher tariffs than final consumption goods. High quality inputs enable domestic firms to increase productivity and the quality and variety of the end products (Lopez Gonzalez, 2016).<sup>6</sup> Moreover, importing and exporting activities create numerous synergies at the firm level. Facilitating local firms' access to lower-priced imported inputs can decrease their fixed costs of exporting, thus encouraging them to export (Pierola, Fernandes and Farole, 2017).

Figure 1.14. Export diversification, income inequality and job quality in African countries

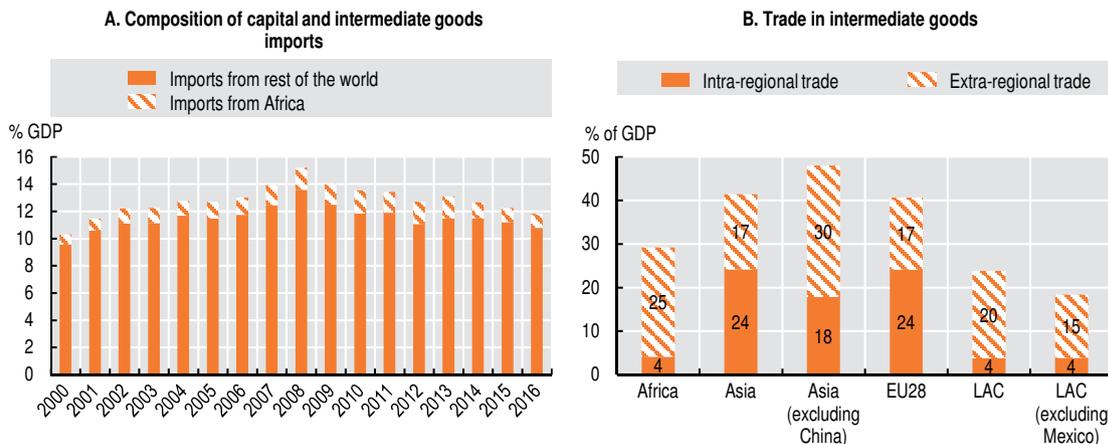


Note: A higher Gini coefficient suggests a higher level of income inequality within the country.

Source: Export diversification is calculated based on UN Statistics Division (2017), UN COMTRADE (database). The export complexity index is from Atlas of Economic Complexity (2017). Gini coefficients are from World Bank (2017b), PovcalNet (database).

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Figure 1.15. Trade in intermediate and capital goods within and outside selected world regions, 2014



Note: Trade in intermediate goods is defined as total trade (i.e. the sum of gross exports and gross imports) in the sectors classified as primary and processed food and beverages destined mainly for industry, other industrial supplies, fuels and lubricants other than processed motor spirits, and parts and accessories for capital goods and transport equipment. The sectors previously mentioned are drawn from the classification by Broad Economic Categories.

Source: Authors' calculations based on UN Statistics Division (2017), UN COMTRADE (database).

StatLink <http://dx.doi.org/10.1787/888933782677>

Regional value chains and emerging markets offer sizable opportunities for small exporters as standards are lower and growth rates higher. In the case of Africa, intra-regional trade in intermediate goods stands at only 4.1% of GDP compared to 24.2% in Asia and 16.6% in the European Union (Figure 1.15, Panel B). Data for 152 countries over 15 years confirm that access to intermediate inputs from regional and global markets have positive impacts on countries' export competitiveness, exports sophistication and domestic value addition (Kowalski et al., 2015). Improving trade facilitation measures such as logistics

and customs performance, intellectual property protection policies, trade infrastructure and the electricity supply significantly contribute to developing regional value chains.

Having a regional integration agreement does not automatically lead to strong trade flows or to establishing regional value chains (IMF, 2016b). Three of the regional economic communities in Africa provide interesting insight in this respect. Cross-border exchanges within the East African Community are found to be five times larger than average trade flows within Africa, while in the West African Economic and Monetary Union, they are about three times larger (see Chapters 5 and 7). At the same time, the Economic Community of Central African States region continues to exhibit low levels of integration, with only 1.3% of total trade being intra-regional. This is mainly due to limited complementarity between countries' trade profiles and underdeveloped trading infrastructure (Avom and Mignamissi, 2017; see also Chapter 4).

The new continental free trade area (CFTA) offers a stepping-stone for Africa's regional economic communities (RECs) to boost regional integration. On 21 March 2018 in Kigali, Rwanda, the head of 44 African countries signed the CFTA, one of the world's largest free trade areas. The CFTA aims to achieve four main objectives:

- create a single continental market for goods and services, with free movement of business people and investments, and thus accelerate the establishment of the Continental Customs Union and the African Customs Union
- expand intra-African trade through better harmonisation and co-ordination of trade liberalisation and facilitation regimes and instruments across RECs and Africa in general
- resolve the challenges of multiple and overlapping memberships and expedite the regional and continental integration processes
- enhance competitiveness at the industry and enterprise levels by exploiting opportunities for scale production, continental market access and better reallocation of resources.

African countries should consider four types of economic upgrading, depending on their current production structure and export performance, as well as the nature of the value chains (OECD, 2013a; Kaplinsky and Morris, 2002):

- **Functional upgrading** entails expanding the range of activities that a country already performs within a specific value chain. If the initial link to a global value chain is in production only, for example in cutting, sewing and trimming shirts, functional upgrading could entail developing upstream activities such as the sourcing of textiles.
- **Product upgrading** refers to the production of more sophisticated products, such as going from whole pineapples to freshly cut ones.
- In **chain upgrading**, the skills acquired are used to enter a new value chain, for example moving to textile production based on the knowledge and skills gathered in the apparel value chain.
- Finally, **process upgrading** refers to increasing productivity in a given stage of a value chain through local innovation (OECD/WTO, 2013; Morris and Barnes, 2009).

Strategies to tap the African and global markets must tailor to the local conditions. Since 2000, some African countries have successfully implemented export-led growth strategies but without creating enough jobs. Box 1.2 proposes several examples to show different paths that African governments have pursued so far.



**Box 1.2. Selected examples of African governments' global integration strategies**

The four African countries below illustrate various global integration strategies, according to their respective strengths and weaknesses.

In **Ethiopia**, the government's Industrial Development Strategy aims to promote exports in labour-intensive sectors such as textiles and garments, leather, sugar, flowers and cement. The government has set up a number of special economic zones to attract foreign investors into these sectors and has linked local producers' associations to the world market. Massive public-led infrastructure investments have taken place in the energy, transport, communications, agriculture and social sectors, albeit their initial levels were low (Moller and Wacker, 2017). Investors in strategic sectors benefit from generous fiscal incentives, reduced import duties for capital goods and raw materials necessary for production, and preferential access to land and concessionary funding. The strategy also includes transport arrangements by the state-owned Ethiopian Airlines.

**Morocco** has attracted FDI into new export activities to take advantage of its geographical proximity to European Union markets, existing trade agreements and political stability. The strategic plans Emerging Morocco 2005-09, followed by the National Pact for Industrial Emergence 2009-2015, focused on seven specific export-oriented activities – known as the seven World Crafts of Morocco: the aeronautics, automotive, electrical equipment, agro-processing, textile and leather sectors and off-shoring activities. The country is performing well in the automotive, electrical equipment, and aeronautics industries and in service related off-shoring activities (e.g. business process outsourcing). The automotive industry became the country's biggest export sector in 2014, and reached USD 5.3 billion in 2015. However, traditional export sectors, such as apparel and textiles, have been losing jobs due to declining competitiveness (El Mokri, 2016; OECD, 2017a).

**Senegal** has successfully begun diversifying its exports through an agricultural value-chain approach. Active government support for selected agricultural chains, such as rice, onions, groundnuts and fruits, has helped the country improve food security and diversify its export basket. Since 2010, Senegal has significantly boosted its exports of horticultural products, mostly to European markets. However, government support has mostly focused on the production side. Post-production segments of the value chain, such as processing, storage and marketing, face important binding constraints, especially in the rice sector.

Senegal's trade openness (total imports and exports of goods and services) was about 75% of GDP between 2011 and 2015. Remittance inflows were at about 10% of GDP annually, boosting growth. Yet, between 2007 and 2009, the economy proved vulnerable to the exogenous shocks of the energy, food and financial crises.

**South Africa** has been successful in upgrading into global value chains. In addition to functioning as an assembly hub for the automotive industry, South Africa has become a global supplier of components (seats and catalytic converters), capitalising on locally available skills and intermediate products. To further diversify the economy, since 2007, the Industrial Policy Action Plans (IPAP) prioritise sectors that are medium to high value added and labour-intensive such as agro-processing, vehicles, textiles and green energy. On top of promoting trade and attracting FDI, the IPAP provide incentives and co-ordinate actions to strengthen skills and industrial and scientific capabilities (Zalk, 2012). These policies have enhanced co-operation and discussion among government ministries, the national development bank, private-sector stakeholders, civil society and universities (Baloy, 2012). Moreover, South Africa's lead companies in the telecommunication, banking and mining sectors are also making direct investments in other African countries to exploit the regional markets. For example, Africa's biggest retail chain, Shoprite of South Africa, now has more than 260 supermarkets in 16 African countries.

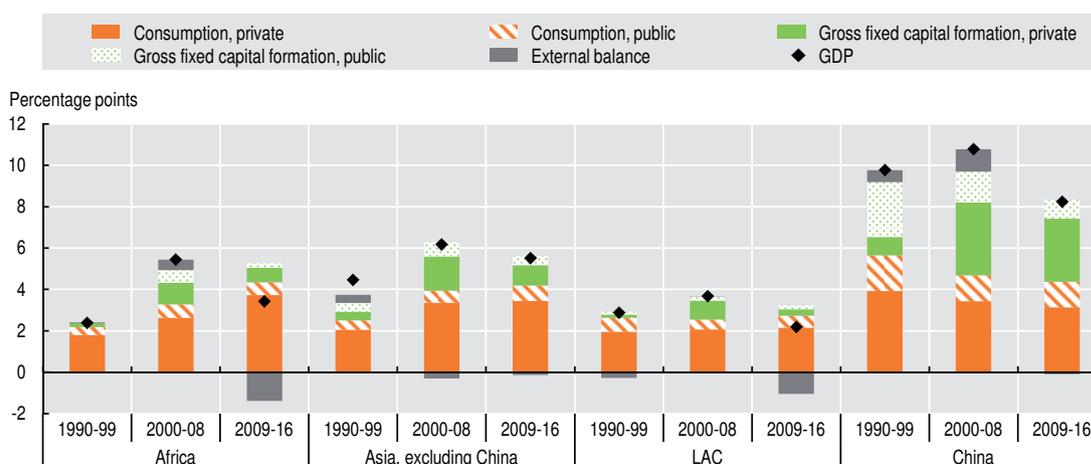
Despite the government's effort to support young entrepreneurs, the share of people aged 15-24 not in employment, education or training remains consistently high. It has been over 30% every year since 2012 – in 2016, over 3 million youth (OECD, 2017b: 131).

## Expanding domestic markets hold great promise for local companies if they can upgrade their products

Africa's regional demand is increasingly favourable to growth for several reasons:

1. The contribution of private consumption to GDP growth has increased progressively and reached 3.7 percentage points annually over the period 2009-16 (Figure 1.16). This is comparable to the level in China and other developing Asian countries.
2. Africa's business opportunities are now attracting international investors interested in more than the continent's endowment in natural resources. The potential of domestic and regional markets attracted 53.4% of new FDI projects to Africa in 2013-17 (FDI markets, 2017). This share is similar to Asia's level (55.7%) and almost ten percentage points higher than LAC's (44.8%).
3. Recent progress in reducing both administrative procedures and the costs of starting and running a company have made the business environment more attractive: 29.5% of foreign investors cite this improvement among the main motivations to invest in Africa, compared to 12% in 2003-07.

Figure 1.16. Decomposition of growth by expenditure in Africa, Asia and LAC, 1990-2016



Note: Data include 52 African countries, 34 developing Asian countries and 23 developing LAC countries. Contribution to growth by change in inventory is close to zero ( $\pm 0.01$  percentage points) and is thus suppressed from the figure.

Source: Authors' calculations based on World Bank (2017a), *World Development Indicators* (database), and IMF (2018), *World Economic Outlook* (database).

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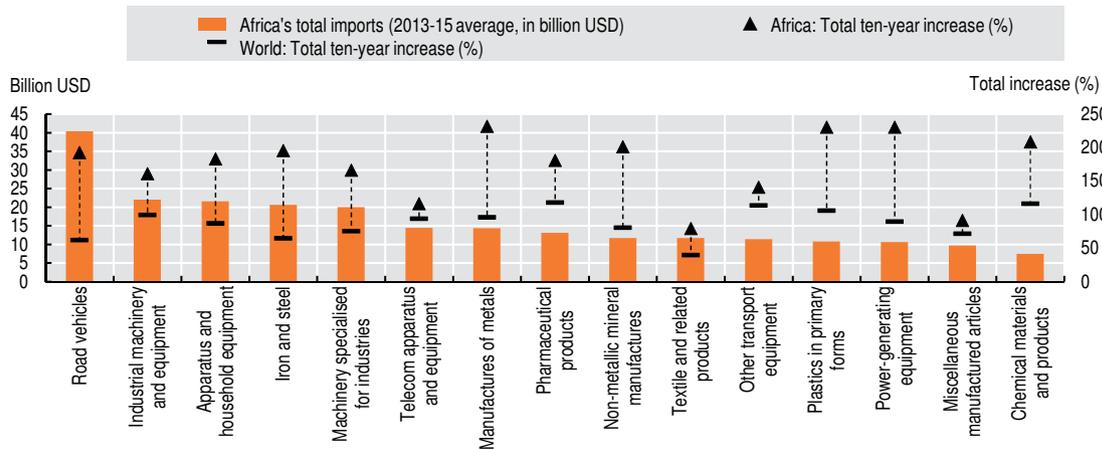
Demand is shifting towards more processed goods. The rapid urban growth of African economies and a higher purchasing power of Africa's emerging middle class are underpinning the growth of private consumption. The middle class, defined as those spending between USD 5 and USD 20 a day, increased from 108 million people in 1990 to 247 million by 2013. Both food and non-food markets, excluding oil products, are more dynamic than the global averages. This change in the demand is driven by Africa's urbanisation and demographic growth, and Chapter 2 will discuss these two processes further.

Food markets are rising over the continent and should triple by 2030 (Byerlee et al., 2013). The diet preferences are changing from staples to higher-value processed foods (see Bricas, Tchamda and Thirion, 2014; Reardon et al., 2018). COMTRADE data shows that demand for processed food is growing fast, more than 1.5 times faster than the global

average between 2005 and 2015. The two most dynamic food imports over that period were meat products (+323% in value in ten years) and beverages (+306%, excluding coffee and cocoa preparations).

Some non-food products are also particularly fast-growing (Figure 1.17). These patterns are common to all Africa's five regions.<sup>7</sup>

Figure 1.17. Africa's top 15 non-food imports, 2013-15



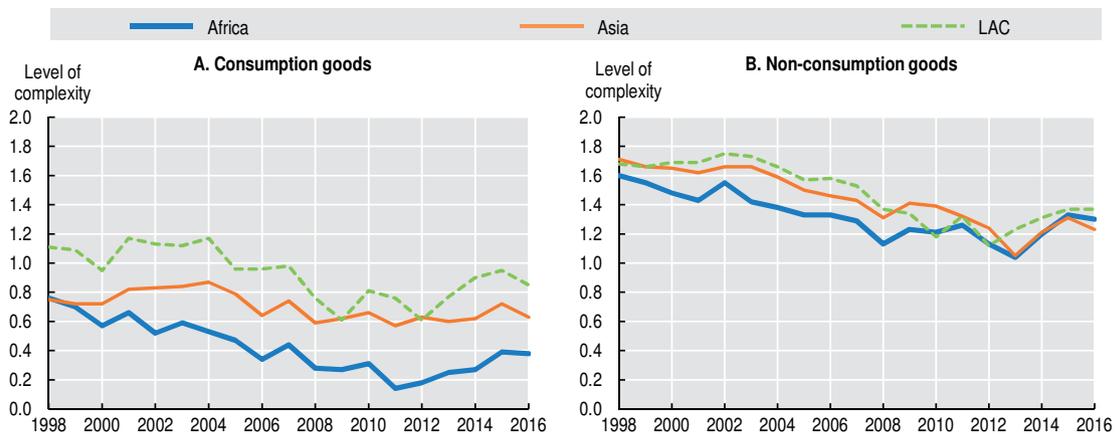
Note: Excluding oil products. Using the two-digit product codes in the Standard International Trade Classification, revision 3 classification. The right axis shows the total increase of the values over a ten-year period.

Source: Authors' calculations based on UN Statistics Division (2017), UN COMTRADE (database).

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The level of complexity of Africa's import products has decreased over time, both for consumption goods and other imported products (Figure 1.18). The complexity level of consumption goods imported to Africa has decreased by half, from 0.8 to 0.4 between 1998 and 2016 (Figure 1.18, Panel A). The lower complexity level suggests that the production technology for those products is becoming more widespread, allowing more countries to supply them. Lower fixed costs allow African firms to vary their products.

Figure 1.18. Level of complexity of imports into Africa, Asia and LAC, 1998-2016



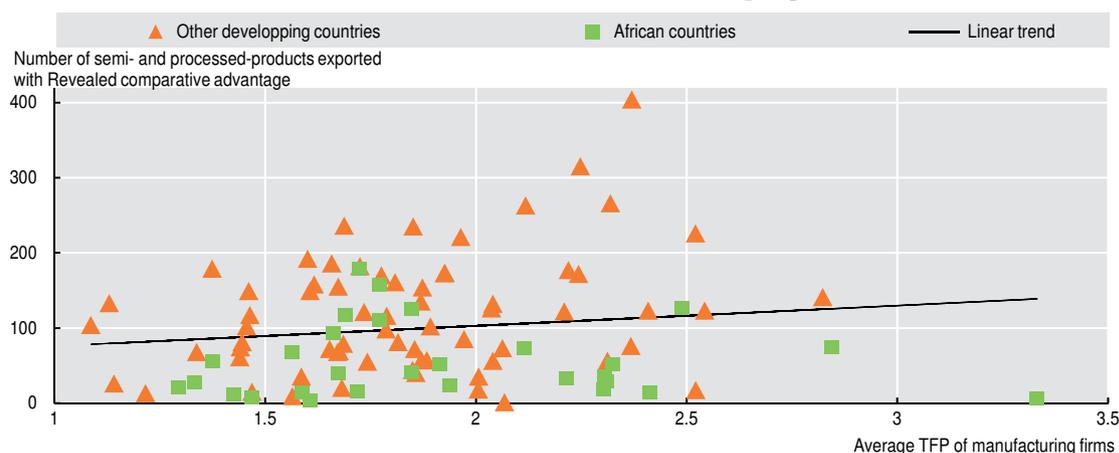
Note: Excluding oil products. The types of goods are defined by Broad Economic Categories classifications for consumption goods (categories 1, 5 and 6) and non-consumption goods (categories 3, 4 and 7). The complexity index of each product, a measure of the relative knowledge intensity in producing the product, is calculated for each year using Hausmann and Hidalgo's methodology (2011).

Source: Authors' calculations based on UN Statistics Division (2017), UN COMTRADE (database).

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Local firms must upgrade their technology and production processes if they are to meet the new domestic demand. For instance, improving production processes and products technology, adding desirable features, quality labelling and certification are necessary to compete on global markets (Porter, 1990). Cross-country analysis shows a positive correlation between improvements in firm-level efficiency and countries' comparative advantage in exports of semi- and processed-goods (Figure 1.19). Microeconomic studies show that households with higher incomes look for higher quality products and standards. In Western Africa, rising incomes are associated with a lower propensity for households to consume informal sector goods, as well as a lower propensity to use informal distribution channels (Böhme and Thiele, 2012).

Figure 1.19. Total factor productivity for manufacturing firms in African countries and other developing countries



Source: TFP calculations for manufacturing firms based on Nguyen and Véganzonès-Varoudakis (2017) using Enterprise Surveys (2017), World Bank Enterprise Surveys. The number of products with revealed comparative advantages is calculated based on UN Statistics Division (2017), UN COMTRADE (database).  
StatLink  <http://dx.doi.org/10.1787/888933782753>

African firms largely lag behind the global technology frontier in most fast-growing sectors. This finding is drawn from a panel of 7 000 enterprises from the World Bank Enterprise Surveys over the period 2006-15 in 70 developing countries and 11 manufacturing industries (Nguyen and Véganzonès-Varoudakis, 2017). In Nigeria, for example, average levels of TFP in manufacturing stand at only 53% of the top 10% most productive firms in developing countries. Nigeria's non-metal manufacturing and food sectors are far below the global production frontier, reaching only 27% and 38% of the highest performers respectively.

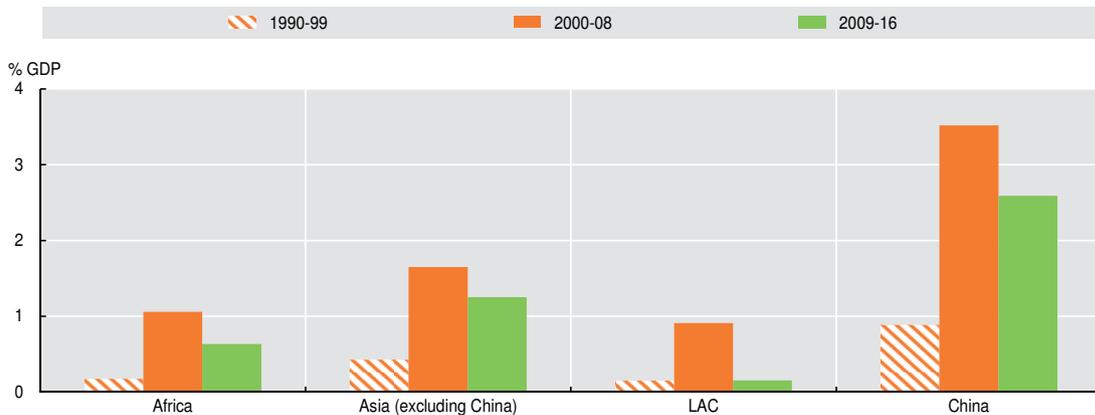
Some interesting exceptions stand out, notably in Morocco and South Africa. Firms in Morocco perform well in several sectors, such as food, leather and metal products. Firms in South Africa appear to be among the best performers in Africa's developing countries in eight manufacturing sectors. The country's TFP level averages 91% of the frontier performance in the food sector and up to 100% in non-metal manufacturing, wood furniture and machinery (see Table 2 in Nguyen and Véganzonès-Varoudakis, 2017).

### New policies can help domestic firms reach the productivity frontier and tap business opportunities

Stronger policies in favour of firms' productivity are required for two main reasons. First, despite the promise of Africa's rising markets, private investment has not yet responded. The contribution of private investment to Africa's growth has significantly lagged behind Asia's level, despite business-friendly reforms (Figure 1.20). In Asia (excluding China), private investment contributed 1.3 percentage points to GDP growth per year between 2009 and 2016. This is more than double the contribution of private investment to growth in

Africa (0.6 percentage points). African entrepreneurs tend to prefer engaging in activities with a relative quick turnover that do not require long-term investment. The largest share (55%) of entrepreneurs work in retail trade, hotels and restaurants (AfDB/OECD/UNDP, 2017). Second, helping African firms reach the global productivity frontier will require additional policy support, beyond the usual business reforms that reduce start-up costs.

Figure 1.20. Contribution of private gross fixed capital formation to GDP growth in Africa, Asia and LAC, 1990-2016



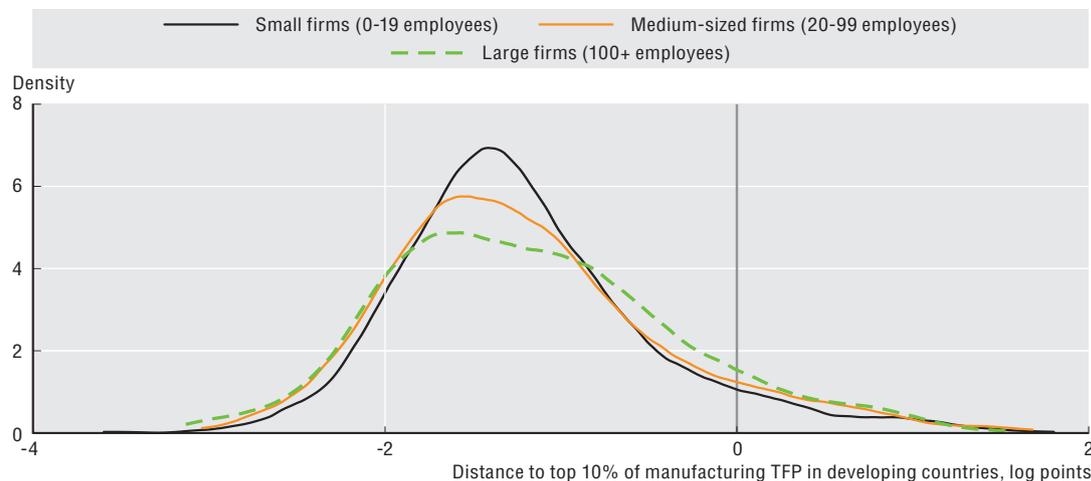
Note: Data include 52 African countries, 34 developing Asian countries and 23 developing LAC countries.

Source: Authors' calculations based on World Bank (2017a), World Development Indicators (database), and IMF (2018), World Economic Outlook (database).

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Even after controlling for factors such as the business environment, most African firms are less productive than those elsewhere. Constraints in the business environment, such as the cost and lack of credit to the private sector, corruption and regulatory uncertainties, and infrastructure bottlenecks, do not fully explain this. After controlling for these factors, the results show that the majority of African firms remain far below the average TFP of the top 10% most productive manufacturing firms in developing countries (Figure 1.21).

Figure 1.21. Distance of African firms to top 10% of total factor productivity for manufacturing in developing countries



Note: These findings are drawn from a panel of 7 000 firms surveyed twice in 70 developing countries and 11 manufacturing industries. The figure controls for multiple indicators of business environments. See details in Nguyen and Véganzonès-Varoudakis (2017).

Source: Authors' calculations based on Enterprise Surveys (2017), World Bank Enterprise Surveys 2006-2015.

StatLink <http://dx.doi.org/10.1787/888933782791>

A number of firm-level factors also contribute to this poor performance, including these two:

1. Management quality of African firms is lower. Bloom, Sadun and Van Reenen (2017) show that, while management capabilities explain a third of variations in TFP across manufacturing firms, management quality is the lowest among the six African countries in their sample.
2. Informality limits productivity growth. Africa's micro-enterprises and SMEs in the manufacturing sector face high opportunity costs to move out of informality, which prevents them from investing and upgrading (Rodrik, 2017: 12). Limited access to good marketing networks, to quality labelling and certification, and to reliable demand make it difficult for informal firms to invest profits in innovation or in improving their products. Even the most productive informal firms face significant constraints. For example, in Ethiopia's manufacturing sector, the largest informal firm has a median capital stock of 16 425 birr (about USD 600) and earns a marginal return to capital of only 1%; whereas a formal firm with comparable capital stock earns at least 16.5% (see Table 4 in Siba, 2015).

To reap the benefits from investing in special economic zones, African policy makers will need policies that include firms serving local markets. Many promising small businesses can benefit from the spill-over effects from business clusters to scale up, upgrade and compete in the production networks. Recently, several African countries such as Ethiopia and Morocco have identified SEZs to attract lead firms and create manufacturing jobs.

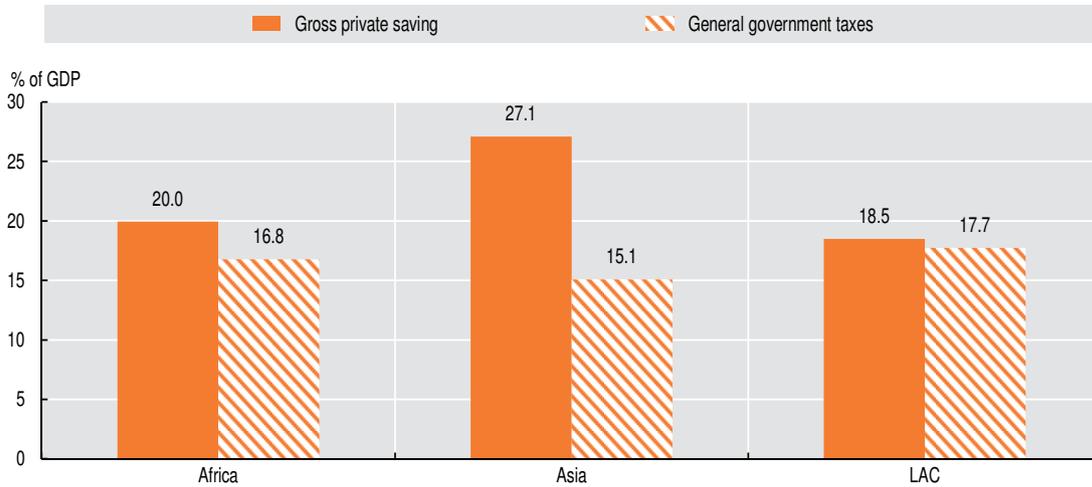
However, SEZs alone cannot provide enough jobs and productivity spill-overs for at least four reasons:

1. Lead firms in SEZs often demand skills and quality levels that African firms and labour pools cannot provide. Therefore, attracting global FDI firms in SEZs can create isolated growth enclaves that lack sufficient production linkages or technology spill-overs to the local economy.
2. The export focus of these SEZs tends to exclude a number of domestic firms that need to operate in local markets. In certain cases, policies offering fiscal exemptions can prevent firms in SEZs from producing for local markets.
3. SEZs will not create enough jobs for the incoming youth bulge in Africa. According to a survey of 91 SEZs in 20 sub-Saharan countries, SEZs account for approximately 1 million jobs, or 0.2% of national employment (Kingombe and Te Velde, 2013).
4. With few exceptions, such as Ethiopia, most African countries do not have the wage structure to compete on labour costs (see Megatrend 1, Chapter 2).

### **Sound policies can help domestic savings and external financial inflows unlock private investment**

Mobilising domestic resources – especially domestic savings – is necessary to foster investment in activities that can increase productivity and create jobs. Domestic savings are the most important and well-distributed resource across developing countries. On average in Africa, they represented USD 422 billion annually over the period 2009-16, which is 20% of the continent's GDP. This is higher than tax revenues over the same period (Figure 1.22). The top ten largest African economies had private savings rates ranging from 49% of GDP in Angola to 9% in Sudan. Yet lower commodity prices and slower economic growth may limit public revenue and spending in the short and medium terms. Improving financial intermediation can help mobilise domestic resources to support productive investment (see Chapter 8).

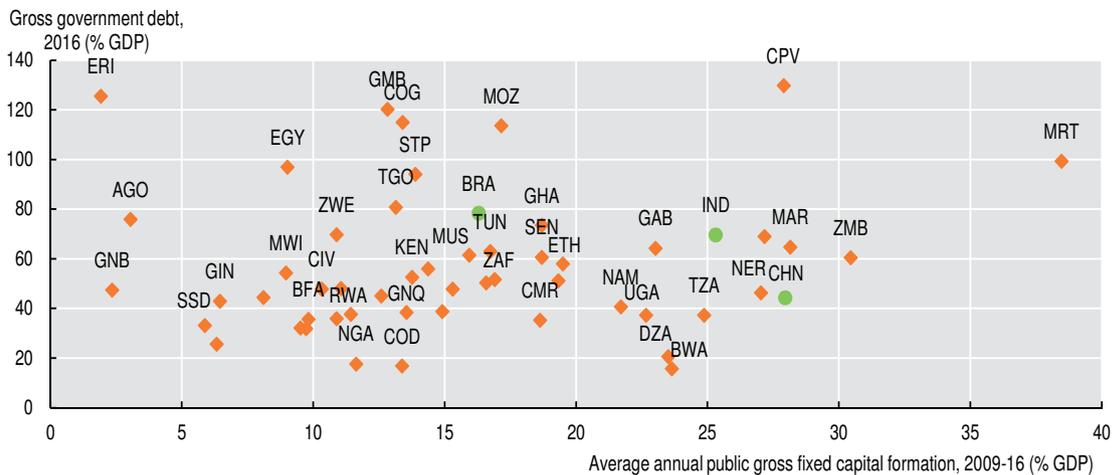
Figure 1.22. Gross private savings and general government taxes, as share of GDP in Africa, Asia and LAC, 2009-16



Note: Data include 42 African countries, 33 Asian countries and 20 LAC countries.  
 Source: Authors' calculations based on IMF (2018), *World Economic Outlook* (database).  
 StatLink <http://dx.doi.org/10.1787/888933782810>

Since 2015, lower natural resource rents and lower economic growth have reduced public revenues in many resource-rich countries, limiting public investment. Countries such as Angola and Nigeria are consolidating their fiscal balance, mostly by cutting capital investment. Public debt is rising in many countries and has already reached 100% of GDP in some (Figure 1.23). The number of low-income countries in debt distress or facing a high risk of it increased from 7 in 2013 to 12 in 2016, and almost all African countries with credit ratings have been downgraded below investment grade (IMF, 2017). This increases the exposure of countries' budgets to external shocks such as the availability of liquidity on international markets and interest rate levels. Maintaining growth momentum and capital accumulation may therefore require mobilising sources other than government debt.

Figure 1.23. Gross government debt versus public gross fixed capital formation in Africa, Brazil, China and India, 2009-16



Note: Data include only 52 African countries because of the limited availability.  
 Source: Authors' calculations based on World Bank (2017a), *World Development Indicators* (database), and IMF (2018), *World Economic Outlook* (database).  
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Africa will need to encourage private investment in productive activities. The public sector already invests more than 20% of GDP annually between 2009 and 2016 in 12 out of 52 African countries where data is available. In another 27 countries, annual public investment was between 10 and 20% of GDP on average in the same period. Investment solely based on public spending can hardly be sustained in the medium and long terms. Private investment stood at only 15% of GDP on average between 2009 and 2016, significantly lower than developing Asia's average of 24% and LAC's average of 17%. In resource-rich African countries, private investment accounted for only 13% of GDP, compared to 18% in non-resource-rich African countries (Figure 1.3, Panel B).

Governments need to combat illicit financial flows (IFFs). IFFs deprive countries of resources that could be used at least partially for redistribution, for financing public goods and for fostering private investments in local businesses. Illicit financial outflows from Africa amount to USD 50 billion annually (AUC/ECA, 2017). This amount is similar to the official development assistance that Africa receives (see Table 1.2). IFFs have five major sources: bribes, tax evasion, criminal enterprise earnings, corporate profit shifting and currency regulation evasion (see Reuter, 2017). The channels for moving illicit funds are many, including trade misinvoicing and money leakages from the balance of payments (Global Financial Integrity, 2015).

Africa needs to improve the overall efficiency of public investment in order to boost productivity. Weak governance of public investments can lead to financial mismanagement and insufficient maintenance (IMF, 2016b) or to low appropriability of investment projects. For example, due to the lack of skills and support services to adapt the imported machineries and technologies to the Africa's context, agricultural productivity growth in Africa is roughly half the average rate of developing countries (Ninn-Prat, 2015). Infrastructural bottlenecks also reduce the capital utilisation rates. For example, electricity outages prevent workers from working multiple shifts and delay production cycles.

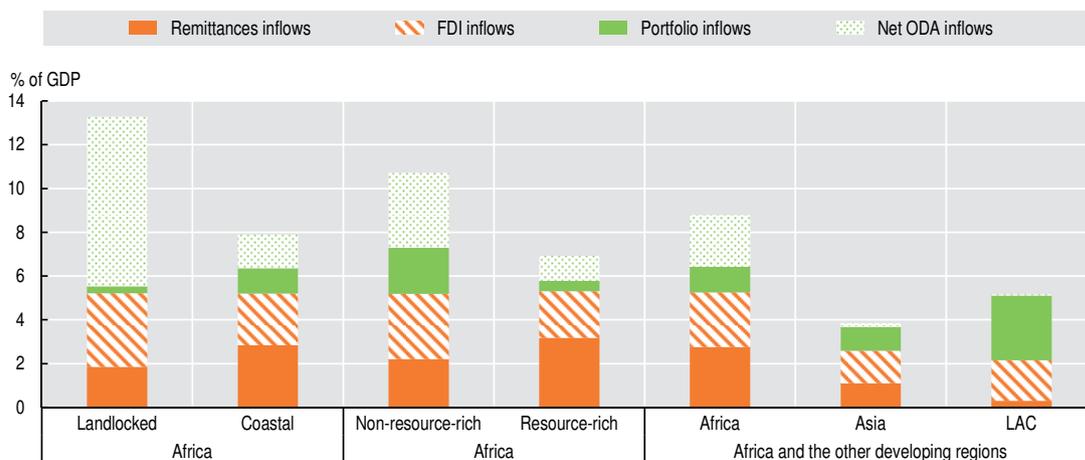
Financial inflows can play an important role in sustaining productive investment, in particular in landlocked or non-resource-rich countries. Total financial inflows (remittances, FDI, portfolio inflows and net ODA) into Africa reached 8.8% of GDP between 2009 and 2016. This level is significantly higher than the average for Asia (3.8%) and LAC (5.2%) (Figure 1.24). In absolute amounts, total inflows into Africa increased from USD 103 billion in 2005 to USD 185 billion in 2016. Between 2009 and 2016, financial inflows into Africa relied much more on remittances and ODA than they did in other continents; remittances and ODA amounted to 2.8% and 2.4% of Africa's GDP respectively. Since the early 2000s, remittances have increased more than fourfold; ODA and FDI have more than doubled (Table 1.2). On average, the landlocked countries receive the highest share (13.3% of their GDP) mainly due to the contribution of ODA, remittances and FDI. Non-resource-rich countries depend more on inflows (totalling 10.7% of their GDP) than resource-rich countries (6.9% of GDP).

Remittances, ODA and FDI inflows impact African economies differently:

- Until now, remittance inflows have mostly served domestic consumption. Remittances have supported household consumption rather than private investment, partly due to underdeveloped savings mechanisms for remittance recipients. Remittance flows can increase social inequalities in countries where immigrants belong to higher income households (Anyanwu, 2011; Adams, Cuecuecha and Page, 2008). Policies to attract remittances to certain sectors, such as diaspora bonds to catalyse investment into public infrastructure projects, have met mitigated success.

- Although ODA has helped reduce poverty in many heavily indebted countries, more can be done to encourage investment in Africa's productive assets. Since 2000, the international community has focused mostly on social sectors as a mean to fight poverty. ODA may have suffered from a lack of co-ordination among donor countries. For example, analysing the data for the period 2006-11, an OECD report identified six least developed countries in Africa as potentially under-aided (OECD, 2013b). Such asymmetry in aid allocations led to the adoption of the Accra Agenda for Action in 2008. This has increased attention to countries most in need, including the African countries.
- FDI in Africa accounted for 2.5% of GDP between 2009 and 2016, but the biggest share was concentrated in the extractive sector. That share (36% of total FDI between 2003 and 2014) had limited spill-overs into the local economy. Since the extractive sector often has few linkages with the local economy, FDI has not spurred further private investment nor created a sufficient number of jobs. Moreover, FDI may lead to higher income inequality as the high skill requirements of the FDI sector may exacerbate poor returns to education (Bogliaccini and Egan, 2017).

Figure 1.24. Total financial inflows as a percentage of GDP in Africa, Asia and LAC, 2009-16



Sources: Authors' calculations based on IMF (2018), *World Economic Outlook* (database), OECD-DAC (2017), *International Development Statistics* (database), and World Bank (2017a), *World Development Indicators* (database).  
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Going forward, African countries can better channel these financial inflows into activities strongly linked with the local economy. Domestic savings and remittances can provide incentives to invest in activities with strong multiplier effects to generate high social returns. Leveraging on those financial resources can help reduce the cost of small capital investments. The widespread use of mobile payments and banking systems (e.g. M-Pesa) creates new services to millions of customers. Such systems can increase the availability of financing and payment services for micro-enterprises and SMEs at reduced costs and risks. Improving the ability for SMEs and young companies to be listed on secondary exchanges can also help. Chapter 8 will look at policies to tap this potential.

Strategies to promote FDI should ensure that the domestic suppliers can align with lead FDI firms' needs in terms of quality and product specifications. Setting-up a national strategy for quality labelling can facilitate the interaction among different actors within the value chains. FDI can help transfer technology and knowledge, in the form of production techniques, management or marketing practices. FDI in Africa has become increasingly diversified and now targets industries such as information

and communications technology, food, and financial services. Econometric analysis shows that the most significant determinants of FDI in Africa's manufacturing sector are domestic market size and the quality of infrastructure (e.g. ports, rail and road) and transport services to access local inputs. These two factors explain 28% of variations in FDI attraction to Africa (Wall, 2016).

Such linkages often make FDI's impact on economic growth and productivity more durable (OECD, 2015; Rand, 2015). Accessing technology and knowledge through linkages with lead firms is less costly and less risky for SMEs in most developing countries than building the whole capacity in research & development of new technology (OECD/World Bank, 2015). An illustrative case is the automobile industry in Morocco, where the opening of new car factories in 2005 led the Moroccan firms supplying these factories to improve their management and other techniques (Hahn and Vidican-Auktor, 2017). Calabrese (2017) finds evidence of increased firm productivity through technology transfer, particularly in the agricultural sector. A number of companies in the agro-processing industries are already engaged in important initiatives in technology transfer, working intensively with local suppliers including small farmers. This is the case for Blue Skies in Ghana; OLAM in Nigeria; SabMiller in South Africa (AfDB/OECD/UNDP, 2014: 164-166); and Cargill, Mars, Nestlé, Olam, SIFCA, and Unilever in Côte d'Ivoire's cocoa and palm-oil industries (OECD, 2016: 55, 75).

ODA to Africa can de-risk private investment and help SMEs comply with international standards. While ODA is essential to alleviate poverty and humanitarian crises, a portion of ODA can also be leveraged as a guaranty to raise more capital funds for long-term investment. For instance, since approximately USD 35 billion per year of total ODA to Africa consists of pure grants, securitising just over USD 5 billion would enable donor countries to raise USD 100 billion upfront. This sum could finance the public portion of "blended" public-private investments in major infrastructure projects in Africa (Birdsall and Okonjo-Iweala, 2017). Such solutions can help countries obtain longer maturities for loans and lower interest rates. Development finance helped mobilise USD 81 billion of private investment between 2012 and 2015 (OECD, 2018). ODA can assist local firms in accessing quality standards and product specifications. It can serve to increase technical and management skills by helping governments improve technical, entrepreneurial and vocational training programmes. ODA can also assist in revising production processes. Finally, it can promote high quality products by supporting quality label initiatives (see OECD/WTO, 2013; OECD/WTO, 2017).

## Notes

1. Three-year moving average.
2. The programme decreased recipient countries' debt services by about 1.5 percentage points of GDP between 2001 and 2015.
3. The Gini index measures the extent to which the distribution of income among individuals or households within an economy deviates from a perfectly equal distribution. The index ranges from 0 in the case of "perfect equality" (each share of the population gets the same share of income) to 100 in the case of "perfect inequality" (all income goes to the share of the population with the highest income).
4. The Commitment to Equity (CEQ) project is led by Nora Lustig since 2008 and is an initiative of the Center for Inter-American Policy and Research (CIPR) and the Department of Economics, Tulane University, the Center for Global Development and the Inter-American Dialogue. The CEQ project is housed in the Commitment to Equity Institute at Tulane. See [www.commitmenttoequity.org](http://www.commitmenttoequity.org).
5. For more details, see De Vries et al. (2015) and Diao, McMillan and Rodrik (2017).
6. For example, between 1991 and 2001, Indonesian manufacturing firms saw their productivity rise by 12 percentage points following a 10-percentage-point fall in tariffs of inputs they imported (Amiti and Konings, 2007).
7. See for example Allen and Heinrigs (2016) and OECD (2016:69) on the case of Western Africa, and Tschirley et al. (2015) on Eastern and Southern Africa.

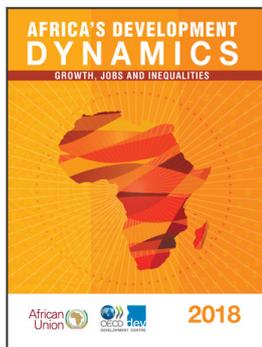
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