Growth and Governance in Africa: Towards a Sustainable Success Story

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Introduction

Africa is increasingly seen as the most promising growth region in the global economy. Its potential has long been recognized, given abundant natural resources and a large, young and fast-growing population. Over the past decade this potential has begun to turn into actual performance, as economic reforms and improvements in governance and institutions have broken a long history of economic instability, conflict and corruption.

If this time it is for real, Africa represents a tremendous opportunity for the global economy and for global industry players, who can contribute to developing the massive endowment of oil and other commodities, building the infrastructure needed to foster economic growth, from railway links to power generation, and improving both distributed and urban health care provision. African businesses are also poised to reap substantial rewards: they recognize the disruptive potential of accelerating innovation as the digital world meets the physical, and they are ready to become enthusiastic early adopters of new technologies. Most importantly, this is a tremendous opportunity for Africa’s citizens to enjoy a rapid and sustained rise in living standards.

Africa’s transformation is not yet self-sustaining. Governance and institutions have improved significantly, but from a low starting point and lag other growth markets. Economic growth has become more broad-based, but remains overly dependent on commodities. Doing business in the region is still difficult, and execution risks high. There is more work to be done. Developing infrastructure and local human capital should rank at the top of the priority list, together with a further substantial improvement in business conditions. Sub-Saharan Africa (SSA) should also aim to accelerate the rise of local manufacturing, to create a large number of well-paid jobs, accelerating the growth of the middle class. Regional and global trade integration should be accelerated. Africa’s governments and the companies investing in the region have a common interest in fostering self-sustaining inclusive growth.

Africa today stands at a cross-road. In this brief paper we take stock of the progress to date and the challenges ahead. We outline four possible scenarios for Africa’s future, and indicate the steps to maximize the region’s potential. The road ahead is long, but the progress already achieved is impressive. We are optimistic. This is the time to bet on Africa.

1. Assessing SSA’s economic growth performance

Shifting gears

Over the past decade and a half, SSA has emerged as the most promising growth region. After two decades of underperformance, starting in 2001 SSA exceeded world growth by an average of 2 percentage points per year; since the great financial crisis it has emerged as the second fastest growing region, with an average annual growth of over 5 percent, closing in on emerging Asia. It is still early days, though: SSA accounts for just about 2 percent of global GDP, even though with over 900 million inhabitants, it is home to 13 percent of the world’s population.

Demographics and consumption

Africa’s population is sizable, young and growing. According to U.N. projections, Africa’s population will rise rapidly from today’s 1.1 billion, adding another 200 million people by 2020; it will have more than doubled by 2050 and roughly quadrupled by 2100. Its projected rate of population growth would outpace that of all other regions: in 2010, Africa accounted for “just” 15 percent of the world’s population, dwarfed by Asia’s 60 percent. By 2050 it will have risen to one quarter of the global population, or one half of Asia’s;
and by 2100 it will be nearly on a par with Asia at 40 percent of the world total. But commodities can be both a blessing and a curse; and for most emerging markets they have been the latter.

This demographic trend poses a challenge, to create rapid job growth to safeguard social stability and ensure rising living standards. But it also represents a tremendous opportunity: the development of a large middle class. The process has already begun. Income levels have been climbing throughout the region, supported by rapid urbanization and growth of the working-age population; the region’s spending profile is similar to India and comparable to where China was 20 years ago. As incomes rise, households will spend more on consumption goods and services, boosting domestic demand and reinforcing growth.

Commodities and beyond
Sub-Saharan Africa’s fortunes began turning when the commodity cycle picked up steam in the late 1990s. Increased international trade, while initially driven by commodities, has opened up opportunities in other industries. Africa’s export mix to most other countries is more balanced, including light manufactured products, processed foods and back office services. Overall, SSA’s share of fuels, unprocessed metals and raw agricultural materials out of total goods exports is about 55 percent: nearly one-half of the region’s exports are goods and services other than commodities.

Much greater benefits could be reaped by accelerating both regional and global trade integration. The first meaningful steps have been taken, notably with a move towards free trade both within and across the East African Community, the South African Development Community, and the Common Market for Eastern and Southern Africa. A proposed Bilateral Investment Treaty between the U.S. and East Africa would substantially expand opportunities for countries in the region, as would deeper trade integration in West Africa. Trade agreements should be complemented by a push to develop a common infrastructure strategy: a denser, interconnected network of transport and
communication lines linking together SSA countries would greatly facilitate trade and a more efficient allocation of resources, boosting economic growth, employment and productivity. Altogether, the creation of a common African market would make it easier for African companies to achieve scale and gain competitiveness on the global scene.

Global investors have been quick to recognize the region’s growth performance and potential. Foreign direct investment inflows to SSA rose from $6.4 billion in 2000 to $42 billion in 2013. Over the past few years, a rising share of capital is flowing to domestic-oriented sectors, such as finance, telecommunications and retail trade. According to U.N. data, the share of consumer-related greenfield projects in Africa rose from 7 percent in 2008 to close to a quarter of all projects in 2012.

Most importantly, economic growth has benefited from a strengthening of macroeconomic management, economic and political institutions, and human capital. Many countries also registered improvement in four (of five) dimensions of the World Bank’s governance indicators: control of corruption, government effectiveness, political stability and absence of violence, regulatory quality—evidence that institutions and governance have become stronger.

Overall, the track record of the last twenty years is impressive. Between 1995 and 2014, about two-thirds of the countries in the region have recorded positive economic growth for at least 10 consecutive years; and about one quarter have enjoyed twenty years of uninterrupted economic expansion. This is clear evidence that there is more to the story than a commodity boom.

2. Infrastructure, competitiveness and innovation

SSA has made limited progress so far in developing a manufacturing sector. While total manufacturing production has grown by 50 percent since the turn of the century, the sector’s value added as a share of GDP declined from 12 percent in 2000 to less than 10 percent in 2012. Manufacturing is essential to create jobs for large numbers of unskilled and semi-skilled workers, raising incomes; moreover, it offers the best possibilities for technology transfer and learning. The knowledge and skills acquisition that takes place within firms complements the contribution of the formal education system and enhances the competitiveness of the workforce.

Development of a stronger manufacturing sector in Africa is impeded by two main factors: (1) Infrastructure bottlenecks, notably in power generation and distribution and in transportation networks; and (2) Still weak and challenging business environments.
Infrastructure development
The poor state of infrastructure is a major constraint on growth. According to the World Bank WDI database and the WEF Global Competitiveness Report, SSA lags behind other developing regions in almost all measures of infrastructure coverage. Gaps are particularly large for road transport, electricity supply and access to water. The dire state of transport infrastructure is one of the main factors preventing the development of large-scale manufacturing.

Sub-Saharan Africa’s greatest infrastructure challenge is power generation. The entire region of approximately 900 million people generated roughly 15 percent less electricity than South Korea (with 50 million people) in 2011. Only 35 percent of the population in SSA has access to electricity, while in South Asia, which has similar per-capita income levels, the figure is twice as high.

Upgrading the quality of infrastructure would enhance production and increase connectivity to local, regional and global markets, enabling faster economic growth. It would boost the productivity of firms and allow them to take advantage of the abundant supply of labor. In addition, better infrastructure contributes to human development, improving access to clean water and health services and powering schools and hospitals. These outcomes mutually reinforce one another, and together with advances in governance, as well as a significant improvement in the business environment and the quality of the workforce, hold the promise of deeper structural economic transformation.

Business environment and competitiveness
While doing business in SSA remains challenging, the business environment has begun to improve. The World Bank’s Ease of Doing Business project assesses and ranks the ease with which you can start a business, register property, enforce contracts, pay taxes, get credit and electricity, resolve insolvency, deal with construction permits, trade across borders and protect investors. Between 2010 and 2014, most SSA countries have gotten closer to the best-practice frontier. Even with this improvement, though, much remains to be done. The map below shows the Distance To the Frontier, an index of how far a country is from best practice, for all countries in 2014 (a darker red color denotes a worse score, a more intense green a better score).

Innovation
In a still challenging environment, African businesses understand well that being nimble, flexible and open-minded is essential. While contending with the basic challenges of underdeveloped infrastructures and overdeveloped bureaucracy, they are very attuned to the fact that the pace of innovation is accelerating, disrupting industries across the globe. In fact, the African business executives polled in the GE 2014 Innovation Barometer rank above the global average in their conviction that the meshing of the digital world with the physical world of machines is bringing about a new industrial revolution. The barometer shows that a strong majority (about 80 percent) of business executives in Kenya, Nigeria and South Africa see innovation as a positive force that has already helped raise living standards in their countries. They recognize that innovation is increasingly becoming a global game, and that collaboration, across small and large companies, universities and government organizations, is essential to innovate successfully.
New waves of disruptive innovations such as the one we are experiencing today can allow emerging markets players to leapfrog existing technologies and gain a precious competitive advantage. African businesses are well aware of the opportunity. While the challenges are substantial, Africa’s willingness to be an enthusiastic early adopter of new technologies can be a massive advantage. The viral success of M-Pesa, the mobile banking and micro-financing system that quickly by-passed the relative under-development of traditional banking, is a case in point.

3. Governance: a pragmatic definition
Defining governance is not as straightforward as one might think. While there is strong evidence that good governance and strong institutions are important for sustainable economic growth, the key is identifying what definition of governance is relevant to economic performance—realizing that the answer might differ at different stages of a country’s development.

Governance and democracy
We take an instrumentalist approach to the question of “what is governance?” For the purposes of this analysis, we define governance as a government’s ability to equitably deliver the core functions of state to its citizens. This is in line with Francis Fukuyama’s view of “…governance as a government’s ability to make and enforce rules, and to deliver services, regardless of whether that government is democratic or not.” We add the notion of equity to Fukuyama’s definition because we feel it plays an especially important role in Africa’s context.

We are not arguing that democracy is irrelevant to good governance—rather, we believe important improvements in governance can be secured before a fully democratic system is established. That the continent has undergone a significant shift away from outright authoritarianism (“big man rule”) is beyond a doubt. However, the depth of this shift has been relatively shallow. Freedom House’s annual Freedom in the World Survey, considered one of the most comprehensive measurements of democratization in the world, shows that over one-third of Africa’s population is still “not free”, with another one half only “partly free”. Clearly, more progress is needed. It is important to recognize, however, that African countries have already achieved meaningful improvements in governance that have also been instrumental to bolstering economic performance.

What do Africans think of Africa’s governance and growth?
How much progress have African governments made in their ability to equitably deliver services to their citizens? When you ask the citizens themselves, the resounding answer is “not enough.” Africa’s strong growth spurt has failed to trickle down to the majority of the continent’s people. A survey released in October 2013 by Afrobarometer, a leading polling organization, indicates that “lived poverty” remains too high notwithstanding strong economic growth, resulting in widespread dissatisfaction with current economic conditions, job creation, and income inequality.

This, however, should not obscure the fact that SSA countries have made significant gains on important metrics such as infant mortality, and that strong economic growth has raised living standards. To some extent, the dissatisfaction recorded by Afrobarometer may reflect the fact that the bar of expectations has been raised both by the improvement recorded so far and by the greater ease with which young Africans today can benchmark their situation against their peers in more developed economies, thanks to greater digital access to information. These higher expectations can still be leveraged into a force for further progress—though if they are systematically disappointed they could instead feed social instability.

Just Enough Governance
If after a decade of strong economic growth, governments’ ability to deliver services and reduce poverty falls short of what their citizens aspire to, why should we think that Africa may finally be turning the corner?

The answer in our view is that SSA has begun to put in place “Just Enough Governance” to kick start a substantial improvement in economic performance. The theory of Just Enough Governance (JEG), echoes that of Minimum Viable Product in technology development. According to JEG, countries at the early stages of economic development should not try to do everything at once—they should avoid launching far-reaching reform programs attempting to improve all aspects of institutions and policymaking. Instead, they should focus on addressing one by one the biggest distortions and the most binding capacity and institutional constraints. There is an open debate on the relative merits of JEG versus a “big bang” approach to

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reform: supporters of the latter argue that deep reforms across the board are self-reinforcing, and that it is easier to build support if reforms are unsettling a wide range of vested interests so that none feels singled out; this approach can also reinforce the idea that the country needs true far-reaching structural change. Proponents of JEG argue that emerging markets often have limited administrative and execution capability, and therefore favor a more targeted approach. Empirical evidence suggests that both strategies, if implemented with determination, can bring success.

Africa’s governments have largely opted for a JEG strategy, and this has helped Africa improve its economic performance. Governments across the sub-continent have increased privatization of moribund state-owned enterprises, lowered trade barriers, decreased corporate taxes, strengthened regulatory and legal systems, and increased infrastructure investment. Much work remains to be done, yet the progress from the policy paralysis of the mid-1970s to the mid-1990s is notable. Probably the most important shift has been the changed worldview of political leaders across Africa towards a more market-oriented, private-sector-friendly policy framework.

It is important to stress that JEG can be a successful starting point but should never be seen as an ending point. The pragmatic and focused strategy advocated by JEG allows governments to score quick wins in the form of improvements in economic performance that can in turn bolster their credibility and political support. These should be used to pursue the next round of reforms, raising the bar at each step—otherwise, the risk is that backtracking will occur and progress will be wasted. We do not know if a big bang approach would have allowed an even stronger economic performance. We do know that the more gradualist JEG approach requires persistence and perseverance.

4. At a cross-road: scenario analysis and strategic implication

Africa stands at a cross-road. After several lost decades, SSA has broken the inertia: the last 10-15 years have seen strong economic growth and significant improvements in policies and institutions. This has helped catalyze investor interest, including strategic investments by China and India as well as rising participation by multinational corporations. A broad-based rise in commodity prices helped spark the improvement; and while broadening the base of growth is essential, we believe that SSA’s wealth of natural resources will remain an important asset for many years to come. If policies keep moving in the right direction, the region’s upside potential is enormous.

The risk of backsliding, however, is still present. Economic growth has not yet sufficiently raised average living standards, leaving many of the region’s citizens dissatisfied. A lot more progress is needed in strengthening political and social institutions and in pushing market-oriented economic reforms. This would help broaden the base of growth beyond commodities and develop a stronger manufacturing sector, which in turn would provide jobs and incomes on the scale needed to bolster the size of the middle class. In short, more progress is needed before reforms become self-sustaining.

The region’s future could play out in one of four different scenarios, depending on the speed of progress in economic and governance reform:

Africa ascending. In this best case scenario, economic and political reforms continue: political, social and market institutions strengthen; the region’s economies become increasingly diversified, with manufacturing playing a stronger role; this brings more jobs and rising incomes, reducing poverty and income inequality. Economic reforms and stronger governance reinforce each other, and improvement becomes self-sustaining. Business opportunities increase rapidly. International investment helps bolster the region’s infrastructure, and develop a stronger and deeper pool of home-grown talent. The development of a common market through shared transport networks and free trade agreements, including ideally a Bilateral Investment Treaty with the U.S., would make it easier for African companies to achieve scale, boosting economic growth, employment and competitiveness.

Back to the future. This is the worst case scenario. Economic reforms stall or are rolled back, and social and political institutions weaken. Growth becomes even more dependent on commodities and it slows, reducing
opportunities and income growth and increasing the risk of social turmoil. International investment remains confined to natural resources extraction, contributing little to local physical and human capital.

**Treading water.** This intermediate scenario would see further strengthening of governance, but little or no advancement of economic reforms. This would be sufficient to avoid social turmoil, but not to substantially reduce unemployment and inequality.

**Run & stumble.** This second intermediate scenario would see faster advancement of economic reforms, but with limited progress on governance. Periods of fast economic growth would provide bursts of strong opportunities, but their sustainability would be undermined by low social stability.

The four scenarios outlined above underscore the difference that the right policy choices can make. What are the enabling conditions that can help steer the outcome towards the upper right quadrant in the chart above?

Lack of infrastructure is the biggest obstacle to faster economic development, as we have seen. Moreover, improving governance should go hand in hand with better delivery of basic services to a broader share of the population. This could be accelerated by a close partnership between government and private sector companies to support the development of distributed power and portable cost-effective health care. The development of denser and more efficient transportation networks would facilitate trade and communications, allowing economic development to spread into rural areas. Progress on these fronts could create a virtuous circle: better living conditions and health standards make it easier for citizens to be more engaged in the political process, supporting further improvement in governance.

**Education and training is another essential pillar.** If strong growth continues and spreads to a wider range of sectors, limited availability of a qualified local workforce will become a serious constraint. Company sponsored training programs can play an important role in filling the gap, creating the skills needed by a faster development of selected industries. Governments and companies should cooperate in the development of professional schools closely aligned to industry, to match the supply of skills to the demand.

**Conclusion**
Africa’s enormous potential has begun to materialize, resulting in faster economic growth and rising living standards. Higher commodity prices have been a key catalyst, but Africa’s story already goes well beyond natural resources: sounder macroeconomic policies, better governance and some improvement in the business environment have already attracted investment across a broader range of sectors.

A lot more work is needed, however, to push progress beyond the tipping point where it will become self-sustaining. Africa has so far been harvesting the low hanging fruits, putting in place Just Enough Governance to spark a rapid improvement in economic performance. To sustain it will require greater investment in infrastructure, to give everyone access to power and health care; the development of a strong manufacturing sector, to generate a rapid growth in jobs and incomes; the bolstering of education and training; greater regional and global trade integration; and a substantial further improvement of institutions and business conditions. The challenges are formidable, but so are the opportunities. Public and private sector actors have a huge interest in working together to lay the basis for strong, sustainable and equitable economic growth. It will not be easy, and it will not be smooth. But the economic success of the last decade and a half shows that the process has begun: Africa is ascending.