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AFRICAN GROWTH – FORGOTTEN ISSUES^A

With economic growth rates at 7%, Africa's economic outlook is looking rosy. Some argue high commodity prices are the cause, casting doubt about the sustainability of current growth rates. However, there is more to current African growth than high commodity prices. African countries are slowly undergoing structural change, with services an increasingly crucial component of growth (it is easy to forget that half of GDP growth in the past 10 years can be attributed to services directly); better service sectors also lead to growth indirectly by addressing growth constraints on agriculture and manufacturing, improve country-wide productivity and promote a diversified economy. Successful African growth strategies will increasingly rely on appropriate services strategies backed by context-specific development of institutions and state-business relations.

Sub-Saharan Africa's GDP is currently growing at 7% (IMF data) and greater demand for and higher world prices of commodities (e.g. food prices have doubled and beverage prices have risen by 90% since 2000, oil prices are at a record US\$ 110 a barrel and metal prices have recorded recent or

overall highs), will have had an impact recently. For example, Zambia's real GDP per capita declined markedly until the late 1990s when copper prices reached a low, and has recently bounced back growing at 3.3% over the last five years due rising copper prices which have more than offset increases costs due to rising oil prices.

However, recent commodity price increases are not the cause of the turn-around in Africa's incomes which began in the mid 1990s (when most commodity prices were still declining) and in some countries before that. For example, Egypt and Botswana have both had positive real GDP growth rates for four decades. Botswana did this on the basis of diamonds and good governance. Egypt has had a more diversified experience, but also has oil. Real GDP per capita in Sudan averaged 4.7% over the last decade benefiting from the recent oil boom and China's engagement, but it began to export oil already in 1989. Uganda's uninterrupted real GDP per capita growth in two decades (average 2.7 per annum) has also been exceptional by African standards and coffee revenues have long played a role.

Further, while commodity prices affect countries in the short run depending on whether they are net importers or exporters (leaving aside whether or not such prices will actually stay this high), econometric and other evidence suggests that in the long-run, indirect effects of commodity prices dominate such as the effects on the world economy, domestic governance and structural change. The long-run growth effects of high commodity prices can be small or even negative except in those economies with good governance or evidence of structural change.

^A For more information on "State-business relations and economic performance in sub-Saharan Africa" see, www.ippg.org.uk/PDF/DWtV%20Draft.pdf by D.W. te Velde, as part of the Research Programme Consortium on Institutions and Pro-Poor Growth; for more information on services and development, see 'The contribution of services to development and the role of trade liberalisation and regulation', by M. Cali, K. Ellis and D.W. te Velde, draft report for DFID. I am grateful to colleagues for comments, including Adrian Hewitt and Steve Wiggins. The author alone is responsible for the opinions expressed. Comments welcome to dw.tevelde@odi.org.uk

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STRUCTURAL CHANGE: THE IMPORTANCE OF SERVICES

Commodity revenues are only one aspect of African growth – and in accounting terms revenues accrue to various economic sectors (e.g. farmers need transport, health and financial services, and their produce needs to be distributed; the mining industry needs water and energy services; commodity rents are more likely to remain in-country with efficient financial and real estate services). Two of Africa's biggest countries, Egypt and South Africa, have a reasonably diversified industrial base (chemicals, electronics, and automobiles). Several African countries including Kenya, Zambia and Malawi export non-traditional commodities such as flowers, fruits and vegetables using global value chains. Countries such as Ghana and Nigeria have a reasonable manufacturing industry aimed at the local market.

However, competition from China and other big emerging countries have reduced Africa's manufacturing potential for some time to come. Whilst new US trade preferences embedded in AGOA may have promoted clothing exports from African countries to the US (the EU had already granted duty free access to most African manufacturing before it offered EBA, but their rules of origin are less conducive to garment exports), with some estimating a seven fold increase in African garments, imports of garment inputs have also risen as a result and total AGOA exports are only 0.15% of GDP in AGOA exporting countries. By comparison, growth in revenues from tourism contributes 0.35% to African GDP each year.

Indeed, the fact that African countries have grown mostly due to an increased growth contribution of services has bypassed many growth experts. The share of services in GDP has increased by 5 percentage points over the last 15 years, having been stable at an unusually low level for two decades before that. Development usually coincides with a growing role of services in the economy (alongside a reduced role for agriculture with lower productivity). Services contributed 47% of real GDP growth in Sub-Saharan Africa over the period 2000-2005, while industry contributed 37% and agriculture 16%. Chart 1 shows that services

have been central to growth since 1994. Over the decade to 2006, the contribution of services to real GDP growth was 51% in Egypt, 35% in Botswana, 44% in South Africa, 41% in Tanzania, 52% in Uganda and a staggering 60% in Zambia.

Foreign aid has played a role in boosting Africa's services sectors such as construction, health and education, but most growth in services depends on travel, transport, trade, financial and telecommunication services supplied by the private sector. The services sector contributed 60% to growth in Kenya over the past five years. Transport and communication services contributed 24 % to overall growth (the same amount as agriculture), wholesale trade contributed 11% and health & education contributed a modest 8%.

Service sectors are diverse, and certain types of services can lead growth. For instance, tourism has been shown econometrically to lead growth especially in poorer countries, e.g. by sourcing agriculture produce locally or by providing externalities on exporting sectors by promoting air access connections required to transport flowers or vegetables from Kenya.

A GROWING ROLE OF SERVICES CAN HELP TO OVERCOME TRADITIONAL GROWTH CONSTRAINTS

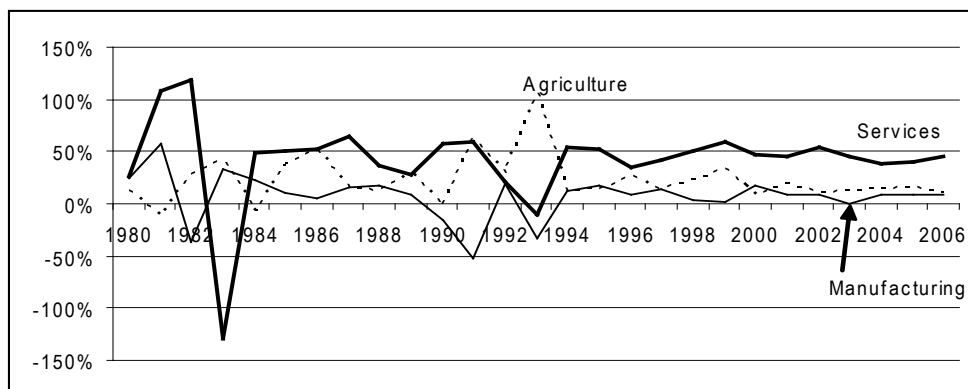
While macro economic instability, dictatorships, and coups are now more scarce (though not absent), the more 'normal' growth constraints such as lack of infrastructure and skills are resurfacing. Apart from being a crucial component of growth directly (see above), more efficient services can overcome traditional growth constraints supported by adequate institutional development (see below).

For example, growth diagnostic tools for Uganda confirm that lack of roads, railways and electricity supply will increasingly dampen growth rates and the ability to diversify. Ugandan textiles exports amount to around US\$3 million per annum, but more impressive has been the increase in manufactured exports to regional markets in Rwanda, Sudan and Congo which have risen over the past decade from zero due to conflict to over US\$20 million per month in 2006. With better roads and other transportation services, more

CHART 1 THE CENTRALITY OF SERVICES IN REAL GDP GROWTH

Contribution by sector in percentage of overall growth in sub-Saharan Africa, 1980–2006

Source: World Bank



non-traditional exports would be possible. Better roads depend on resources, but also on efficient and effective agencies co-ordinating investment.

There are obvious examples from the power sector. Frequent power outages resulted in an annual loss of 15 % of manufacturing output in Nigeria. Some estimate that the recent power crisis in South Africa dampened GDP growth by half a per cent, which could have been prevented with better informed policies. Copper mines in Zambia are constrained by lack of electricity supply. As they consume 50% of the country's electricity, specific institutions co-ordinating demand and supply are required to solve this constraint.

Lack of competitive air access also constrains growth across the continent. Heavily regulated routes are comparatively expensive while routes with competition have reduced fares and increased capacity (Swaziland/Mauritius). The experience of the Botswana Accountancy College shows that promoting domestic education services using public-private partnerships can address a specific skills gap within a decade.

Services are particularly helpful for landlocked and remote countries. An efficient ICT sector opens up new export frontiers for developing countries, including those (landlocked) countries traditionally constrained by high transport costs. The adoption of ICTs enables specific services (and goods) to be traded, or offshored without the need for traditional transport modes. IT enabled services in Mauritius are growing at 25% a year. Rwanda is also seriously promoting the ICT sector. Institutions for services are sometimes regional in nature. When the political problems have been solved, more efficient port and rail services in Kenya will have positive growth spillovers and remove growth constraints in nearby landlocked countries.

Finally, evidence suggests that commodity dependence is harmful for growth especially because of the effects of volatile commodity prices on GDP volatility. An increased share of services might reduce the country's volatility and allow

easier operation of financial institutions, improving the prospects for investment and growth.

INSTITUTIONAL DEVELOPMENT NEEDS TO SUPPORT THE PROCESS OF SERVICES AND GROWTH IN AFRICA

In order to sustain growth and productivity change in Africa, the question is not whether to move into services but at what speed, and how. Services contribute to and lead growth directly, make up the bulk of the investment climate, improve country-wide productivity and provide key inputs into manufacturing and agriculture. Growth strategies will increasingly rely on successful services strategies as well as general development policies that promote technological change, skills enhancement and higher productivity.

Appropriate institutional development is critical for transformative and sustained growth – and this covers the functions of institutions from defining property rights, to providing reciprocity in market operations to co-ordinating actors. Much has been debated about the institutions that might help countries to cope with natural resource booms and how Botswana succeeded and Nigeria failed to develop on the basis of natural resources. What is even less clear is how institutions are formed and sustained to deal with key growth constraints including those that can be addressed by development of the services sectors such as building roads, providing a good investment climate for railways, solving electricity supply and power outages, dealing with air access, enhancing tertiary education services, and promoting an ICT sector. While there are good examples of supportive institutional frameworks, such as good state-business relations in Mauritius and Botswana, is the institutional framework elsewhere ready to support the structural change in Africa in order to sustain currently high growth rates?

The IPPG Programme is a shorthand name for the *Research Programme Consortium on Improving Institutions for Pro-Poor Growth*, launched in September 2005.

The inspiration for the programme comes from two sources. The first is the recognition that 'institutions' – meaning relatively stable social arrangements and the formal rules, laws and conventions and informal norms that are associated with them – exercise an enormously important influence upon patterns and rates of economic development and change. The second is the concern that while it is by now clear that economic growth is a **necessary** condition for the sustainable reduction of poverty, it is not a **sufficient** condition for such reduction to take place. Consequently, if the Millennium Development Goals are to be achieved, it is necessary to think of ways whereby growth can be made distinctly pro-poor. 'Pro-Poor Growth' (PPG) means simply economic growth that is accompanied by improvements in the real incomes of poor people – economic growth that is actually driven, at least in part, by improvements in the incomes of poor people.

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More information along with IPPG discussion and briefing papers, guides to the research undertaken by the IPPG consortium and news on the Programmes activities can be found on the IPPG Programme website as above.