CARNEGIE
ENDOWMENT FOR INTERNATIONAL PEACE

POLICY OUTLOOK

Whither Africa?

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Summary

After stagnating for much of the postcolonial period, economic growth in Africa has accelerated since the mid-1990s. Improved terms of trade, better macroeconomic and education policies, and greater demand for services helped Africa's annual GDP growth rate more than double to 4.6 percent from 1999–2008 compared to the previous decade. Impressively, GDP in African economies accelerated more quickly than that of developing economies in other regions.

To continue this growth, Africa must overcome numerous challenges. Africa suffers from low investment and savings rates, a lagging demographic transition as the continent's high fertility rate creates a bulge in the number of young people requiring education, low productivity, and a low level of exports—even as export prices have increased.

Still, Africa also has a number of long-term growth opportunities. By developing ties with emerging economies such as China and India, Africa will be able to export more goods abroad, particularly as income and wages in those countries grow. The emergence of a middle class in Africa will also create more demand.

To ensure Africa successfully moves up the development ladder, policy makers must improve the continent's governance and business climate, allowing it to compete successfully with other poor but increasingly dynamic developing regions. Specific steps include:

- **Improve the investment climate.** Africa must take small steps—such as reducing the cost of registering and closing a business—and make fundamental reforms—such as strengthening the rule of law—to make the business environment more predictable. Improving trade logistics will also help Africa reap new opportunities as production processes become more globalized.

- **Raise agricultural productivity.** Few sectors offer greater room for improvement than agriculture, as Africa has the lowest cereal yield per hectare of any developing region. Africa should use genetically modified seeds, complementary fertilizers, and more efficient farming to boost crop yields.

- **Invest in a skilled labor force.** Policy makers must raise the quality of education—for example, through increasing enrollment in the sciences and improving skills such as numeracy and problem-solving—to close the widening innovation gap with other developing regions. Highly skilled workers make up the largest share of Africa's emigrants. Adequate compensation, better job opportunities, a strong business climate, and easy access to information technology will help African economies retain skilled workers.

Africa's continued—and accelerated—growth over the long term is by no means guaranteed. But if policy makers can build on their successes so far and tackle tougher second-generation reforms, they can help Africa become more competitive, improve productivity, and increase per-capita incomes well into the future.

Africa's improved growth performance in recent years has been widely noted. Gross domestic product (GDP) grew by an average rate of 4.6 percent annually from 1999–2008, more than twice its pace in the previous decade. While the economic expansion was strongest in oil-exporting and other resource-based economies, the acceleration was widespread.

Africa's increase in growth was associated with a number of favorable factors. Most notable was its improved terms of trade—a measure of the difference between the growth of export and import prices—and better policies, especially in macroeconomic management and education.

Despite its overall growth, Africa faces many economic challenges.

These improved macroeconomic policies helped Africa weather the economic crisis reasonably well; its growth in 2009 surpassed that of Latin America, Europe, and Central Asia, but was not nearly as high as that of developing Asia and the Middle East. Dependence on agriculture and limited financial linkages to the global economy helped Africa absorb the external shocks. The region, however, suffered a 12 percent loss in its terms of trade in 2009, as well as a sharp decline in capital flows and a slowdown in remittances.

Despite its overall growth, Africa faces many economic challenges. The advance in its per-capita income continues to lag behind that of other developing regions. Furthermore, fundamental economic factors needed to sustain growth—such as low rates of savings and investment—remain weak.

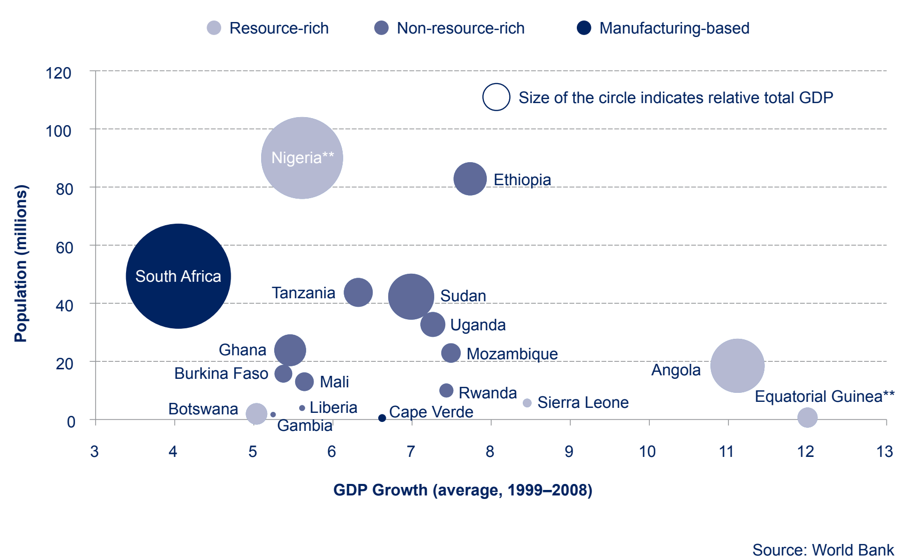
Given this mixed picture, it is too soon to say whether Africa's new growth pattern will persist and even intensify, which it must do to catch up significantly to other regions. But new hope exists that continued reforms—especially those affecting governance and the business climate—could lay the groundwork for sustained advancement on the world's poorest continent.

Recent Performance

After stagnating for much of its postcolonial period, economic growth in Africa has accelerated since the mid-1990s. GDP increased by an average of 4.6 percent a year from 1999–2008, more than twice its pace in the previous decade. Seventeen African economies—twelve of them low-income—grew at 5 percent or more in the decade leading up to 2008, up from only seven economies during the previous decade (figure 1).

The economic expansion was strongest in lower middle-income economies, which grew by 6 percent a year from 1999–2008; this growth was largely driven by oil and mineral exporters that enjoyed the commodity prices boom in the 2000s. But the acceleration was widespread throughout the continent and included South Africa, an upper middle-income country that accounts for more than one-quarter of Sub-Saharan Africa's GDP.

Figure 1. TOP PERFORMING AFRICAN ECONOMIES*



*Except South Africa, these economies grew by an annual average of more than 5 percent over 1999–2008.

**Actual size of Nigeria's population is 150 million, actual value of Equatorial Guinea's average GDP growth rate over 1999–2008 is 23.2.

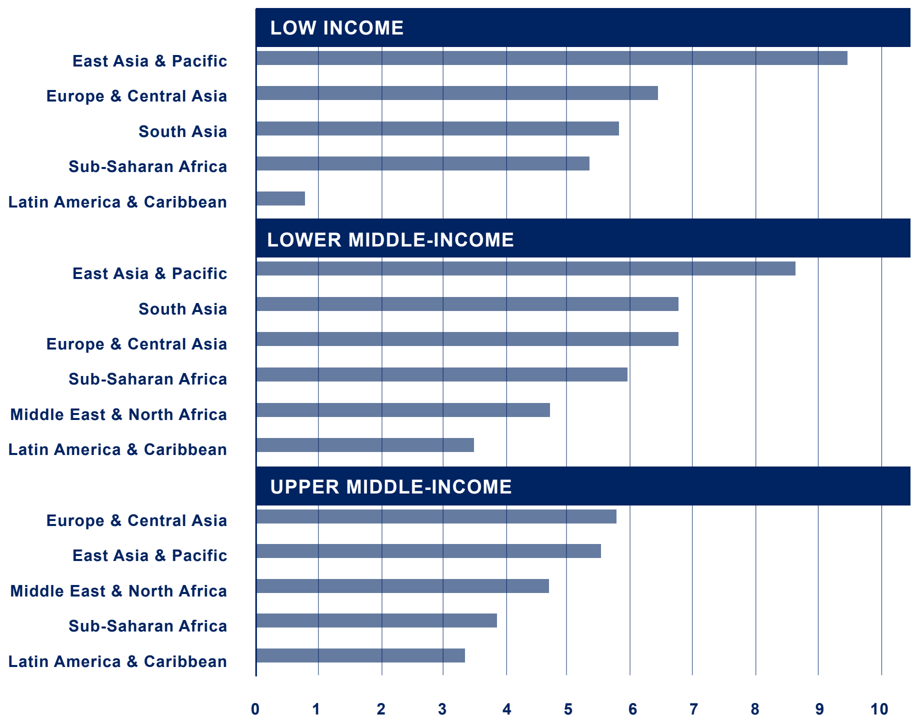
Africa's growth also accelerated more than that of developing economies in other regions, albeit from a dismally low level. The doubling of Sub-Saharan Africa's GDP growth rate from low levels compares with much smaller proportional rises—by factors of 0.7 to 1.6—in East Asia and the Pacific, South Asia, Latin America, and the Middle East and North Africa (MENA). This is also true when Sub-Saharan African countries are compared with those in the same income group in other regions.

Continued reforms—especially those affecting governance and the business climate—could lay the groundwork for sustained advancement on the world's poorest continent.

Crucially, the continent finally ended its long period of negative per-capita income growth, as per-capita income grew by an average of 2 percent per year in the 2000s.

Despite the marked uptick in growth, the region's growth rates from 1999–2008 remained in the bottom half of developing economies. Countries in Africa grew more slowly than those at corresponding income levels in East Asia and the Pacific, Europe and Central Asia, and South Asia (figure 2). For example, per-capita income in low-income African economies grew at about one-fourth the pace of those in low-income economies in East Asia and the Pacific, including Laos, Myanmar, and Cambodia.

Figure 2. GDP GROWTH (1999–2008 AVERAGE, %)



Source: World Bank and authors' calculations

When making comparisons with other developing regions, it is important to recall that per-capita income in Africa started from an abysmally low level, and that base levels matter. For example, even if Africa's per-capita income continues to grow at 2 percent per year for the coming decade, its per-capita income will only gain $460 (in purchasing power parity, or PPP, terms) over that time. In contrast, if per-capita income in Japan—one of the richest and slowest-growing economies in the world—grows by just 1 percent a year over the same period, its absolute per-capita income gain will be more than seven times greater than that of Africa, and the gain alone will be nearly 70 percent higher than Africa's current per-capita income. As a result, the absolute gap in income will widen considerably even if Africa makes proportional gains.

Very low initial levels of income and slower growth also help to explain why Africa continues to lag behind other developing regions in eradicating absolute poverty. Though the number of Africans living on less than $1.25 a day declined from 58 percent of the total population in 1990 to 50 percent in 2005, in absolute terms, the number of people living in poverty rose from nearly 300 million to 380 million.

In addition, other poor developing regions made much greater strides in reducing poverty over the same period. East and South Asia, which had poverty rates comparable to Africa's in 1990, reduced their poverty rates by 38 percentage points and 11 percentage points, respectively, by 2005, owing to their sustained rapid economic growth over the past few decades.

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Widespread Growth Across Countries and Sectors

While resources and improved terms of trade are an important part of the improved growth performance in Africa, non–resource-rich, low-, and middle-income economies also grew. Growth occurred broadly across sectors, with services playing an important role.

Resources are a Big Part of the Growth Picture

The rapid pace of growth in the ten lower middle-income African economies—which registered the strongest expansion among different income groups in the region—relies significantly on the four oil-exporting economies in this group: Angola, Cameroon, the Republic of Congo, and Nigeria. Nigeria and Angola—which account for about two-thirds of the region's lower middle-income economies—expanded by 5.6 percent and 11.1 percent per year, respectively, from 1999–2008. Comparing the decade 1999–2008 with the previous one, annual GDP growth in the oil-exporting countries increased by 3.7 percentage points, compared to about 0.9 percentage points in the six non–oil-exporting lower middle-income economies, which include Senegal and Cote d'Ivoire.

In resource-rich economies—where rent from resources accounts for more than 10 percent of government revenue and represents nearly one-third of the continent's GDP—output grew by 6 percent annually over 1999–2008—about twice that of the previous decade and higher than the 4.7 percent growth in the non–resource-rich economies. Among the resource-rich economies, oil-exporting economies[1] benefited from the rise in oil prices, which surged from an average of $15 a barrel in 1998 to about $100 a barrel in 2008. As a result, oil-exporting economies' GDP growth has more than doubled to 6.6 percent: 2 percentage points higher than in oil-exporting MENA economies and marks the highest growth rate among major country groupings in the region.

Growth Has Come From More Than Resources

Resources do not tell the whole story, however. The 36 non–resource-rich economies in the region more than doubled their nearly 2 percent growth in the previous decade, mainly due to a fast-growing service sector—although their growth still lagged behind resource-rich economies. Top performers in this group include countries such as Ethiopia, Mozambique, and Uganda, which grew by an average of 7 percent or more per year in the decade before the crisis.

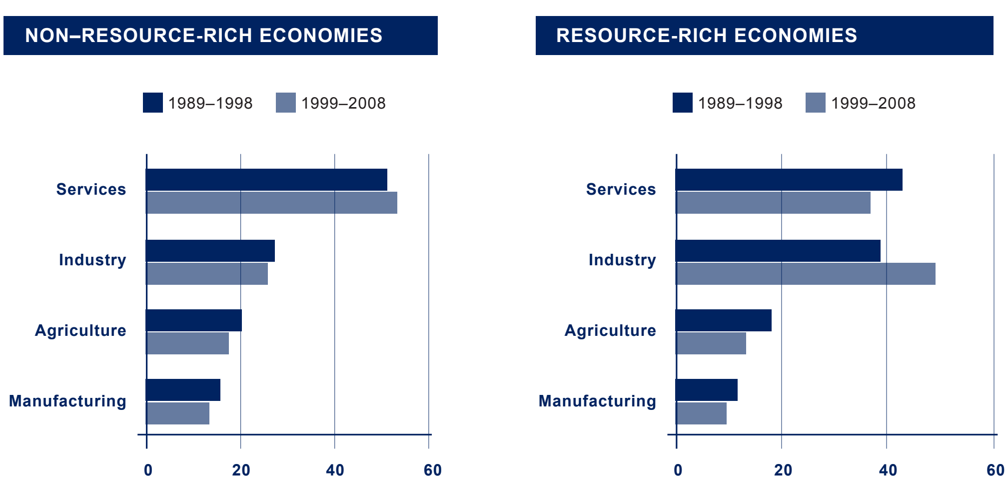
Non–resource-rich economies also showed substantial improvements in trade and foreign investment, though at a significantly slower rate than in resource-rich economies, especially oil-exporting ones. Exports of non–resource-rich economies increased by 4.7 percent of GDP between 1989–1998 and 1999–2008.

However, this trailed the 8.1 percent of GDP in resource-rich countries, reflecting the more favorable external environment for resource-related exports. Foreign Direct Investment (FDI) also increased sharply to 2.5 percent of GDP from a low base over this period, but still remained lower than the 2.7 percent of GDP that resource-rich economies attracted in the previous decade.

Services Have Become the New Drivers of Growth

Growth in non–resource-rich economies occurred broadly across sectors, with services making an important contribution. In contrast to resource-rich economies, the service sector in non–resource-rich economies was the major source of output, accounting for more than 50 percent of GDP, and increased as a share of GDP. The share accounted for by agriculture and manufacturing, meanwhile, fell slightly (figure 3).

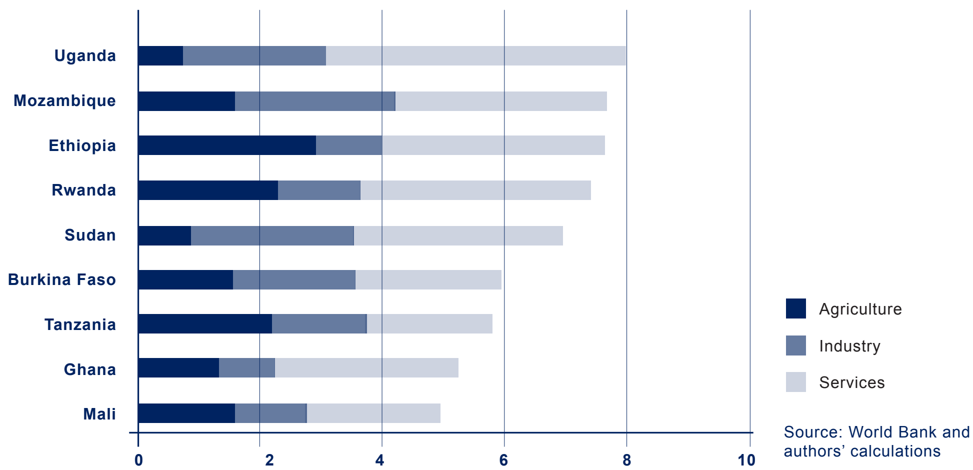
Figure 3. SECTOR'S VALUE ADDED (% OF GDP)



Source: World Bank

An analysis of sectoral contribution to economic growth[2] in nine selected top-performing non–resource-rich African economies[3]—which grew by more than 5 percent from 1999 to 2008—shows that services accounted for more than 40 percent of economic growth in nearly all nine economies, making them the primary driver of growth (figure 4). The rise of services largely reflects increased public-sector spending in education and health, as well as expanded private-sector areas such as real estate, hotels and restaurants, and banking.

Figure 4. CONTRIBUTION OF SECTORS TO GROWTH IN VALUE-ADDED GDP (1999–2008 AVERAGE, %)



Source: World Bank and authors' calculations

Lack of Progress in Manufacturing

Though diversification toward services is important, the decline in the share and contribution of agriculture was not accompanied by an increase in manufacturing. While agriculture was the largest contributor to total value-added GDP growth in the 1990s in most of the top-performing non–resource-rich economies, its share contribution to GDP growth ranged from 9 percent in Uganda to 38 percent in Ethiopia.

This decline is partly due to low productivity growth in the sector and the rapid growth of services. However, while a modest increase in industry accompanied the substantial rise in services, industry's ability to help sustain growth in the long term is limited. Most of the increase in industry came from non-manufacturing activities, such as mining and construction.

The share of manufacturing value-added in the GDP of most of these non–resource-rich economies also fell in 1999–2008 compared to the previous decade. In Uganda and Sudan, where the GDP share of industry increased by more than 10 percentage points, manufacturing contributed very little.

Even in resource-rich economies, the share of manufacturing fell on average. In Nigeria, a major resource-rich economy, the decline in the share of manufacturing was accompanied by a sharp rise in the share of services, signaling the "Dutch Disease."[4]

What Propelled Africa's Growth?

Understanding the policies and external environment behind Africa's improved growth and its performance relative to other developing regions offers more insight into how Africa can improve its economy in the coming years.

Africa Compared: The Policy Factor

Better macroeconomic management has clearly helped Africa. The continent made significant progress in reducing macroeconomic imbalances, including budget deficits and inflation, over the past decade.

Between 1989–1998 and 1999–2008, average inflation fell by two-thirds in lower middle-income economies, and by half in most low-income (excluding Zimbabwe) and upper middle-income economies. Africa's two largest economies, South Africa and Nigeria, reduced their inflation rates by 50 percent and 66 percent, respectively. In the 2000s, nearly 30 of 45 African countries enjoyed single-digit inflation—ten more countries than in the 1990s. Low-income and lower middle-income economies also saw inflation drop substantially compared to developing countries in other regions.

Thanks to large fiscal surpluses in oil-exporting economies in the 2000s—which averaged 6.3 percent of GDP—Africa's fiscal balance (including grants) turned from a deficit of 2.6 percent of GDP in 1997–2002 to a surplus of 1.3 percent of GDP in 2008. The continent's average external debt as a percentage of GDP also fell by one-quarter between 1989–1998 and 1999–2008, due in part to faster economic growth and debt relief under the Heavily Indebted Poor Countries (HIPC) initiative. This reduction was bigger than those in other developing regions. In some countries, such as Botswana, funds were established using rents from mineral wealth to provide for public debt service.

The region also made substantial gains in education enrollment. Gross primary school enrollment rose from 78 percent in 1999 to 97 percent in 2008, while secondary school enrollment increased from 24 percent to 33 percent over the same period. Though education enrollment remains far lower in African countries than in other developing economies, the increases in enrollment over the last decade were greater than those in other developing regions. Nevertheless, most African economies face a severe shortage of highly educated people, a segment of the population critical to sustaining the current growth momentum.

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Africa has also become more integrated through trade. Between 1989–1998 and 1999–2008, exports of goods and services as a percentage of GDP increased by 5 percentage points to 32 percent—comparable to increases of 5.6 to 7.6 percentage points for MENA, South Asia, and Latin America and the Caribbean. Trade reforms have also reduced tariffs in Africa, though less than in other developing regions. In the two decades leading up to 2008, tariff rates for manufactured products fell by about 46 percent in Africa, compared to a decrease of more than 70 percent in all developing economies. Still, high transaction costs, such as backward infrastructure and inefficient customs procedures, remain constraints to regional integration.

Despite these improvements, Africa remains hobbled by major policy and institutional weaknesses, which are greater than those faced by other developing regions. At around 46 percent of GDP, foreign debt in Sub-Saharan Africa is still 10 percentage points higher than that in Latin America and the Caribbean or MENA. Inflation is still above 10 percent in about fifteen African countries.

And even with some recent successes—which placed countries such as Rwanda among the top global reformers in the World Bank's 2010 Doing Business Index—the business climate in Africa remains enormously challenging, with low scores in ease of starting a business, obtaining credit, and securing investor protections. The average rank of Sub-Saharan Africa was the lowest among developing regions in all but two of the nine components of the World Bank's ranking (dealing with construction permits and enforcing contracts). In particular, lower middle-income economies—which include large countries like Nigeria and Cameroon—scored poorly, with all countries ranking in the bottom half of the 53 lower middle-income developing economies.

The number of state-based conflicts—which severely impaired growth in many African countries in the past—has fallen in Africa, from sixteen in 1999 to six in 2005, and democracy is becoming more established across the continent (figure 5).

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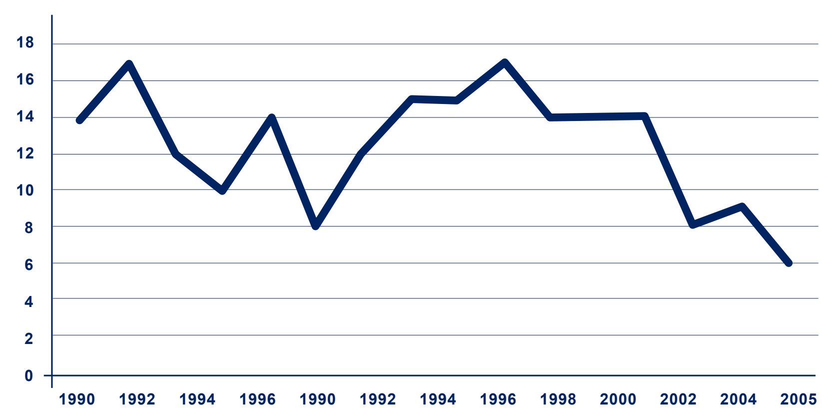
Figure 5. NUMBER OF STATE-BASED ARMED CONFLICTS IN SUB-SAHARAN AFRICA



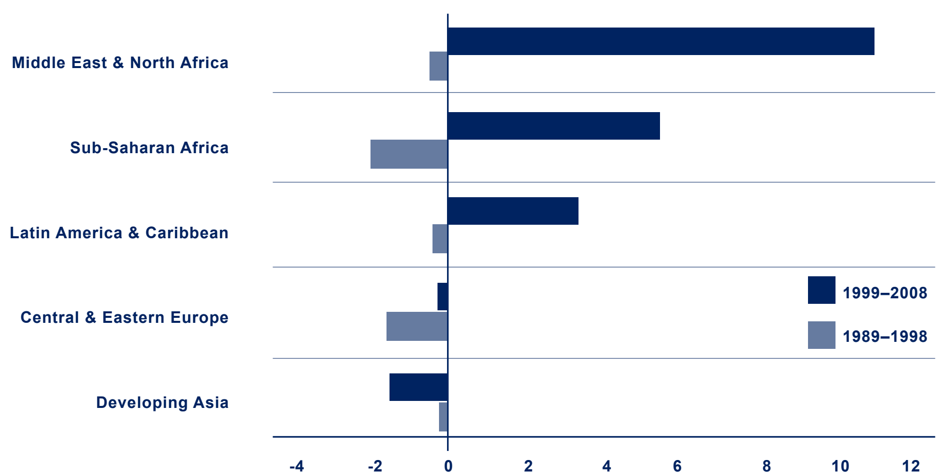
Source: Human Security Gateway Database

There has been a clear shift toward more elections and stronger political institutions, particularly in some of the top performing African economies, such as Ghana. However, the region still has work to do. There are still major conflicts—such as in Darfur, Chad, and Somalia—that have not been resolved. The region also continues to receive low scores on World Bank governance indicators—including political stability, rule of law, and government effectiveness—which could affect its ability to grow in the future. Furthermore, despite the increase in the number of parliamentary elections, executive dominance still persists.

Africa Compared: The External Environment

More than other developing regions, Africa—where commodities accounted for more than 70 percent of exports—has benefited from significant improvement in its terms of trade since the mid-1990s. The terms of trade for Africa's goods in 1999–2008 were about 7 percentage points higher than in 1989–1998, compared to a much lower increase in Latin America and a 1.4 percentage point decline in developing Asia (figure 6). Oil exporters in the Middle East and Africa saw the largest advances in terms of trade, helped by the surge in oil prices over the past decade. A similar increase in the price of other raw materials, such as minerals, also helped Africa.

Figure 6. TERMS OF TRADE OF GOODS
Average Annual Change (percent)



Source: IMF

The jump in Africa's exports—which increased more than four-fold from 1998–2008—also reflects its rising trade with fast-growing developing economies. The share of developing economies in Africa's extra-regional trade increased from nearly 20 percent in 1995 to 33 percent in 2008. Primary products, such as oil and agricultural commodities, accounted for 75 percent of Africa's exports to non-African developing economies in 2008, up from 55 percent in 1995.

In addition, China has become a major player in Africa, more so than in other developing regions. China increased its share of Africa's exports by 10 percentage points from 1998–2008, compared to a 6 percentage point increase in MENA's exports and a 4 percentage point rise in Latin America's exports.

The increase in Africa's trade has been accompanied by a surge in inward FDI, with nearly half of the FDI flows into Africa from 1999 to 2008 going to oil-exporting economies. Net inflows of FDI reached about $35 billion in 2008 and averaged around $17 billion in 1999–2008, a more than four-fold increase from the previous decade's $4 billion average. However, even this impressive growth lags behind that of other developing regions—Eastern Europe and Central Asia, MENA, and South Asia—which also started from relatively lower levels.

Some Factors Likely to Restrain Africa's Long-Term Economic Growth

The policy factors that have spurred growth acceleration in the past decade are encouraging. Nevertheless, fundamental weaknesses in Africa—such as low rates of savings and investment, as well as inadequate structural diversification—offer reasons for caution.

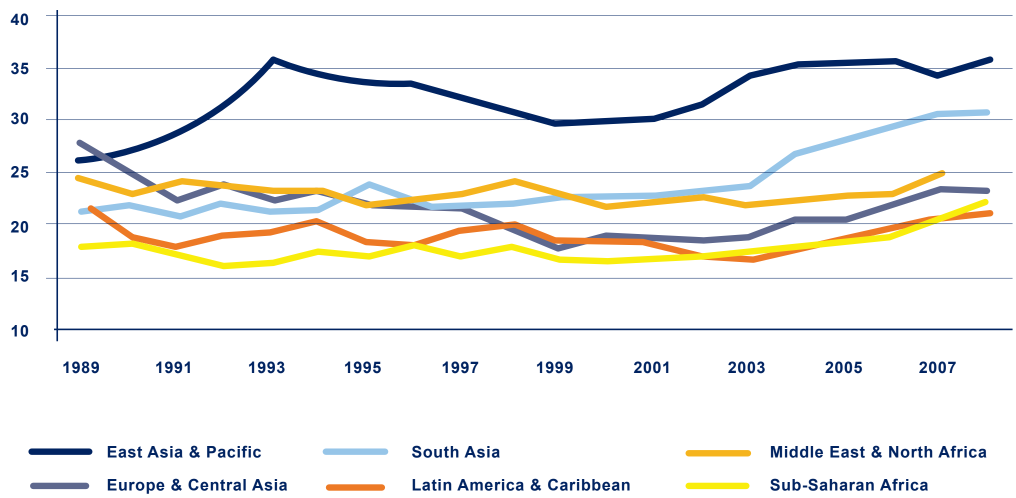
Low Investments and Savings

The investment rate in Africa has remained below 20 percent of GDP in the past decade, the same rate as the previous decade and much smaller than the 30–35 percent rate in the most successful developing regions that have managed to sustain growth for a long period, such as China or Indonesia (figure 7). In large economies such as South Africa, Nigeria, and Ethiopia, investment rates averaged around 19 percent of GDP in each of the past two decades, more than 10 percentage points below that of rapidly growing Asian countries such as Thailand and Vietnam.

Encouragingly, FDI accounts for a larger share of this total investment, by more than doubling from a small base. However, FDI tends to flow to traditional sectors, such as mining and petroleum, and African economies need to raise the level of domestic investment to support the development of productive sectors.

Investment in the region has been constrained in part by weak resource mobilization. In addition to underdeveloped financial intermediaries and other institutional weaknesses—such as inadequate infrastructure and lack of political stability—which reduced the capacity to mobilize savings, incomes are too close to subsistence levels in many instances to allow for savings. Domestic savings rates, around 16 percent, are much lower than the 25–40 percent in developing Asia, showing Africa's dependence on foreign sources of capital, such as aid and loans, to finance investment.

Figure 7. INVESTMENT (% OF GDP)



Source: World Bank

Lagging Demographic Transition

Given limited resources, an important obstacle to sustained growth of per-capita income and productivity in the coming years is Africa's lagging demographic transition,[5] which causes a bulge in the number of young people requiring education. High levels of population growth, reflecting the fertility rate of five births per woman—more than twice the rate in most other developing regions—and an age-dependency ratio of around 85 dependents for every 100 workers—which is 25–40 percentage points above those of other developing regions—present clear challenges to providing adequate human capital formation. However, this lagging demographic transition will also provide a window of opportunity in the long term as fertility rates and the age-dependency ratio decline. According to UN projections, the fertility rate in Africa could fall to three births per woman by 2030 and below 2.5 births by 2050, as female education improves and family-planning services become more readily available.

The labor force—nearly 500 million people strong currently, about half the size of China's—is expected to increase by 50 percent in the coming fifteen years as the youth population ages. This enormous infusion of labor will likely induce high growth of aggregate output in Africa. Whether this translates into high growth of per-capita GDP will depend on governments' ability to invest in education and, most importantly, on the quality of education outcomes.

Low Productivity

Africa's slow growth in the past has been characterized by little or no improvement in total factor productivity, the portion of output not explained by the amount of inputs used in production. Thus, future growth will depend on advances in technological capabilities and other contributors to total factor productivity, not just on the accumulation of labor input and fixed investment.

To evaluate Africa's capacity to increase total factor productivity, an index measuring the capacity to absorb foreign technology—which reflects measures of capacity (e.g., education) and the business climate, including openness to trade—is computed. Components of the index include education, infrastructure, governance, and business climate.[6]

Despite recent advances in Internet and mobile phone access, investment in Africa's infrastructure remains limited.

Of 30 developing economies evaluated, representing the five largest economies from each of the six World Bank developing regions, four large African economies—Nigeria, Angola, Kenya, and Ethiopia—fall in the bottom quarter of the sample, due mainly to low scores in governance, education, and infrastructure. South Africa—with its relatively high scores on business climate and governance indicators—is ranked in the top ten countries and offers better prospects to accelerate productivity growth.

The average infrastructure and education index—which includes paved roads, Internet usage, and secondary education enrollment—for the five largest African economies lags more than 20 percentage points behind the average of the 30-country sample. Despite recent advances in Internet and mobile phone access, investment in Africa's infrastructure remains limited. In contrast, Central European and East Asian economies such as Poland and Thailand are especially well placed to improve productivity further, thanks to improved infrastructure.

Disappointing Export Performance

Though rising exports contributed to Africa's improved growth performance, most of the rise in exports came from prices rather than volumes. The volume of exports grew by 4.7 percent per year on average over 1999–2008 compared to the previous decade—considerably lower than the 16 percent increase in the value of exports—and slower than the 5.7 percent in the previous decade. The increase in export value was also more than offset by an accompanying increase in imports.

As a result, the region saw a slight deterioration in its trade balance, while most other developing regions saw improvements. Furthermore, while the share of Africa's exports in GDP improved by about 5 percentage points to 32 percent over this period, it was the smallest increase among developing regions of the world.

Most countries in the region remain primary product exporters, except for a few economies such as South Africa and Mauritius, where manufactures account for more than 50 percent of total exports. Primary products, such as oil and agricultural commodities, accounted for 75 percent of Africa's exports to non-African developing economies in 2008, up from 55 percent in 1995. According to the United Nations Conference on Trade and Development, the Africa export concentration index increased by 82 percent from 1995–2009, from 0.23 to 0.42, reflecting Africa's increasing dependence on a limited number of commodities.

Furthermore, the share of inter-Africa trade in the region's total exports—only 11 percent in 2008 and little improved from the previous decade—is much lower than that of other developing regions, reflecting constraining factors such as high transaction costs and the limited complementary nature of exports in Africa. Africa's export market share was also almost unchanged over the last two decades at around 2 percent of world exports.

Volatile and Downward-Trending Commodity Prices

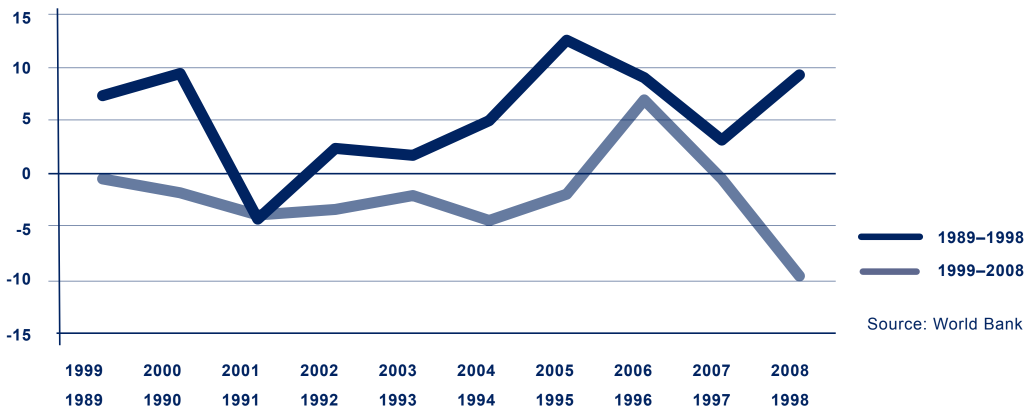
Africa's over-dependence on commodities—which accounts for more than 70 percent of total exports—makes the region vulnerable to external shocks. Primary commodity prices—which have declined historically relative to manufactured goods—may not only remain highly volatile but also resume their secular decline.

Primary commodity prices have declined historically relative to manufactured goods, with estimates of long-term decline ranging from -0.6 to -2.3 percent per year.[7] Interrupting their long-term trend, commodity prices have surged since 2002 and terms of trade of goods for Africa have *increased* by an average of 6.5 percent annually over 2002–2008, compared to a 0.4 percent *decline* in the decade before that (figure 8).

While the long-term downward trend may have been temporarily interrupted by demand increases for many commodities from fast-growing developing countries, it is likely that increased investments and technological progress will cause supply to increase as well.

The ongoing and projected slowdown of global population growth will also slow commodity demand growth. For example, food production can increase greatly, as recent Food and Agriculture Organization (FAO) and Organization for Economic Co-operation and Development (OECD) estimates show that an additional 1.6 billion hectares could be cultivated, up from 1.4 billion hectares currently. If that happens, the gradual downward trend in the prices of commodities relative to manufactured goods may return.

Figure 8. TERMS OF TRADE OF GOODS (% CHANGE)



Factors That Could Boost Long-Term Economic Growth

Despite these challenges, Africa also faces a number of long-term opportunities: reorientation of economic ties toward fast-growing emerging economies could increase demand for its resources; the emergence of a middle class within Africa and increased urbanization will support domestic demand; rising wages in China and other developing countries will expand markets and also allow more room for Africa to compete in manufactures. The challenge will be for policy makers to take advantage of these opportunities to permanently boost Africa's economy.

Mushrooming Economic Ties With Emerging Economies

While Africa has a long history of trade with Europe and other advanced economies, it now sends about half of its exports to other developing countries. This is mainly driven by its rapidly rising trade with Asian economies; Asia's share of Africa's trade doubled to 28 percent over 1990–2008. Increased demand for commodities in developing economies, particularly those in Asia, will help Africa's economy by seeking its resource exports. By mid-century, China and India are expected to be among the top three export destinations for Africa, accounting for one-third of its exports.[8]

This trend is likely to continue as projections suggest that the share of world trade held by developing countries will more than double over the next forty years, reaching nearly 70 percent by 2050. The reorientation toward developing economies will also reduce Africa's vulnerability to a growth slowdown in advanced economies, with the EU and the United States expected to account for only a quarter of Africa's exports by 2050, down from more than 50 percent in 2006.

Emergence of a Middle-Class Consumer in Africa

Africa's economic growth in the long term will also be supported by the emergence of middle-class consumers and increasing urbanization. For example, in 1998, six large African economies[9]—which account for two-thirds of the continent's GDP and more than one-third of its population—had nearly 40 million people in the Global Middle and Rich (GMR) class with annual incomes of at least $4,000 (in 2005 PPP). In just ten years, the size of the GMR in these countries increased by 60 percent and reached 61 million people.

Reflecting rising average incomes and under plausible income distribution assumptions, many African economies in the next few decades will have a large proportion of the population in the GMR. Specifically, Ghana, Kenya, and South Africa—which represent about 35 percent of the continent's GDP—will have 40–50 percent of their populations in this class. As more African households enjoy disposable income, they will likely spend a substantial share of it on household and personal products, durable goods, and services, representing a potential boon for African suppliers and supporting economic growth with a domestic source of demand.

This emergence of the middle class will also be accompanied by increasing urbanization, which will likely support growth, especially in services. In 1990, less than 30 percent of Africans lived in cities, compared to 40 percent today (about 300 million people, close to that of India's urban population). The 4 percent annual rate of urbanization observed in Africa over the last decade—twice that of Latin America and a third higher than that of East Asia—suggests the urban population will continue to increase significantly.

Rising Incomes and Wages in China and Elsewhere

The rise of wages in large emerging economies—and the accompanying rise of a large middle class—will likely open some space for Africa's exports. In China, for example, the GMR class is expected to grow from about 120 million people in 2009 to 780 million people in 2030 and 1.1 billion people in 2050. As wages and capital/labor ratios rise in these most successful developing economies and grow closer to those of advanced economies, new markets for Africa will open up. This may also open a door to low-wage countries in Africa to advance exports of low-wage manufacturers.

Policy Recommendations

Africa's recent performance is best interpreted as a first step up the development ladder. The continent has made genuine inroads on first-generation reforms, namely macroeconomic stability and openness to the world. For the climb to continue, African countries must tackle much tougher second-generation reforms, such as improvements in governance and the business climate. Such reforms will enable it to compete for investment and for markets with other poor but increasingly dynamic developing regions.

Improve the Investment Climate

A major component of improving productivity and competitiveness in the long term is increasing the rate and effectiveness of domestic investment. While many African economies have made significant institutional reforms to improve their business climate, private investment is still constrained by high transaction costs and the perceived uncertainties of doing business.

Some elements needed to improve the business climate include small steps such as reducing the cost of registering and closing a business; improving the customs inspection process by replacing paper-based data systems with an electronic data system, for example; and reducing the costs associated with bureaucracy—in other words, cutting the red tape. Such detailed reforms would help make investment easier and more attractive.

More fundamental reforms include strengthening the rule of law, thus making the business environment more predictable. This may include reforming property law to improve investor protections and creating and nurturing an efficient legal environment to enforce contracts and resolve disputes. Such reforms are important for all investors, and particularly foreign investors, who are operating in an unfamiliar environment and can easily choose to go elsewhere. These investors bring not only needed foreign capital but also technological capability and business knowledge that can spill over into the rest of the economy.

A sustained effort to improve trade logistics is also needed to reap new opportunities in emerging trends in global trade, where production processes are divided into many stages and carried out in different locations. While African countries have been able to attract FDI by targeting their abundant natural resources, more incentives are needed to attract FDI that involves manufacturing.

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Reforms in so-called backbone sectors—such as power, telecommunications, transport, and finance—help improve efficiency throughout the economy. In resource-rich economies, there may also be a need to improve mining codes by increasing transparency and accountability of contracts and introducing effective regulatory regimes.

Raise Agricultural Productivity

While agriculture contributes more than 30 percent of GDP and 70 percent of employment, Africa has the lowest cereal yield per hectare of any developing region. Few sectors offer greater opportunities for improvement. Policy makers need to develop a plan for harnessing science and technology to provide a substantial increase in agricultural productivity. Africa needs to use genetically modified seeds and their complementary fertilizers—which have resulted in a dramatic yield increase in most of the developing world—as well as more efficient farming to boost crop yields. However, these approaches need to be tailored to countries and agro-ecological zones.

Invest in a Skilled Labor Force

Clearly, improving education in Africa is an important element of developing the skills required to increase productivity and be competitive in a global marketplace. While many countries have made significant progress in increasing enrollment and graduation rates—especially at the primary and secondary education levels—there is still a great need to provide quality education through such skills as improving numeracy, problem-solving, and critical thinking skills. At the university level, increasing enrollments in sciences—such as the engineering and medical fields—is important to close the widening innovation gap with other developing regions.

Highly skilled workers constitute the largest share of all emigrants from Africa. Policy should target how to keep these skilled professionals. This will be particularly helpful for small economies, such as Cape Verde and Mauritius, which both have large segments of their population educated at the tertiary level and a large share of emigrants. Retaining skilled professionals requires, among other things, adequate compensation, better employment opportunities, a strong business climate, and easy access to information technology. In addition, countries with a large Diaspora population—such as Nigeria, Ghana, and Ethiopia—could draw on their skilled labor force to facilitate trade, investment, and technology transfer, including through temporary or permanent return to Africa. Technology transfer from abroad may take the form of adapting innovations in organizational and institutional structures, which are important to improving labor and capital productivity.

Conclusion

The widening gaps in income and in governance and business climate indicators—compared with those of other developing regions—suggest that the rate of productivity advance in Africa will continue to be slow, and some of the recent optimism may not be fully warranted. Prospects for sluggish growth in industrial countries—still Africa's main export destination—and the likelihood that commodity prices will continue to show high volatility also argue for caution. In addition, commodity prices may decline as supply responds to high prices. Both domestic savings and investment rates in Africa remain much lower than successful emerging economies that have seen large growth acceleration in the past.

However, there is clearly new hope for Africa, grounded in improved stability, the rise of an African middle class, and the opportunity presented by stronger links with fast-growing emerging markets. In the long term, as wages rise in these countries, Africa's comparative advantage could shift toward manufactures, and new export growth opportunities may open up—allowing the world's poorest continent to make real, sustained economic progress.

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Notes

1 According to the IMF's definition of oil-exporting economies, oil exports account for 30 percent or more of merchandise exports. This group includes Angola, Cameroon, Chad, Congo Republic, Equatorial Guinea, Nigeria, and Sudan.

2 Each sector's contribution to total value-added growth is computed by using data on sectoral growth and sectoral share of GDP.

3 These economies include Uganda, Mozambique, Ethiopia, Rwanda, Sudan, Burkina Faso, Tanzania, Ghana, and Mali.

4 The "Dutch Disease" is related to the negative effects of a resource boom and reflects the decline in manufacturing activities and competitiveness as the exchange rate appreciates and wages rise.

5 Delayed demographic transition describes population change when a country moves from high to low fertility and mortality rates as part of economic development.

6 For a detailed explanation of the methodology behind the computation of the index, see Uri Dadush and Bennett Stancil, "The World Order in 2050," Policy Outlook, Carnegie Endowment for International Peace, 2010.

7 Roman Grynberg and Samantha Newton, *Commodity Prices and Development* (Oxford: Oxford University Press, 2007).

8 See Uri Dadush and Shimelse Ali, "The Transformation of World Trade," Policy Outlook, Carnegie Endowment for International Peace, 2010.

9 These include Angola, Cameroon, Cote d'Ivoire, Kenya, Nigeria, and South Africa.

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