Discussion of Roger Nord's Presentation: Africa - Opportunities and Challenges

I would like to thank Roger for his fascinating and insightful presentation. In my remarks I want to focus on two of the issues raised by Roger in his presentation: what has driven the acceleration in real economic growth in sub-Saharan Africa (SSA) since the late 1990s? and what are the key challenges which the region faces in the medium term if it is to sustain robust growth?

What lies behind the acceleration of economic growth in SSA?

As Roger points out, although the oil exporters have achieved the fastest growth during 1995-2010, the acceleration of growth in SSA has encompassed both the resource intensive and the non resource economies, so the natural resource boom that has occurred over the last decade or so is not an adequate explanation, by itself, for the region's much improved growth performance. What I think is fundamental to the acceleration of growth in SSA over the last 10-20 years has been a shift of labour out of agriculture and into predominantly urban services and construction. Unfortunately we do not have comprehensive continent wide time series data on the inter-sectoral shares of the workforce, but given that the urban population grew at more than twice the rate of the rural population of SSA in the first decade of the millennium (3.8 percent per annum for the urban areas compared to 1.7 percent for the rural areas) it is inevitable that there has been a relative shift of labour away from agriculture.

The rapid growth of the urban based services and construction industries has been made possible by some of the factors noted by Roger in his presentation; liberalisation of the economy, improved macroeconomic stability, financial deepening and inflows of foreign capital, aid and remittances as well as by technological innovations which have transformed industries such as telecommunications. These factors have created markets for urban services which barely existed two decades ago and enabled entrepreneurs to set up businesses to serve them. In the 1980s and 1990s, SSA economies were operating far within their production possibility frontiers, because of macroeconomic mismanagement, ubiquitous Government controls over resource allocation which stifled private enterprise and in many countries, civil strife. The removal of these constraints has revived growth in SSA.

The shift of labour out of agriculture into non agricultural activities has had a profound impact on real GDP growth, not because labour productivity in non agricultural activities is particularly high but because labour productivity in agriculture is so abysmally low, as illustrated on slide 33 of Roger's presentation. The median level of value added per agricultural worker in SSA is less than $450 per year.

I will use the data from Uganda to illustrate these points about the impact of the inter-sectoral shifts in labour, but I think that they are relevant to many other countries in SSA. Between 2005/06 and 2009/10, the share of the Ugandan workforce whose main source of employment was agriculture fell by six percentage points, from 71.6 percent to 65.6 percent; i.e. by 1.5 percentage points per year.[1] In 2005/06, the nearly 72 percent of the workforce employed in agriculture produced less than a quarter (24 percent) of the economy's value added. Hence average productivity per worker outside of agriculture is eight times what it is in agriculture. Given this vast differential between labour productivity in agriculture and that in non agricultural sector industries, the shift in the share of the labour force out of agriculture of 1.5 percent per year which took place during the second half of the 2000s contributed 3.5 percentage points per year to Uganda's real GDP growth; i.e. it can account for most of the real GDP per capita growth of 4.4 percent which occurred during this period.

What are the medium term challenges for sub-Saharan Africa?

The nature of the economic growth which has occurred in large parts of SSA in the last decade has been problematic in many important respects, which gives rise to concerns over its long term sustainability. As I have mentioned, growth has been propelled by a shift of labour out of agriculture, mainly into services and construction. However, the majority of new jobs created in SSA in the non agricultural sector are informal or semi formal jobs in small and micro-enterprises, or involve self employment. Labour productivity in non agricultural small and micro-enterprises, although much higher than it is in agriculture, is nonetheless very low. Furthermore this type of employment provides little scope for any dynamic productivity growth through the use of new technology. Firms are too small to adopt new technology, they lack access to capital and most only survive for a few years. As a result, although these firms provide a valuable social function in terms of employment creation, they are unlikely to contribute to long term structural transformation of the economy.

In contrast to the performance of small and micro-enterprises, the growth of employment in medium and large enterprises has stagnated. In Uganda, the average size of the workforce of

[1] The data are from the Uganda National Household Survey 2010, p37.

companies employing more 100 workers fell by 40 percent in the first decade of the millennium. Their share of the formal sector workforce fell from 20 percent to 10 percent between 2000 and 2010. This has profound implications for economic growth over the long term, because labour productivity in medium and large firms is much higher than in small and micro-enterprises and also because medium and large firms are much more able to generate productivity growth through time, through capital investment and upgrading of workers' skills. Labour productivity in the medium and large firms in Uganda increased rapidly since the turn of the millennium, with these firms investing in new capital (much of it labour saving). But these firms have not expanded fast enough and there have been too few new medium and large firms set up in Uganda, with the result that the economy is not generating high productivity jobs in the formal sector.

The stagnation of employment growth in medium and large scale firms reflects the paucity of private sector investment in SSA. The average share of private investment in GDP in SSA was only 12.6 percent during the first decade of the millennium.[2] Furthermore, most of the private investment which took place was in capital intensive industries or in real estate; there has been very little private investment in labour intensive manufacturing throughout SSA. Although the private investment rate in Uganda during this period was slightly higher than the regional average, at 16.5 percent of GDP, this was still far lower than the private investment rates of 30-40 percent of GDP attained in developing Asia.

The weakness of private investment in SSA is partly explained by low savings rates. Gross national savings averaged only 16 percent of GDP in SSA in the 2000s, compared to more than 40 percent of GDP in developing Asia. The low rates of private investment also reflect difficulties in the institutional climate for private investment, which raise the cost and risks of doing business on the continent.

If the pattern of employment generation which occurred over the last decade continues, with job growth concentrated in low productivity small and micro-enterprises, there is a danger that average labour productivity outside agriculture will decline, as it has in Uganda during the first decade of the millennium, which will then impart downward pressure on real economic growth. In the long term, rapid economic growth per capita will only be sustained if more high productivity jobs are created in the formal sector, together with an increase in the productivity of the workers who remain in agriculture, through the modernization of smallholder agriculture.

[2] Data from African Development Indicators, 2011.

The most critical challenge facing SSA, if it is to achieve structural transformation over the long term, is to raise private investment in labour intensive industries; including agro-processing, light manufacturing and service industries. It is particularly important to attract more private investment into labour intensive traded goods industries, for two reasons; the traded goods sector is usually the source of much more rapid productivity growth than the non traded goods sector, and the growth of the traded goods sector is not constrained by the small size of the domestic market. Structural transformation in developing economies is driven by investment in traded goods industries.

The optimal policies needed to boost private investment in labour intensive industries will depend on the binding constraints to investment, which are not necessarily uniform across countries in SSA. Policy makers need a better understanding of the binding constraints in each country, which will only be possible if more research is conducted on this issue. Nevertheless, it is likely that a combination of policies will be needed to generate higher private investment rates. These include: institutional reforms to strengthen the business climate, to protect the rights of investors; measures to reduce the high costs of doing business emanating from expensive and unreliable infrastructure services; policies to raise domestic savings rates, to expand the resources available for investment by domestic firms; improving secondary educational attainment and upgrading the vocational skills of the workforce; and reforms to exchange rate policy so that traded goods industries can benefit from more stable and competitive real exchange rates.