

Africa Competitiveness Report: Why Africa?

Stephen A. O'Connell¹
November 18, 2000

It's a privilege to open this conference convened by young entrepreneurs who will make a difference in Africa. They wish to invite you in. I do too. It's not really my invitation to make, but the fact is that I'm what the African political economy literature calls an "Afro-optimist." A pessimist, as you know, is someone who thinks things are definitely going to be bad. An optimist is someone who thinks it's uncertain(!).

My topic is competitiveness. One can of course get detailed annual reports on country competitiveness from the World Economic Forum or IMD International. But with the exception of South Africa and Mauritius, and in one case, Zimbabwe, these sources don't classify African countries as emerging markets. The reason is that most African countries have very small financial markets and are not exporting manufactured goods. Outside of South Africa, the continent receives very little portfolio capital and not much foreign direct investment except in the mineral sector. Even South Africa is really still waiting for FDI to get rolling. So the countries we'll be discussing today are at best, in the hopeful phrase of the conference, 'emerging' emerging markets.

What do we mean, then, by competitiveness, for 'emerging' emerging markets? I'm going to take a developmentalist perspective. What I will mean by competitiveness is the ability to attract private domestic and foreign investment into labor-intensive, export-oriented manufacturing, so as to develop manufacturing capacity and diversify exports away from primary products and their processed derivatives. Now, these objectives are not new; they have always been on the agenda of African governments. But four decades after independence, the African manufacturing sector remains, with a few exceptions, small and weak. Primary commodity dependence is extremely high, as is the degree of concentration of primary exports into a few major commodities. The latter situation was brought home in the continent's most recent growth cycle, which tracked a boom in commodity prices in the mid-90s and then a collapse in the aftermath of the Asian financial crisis (the position of net oil importers in Africa is now doubly difficult, with export prices down and oil prices up). The fact is that *competitiveness as I have defined it was not on the agenda in Africa, until recently* – to be precise, until around 1990. It is on the agenda now. I want to tell you why, how, and where.

There are nearly 50 countries of Sub-Saharan Africa, so we'll have to do some aggregating to see the forest for the trees. I'm going to focus on the 10 biggest countries, with size defined essentially but not exactly by the size of real GDP at international prices. What I've done is to pick out the 10 countries with real GDPs bigger than \$20

¹ Opening Keynote address presented at the Wharton African Business Forum 2000: Africa – Investing in an Emerging! Emerging Market, November 18, 2000. Professor of Economics, Swarthmore College, Swarthmore PA 1908. Phone: 610-328-8107. Email: steve_oconnell@swarthmore.edu.

billion dollars and populations bigger than 13 million. They are, in declining order of real GDP in 1997: South Africa and Nigeria, with GDPs of roughly \$300 and \$100 billion (less than half that, at official exchange rates), and then 8 economies with GDP below \$50 billion: Sudan, the DRC, Kenya, Ethiopia, Ghana, Cameroon, Cote d'Ivoire, and Uganda. Why focus on these countries? The simple answer is that what happens in these countries in the next decade will determine what happens in the continent as a whole. This is not the same thing as saying that export-oriented investment can succeed only if it takes place in the G-10. But the broader development picture depends on the big players.

I'll briefly ask three questions: why, how, and where? First, if African governments do indeed have a new resolve in favor of competitiveness in manufacturing, why is this? What are the roots of this resolve? Second, how is this resolve manifested in institutional and policy change? Third, where are things moving with resolute speed and where aren't they?

To begin, then: what are the roots of change in the African competitiveness environment? In terms of the actual structure of output and exports, relatively little has changed. But between about 1988 and 1994, the continent began to write a new page in its history, one that is fundamentally more inviting to the private investment than the preceding page. Now, in focusing on labor-intensive manufactured exports, we're not talking about large-scale investments. But given the fixed costs associated with identifying and serving foreign markets, we should not expect to see a lot of exporting being done by firms smaller than about 100 workers. So the environment I'm referring to must be one that rewards *fixed and partially irreversible investments*. We're also talking about sectors like textiles and garments that, unlike agriculture and mining, are *transactions and information-intensive*. Firms have to respond quickly to foreign orders and have to rely on public infrastructure and domestic suppliers for key inputs. Before about 1990, the African investment environment was definitely adverse for this category of investment.

In 1755, Adam Smith said that "Little else is requisite to carry a state to the highest degree of opulence ... but peace, easy taxes, and tolerable administration of justice; all the rest being brought about by the natural course of things." We will come back to whether this minimalist prescription is sufficient for the development of export competitiveness in manufacturing. But there can be little doubt that it is necessary. *Armed conflict* localizes transactions and information, and is particularly destructive of fixed investment. *High taxes*, including those levied through exchange controls or bureaucratic corruption, restrict entry and expansion in the formal sector, driving private investment into footloose and liquid forms, including retail trade and capital flight. *Unenforceable property rights* undermine the credit and supplier relationships that are essential to the transactions-intensive manufacturing sector. Any one of these can derail the development of competitiveness in manufacturing.

Now it is not true, of course, that *all types* of private economic activity require these conditions in order to be profitable. Africa has always been host to foreign direct investment in oil, diamonds, copper, and other minerals. A military or police presence can define property rights over mineral rents even in the presence of armed conflict and

in the absence of a functioning judiciary; and taxes are inoperative when one is dividing rents with political elites. But where mineral rents have been present they have tended powerfully to undermine export competitiveness in Africa. They have done so both directly, by appreciating the national currency and squeezing profitability in agriculture and manufacturing; and indirectly, by supporting predatory regimes at the national level and rebel movements at the local level. In our G-10, Nigeria and DRC are exemplary of these two pathologies of mineral wealth. Even outside the mineral sector, industrialization policy tended to follow a similar pattern through the mid-1980s. Sustained by heavy discrimination against agriculture, investment at any appreciable scale tended to be pulled inside the ambit of the state, whether through state enterprises or through an accommodation with economic elites that were not politically threatening.

Between 1960 and 1990, in fact, not one of our big 10 succeeded on Smith's minimalist prescription. In fact, one needed a magnifying glass to find a country in Sub-Saharan Africa that did reasonably well in providing an environment of peace, easy taxes, and tolerable administration of justice. Mauritius did qualify, and in fact this island in the Indian Ocean has been Africa's only really successful exporter of labor-intensive manufactured goods. Botswana did too, and even in the face of mineral rents from diamonds. Botswana has been one of the world's fastest-growing economies since the mid-1960s. But the total population of these two countries, taken together, is well under 3 million. In the rest of the continent there were no successful imitators of these two, whether small or large, before the 1990s.

So what happened in the early 1990s to change this picture? Economic policy had been changing fitfully since the early 1980s, as macroeconomic crisis had put African governments in a position of trading policy reforms for structural adjustment loans. But between 1988 and 1994, the continent became a major participant in what Samuel Huntington has called the 'third wave' of democratization in the 20th century. Two major things conspired to make this happen. The first was internal disaffection brought on by prolonged economic crisis – disaffection that was focused on authoritarian regimes that had weathered the crisis virtually everywhere in Africa, having earlier removed the political mechanisms for their own replacement. (In our G-10, for example, where political independence had been achieved, South Africa aside, between 1956 and 1963, and where the political constitutions adopted at independence guaranteed substantial political liberties, a transition to 1-party or military rule had taken place in all countries *by 1966*. Some analysts have argued that structural adjustment subsequently reinforced the authoritarian tendencies of African regimes.). The second was the end of the Cold War, which not only removed the financial and military props to regimes like those in Zaire/DRC and Ethiopia, but more broadly, exerted a powerful demonstration effect in favor of political freedom and the market-based economy. Other important developments reinforced these, and perhaps 2 are worth emphasizing:

- French colonialism, in an important sense, ended in this period, with withdrawal of intervention in favor of non-democratic incumbents in the late 1980s, and, in 1994, with devaluation of the CFA franc.

--The democratic transition in South Africa exerted its own demonstration effect for freedom and pluralism, while also removing support for rebel movements in Mozambique and Angola and reorienting the postures of the front-line states from confrontation to wary cooperation with their dominant neighbor.

Taken together, these developments removed a set of props to corrupt and fundamentally anti-competitive policy regimes in Africa. Intertwined with these developments is a process of learning that has narrowed considerably the policy and political options open to African leaders. The result, ironically, has been a kind of divergence: where states have undertaken economic reform while managing an orderly expansion of civil liberties, the situation on the ground now looks at least as promising as it did in the early 1960s. Macro policy is reasonably prudent and market-oriented, making some allowance for the populist temptations of democratic regimes; and political freedoms exist not only on paper but also in reality. In other cases, however, most notably in Zaire/DRC, the state has collapsed altogether, suggesting the ephemeral nature of externally supported order during the post-colonial period.

There are, of course, key differences; it's not exactly "back to the future." On the negative side, initial conditions are surely tougher now than in the 1960s. Population growth has been rapid and largely a disaster; AIDS, malaria and other public health problems are of a completely new order of magnitude; outside of South Africa, political liberalization has been markedly slower in our G-10 than in the rest of Africa, although it has happened; and particularly in Central Africa the scale of inter-state involvement in armed conflict is new. But on the positive side we have three decades of learning about the failings of inward-looking, state-led industrialization under African conditions; or more positively, about the potential returns to outward orientation and the importance of partnering with the private sector (including the powerful demonstration effect of Asia, Chile, and yes, Mauritius). Documents of the Economic Commission for Africa, including its recent collaboration with the World Bank, are imbued with these lessons. Institutional commitments have begun to reflect these lessons and to underpin policy credibility. Eight of our G-10 are WTO members and Sudan is in the accession process; only Ethiopia remains outside. Seven of the G-10 have accepted the obligations of Article VIII status in the IMF, which requires them to forego exchange controls on the current account; only South Africa had accepted this obligation before 1990. Uganda and Ghana, and perhaps others of the G-10, have new central bank charters that grant considerable independence in the pursuit of monetary stability.

Another feature of the current environment that differentiates it from the 1960s is the high level of external debt of most African countries. Particularly when a portion is not expected to be repaid, a large debt exerts a potentially heavy tax on investment and policy reform – and perhaps particularly on policy reform in support of export expansion. From this perspective, the recent expansion of the World Bank/IMF HIPC Initiative is a very promising development. The benchmark for a sustainable debt burden has been lowered by 25 percent from the original HIPC targets proposed in 1996. This widens the set of countries eligible for relief, and for those that would have received relief under the initial

arrangement, it typically increases the amount of cancellation by a good bit more than 25 percent (the reason being that original debt levels were in most cases not dramatically over target). The more ambitious targets also increase the likelihood that cancellation will increase net resource transfers from the donor/creditor community as a whole. Of our G-10, only South Africa and Nigeria are ineligible for HIPC relief.

Let me close by returning briefly to Smith's peace, easy taxes, and tolerable administration of justice. I've proposed these as deep determinants of export competitiveness in manufacturing and argued that where civil strife can be contained the future looks different and much better than the past for African countries. But the most dramatic cases of success in manufacturing for export are Taiwan and Korea, two countries in which government intervention in favor of exporting and technology acquisition was very extensive. Doesn't the Smithian paradigm undervalue the activist role for government? My quick answer, perhaps to be revisited in subsequent discussion, is that there is a sequencing issue here. Smith's triumvirate provides a set of necessary conditions and therefore a clear focus for policy in the near term – including, for example, regional efforts to solve security problems and national efforts to develop institutional restraints that lock in good economic policy. Without continued progress in these areas, there is little scope for the successful exercise of an interventionist industrial policy. The extraordinary thing is that economy policy debates on the continent are now being framed in precisely these terms. The urgency and the necessity of Smith's triumvirate are not in question.

At a deeper level, it seems to me that the uncertainty of an Afro-optimist has to do with what kinds of participatory political regime will prove effective at confronting the forces of social division in Africa's large and most important states. Regimes that fail to accommodate mass political participation are off the table, at least for the moment; they have not worked. But neither have the wrenching economic and political reforms of the last decade paid off, yet, in major success. There is some evidence of general advance in growth and investment: the average GDP growth rate has risen about 6/10ths of a percentage point between the 1980s and the 1990s. Outside of the G-10 there has been some rise in investment as a share of GDP. But the sluggish response of investment and growth points to two continuing conundrums of political and economic liberalization in Sub-Saharan Africa.

First, there is what might broadly be called a reputation problem. External assessments appear to be "sticky," in the sense that country-risk agencies rate African countries lower than the measurable fundamentals – budget deficits, exchange controls, civil liberties – would suggest. And when ratings improve – as with South Africa's recent promotion to investment grade by Standard and Poor's – the private sector response is not strong. As entrepreneurs, you can interpret this image problem in two ways. It may be that the rating agencies and other investors know better than you do what is really wrong. But if they don't, then investment opportunities exist, today, that are undervalued because of reputation effects. As entrepreneurs your job is to put some weight on the second interpretation.

Second, the development problem itself is sticky. We know what doesn't work. But models of what does work are small and special, at least within the continent. As an illustration of the scope of strategic uncertainty, consider the very different strategies of Uganda and Ghana vis-à-vis debt relief under the HIPC Initiative. Uganda was the first to receive relief under the original terms, and this relief appears to have crowded in private capital. "Private transfers" are now one of Uganda's biggest sources of export revenue; this is capital flight, coming home. Ghana, in contrast, has voluntarily withdrawn itself from the HIPC process (it is the only eligible country to do so). Perhaps Ghana had relatively little to gain from the original HIPC terms, but a good bit more is at stake in the expanded initiative. Ghana's view appears to be that the right way to bring private capital in is to pay one's debts outright. Which view is correct? There is no single answer here; perhaps it is relevant that Ghana has already been attracting a larger share of private capital in its net inflows, so that its dependence on official capital is milder. But in both Uganda and Ghana, I believe that the government has its eye on the right question: how to create a strong environment for investment.

Let me close by reiterating my central message that the world has changed. The date to keep in mind is 1990, not 2000; things are well underway. Reputations are being built; African countries have been moving, some in fits and starts, others more resolutely. The overall direction is clear. Ghana is waiting for you; Uganda is; South Africa is. Nigeria has a new democratic opening. Cote d'Ivoire has tremendous potential, clouded by its recent political difficulties. Tanzania is the best-kept secret on the continent.

Thank you, and enjoy your exploration.