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JPO Mai Ono

African Economic Outlook 2007: Measuring the Pulse of Africa

Date and Time: Tuesday, May 28, 2007, From 10:30am to 12:00pm

Venue: FASID Seminar Room 1

Presenter: Mr. Kiichiro Fukasaku (OECD Development Centre)

Mr. Federico Bonaglia (OECD Development Centre)

<Presentation>

1. Brief introduction on African Economic Outlook (AEO)

Jointly produced by the OECD Development Centre and the African Development Bank (AfDB), the AEO provides a comparative analysis of recent economic, social and political development and consistent statistical data on 31 countries (which equals to more than 90% of both African GDP and population). It also includes a continental overview and a thematic section, which in 2007 focussed on access to drinking water and sanitation (previous editions featured transport infrastructure, financing SMEs, access to energy, and privatization). We believe the AEO helps internal capacity development for both the bank and member countries to monitor and review the economic and social development of the continent. For the first time, next year's edition will see the OECD Development Centre become a junior partner, while the AfDB will take over the work on country notes for most of the African countries, except a few countries, including South Africa. The country coverage will expand further and more attention will be given to improving the quality of the report especially with regards to the development of monitoring indicators and macroeconomic forecasting model, as well as deepening the analysis of the thematic section.

2. General African economic performance

The boost of African economies is chiefly attributable to the rise in oil and other commodity prices, although a softening of commodity prices has been apparent more recently. Good harvest, improved macroeconomic policies and political stability are also seen as contributing factors. Such a rather bright picture needs qualifications, as the average African growth rates masks significant disparities amongst countries.

Future challenges differ between oil and mineral exporters and importers. Resource-exporting countries need to capitalise on their gains, invest in domestic

infrastructure and human resource development so as to offset the negative impact of changing rates and to improve their endowment of economic competitiveness. They also need to create positive spillover to domestic economy, while preventing the so-called Dutch diseases. Improved resource management is essential. A numbers of similarities can be seen between many of the African and Latin American countries.

Major challenges for net oil-import countries include (1) inflation pressure associated with higher energy prices, (2) widening trade deficits and (3) streamlining poverty reduction expenditures

3. Africa and Globalization

Africa is only marginally benefitting from globalisation. While Africa experienced the fastest growth in FDI inflows compared to other regions over the last years, net FDI to Africa (80% of which is concentrated in few, resource-exporting countries) only amounts to US\$30 billions, which represents less than 4% of world FDI inflows. In 2006 Africa experienced a sudden increase in portfolio capital inflows. According to investors, the surge of capital inflows to Africa is more a result of “push” factors (such as excess global liquidity and low yields on other markets) than of “pull” factors (better macro fundamentals, improved business climate). It cannot be denied, however, that reform in financial systems and better macroeconomic management also played a role.

The challenge thus is how to turn this current situation into a more sustainable one, where Africa could become a more active player in globalisation. Overall, maintaining macroeconomic stability is needed, as trade deficit is growing recently. This also requires a more effective use of external resources, including aid. Aid for trade, which includes productive capacity building and infrastructure development, provides a useful platform for donors and recipient governments to work together and ensure that aid is used more effectively. In any case, aid for trade should not be considered as a substitute for meaningful market access.

Globalization has posed serious challenges for Africa, especially where private sector capacities are not improved in tandem. Mauritius and Lesotho, once considered successful cases of Africa’s clothing exports, are now undergoing a difficulty period of industrial adjustment. Many foreign-owned factories have closed down, as the quota system associated with the Multi-Fiber Arrangement had been phased out by 2005. This highlights the underlying capacity problems found in many African countries (see Q&A for further discussions). The Development Centre has also been focusing on the likely impact of the rise of new economic actors on the Continent, such as Chinese and Indian firms, as well as some African companies, for instance, South African firms.

Globalisation can be an important source for African growth. However, the real GDP growth is not necessarily translating itself into poverty reduction (with few exceptions in North African countries, South Africa and Mauritius). The real question therefore is how to move from aggregate growth to broad-based growth. A better provision of water and sanitation is an important part of it.

4. Water

Despite the fact that Africa is relatively rich in water, most countries are off-track with respect to meeting the MDG goal on water and sanitation. Surprisingly, countries in North Africa, which have the lowest resources in the Continent, are those that have almost achieved universal access to drinkable water for their citizens. The biggest concern is how water is extracted and distributed and how waste water is treated. Water losses due to poor management are a major problem- it is estimated that about 50 per cent of water which is extracted is lost. In looking forward, more attention should also be paid to improving sanitation, since poor sanitation poses a major health risk and can jeopardise improvements with access to water.

African governments need to move toward a more integrated management of water resources in order to address different uses of water, implementing a tariff system which takes into account consumers' actual use and capacity to pay and increases the fees for polluters. This requires inter-ministry and also regional cooperation, given that many African countries shares their water basins with neighbouring countries.

The African situation is particularly difficult as both efficiency and equity issues must be taken into consideration. While water is a basic need for users, cost recovery should be the ultimate objective for the providers. Infrastructure in this case is capital-intensive with significantly lower rate of return (5-10%) compared to other sectors like power generation (around 15%) and telecommunication (18-20%), which discourage private investment. Donors and governments should lower these risks by providing guarantees. Another key challenge is how to make subsidies less distorting

<Q&A session>

1. General African economic performance

Gross prospect in African countries/ source of sustained growth

Current commodity and oil boom in Africa started 4-5 years ago, while some African countries (such as Mozambique, Uganda, and Tanzania) have demonstrated a sustained growth over nearly 10 years. For instance, in Mozambique there were two sources of

growth: (1) the massive flow of post-conflict reconstruction aid, and (2) the “Mega-projects” driven by FDIs from Australia and other countries investing in the country’s mining and aluminium industry. As a result, the country’s export sector is heavily dependent on aluminium, whereas the benefit of aluminium exports is not enjoyed by the rest of the economy given the high capital intensity and little room for linkages creation. Mozambique needs to promote industrial diversification (e.g. agriculture and tourism) and develop linkages from the mining sector to the rest of the economy. The country’s double challenge is how to improve productivity and generate more employment.

Assessing the debt relief policy

Whether the debt relief policies on African countries, completed earlier this year, will encourage, or conversely, prevent fresh money from coming in, is still an open question. The bottom line of the issue is the African government’s management capacity to strike a right balance between their needs for collecting new money and refraining from running again unsustainable debt levels. Donors have committed to doubling aid inflows to Africa by 2010. Until now, the increase has mainly come from debt relief and humanitarian assistance. Donors will now have to find fresh resources to meet their pledges. They will also need to take into account the absorptive capacity of the African governments in future lending, as it is set out in OECD-DAC guidelines for donors.

Industrial policy

While trade liberalisation has boosted FDI to Africa, it has also contributed to a decline of some domestic industries in some countries (e.g. cashew nuts in Mozambique). Massive inflows of international investments can also worsen the trade deficit; for example, a large part of the trade deficit in Mozambique is associated with capital equipment imports for *the Mozal Aluminium* smelter. This raises the question of whether industrial protection is needed to sustain growth. Mr. Bonaglia argued that protectionism would not bring us anywhere, and thus the best solution is to sustain private sector development and emerging entrepreneurship by seeking better policy recipes (as argued in the OECD Development Centre *Policy Insight* No. 48).

2. African Globalization

Market access

Mr. Bonaglia emphasized that the key issue is how to improve African country’s supply-side capacities rather than the market access itself. The difficulties experienced

by clothing exporters when the quota system ended bear testimony to this problem. Even when a special trade arrangement to lower the tariff exists, non-tariff barriers remain a major obstacle. Many African countries are still unable to benefit from preferential market access because of their lack of capacity to meet export standards for their products. Donors shouldn't be directly involved in business, but they may still play a role by providing the supplementing source of expertise (setting out testing facilities, etc.)

ODA architecture

The re-examination of the international financial architecture, including the role of ODA, is essential. The donor community has embarked on major efforts to improve aid effectiveness with the adoption of the Paris Declaration. The OECD has launched this year a new Global Forum on Development. Themes discussed in occasion of Global Forum meetings include ODA architecture, the role of foundations, grant versus loans, and strengthening local ownership, to name a few. The forum is in its second year and its contents are available online (www.oecd.org/development/globalforum).

3. Water and sanitation

Water supply business in Africa

In order to improve the deficiency of water provision and technological transfer, it is necessary to attract increasing participation of new investors. Private investors in the water sectors exist in Africa, yet returns on investment in this sector are relatively low and risks are high. Governments can work together with private sector and donors to create an enabling environment for private actors to invest more.

Improving social indicators (including water) and growth

There is no trade-off between fostering growth and employment creation and improving social indicators such as education and health. Human capital is a key determinant of growth and private sector development. For instance, HIV is now a significant threat to employment in some countries like Botswana. Access to water will likely allow women to participate more actively in labour force.