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Executive summary

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Executive summary

Macroeconomic prospects

Africa's GDP grew at 6.6% in 2012 from 3.5% in 2011. This acceleration was partly due to considerable rebound in Libya's GDP which in 2012 grew by 96%, after a sharp contraction of 60% in 2011 following the revolution. Netting out the Libyan effect, growth in Africa's real GDP was recorded at 4.2%. Thus, Libya's economic recovery added more than 2 percentage points to Africa's growth in 2012.

The medium-term economic outlook for Africa remains favourable despite some country specific challenges and headwinds from the global economy, in particular Europe's debt crisis and fiscal uncertainty in the United States. The projection assumes a gradual improvement in global economic conditions, consolidated domestic macroeconomic stability coupled with reign of peace in countries still plagued by political instability. Under these conditions, Africa's economy is projected to grow by 4.8% in 2013 and accelerate to 5.3 % in 2014. The main engines of growth are expected to be expansion in agricultural production, robust growth in services and, a rise in oil production and increased mining activity mainly in resource-rich countries. This relatively broad-based pattern of economic growth will be underpinned by resurgence in supply and domestic demand conditions, the latter driven by an increase in consumption and investment.

Furthermore, assuming that the risks in parts of the region are contained, West Africa is expected to continue to lead Africa's growth rally. Central Africa and East Africa are also expected to achieve robust growth. In Southern Africa growth will remain blighted by slow recovery in South Africa, the region's largest economy. In North Africa, the slow pace of transition to democracy is likely to continue to affect the economies of the region, despite strong recovery in Libya's oil production.

In 2012, Africa's monetary authorities had to contend with inflationary pressures stemming from higher food and fuel prices and, in some East African countries, rapid credit expansion and depreciation of exchange rates. Accordingly, average inflation in Africa increased to 9.1% from 8.5% the previous year, with Sudan's inflation topping at 36%. Therefore, in view of inflationary risks, the authorities in several countries pursued a delicate trade-off between supporting economic growth and controlling domestic inflation. In some countries, fiscal policy was used to boost demand, thus mitigating the adverse impact from the global economy. However, countries with limited fiscal space, continued with fiscal consolidation strategies to ensure debt sustainability. For 2013 and 2014, we expect some easing of inflationary pressures, largely due to relatively stable oil and food prices.

The main short-term challenge for the continent is to consolidate stable macroeconomic conditions in the face of a more volatile economic environment. In addition, institutions and regulations for private sector activity must be further improved. Addressing infrastructure bottlenecks, increasing access to key public services such as education, health and security would put countries on a durable high growth path while simultaneously paying heed to concerns of high poverty and widening income inequality.



External financial flows

External financial flows to Africa have quadrupled since 2001 and reached a record high in 2012. After a decline in 2011, both foreign direct and portfolio investment recovered in 2012. In 2012, external financial flows represented an average of 18% of GDP for low-income countries (LICs), 11% of GDP in lower middle-income countries (LMICs) and 4% in upper middle-income countries (UMICs). Equally, remittances from Africa's migrants have been on the rise and have continued to be an important source of livelihood for many during adverse shocks and a lifeline particularly for the poor.

In contrast, half of African countries still rely on aid as the largest external source of financing their development needs. Official Development Assistance remains an important financing for the LICs (64% of the total external inflows) while LMICs rely more on remittances (55% of total financial inflows) and UMICs largely depend on portfolio inflows and foreign direct investment (FDI; 47% and 29%, respectively). While portfolio investment provides an opportunity to strengthen financial infrastructure and liquidity, it also poses a risk of sudden reversal of capital flows such as that witnessed in South Africa during the global financial crisis.

In 2013, FDI to Africa is projected to remain buoyant, increasing by over 10% in 2013, close to the levels recorded in 2008. The southern African region is expected to be the main recipient of FDI flows, with new resource-seeking investment expected in Angola, Mozambique and South Africa.

Trade policies and regional integration

The share of Africa's exports to its emerging trading partners continues to progressively increase, notably to China, but also India, Brazil and others. Yet, for the time being Europe and the United States continue to be Africa's main trading partners. Africa is also seeking to strengthen regional integration and recognises the need to speed up its implementation process. This should allow tackling specific challenges linked to the small size of many African economies. These include stiff competition in international markets and impaired bargaining power in international trade negotiations.

Africa's fragmentation, characterised by many small economies also poses another challenge. This has been worsened by poor institutional arrangements and insufficient co-ordination at national and sub-regional levels, which collectively undermine the role of regional integration communities in fostering trade and economic growth. Nonetheless, the initiative of the Tripartite Free Trade Area adopted by Heads of State and Government of COMESA, EAC and SADC can serve as a useful model for a new approach to regional integration.

Human development

Many countries in Africa have recorded improvements in human development as measured by the Human Development Index. However, progress has been slow. Income inequality is widening and education and health indicators are deteriorating in some parts of the continent. As a result and, in addition to resurging cycles of conflict and a restricted access to finance and other services, many people have remained trapped in poverty, depriving them the benefits implied by higher economic growth. Thus, African countries are faced with a "development challenge" – one of transforming renewable and non-renewable natural capital into national wealth – infrastructure, shared income and human capital.



Human development, in combination with access to infrastructure, finance and, information, communication and technology, is an important enabler of structural transformation in Africa. Specifically, human capability drives structural transformation by influencing both the rate of innovation and uptake of new technologies. Thus, more attention should be directed at improving the quality of education and health care systems and fostering job creation in order to narrow income inequalities.

Political and economic governance

Over the past few years, a number of countries have made notable progress with regard to improving the regulatory framework, business environment and strengthening democratic institutions. Multiparty elections are firmly taking root across Africa. However, progress continues to be slow with some countries still experiencing an erosion of democratic gains and a return to cycles of violence and political instability. For instance, recent political events in Central African Republic, Mali and Guinea-Bissau are reminders of the fragility of budding democracies.

The increased incidences of terrorist activities and organised crime have emerged as major threats to security in parts of Africa. Combined with lingering cross-border conflicts, these threats form pockets of instability in remote areas devoid of government control and oversight. In North Africa, popular protests continued in 2012 as citizens primarily pressed for further and deeper political reforms. In other parts of Africa, the protests were mainly associated with increasing cost of living and a call for better employment and social conditions. Building strong institutions including enabling citizens to engage with government and provide feedback on the quality of services and policies would also contribute to more effective use of natural resources for more equitable and sustainable development.

Regarding economic governance, progress has been made on a number of fronts, notably in improving business regulatory practices and removing bottlenecks for registration of new businesses. Rwanda continued to be the leading reformer in Africa. 17 other African, mainly low-income, countries have exhibited marked improvements in narrowing the divergence with Africa's good performers. Despite these achievements, African countries continue to be in the lower ranks relative to other regions. For instance, in a few countries, the business environment deteriorated as measures implemented added to the complexity and cost of doing business.

Special theme: Structural transformation and natural resources in Africa

African economies today face the formidable challenge of creating gainful employment opportunities for millions of people not just by sustaining the pace of growth, but also by making it more inclusive. Structural transformation is fundamental to meeting this challenge and Africa's abundant natural resource wealth can provide the base.

Structural transformation entails the rise of new, more productive activities and the movement of resources and labour from traditional activities to these newer ones, raising overall productivity. Without the first, there is little that propels the economy forward. Without the second, productivity gains are not diffused to the rest of the economy. Reversing the previous trend of the 1990s, structural transformation in Africa has been positive over the last 10 years: overall productivity rose and labour moved to more productive activities. However, productivity growth was too slow and has not created enough jobs to lower poverty. In other words, Africa's inclusive growth deficit remains wide and faster structural transformation is fundamental to narrow this divergence.



Given Africa's comparatively low skill-to-labour ratio, it needs mainly low-skilled jobs to make this happen. Manufacturing rather than services provides the basis for low-skilled jobs. However, in many countries the conditions are not yet in place. To get there, Africa must work on its strengths. The continent has a strong comparative advantage in natural resources, either in the form of energy, minerals or agriculture. These can be the drivers of structural transformation through linkages, employment, revenue and foreign investment, provided adequate business environment and supporting policies are in place. There is no inherent trade-off between commodity-based and labour-intensive industries: countries with diversified natural-resource sectors also exhibit more diversified manufacturing.

Unfortunately, this has not been recognised in the past attempts at accelerating industrialisation in Africa. Too often, the importance of learning processes for building productive capabilities had been ignored. Although natural resources have contributed no less than a third to Africa's growth during the last decade, much potential remains untapped. Large-scale agricultural transformation has yet to happen and much of the continent's natural wealth is still unexplored. But this is changing for the better: as exploration and production expand, Africa stands to gain more from its resources.

Getting it right requires the right policies. To this end the AEO 2013 develops a four-layer approach to harnessing natural resources for structural transformation.

1. Putting in place the right conditions for structural transformation is layer one. This includes basics such as infrastructure and education for strengthening skills, but also sufficiently large and competitive markets. Broad-based tax systems and accountable institutions that share power and keep rent-seeking at bay are equally essential.
2. Meeting the specific requirements of the primary sectors to fuel transformation constitutes layer two. All resource types need good land management to thrive. Resource-specific skills and research are fundamental to natural resource-based structural transformation. In addition, agriculture needs transport opportunities, fertilisers and more resistant plant varieties. Extractive resources need the right incentives for exploration and often specific infrastructure, especially energy.
3. The third layer is concerned with optimising the revenue from natural resources and investing it wisely. State ownership has not generally proven superior to private ownership for the optimisation of revenues from natural resources. Taxing rents through negotiation and legislation seems more effective, but many African states require support to do it well. Investment of resource revenues should tackle the bottlenecks to structural transformation in general and those specific to the development of the natural resource sectors (the first two layers). This requires strong investment management capacity and a stable expenditure framework, supported by transparency and citizen oversight. However, this is easier said than done: in the past many countries failed to manage their resource revenues well. Their lessons must be heeded. Natural resource exploitation also comes with environmental challenges that need strong management and foresight.
4. Finally, layer four is about promoting structural transformation with active policies, focusing on increasing agricultural productivity and building linkages to and from the extractive industries. Agricultural transformation has been the key to many economic success stories in Asia, Latin America and Europe. Africa can do a lot to start its own green revolution and push ahead the commercialisation of agriculture. Extractive industries, especially mining, provide many more opportunities than commonly thought. Linkages through the supply chain (backward linkages) hold potential for employment creation and for building new capabilities that can be the basis for new activities in a variety of sectors.



The policy toolkit for governments includes co-ordination of investments in training, infrastructure, logistics and research, policies geared at attracting FDI and local content regulations. International lead firms have an important role to play too, especially by adapting their procurement to sourcing locally, and supporting local suppliers to develop the necessary capacity.

Africa's natural wealth holds great potential for accelerating structural transformation and making growth more inclusive. The challenge for African countries is to adapt the layers presented here to their own context and focus on the sectors that hold promise for low-skilled jobs to open up opportunities for sustainable job and wealth creation.

Part one

Africa's performance and prospects



