2017 AFRICA EMERGING MARKETS FORUM

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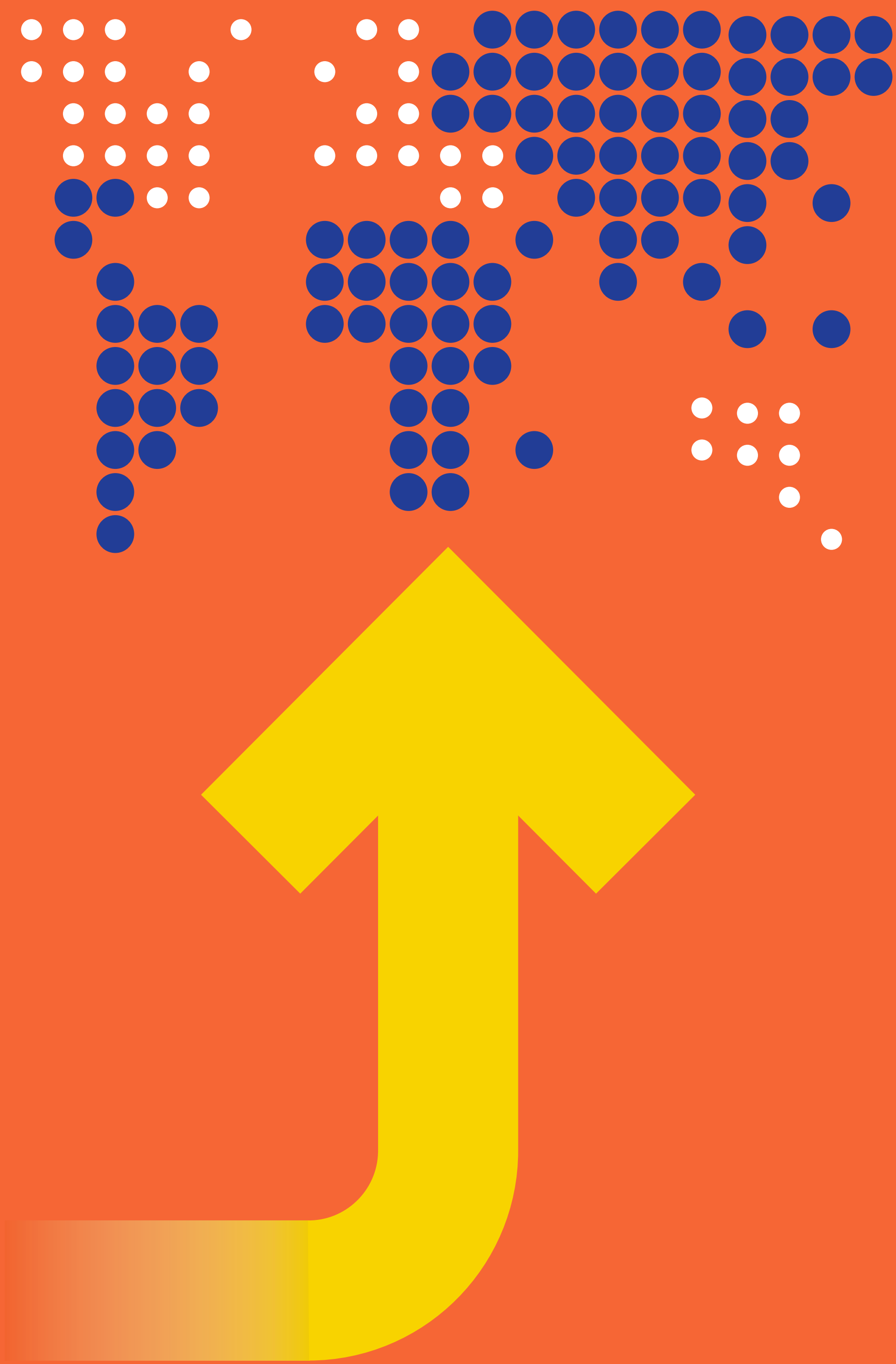

Background Paper

Imagining Africa 40 Years From Now

Theodore Ahlers

JICA

Emerging Markets Forum

A nonprofit initiative of the Centennial Group

Imagining Africa 40 Years from Now

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Preface

Dear participants,

This paper is one of ten papers which are expected to form a book focused on imagining Africa four decades from now. Of these ten papers, five will serve as background papers for sessions at the Fifth Africa Emerging Markets Forum:

- *Imagining Africa 40 Years from Now*
- *Demographics and Urbanization: Planning Cities That Work*
- *Building Human Capital: Improving Education Quality*
- *Transforming Rural Africa: Growing a Productive Agriculture Sector*
- *Africa's Infrastructure Deficit: Closing the Gap*

Another paper, *New Threats to Africa's Stability and Growth*, will also be distributed at the Forum. The remaining four papers are available on the EMF website:

- *The Impact of Commodity Terms of Trade in Africa: Curse, Blessing or Manageable Reality?*
- *Africa's Inclusive Growth Challenge*
- *Economic Diversification of African Economies*
- *Regional Economic Integration in Africa*

Following this Forum, the papers will be revised and published as chapters in a book which will be widely distributed to African leaders and policymakers, among other stakeholders. As such, we will welcome your comments and feedback during and after the sessions.

Harinder Kohli
Founding Director & Chief Executive
Emerging Markets Forum

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This paper was prepared by Theodore Ahlers with research assistance from Alden LeClair. Harpaul Kohli prepared the global model scenarios. The paper benefited from comments from Hiroshi Kato, Harinder Kohli, Anil Sood, and Claudio Loser.

Executive summary

Africa faces both big opportunities and worrisome threats, and which Africa emerges over the next 40 years—a dynamic continent with a growing influence in the world or an economic backwater that exports its people and capital—depends on what countries do now. This paper presents two indicative scenarios to 2060, looks at actual performance in the current decade, highlights the differences in performance among countries, and identifies the biggest policy issues to be addressed if Africa is to converge with the rest of the world.

The pace of population growth, productivity growth, and level of investment have staggering implications for people's lives over the next 40 years. Africa is growing and many socio-economic indicators are improving, but it is no longer catching up with the rest of the world—converging. Policy reforms are urgent if Africa is to converge with the rest of the world and thus be able to meet the aspirations of its people. If Africa is to catch up with the rest of the world it needs annual per capita GDP growth of 3½ percent or more between now and 2060. Convergence means millions fewer poor and half a billion more middle-class Africans.

Country performance, of course, remains highly variable, and 13 countries have averaged per capita income growth above 3 percent for the last decade. But, in the aggregate, Africa is slipping—its per capita GDP growth has been below the world average since 2010. The progress of these high performers shows that convergence is possible in Africa. It is what countries do—the policies of their governments, the responsiveness of their entrepreneurs, the integrity of their institutions, and the political will of their leaders—that makes the difference, not their resource endowments. The challenge is to extend African best practice to more of the continent's countries.

Africa's growth and convergence in the first decade of the century was real and built on solid reforms in many countries. It was also greatly facilitated by exceptional external circumstances: ever-increasing commodity prices, strong global growth, and highly liquid global capital markets. These three exceptional external circumstances have now ended—and are very unlikely to return soon. This is neither unexpected nor necessarily the end to Africa's quest for convergence. Restarting convergence does, however, mean a return to the fundamentals—more investment and more reform to enhance productivity growth with a focus on inclusion.

Action on seven fronts is particularly important to enable a return to a convergence path: accelerating the demographic transition, reducing commodity dependence, increasing savings and investment and unleashing the private sector, accelerating productivity growth, reducing conflict and fragility, adapting to climate change, and reducing disparities. The demographic transition is proceeding even more slowly than envisioned three years ago and requires both urgent attention to fertility trends and measures to address the implications for job creation. Commodity exports contributed to fast growth of African countries through 2011, but, as commodity prices have declined, urgent adjustment to macro policy frameworks is now required. Both savings and investment levels remain too low to sustain convergence with the rest of the world. Ultimately, convergence will depend on faster productivity growth, which will require aggressive action to build human and institutional capital. Conflict, fragility, and inequalities could undermine progress elsewhere if not addressed aggressively. In the medium and long term, Africa must adapt to a changing climate that threatens both its agriculture and its cities. Finally, continental inequality is rising and will only decline if African best practice policies spread to the weak performers. If countries do not respond rapidly to these challenges, the gains of the last decade will be lost.

The policy implications are clear. Some countries are managing the above challenges well. Urgent action is needed to generalize these African best practices across the continent. The policy implications may be clear, but success in implementation is not. Capable states and strong, pragmatic leadership will determine the outcome. Results depend more on politics than technical economics.

The stalled performance of recent years is an urgent call to action for all who want a prosperous, rather than marginalized, Africa in 40 years.

The biggest threats to success are complacency and a lack of political will to tackle the big problems. A societal consensus on the reform agenda, and the political leadership to forge it, while present in a few countries, is missing in most. The stalled performance of recent years is an urgent call to action for all who want a prosperous, rather than marginalized, Africa in 40 years.

Imagining Africa 40 Years from Now

The next 40 years—which Africa will emerge?

Africa faces both big opportunities and worrisome threats, and which Africa emerges over the next 40 years—a dynamic continent with a growing influence in the world or an economic backwater that exports its people and capital—depends on what countries do now. This paper presents two indicative scenarios to 2060, looks at actual performance in the current decade, highlights the differences in performance among countries, and identifies the biggest policy issues to be addressed if Africa is to converge with the rest of the world and avoid the potential social and political turmoil associated with its projected demographics.

The pace of population growth, productivity growth, and level of investment have staggering implications for people's lives over the next 40 years. These implications are illustrated by the differences in per capita incomes, poverty, and size of the middle class under two indicative scenarios: the central scenario of the latest Centennial Group global economic model[1] and an Africa convergence scenario.[2] As discussed in greater detail below, the difference between the two scenarios is driven by differences in the level of investment in Africa and in the pace at which structural reforms are undertaken to increase productivity. While it is possible to argue for more pessimistic or more optimistic scenarios, a comparison of these two scenarios illustrates what is at stake.

Need annual per capita income growth of 3½ percent

In the central scenario, Africa would grow over the next 40 years but make no further progress in catching up with the rest of the world. Africa's share of global GDP would almost double to around 9 percent (in line with its population growth) after averaging only around 4 percent (2014 PPP$) for the last 40 years (Figure 1). Under such a scenario, Africa would be economically more important and its people somewhat better off. It would not, however, be converging with the rest of the world. Africa's share of world GDP under the central scenario is considerably less than envisaged in the Africa convergence scenario, under which Africa's share would more than triple to around 15 percent of global GDP by 2060.

Faster economic growth since the mid-1990s slowed the long slide in Africa's per capita GDP as a share of the global average. But it has remained around one third of the global average for the last 15 years (Figure 2) while that for Asia has continued to grow rapidly. The African averages, of course, mask a high level of variation among countries. The issue is not that all African countries are slipping but that divergence in performance across Africa is growing. For Africa to converge with the rest of the world, a much larger number of countries will need to pursue African best practice policies.

In the central scenario, Africa's per capita incomes would rise (Figure 3) but, even 40 years from now, per capita incomes would still be stuck at only a third of the global average (Figure 4). The rest of the world would be growing faster and Africans would not be on track to catch up. Such an increase in per capita incomes is much less than that envisaged under the Africa convergence scenario where by 2060 per capita incomes would increase five-fold relative to today's level and increase from one-third of the global average to over one-half. This is what Africa needs to meet people's fast rising expectations.

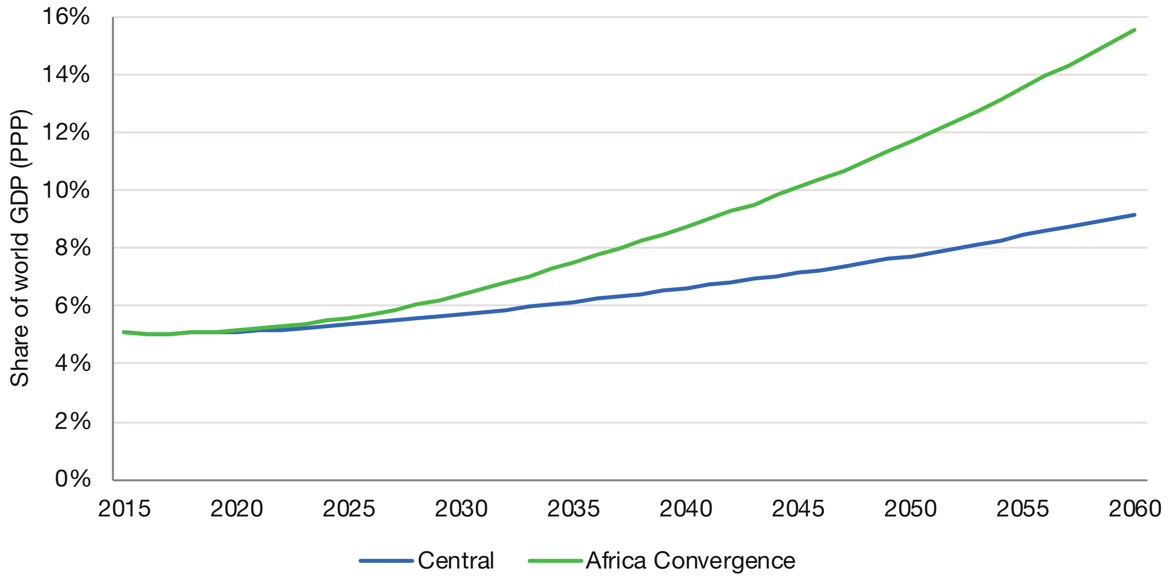
If Africa is to catch up with the rest of the world, it needs annual per capita GDP growth of 3½ percent or more between now and 2060. In the central scenario, global per capita income growth over the next 40 years would be around 2½ percent per year. If Africa is to converge, it must aim for per capita growth at least a percentage point higher. In the central scenario, Africa's annual per capita income growth would be only around 2.2 percent through

1. See Kohli, H. (ed.) (2016), The World in 2050: Striving for a more just, prosperous, and harmonious global community, Oxford University Press, for a discussion of the global central scenario.

2. The Africa convergence scenario in this paper is an update of the convergence scenario that originally appeared in Ahlers, Kato, Kohli, Madavo, and Sood (eds.) (2014), Africa 2050: Realizing the Continent's Full Potential, Oxford University Press. It applies the original Africa convergence parameters (increasing investment and accelerated productivity growth in Africa) to the updated Centennial global model and extends the scenario to 2060.

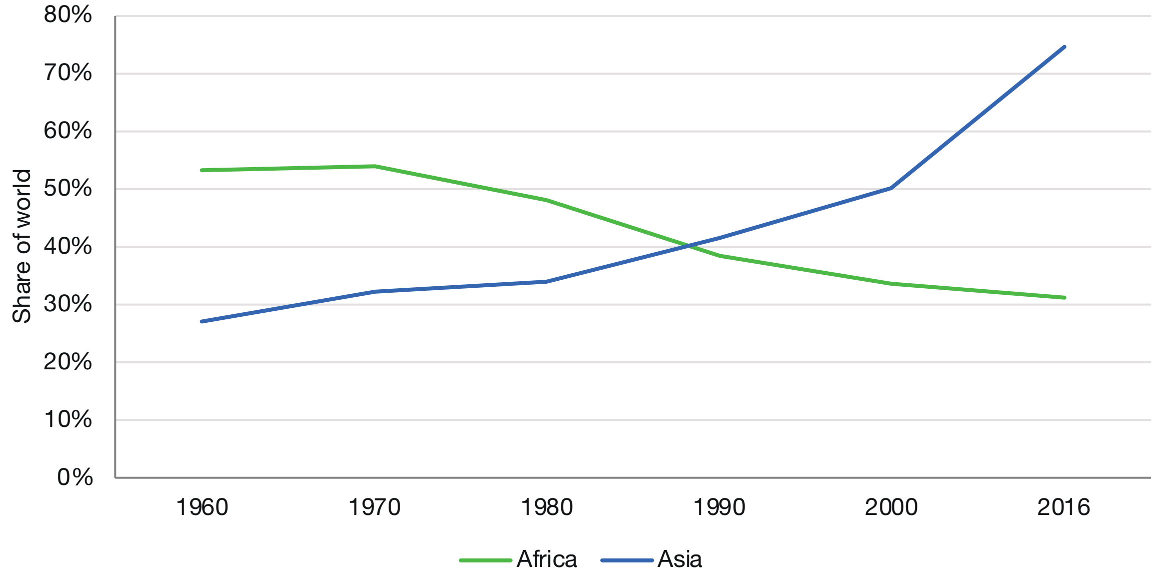
In the central scenario, Africa would grow over the next 40 years but make no further progress in catching up with the rest of the world.

Figure 1: Africa's share of world GDP (PPP), 2015-60



Source: Centennial Group (2017)

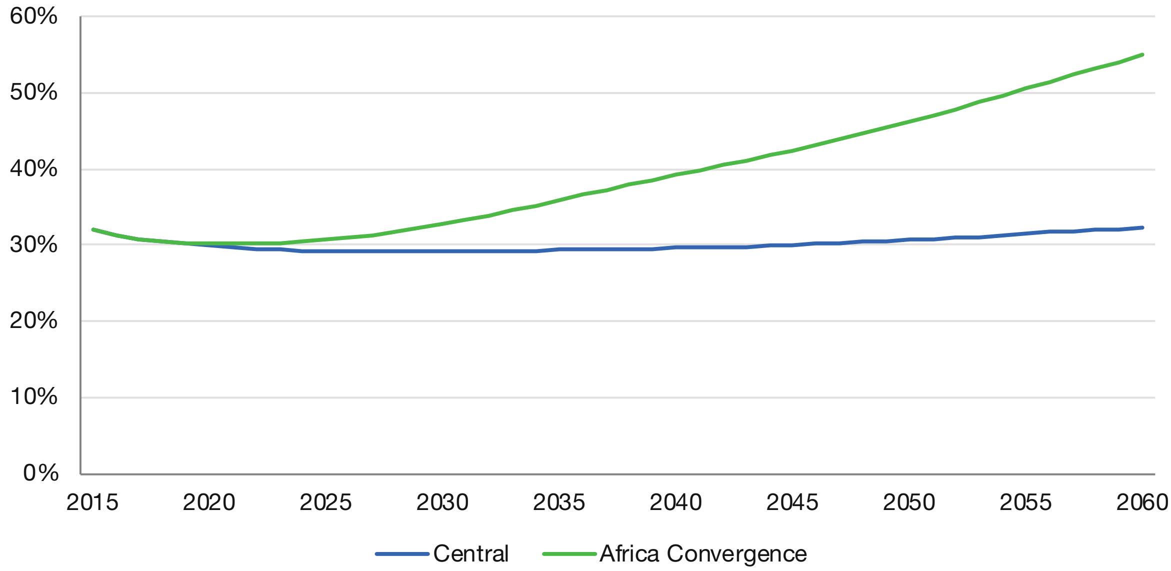
Figure 2: GDP per capita as a share of the world average, Africa and Asia, 1960-2016



Source: IMF (2017)

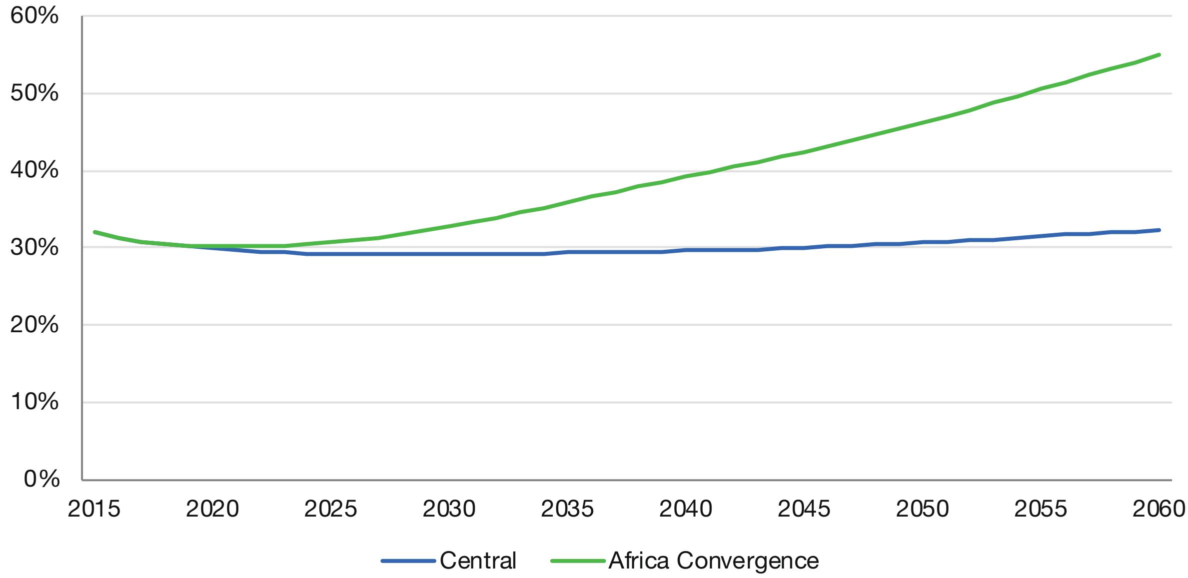
In the central scenario, Africa's per capita incomes would rise but, even 40 years from now, per capita incomes would still be stuck at only a third of the global average.

Figure 3: GDP per capita (PPP), 2015-60



Source: Centennial Group (2017)

Figure 4: Africa's GDP per capita as share of global average (PPP), 2015-60



Source: Centennial Group (2017)

The evolution of GDP and per capita incomes in the central scenario means 200 million more people in poverty than in the convergence scenario.

2040 and 2.7 percent from there to 2060. Under the convergence scenario, it would be 3.6 percent and then rise to 4.3 percent.

Convergence means millions fewer poor and half a billion more middle class Africans

The evolution of GDP and per capita incomes in the central scenario means 200 million more people in poverty than in the convergence scenario. Under the central scenario, the poverty headcount ratio in Africa would decline from 34 percent in 2015 to around 13 percent in 2060 (Figure 5). The number of poor would be more than 200 million higher than under the convergence scenario where poverty falls to 2 percent.

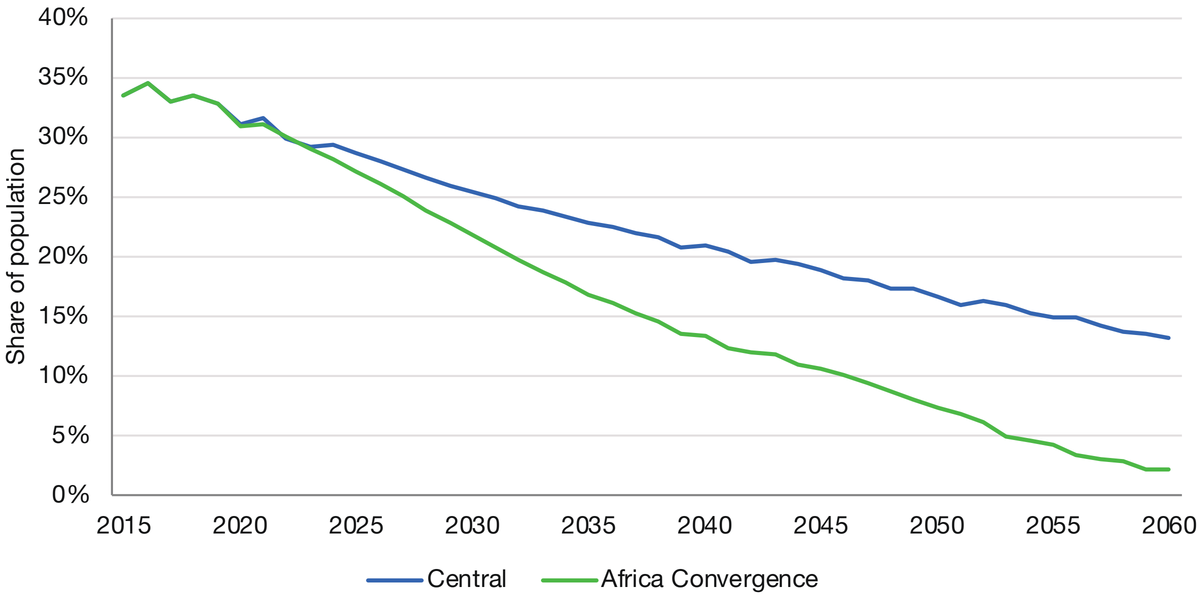
The central scenario also implies more than half a billion fewer Africans in the middle class by 2060 than in the convergence scenario. Under the central scenario, the proportion of Africans in the middle class rises from some 20 percent today to about 50 percent in 2060 (Figure 6).[3] This is far below the more than 70 percent middle class envisioned in the Africa convergence scenario. Again, the difference in human terms is large—more than half a billion fewer Africans in the middle class.

Africa diverging

The big question for African leaders in all fields is how to restart and sustain the convergence that has stalled in recent years. Africa's share of world population has been rising since the early 1900s but its share of world GDP has continued to decline for almost a century (Figure 7). In practical terms, this means that people's incomes fell dramatically relative to the rest of the world. This long-term secular trend was reversed in the mid-1990s, when

3. Middle class is defined as per capita income between $10 and $100 per day in 2005 PPP$ as set out in Homi Kharas, "The Emerging Middle Class in Developing Countries," OECD Development Centre Working Paper 285, 2010. In 2014 PPP$ this corresponds to per capita income between $12 and $108 per day.

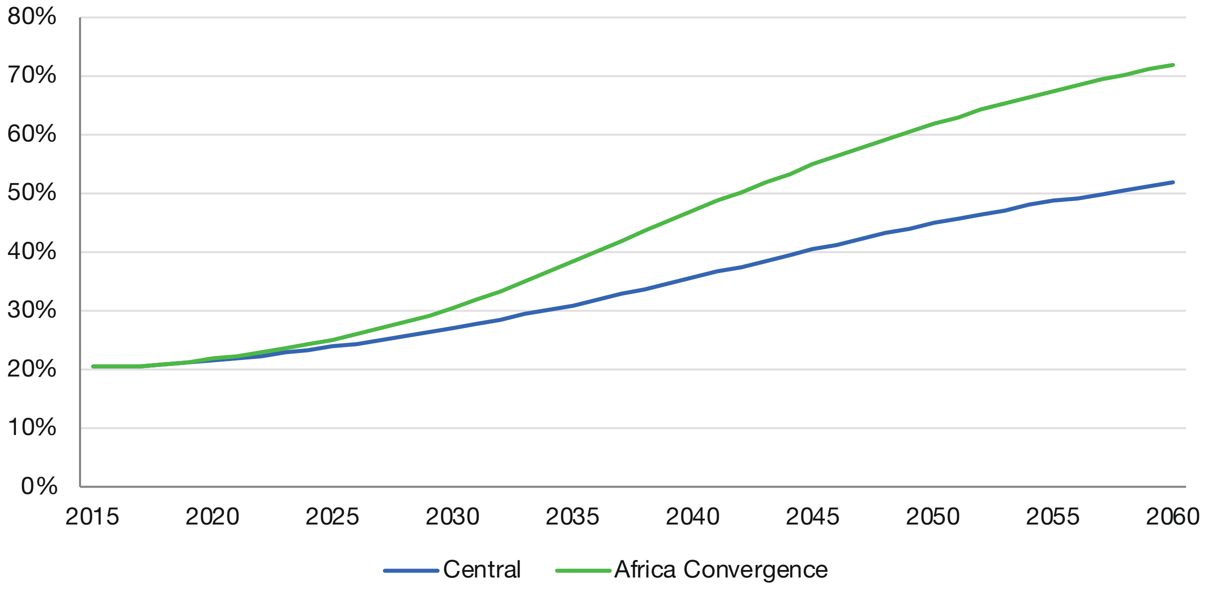
Figure 5: Poverty level in Africa, 2015-60 (% of population)



Source: Centennial Group (2017)

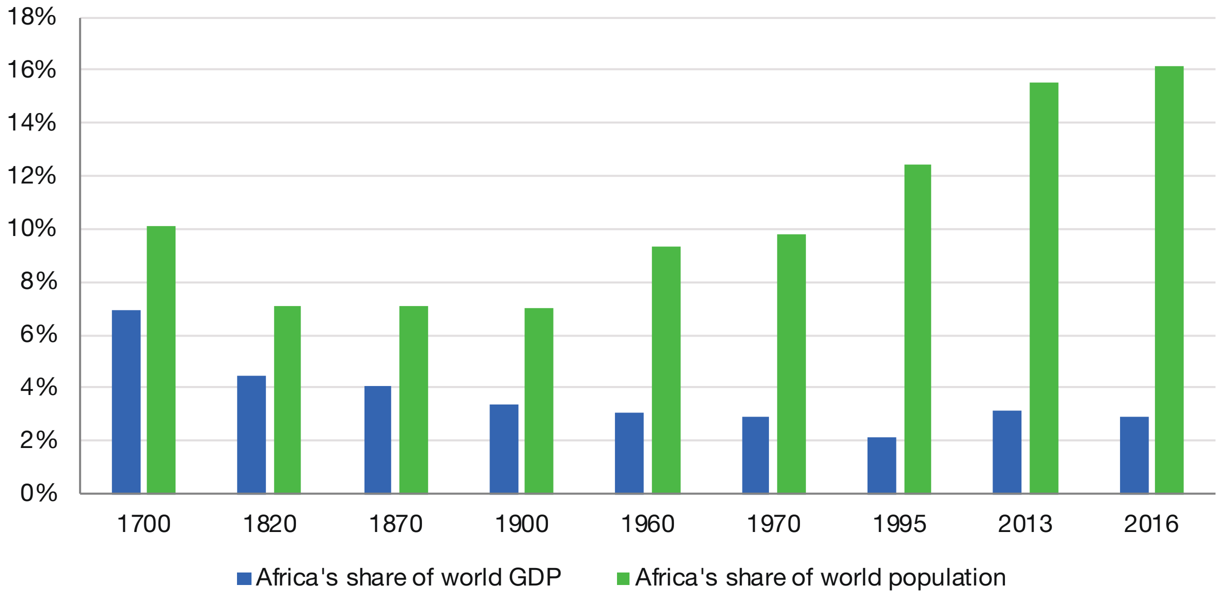
The big question for African leaders in all fields is how to restart and sustain the convergence that has stalled in recent years.

Figure 6: Share of middle class in Africa, 2015-60 (% of population)



Source: Centennial Group (2017)

Figure 7: Africa's share of world population and world GDP, 1700-2016



Source: Maddison (2013) for 1700-1900; Centennial Group International (2016) for 1960-2016

For the first time in 20 years, per capita income in Africa declined in 2016 and it is expected to rebound only weakly in 2017.

Africa's share of world GDP (at market exchange rates) grew rapidly for some 15 years, reaching 3 percent in 2013: Africans were catching up with the rest of the world. That growth stalled at the beginning of this decade and has not resumed. As a result, Africa's share of world GDP in 2016 was still only 3 percent.

Africa has been growing and many of its socioeconomic indicators continue to improve, but it is no longer catching up with the rest of the world as measured by per capita incomes. Economic growth has slowed around the world since 2010 but more so in Africa than elsewhere. GDP growth in Africa in 2016 and 2017 will be well below global GDP growth.[4] For the first time in more than a decade, Africa's share of global GDP will shrink, in striking contrast to 2000-10 when Africa's share of global GDP grew. Throughout this period, Africa's share of global population has steadily risen, as its population growth rate has continued to outpace that of the rest of the world.

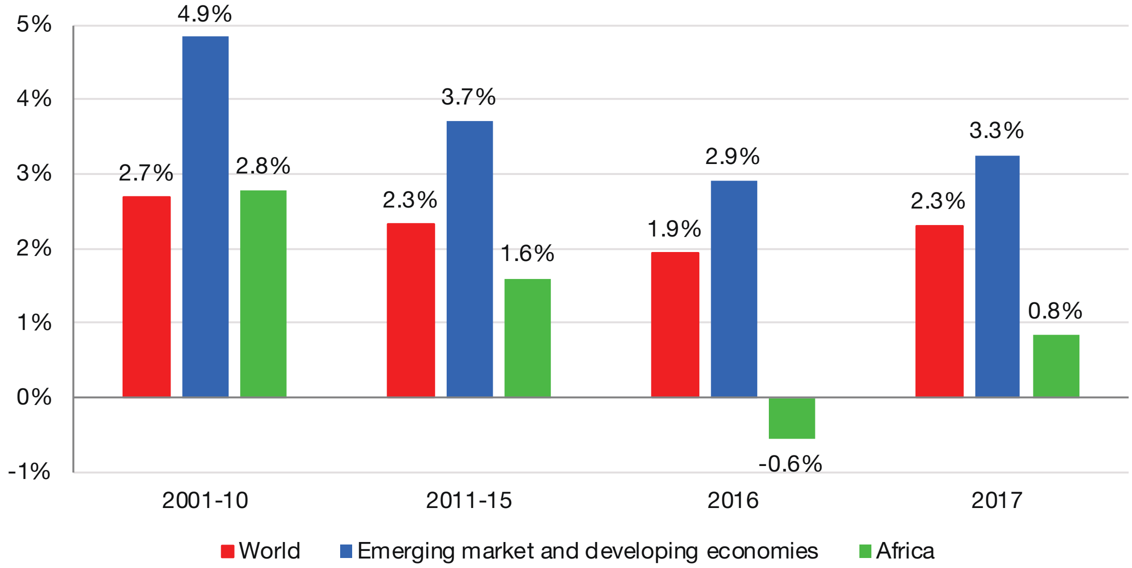
Africa is now again diverging with the rest of the world. Per capita incomes in Africa have been falling relative to the rest of the world throughout the current decade (Figure 8). Africa's per capita incomes have continued to grow since 2010 (1.2 percent a year), but global per capita incomes have grown twice as fast (2.3 percent) and those in emerging and developing economies, three times as fast (3.5 percent). The gap has, moreover, been growing. For the first time in 20 years, per capita income in Africa declined in 2016 and it is expected to rebound only weakly in 2017. This performance should be a wake-up call to all African leaders and institutions.

Policies rather than endowments determine performance

African averages conceal enormous differences between countries, and this divergence tells a more revealing story than the continent-wide average. First is the difference between countries highly dependent on oil

4. IMF World Economic Outlook (WEO) (2016)

Figure 8: Per capita GDP growth has slowed more in Africa than elsewhere



Source: Author's calculations based on IMF (2017)

The divergence among countries shows that policies rather than natural resource endowments determined performance.

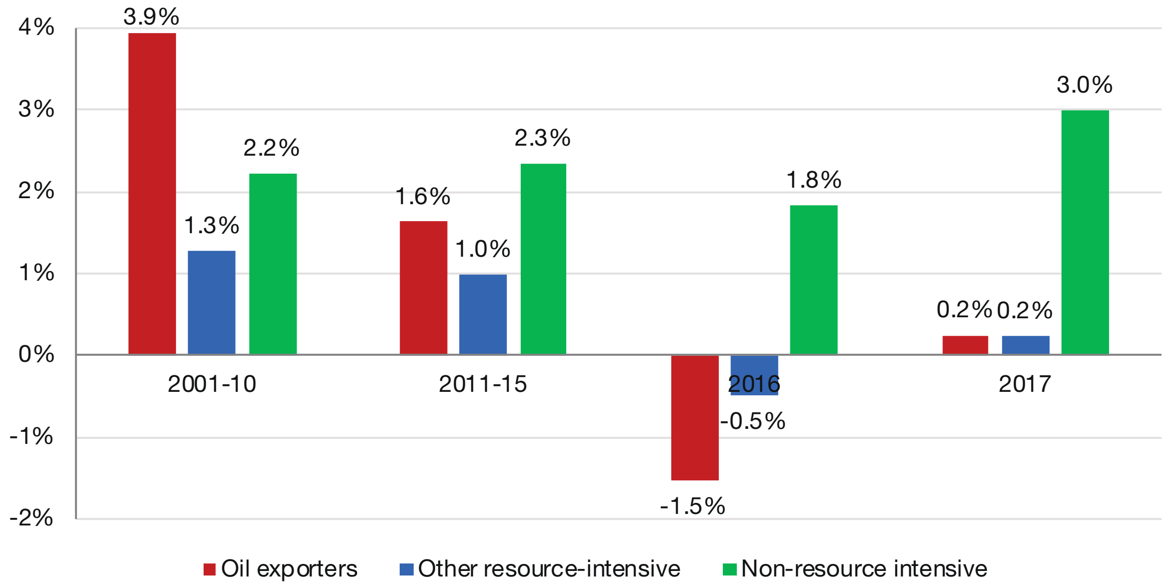
or mineral exports and those not.[5] Second is the difference between strong and weak performers in these groups. In the first decade of the century, per capita incomes in Africa's oil exporters grew very rapidly (3.9 percent a year) driven by the income gains from high and rising oil prices (Figure 9).[6] But their per capita income growth fell by two-thirds between 2011 and 2015 (to 1.6 percent a year), turned negative in 2016 (–1.5 percent), and remains stagnant in 2017. Per capita income growth in the other resource-intensive economies has been much lower but followed a similar downward trend. For the non-resource-intensive economies, per capita income growth has been modest, but it has been accelerating since 2000 and far above that for the oil or other resource-intensive economies throughout the current decade.

The divergence among countries shows that policies rather than natural resource endowments determined performance. Since 2010, 13 countries in Africa have achieved average per capita GDP growth rates above 3 percent a year.[7] This very diverse group of high performers includes countries large and small; landlocked and coastal; resource-intensive and non-resource-intensive; and with low-, lower-middle, and upper-middle incomes. None of these characteristics determine performance. Instead, it is what countries do—the policies of their governments, the responsiveness of their entrepreneurs, the integrity of their institutions and the political will of their leaders—that makes the difference. This is good news for the continent. Many countries show that convergence is possible, even with less auspicious global conditions. If this African best practice were generalized, the continent would be transformed.

5. Oil exporters are defined as those in which oil exports constituted more than 30 percent of merchandise exports in 2010–14. Other resource-intensive economies are those in which minerals and gas constituted more than 25 percent of merchandise exports in 2010–14.
6. See also Loser, C. & Vilkelyte, I., (2017) The impact of commodity terms of trade in Africa: Curse, blessing, or manageable reality?. Fifth Africa Emerging Markets Forum, Abidjan, 26-27 March 2017.

7. Botswana, Côte d'Ivoire, Democratic Republic of Congo, Djibouti, Ethiopia, Ghana, Lesotho, Mauritius, Mozambique, Namibia, Rwanda, Seychelles, and Tanzania.

Figure 9: And it slowed most for oil exporters, 2001–16 (%)



Source: Author's calculations based on IMF (2017)

If African best practice were generalized across the continent, Africa would be transformed. And the Africa of 2060 would indeed meet the aspirations of its people.

Act now....or accept marginalization

Which Africa emerges by 2060 depends most on what governments, firms and entrepreneurs, and civil society do now. Global economic conditions may be tougher and new challenges have arisen but a number of countries continue to do well. These countries have shown what needs to be done and had the political leadership to do it. Elsewhere, political will to reform is often the missing ingredient. Again, if African best practice were generalized across the continent, Africa would be transformed. And the Africa of 2060 would indeed meet the aspirations of its people.

Tougher world demands tougher action

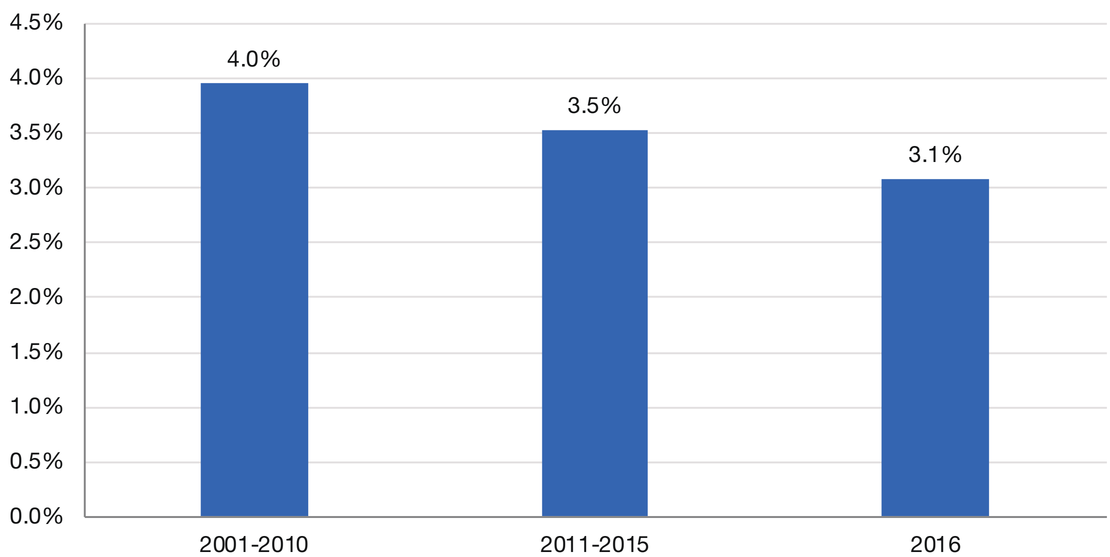
Slower global growth, lower commodity prices, and tighter capital markets make the world a tougher place—and demand tougher reforms if Africa is to converge with the rest of the world. First, global growth in 2016 is down by nearly a quarter compared to a decade earlier (Figure 10). Having averaged more than 4 percent over 2000-10, global growth has been on a downward trend since 2011 and fell to just 3.1 percent in 2016. It is, moreover, projected to remain below 4 percent over the next decade, with many downside risks. Among other things, this means that markets for African exports will grow more slowly.

Second, the super-cycle of commodity price increases has ended. Commodity prices tripled between the late 1990s and 2011 (Figure 11). As a result, Africa's terms of trade rose dramatically, much more than in other regions such as Asia, with an accompanying increase in income. Commodity prices have since fallen by half. They are still higher than they were in 2000 but are not projected to return to the levels of 2006-13 in the next decade.

Finally, capital markets have tightened and the very low interest rates and high liquidity of recent years that facilitated a surge in African sovereign debt issuance are gone. The Africa frontier markets (NEXGEM)[8] spread was less than 350 basis points two years ago, but has now

8. The J.P. Morgan Next Generation Markets index (NEXGEM) includes the smaller, less liquid emerging market economies where investment opportunities in external debt markets are limited relative to the larger BRIC countries and other emerging economies where external debt issuance is frequent and large. NEXGEM Africa includes Cote d'Ivoire, Kenya, Ghana, Zambia, Egypt, Nigeria, Gabon, Senegal, Angola, Ethiopia, Mozambique, and Tanzania.

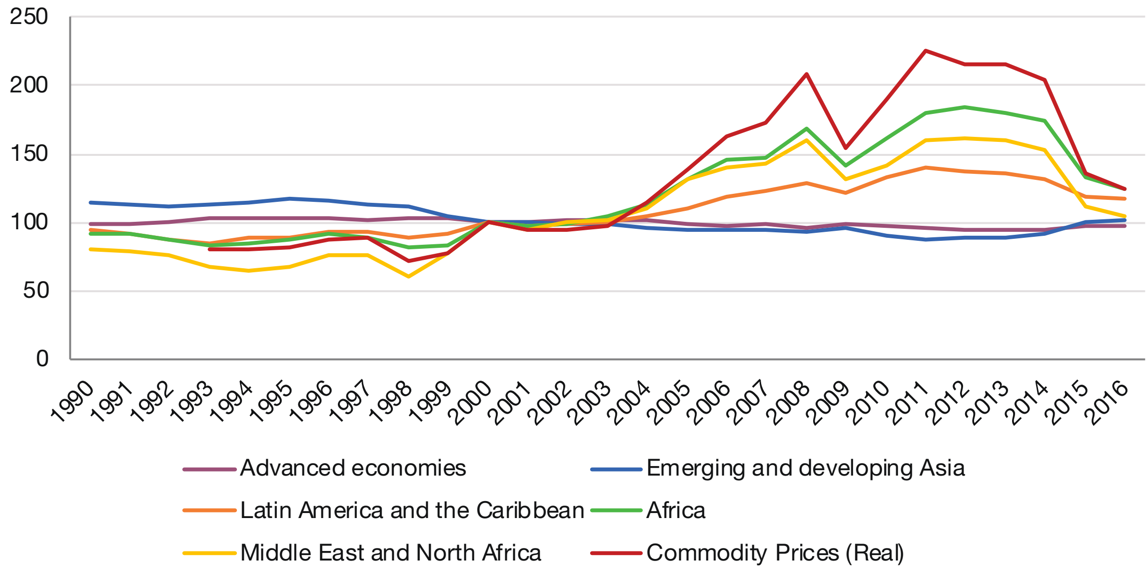
Figure 10: Average world GDP growth



Source: Centennial Group (2017)

To realize its potential and avoid future social conflict Africa needs to re-start convergence.

Figure 11: Terms of trade for selected regions (2000 = 100)



Source: IMF (2017, 2016)

increased by 75 percent to around 600 basis points (Figure 12). In addition, the spread between the Emerging Markets Bond Index (EMBIG) and that for African frontier markets has more than tripled moving from around 70 basis points to around 250.[9] Global rates have risen and the appetite for risk has declined.

Africa also has many opportunities. If these opportunities are seized, the continent can be transformed. Africa has good scope to catch up with global best practice—as Asia did over the past half century—to converge with advanced economies and realize higher incomes for its people. If fertility rates are reduced, Africa's demographics could become its greatest long-term comparative advantage, since by 2050 it will be the only region with a young and growing work force. Urbanization and a rapidly growing middle class could drive productivity growth throughout the continent. Technological advances could increase productivity and alleviate many challenges facing the region. The shift of the global economic center of gravity toward Asia offers new market opportunities. And the continent's strong natural resource base can, if managed well, fuel growth.

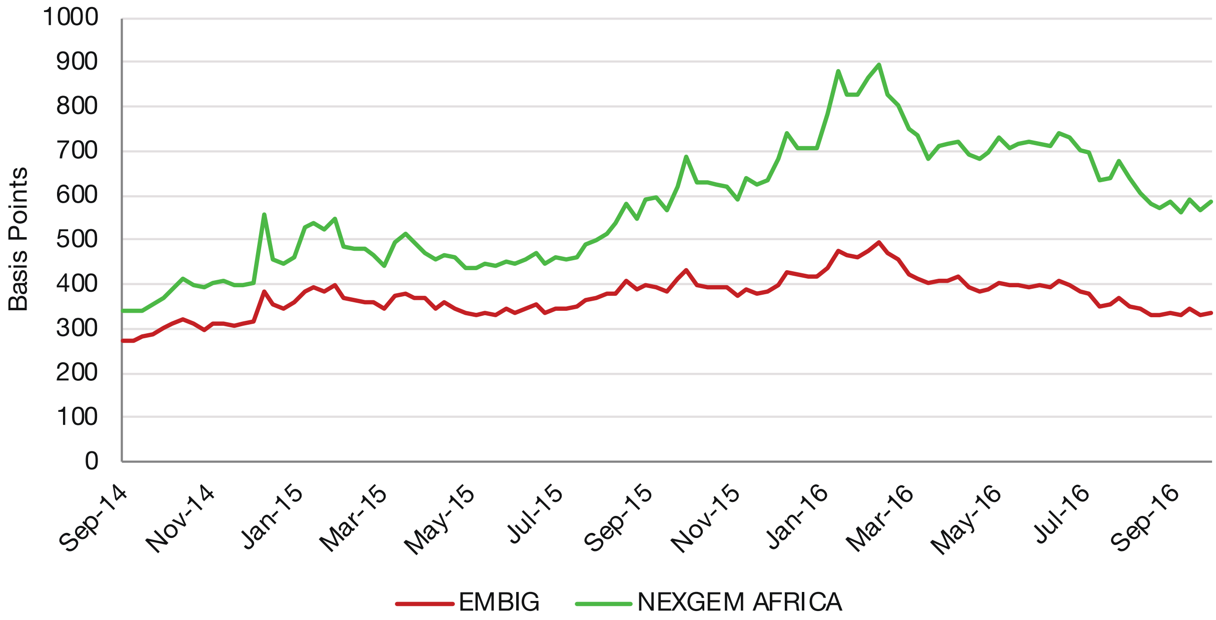
Restarting convergence—seven priority areas for action

To realize its potential and avoid future social conflict Africa needs to re-start convergence. The changes in the external environment discussed above are not a surprise—what counts is what countries do, beginning now. The important questions now are (a) how effectively countries invest in physical and human capital for future growth and to increase their resiliency and (b) how quickly they adjust to the new circumstances. Country performance on these points is highly variable across Africa but is, in the aggregate, weak. If countries do not respond rapidly to the new circumstances, the gains of the last decade will be lost. Action on seven fronts is particularly important

9. The J.P. Morgan Emerging Market Bond Index Global Diversified (EMBIG index) is a uniquely weighted US-$-denominated emerging markets sovereign index and is the most widely followed benchmark in its class.

The slow demographic transition in Africa has a very large cumulative effect and big implications for the jobs challenge.

Figure 12: **Emerging market and Africa sovereign spreads, September 2014-September 2016**



Source: Bloomberg (2016)

to enable a return to a convergence path: accelerating the demographic transition; reducing commodity dependence; increasing savings and investment and unleashing the private sector; accelerating productivity growth; reducing conflict and fragility; adapting to climate change; and reducing disparities.

Accelerate the demographic transition

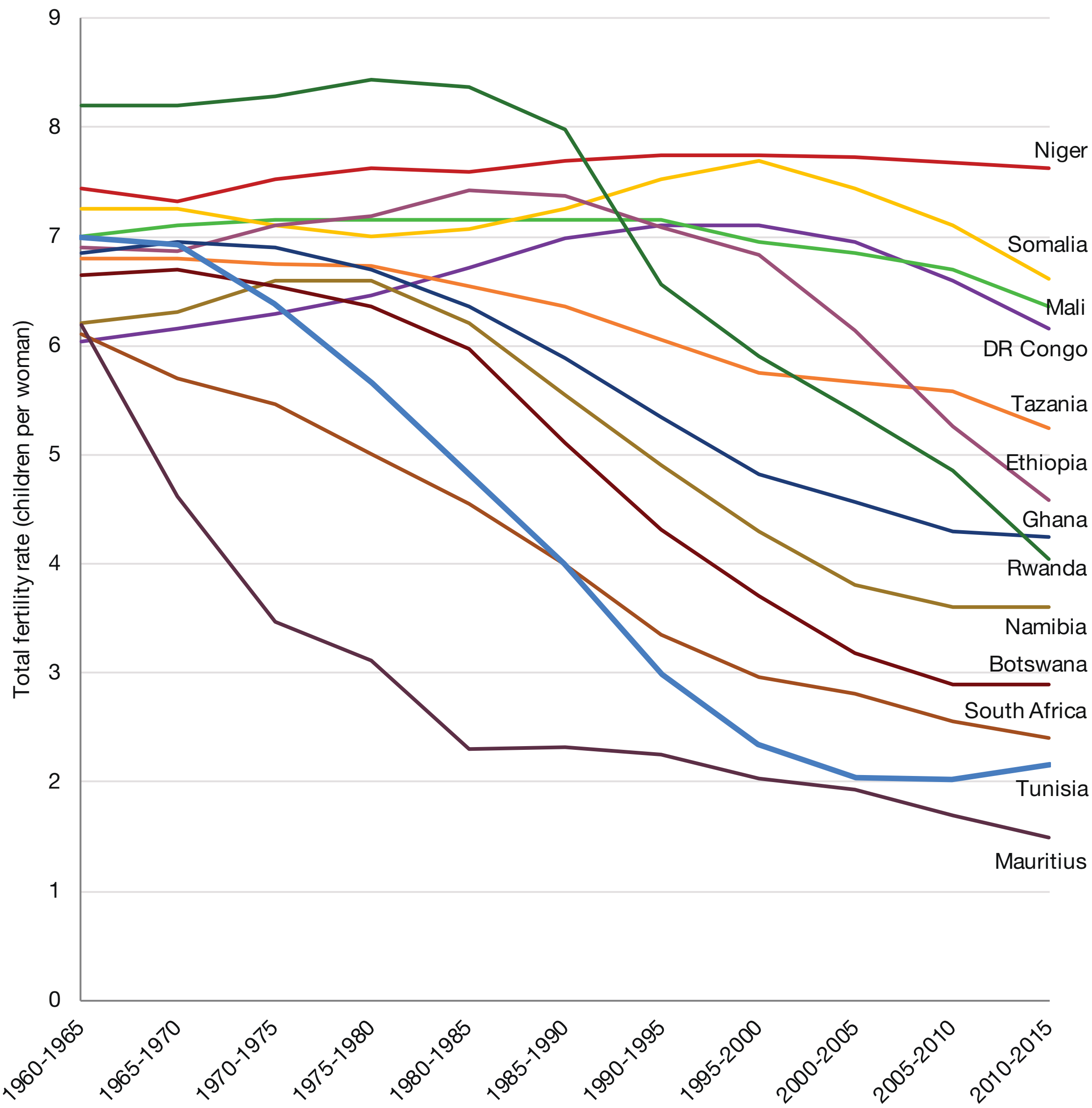
According to the latest UN projections, Africa's transition to a modern demographic profile of low fertility and low infant mortality is proceeding even more slowly than previously foreseen. The variation in the evolution of fertility rates across countries is remarkable. Figure 13 shows fertility over the last 50 years for 13 countries that span the current variation in fertility levels. Three things are particularly striking: (i) 50 years ago, all the countries had fertility rates above 6; (ii) many countries have demonstrated that rapid declines are possible over a decade or two, such as Mauritius and Tunisia in the 60s and 70s, Botswana and South Africa in the 80s and 90s, and Ethiopia and Rwanda over the last twenty years; and (iii) at the same time, fertility levels in a number of countries have not changed at all in 50 years. The result is that fertility now varies from around 2 to more than 7.

The slow demographic transition in Africa has a very large cumulative effect and big implications for the jobs challenge. Africa's dependency ratio is projected to decline through 2050 creating the possibility of a large demographic dividend. The slow demographic transition, however, makes both the human capital formation and job creation challenges, and hence realization of a demographic dividend, orders of magnitude more challenging in Africa than elsewhere.

Good jobs require skilled people—providing quality education for all will be possible only with slower population growth. Given the challenges of providing access

The slow demographic transition in Africa has a very large cumulative effect and big implications for the jobs challenge.

Figure 13: **Fertility rates by country, 1965-2015**



Source: UN Population Division (2015)

The impact of the slow demographic transition on the jobs agenda is dramatic.

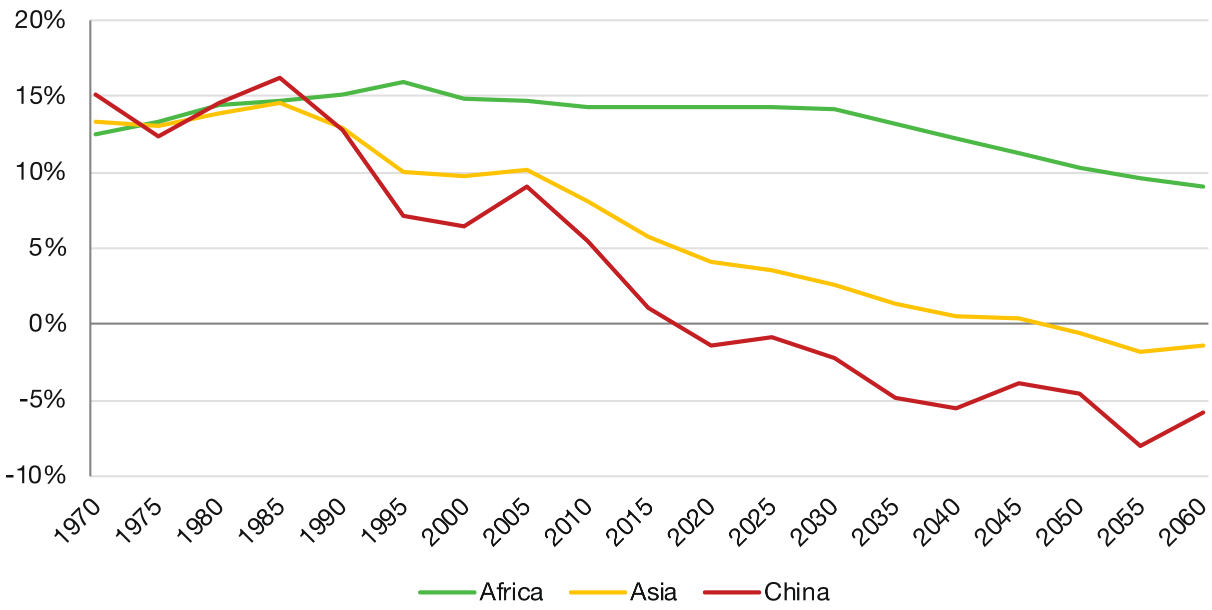
to a quality education to today's school-age population in Africa,[10] the speed at which that population increases is critically important. Today there are some 420 million children aged 5-19 in Africa. Under the UN's "medium fertility" scenario, their number would almost double to 830 million by 2060, which is 34 million more than foreseen just three years ago. Under the "high fertility" scenario, the increase would be 600 million and at current fertility levels would be a staggering 1.1 billion. The institutional, as well as fiscal, capacity to provide quality education to such increased numbers of students is at best questionable.

The impact of the slow demographic transition on the jobs agenda is dramatic (Figure 14). Africa's working-age population has grown by more than 10 percent a year for the last 60 years and will do so for another 35 years. This is in sharp contrast to the experience in Asia, for example, where the working-age population grew by more than 10 percent for only 30 years and in China for only 25 years. Put differently, Asia needed rapid job creation over a generation to absorb the increase in its working-age population but Africa would need a century of rapid job creation to do the same.

These demographic prospects have three important implications for African governments and policy makers. First, it is even more urgent to accelerate Africa's move to a modern demographic profile of low infant mortality and low fertility. The highly heterogeneous experience of African countries in reducing fertility (Figure 13) reveals the importance of making modern contraceptives available to all, educating girls, and getting political and civil society leaders to speak openly about the issue. The important message is that many African countries have shown that it can be done and there is an urgent need for the others to follow their lead.

10. See Alavuotunki, K & Reinikka, R. (2017). Building Human Capital: Improving Education Quality. Fifth Africa Emerging Markets Forum, Abidjan, 26-27 March 2017.

Figure 14: Working-age population growth rates, 1965-2050



Source: UN Populoation Division (2015)

Recognizing that only private firms, rather than governments, can possibly create the needed jobs, implies a much more ambitious agenda across the continent to create the conditions for firms to be competitive and to grow.

The second implication is that, even with a heightened effort to reduce fertility, the job creation challenge in Africa is structurally different than in other regions (see Figure 14). For Africa, it is not a question of rapid job creation for one generation to reap a demographic dividend. It is a question of keeping ahead of a century of extraordinary growth in the working-age population. Recognizing that only private firms, rather than governments, can possibly create the needed jobs, implies a much more ambitious agenda across the continent to create the conditions for firms to be competitive and to grow.[11]

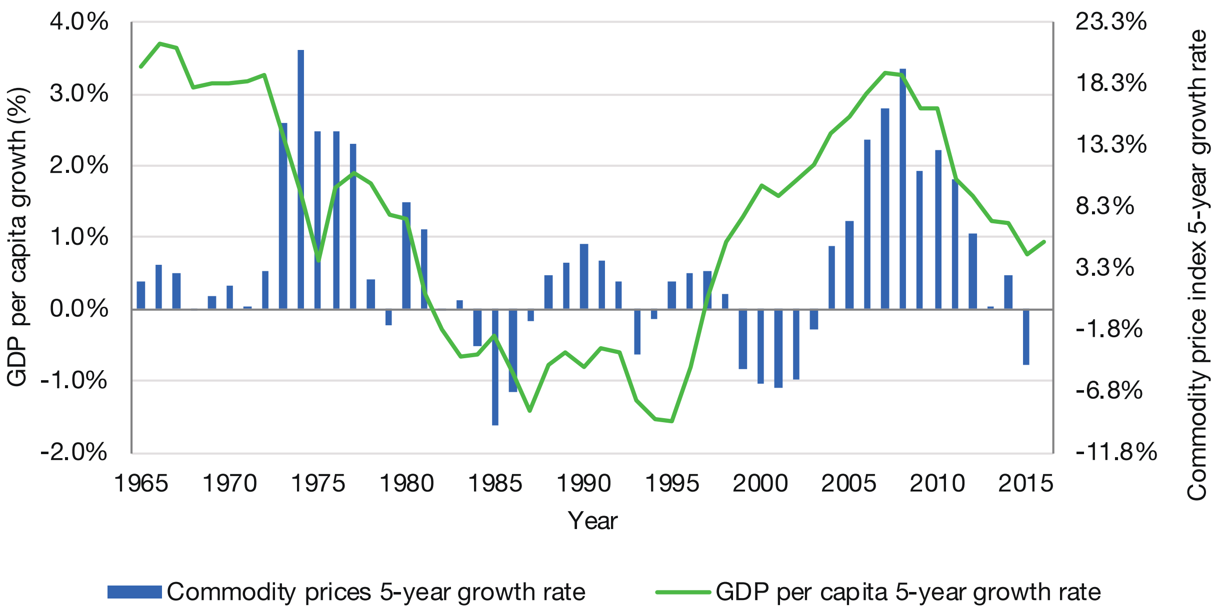
The third implication is that employment in agriculture and in traditional services will grow, and increased attention needs to be put on raising productivity of workers in the informal sector.[12] Given the prospect of another 35 years of extraordinary growth of the working-age population and the current low share of formal wage employment, even if such employment were to grow spectacularly it could not absorb today's underemployed and the inevitable increase in the labor force. As noted above, firms, not governments, create jobs but the modal size of a firm in Africa is one person (frequently self-employed in agriculture or services). These "firms" will grow in number and their productivity must increase for incomes to rise.

11. Bond, J. (2017a). Economic diversification of African economies. Fifth Africa Emerging Markets Forum, Abidjan, 26-27 March 2017.
12. See Fox, L. (2017). Africa's inclusive growth challenge: Reducing deprivation and creating jobs. Fifth Africa Emerging Markets Forum, Abidjan, 26-27 March 2017.

Reduce commodity price vulnerability

Africa's commodity dependence and hence vulnerability to commodity price swings has increased over the last 20 years. The acceleration in per capita income growth through 2012, and the subsequent fall, is due to many factors but remains very closely linked to commodity prices, as shown in Figure 15. Some countries have made progress but, as a continent, Africa has not reduced its vulnerability to commodity price swings. The share of commodities in

Figure 15: Per capita income growth rate and commodity price index growth rate, 1965-2015



Source: IMF (2016, 2017)

The substantial decline in commodity prices since 2013-14 has, and will continue to have, substantial repercussions on African economies, particularly among countries with a high concentration of oil and mineral exports.

African exports increased from around 71 percent in 1995 to 76 percent in 2014. As a result, the substantial decline in commodity prices since 2013-14 has, and will continue to have, substantial repercussions on African economies, particularly among countries with a high concentration of oil and mineral exports.[13]

More than a quarter of Africa's real GDP growth from 2000 to 2013 can be attributed to rising commodity prices. Commodity prices more than doubled from 2000 to 2012 and even with the subsequent fall are still more than one third higher than they were in 2000. The high concentration of commodities in African exports means that Africa's terms of trade also increased substantially after 2000 and the increase was greater than that in any other region. As a result of these large terms-of-trade gains, the annual increase in real disposable income (6.3 percent), or gross domestic income, was much greater in 2000-12 than the increase in GDP (5 percent). In addition to the direct increase in income from the terms-of-trade improvement from 2000 to 2013, the expected multiplier effect also led to an estimated annual increase of GDP of 1.3 percent. If the terms of trade were to stabilize at current levels, then future trend GDP growth in Africa would be only around 3.6 percent of GDP.

In the aggregate, African economies not only did not reduce their commodity dependence (admittedly difficult) but, for the most part, neither created buffers to commodity price shocks nor adjusted to the new circumstances. Individual country performance is again highly variable but, in the aggregate, Africa has responded to the decline in the terms of trade, which most projections suggest will be long-lived, by drawing down reserves and increasing borrowing rather than adjusting. This response creates an urgent need to steer economies to a sustainable path if the high economic and social cost of disorderly adjustment is to be avoided.

Three types of policy response are urgently needed. First, countries need to adjust to the income loss from lower commodity prices and avoid excessive borrowing to delay adjustment. Broadly, orderly, managed adjustment requires fiscal and monetary policies that are consistent with debt and balance-of-payments sustainability. Ideally, these policies would be supported by a flexible exchange rate regime, which would allow for an independent monetary policy and would provide countries with a critical policy instrument to help absorb external shocks.

Second, they need to reduce future vulnerability by establishing mechanisms, such as fiscal rules and stabilization funds, to smooth expenditure over boom-and-bust cycles.[14] A structural fiscal rule would smooth public spending patterns over time to reduce the pro-cyclicality of public expenditures observed at present as governments increase expenditure when commodity prices rise and are forced to cut them when prices fall. A commodity stabilization fund similar to the Copper Stabilization Fund of Chile together with structural fiscal targets, namely a budget based on long-term trends and not only on current developments, would be optimal for these purposes.

Finally, and most importantly in the long run, they need to diversify their asset base by transforming resource rents from extracting natural resources into human and physical capital. Diversification of their asset base is a key step towards eventual diversification of income flows.[15] Diversification is frequently thought of in reference to economic activities, e.g., manufacturing or services, but diversification of assets is even more important. Rich countries hold the vast bulk of their assets in the form of intangible capital (human and institutional capital) rather than natural resources or produced capital (e.g., roads, power systems, factories). From a continental perspective, one of Africa's biggest challenges is to transform its natural resource wealth into human capital, produced capital, and financial assets, i.e., to diversify its asset base. Only with

13. Loser & Vilkelyte (2017)

14. See Loser et al. (2016) and the macroeconomic (Chapter 9) and natural resource (Chapter 12) chapters in Ahlers et al. (2014).

15. Bond (2017a)

Beyond confidence and rule of law issues, development of financial systems that offer savings instruments to all potential savers is key.

a diversified asset base can incomes be de-linked from commodity price fluctuations.

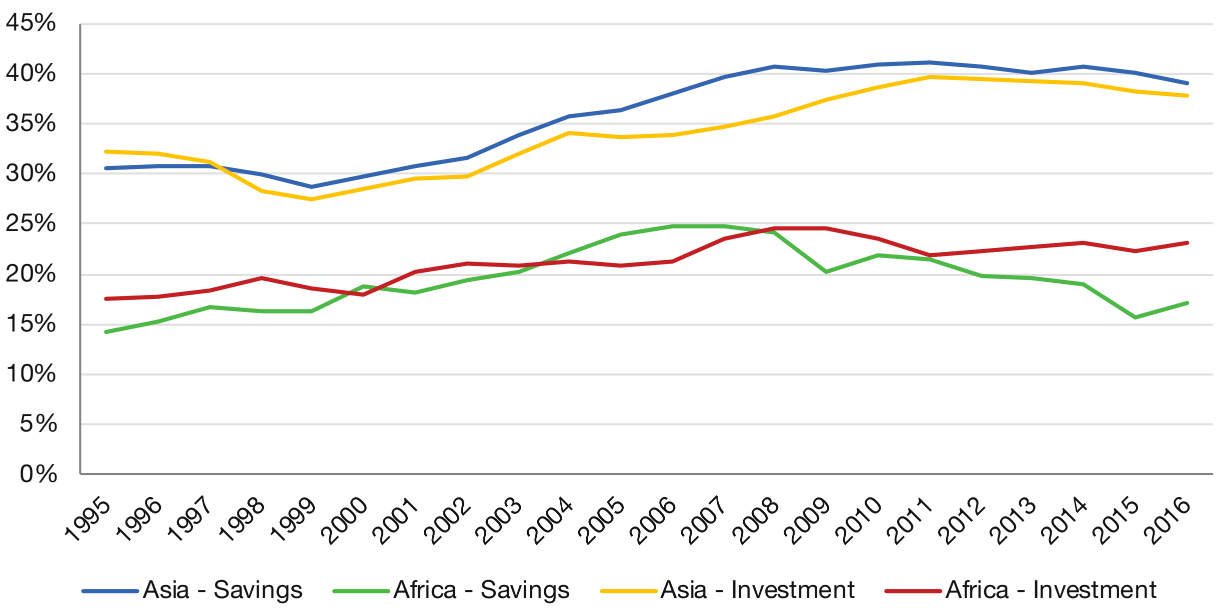
Increase savings and investment—Unleash the private sector

Savings in Africa increased somewhat during the boom years but have since fallen back to just 17 percent of GDP—the same level as 30 years ago (Figure 16). Country performance varies and solutions need to be country-specific, but Africa will not converge with the rest of the world with such low savings rates. By comparison, savings rates in Asian low- and middle-income countries increased steadily over the same period. As a result, the gap between African and Asian savings rates is twice as high today as it was in 2000.

Low domestic savings are the result of both low public and private savings. Low public savings have, for the most part, been driven by rapid increases in current expenditure and poor domestic resource mobilization. Low private savings reflect many issues but, perhaps most fundamentally, a question of citizens' confidence in their country and in the rule of law. Beyond confidence and rule of law issues, development of financial systems that offer savings instruments to all potential savers is key.

The investment gap between Africa and Asia has also increased. Despite low savings, investment in Africa has increased slightly from around 20 percent of GDP at the beginning of the century to 23 percent in 2016. But Asian investment rates have increased much faster so that the gap in investment rates is 50 percent higher than in 2000. Low public investment is largely an issue of the composition of public expenditure, where current expenditures have grown at the expense of public investment. A particular challenge for the coming decade will be to protect the level of public investment, as governments may find it easier to squeeze public investment further (rather than raise revenue or cut current expenditure) in a less favorable economic environment. Low domestic private investment

Figure 16: Savings and investment rates, 1995-2015 (% of GDP)



Source: IMF (2017)

The bulk of any increase in investment in Africa must come from private sources. This is not happening today.

is largely a reflection of a poor investment climate. The investment challenges are more fundamental than just poor "Doing Business" indicators in that they reflect citizens' appreciation of opportunity (are there profitable investments to be made?) and the rule of law (if successful, can they reap the rewards or will the profits be lost to well-connected special interests?). A more pragmatic and business-oriented approach to regional integration could also foster increased investment by creating larger markets.[16]

Massive outflows of both human and financial capital are the most telling indicator of citizens' confidence in their country. A recent ILO survey found that an astounding 38 percent of African youth wished to migrate.[17] Massive capital outflows are a further reflection of this lack of confidence. Over the last five years, annual illicit outflows have ranged from $50 billion to almost $200 billion depending on the methodology used. This implies annual illicit outflows on the order of 4½ to 7 percent of GDP.

The low level of investment is manifested in the real problems of poor infrastructure and weak human capital. Infrastructure investment requirements in Africa are estimated to be in the range of $100-$150 billion (2015 US$) annually compared with current levels of around $75 billion.[18] The resulting poor infrastructure is widely recognized as a constraint for faster growth.[19] Human capital investment is similarly deficient. Despite recent increases in enrollment rates, education outcomes seriously lag those in other regions.

Given its high population growth, Africa needs GDP growth of around 6 percent to rapidly converge with the rest of the world. Such growth is highly unlikely with investment rates hovering just above 20 percent of GDP. Public savings should be a key part of raising national savings rates. Unfortunately, in the aggregate, African countries have used the boom times to increase current expenditure even more than revenue, so that savings as a share of GDP have fallen. Part of the macroeconomic adjustment will require in many countries reduced, but more effective, current expenditure to generate the savings for increased investment.

Public investment is an important but small part of the solution. Countries undoubtedly need to increase domestic resource mobilization, as discussed in the 2015 Addis Summit on Financing for Development. Under the best of circumstances, however, given tighter capital markets and fiscal sustainability concerns, even with better managed current spending, increases in public investment will be small relative to the need. The most critical use of public funds may be, in combination with policy reforms, the reduction of risk for private sector investors in order to mobilize much larger private investment from both domestic and foreign sources.

The bulk of any increase in investment in Africa must come from private sources. This is not happening today. The reasons are broadly two. First, investors, in general, recognize the potential in African countries but neither domestic nor external investors have the confidence to invest because of concerns about macro stability, the rule of law, the stability of the policy framework, or the power of insiders and vested interests. Whatever the cause, until countries identify, debate, and resolve the reasons for low investor confidence, including by their own citizens, private investment is unlikely to increase significantly. Second, and relatedly, many countries in Africa have self-contradictory views of the private sector. On the one hand, they acknowledge in principle that job creation and growth will only come from private sector investment. On the other hand, they view the private sector as almost predatory, interested only in extracting rents and exploiting workers, or as a source for financing party or ethnic politics. The latter view is probably related to the crony capitalism found in many countries. Whatever their origins, these views are

16. Tuluy, H. (2017). Regional Economic Integration in Africa. Fifth Africa Emerging Markets Forum, Abidjan, 26-27 March 2017.
17. World Employment and Social Outlook 2016: Trends for youth, International Labour Office – Geneva: ILO, 2016.
18. Bond, J. (2017b). Africa's Infrastructure Deficit: Closing the Gap. Fifth Africa Emerging Markets Forum, Abidjan, 26-27 March 2017.
19. Ibid.

Governments (and societies) need to have a much clearer view of what they want. If it is a dynamic, competitive, job-creating private sector, then the de facto policies of the recent past will not do.

incompatible. Governments (and societies) need to have a much clearer view of what they want. If it is a dynamic, competitive, job-creating private sector, then the de facto policies of the recent past will not do. It is not simply a question of fixing a regulation here and there, however necessary that may be, but of changing mentalities.

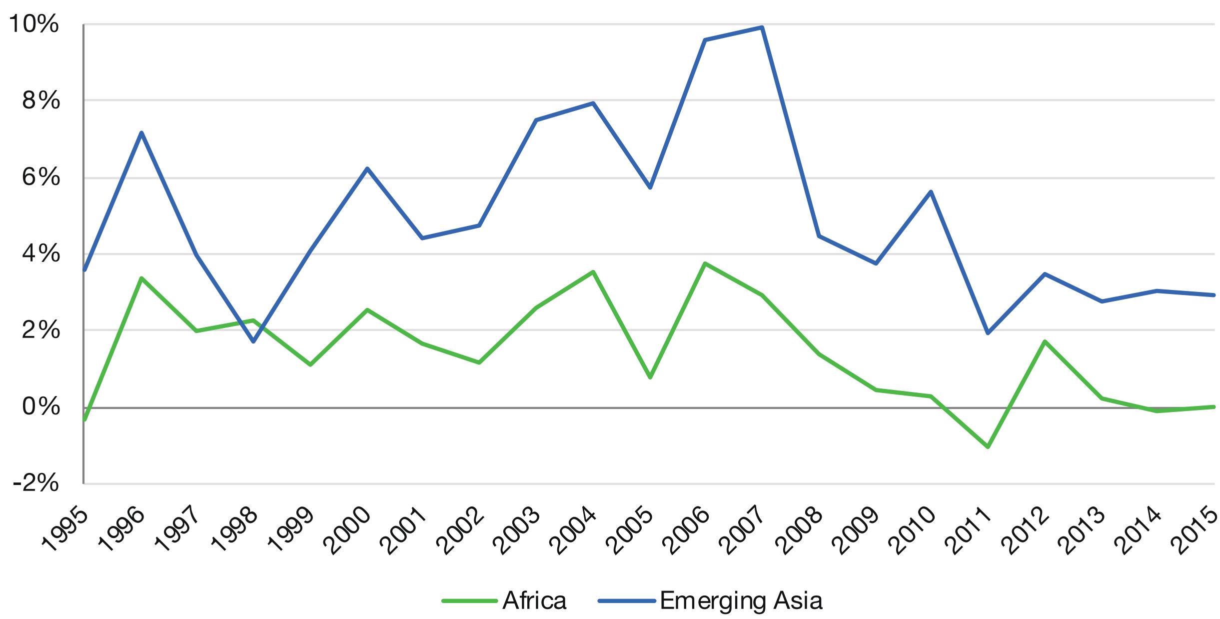
Accelerate productivity growth

Raising per capita incomes in Africa on a sustained basis will ultimately require raising productivity. Given Africa's low level of capital, per capita incomes in many countries can still grow by increasing the stock of capital, i.e., by investment. However, sustained per capita income increases will increasingly depend on productivity increases. African total factor productivity (TFP) growth has been dramatically below that of emerging market and developing countries in Asia for the last twenty years (Figure 17).

Improvements in human and institutional capital are key to raising productivity. As discussed above, rich countries hold the vast bulk of their wealth as human and institutional capital, which is key to their high productivity and hence incomes. One aspect of human capital development in Africa requires urgent attention: the quality of education.[20] New evidence suggests that a majority of African students have not mastered beginning-level skills even after 6 years of schooling. Moreover, most students spend only 2-3 hours a day in learning activities even while in school, and teachers spend relatively little time teaching. Basic skills are the foundation for all future learning and cannot be leapfrogged. The waste—students in school but not learning, graduates condemned to low-productivity jobs, and large public expenditure on education with no results—is staggering. Fortunately, the variation across schools and across countries shows that learning outcomes are largely

20. Alavuotunki & Reinikka (2017)

Figure 17: Total factor productivity growth, 1995-2015 (%)



Source: Centennial Group (2017)

It is urgent for African leaders and the international community to invest now to foster adaptation to climate change, including in agricultural research, urban infrastructure, and improved water management.

determined by how money is spent rather than how much money is spent. All African leaders (and societies) need to focus on learning outcomes, rather than numbers of buildings built, and on what teachers know and do, rather than just numbers of teachers or the politics of teacher unions.

Raising productivity will require not only faster adoption of new technologies but also strengthening the institutions (from rule of law to labor market flexibility) that allow businesses, from family farms to conglomerates, to combine inputs in more productive ways. In a very practical way, this is where the inclusion agenda meets the growth agenda. African entrepreneurs succeed around the world, including surviving very tough environments. They prosper, however, where initiative by all members of society is encouraged and where the fruits of that initiative are not stolen.

Reduce conflict and fragility

Countries involved in armed conflict or so fragile that they cannot provide security and other basic services to their populations present a special challenge and a special risk to their neighbors. More than one in three African countries (20 of 54) are classified as fragile on the harmonized list established by the AfDB and the World Bank. Almost 290 million people, a quarter of the continent's total, live in these countries. Unfortunately, the situation has improved little since the harmonized list was first produced in 2010; 16 of the 20 countries have been on the list since it was created, the share of Africa's population living in fragile countries has not changed, and the absolute number of people in fragile states has increased by about 150 million. The situation in the Sahel—which combines arms from Libya, extremist religious expansion, and persistent poverty—is particularly worrisome.[21]

Ending conflict and building capable states from fragile ones is clearly a long-term undertaking but three things may help in the short run. First, more aggressive mediation by regional bodies and the African Union when internal conflicts are brewing may reduce the dangerous and hard-to-reverse slide into open conflict. Second, when mediation efforts fail, greater regional military capacity to intervene quickly may prevent further deterioration. Finally, it is urgent that the international community recognize that security is a global public good and that weak states, in the Sahel, for example, cannot finance the required level of security expenditure without increased international support.

Adapt to climate change

The economic impact of climate change at the country level is difficult to quantify, but most climate models indicate that throughout Africa temperatures will rise, rainfall will become more variable, and severe weather events will become more common. From a continental perspective, the biggest climate issue for Africa is not reducing emissions (however laudable) but adapting to coming climate change. Green (i.e., emission-reducing) investments may have high returns, foster broader green growth, and generate favorable financing but they will have little impact on global emissions. The climate change already underway will, however, have dramatic effects on agriculture, the largest source of employment on the continent, and on coastal cities, home to a rapidly increasing share of the population.[22] Although the specifics are beyond the scope of this paper, it is urgent for African leaders and the international community to invest now to foster adaptation, including in agricultural research, urban infrastructure, and improved water management.

Reduce inequality and disparities

The combination of large and growing disparities between the rich and poor; unequal access to education, health, and other social services; and a large share of the population still living in poverty constitutes a social time bomb for much of Africa. Unfortunately, these disparities

21. Michailof, S. (2017). New Threats to Africa's Stability and Growth. Fifth Africa Emerging Markets Forum, Abidjan, 26-27 March 2017.

22. Ingram, G. (2017). Demographics and Urbanization: Planning Cities That Work. Fifth Africa Emerging Markets Forum, Abidjan, 26-27 March 2017.

Continental inequality will only fall if African best practice—whether in demographic, macroeconomic, or structural policies—is generalized across the continent.

continue to grow at the national and regional levels and with respect to the rest of the world.

From a continental perspective, the largest part of inequality is within countries. At the national level, Gini coefficients are relatively high in Africa, ranging from 32 to 63, but have not shown any consistent trend either up or down over the last decade. Of the 36 countries for which data is available, the Gini coefficient rose in 18 countries and fell in another 18 countries.

The biggest increase in inequality, however, has come from an increase in the differences between countries.[23] Per capita incomes in the five richest African countries are 24 times larger than those of the poorest five countries today, compared to 16 times larger 20 years ago.

Reducing continental inequality requires poorly performing countries to catch up with their better-performing neighbors. The combined effect of national and inter-country inequality is a continental Gini coefficient of 56, which is higher than that of any other region except Latin America. In Latin America, however, the Gini coefficient is falling while in Africa it is rising. Continental inequality will only fall if African best practice—whether in demographic, macroeconomic, or structural policies—is generalized across the continent.

Conclusion—Capable states and pragmatic leadership

Africa's advantages—strong resource base, growing labor force, growing consumer base—remain but convergence has stalled. In the changed global environment, this combination naturally calls for more concerted action to address the above-mentioned seven challenges. Fortunately, there is considerable technical consensus on what needs to be done, and a number of African countries continue to show how to do it. If these African best-practice policies were generalized, the continent would be converging with the rest of the world.

Politics will affect outcomes more than technical economics. In many countries, both in Africa and elsewhere, dysfunctional politics constrain policy choice and implementation. Political leaders often face incentives to focus on private (family, party, region, ethnic group) gain rather than to provide public goods. Outcomes are dependent on how political systems evolve. Citizen engagement and greater transparency may contribute both to creating capable states that deliver security, rule of law, and services to all citizens, and to the emergence of strong, pragmatic leaders who focus on results not ideology and who are accountable to citizens. Capability is largely a question of governance--of how institutions work and work together. Capable states are not created overnight but are the result of sustained efforts to strengthen capacity and build credibility and accountability. Capable states can encompass a wide variety of political systems but ultimately they need to be accountable to their citizens for delivering results. Strong, pragmatic political leadership could accelerate change in the short term and lay the basis for sustained strengthening of institutions, including political ones. The biggest threats to success are complacency and a lack of political will to tackle the big problems. The challenge is less what to do than how to implement the chosen course of action and how to sustain a "do whatever it takes" mentality to get results.

The agenda summarized above is intentionally long on issues and approaches and short on specific measures for two reasons. The first is simply that, as often observed, Africa is very diverse and detailed action plans must be country-specific. The second, and more important, reason is that solutions that do not emerge from some form of national debate about what exactly is the problem to be solved and what needs to be done are very unlikely to succeed. Countries can benefit enormously from the experience of others but they need to develop a minimum societal consensus on what needs to be done if they are to sustain the concerted action necessary for success.

23. Ibid.

The stalled performance of recent years is an urgent call to action for all who want a prosperous, rather than marginalized, Africa in 40 years.

Such a societal consensus on the reform agenda, and the political leadership to forge it, while present in a few countries, is missing in most. The stalled performance of recent years is an urgent call to action for all who want a prosperous, rather than marginalized, Africa in 40 years.

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