Current Path

Conclusion: The lack of productive realignment of African economies

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With Africa's large and growing labour force, the matter of labour's contribution to economic growth is of particular importance to the continent, which does not have deep pockets of capital and does not benefit from high levels of technology—the other two sources of productivity improvements.

Global labour productivity growth slowed from a peak of 2.8% in 2007, just before the global financial crisis, to a post-crisis trough of 1.4% in 2016, and it remained below 2% a year in 2017/18. By 2018, the output per hour of work had declined for over a decade.

In theory, the potential for improvements in productivity as part of digitisation and automation is enormous. However, with a shrinking labour force as a portion of the total population in most middle- and high-income countries, artificial intelligence and automation first need to offset the reduction in production from that smaller labour force before these countries experience an increase in economic growth. With its growing working-age population, Africa is potentially in a favourable position. However, it comes off a shallow base. Many countries are still several decades away from achieving a favourable ratio of working-age persons to dependants (as discussed in the theme on Demographics).

In addition to getting more rapid economic growth from the contribution of a more significant and more productive labour force, Africa needs much more substantial capital inflows to fund its infrastructure requirements. It has the world's most rapidly growing population, requiring more schools, hospitals, roads, harbours, railway lines, and other infrastructure every year. The first port of call is, of course, that African countries need to improve their low domestic revenue mobilisation and improve wastage within government expenditure. In addition, Africa needs much higher rates of FDI, examined in the theme on financial flows.

The continent must also be able to sustain higher debt levels and benefit from more concessional financing.

According to the Organisation for Economic Co-operation and Development (OECD), a 30% to 50% debt threshold range is a reasonable target for emerging economies, including Africa's 46 low-income and low-middle-income economies. The OECD further recommends that a prudent debt target should average 15 percentage points below the debt threshold since exogenous events, such as COVID-19 or Russia's invasion of Ukraine, could push up interest rates. Domestic developments such as unrest or a coup can cause countries to lose market confidence and increase their borrowing costs. Therefore, according to the OECD, most African countries can only sustain debt levels of 15% to 35% of GDP, which is significantly below requirements.

Five matters are crucial in considering the debt-to-GDP ratio. The first is how much the debt costs, i.e. the interest rate at which the debt is incurred. A 2023 report by UNCTAD reveals that Africa pays four times more for borrowing than the US and eight times more than the wealthiest European countries.

The second is the currency in which the debt is held. Currency depreciation regularly increases the public debt stock in many African countries because a significant portion of the debt is in foreign currency. For instance, with the COVID-19 pandemic, on average, exchange rate depreciations increased public debt in Sub-Saharan Africa by ten percentage points of GDP by the end of 2022.

Third, what is the economic growth rate? An expanding economy offsets debt repayments by increasing in size, thus reducing the size of the debt as a portion of GDP. After Africa's debt peaked at 26% of GDP at the height of the COVID-19 pandemic in 2020, it declined to 24% two years later as modest economic growth resumed.

Fourth, how vulnerable is the borrower to exogenous effects? A single-commodity-based economy is, for example, very vulnerable to price swings. In contrast, a diversified economy where agriculture, manufactured goods and service exports contribute to earnings is much more resilient.

Finally, prudent financial management is essential. Is the money loaned put to productive use?

There is no silver bullet to this dilemma. It requires a host of responses, starting with the quality of domestic governance and extending to restructuring the voting rights of IFIs. Africans must be able to afford much higher debt levels (at least 50% to 60% of GDP), which is only possible at very low concessional rates. This means someone somewhere needs to offset the additional risk premium as Africans work to improve stability and reduce risk through better governance.

Beyond the effects of labour's limited contribution to growth in Africa and the lack of capital, Africans need to embark on a productive economic transition. Instead of transitioning from agriculture to manufacturing to services, the growth trajectory that delivered the most rapid improvements in general well-being in other regions, the African transition is from subsistence agriculture to low-end services in informal urban areas. Africa has not benefited from a revolution in its agriculture sector, nor has it been able to industrialise. Currently, the service sector (i.e. lending, recreation, tourism, transport, food) constitutes the most significant economic sector by value and is significantly larger than any other sector, including agriculture and manufacturing. However, the impact of the COVID-19 pandemic accelerated growth in the low-end service sector due to lower investment, erosion of human capital because of unemployment, loss of schooling, and a retreat from global trade and supply chains. The COVID-19 pandemic has encouraged the digitisation and rapid adoption of new technologies. Still, the associated productivity gains may be unevenly distributed—in particular, bypassing those countries with widespread, stable Internet access, solid institutions and sound education systems and causing employment losses in some sectors.

Chart 16: Key constraints on Africa’s development

1. Low productivity because of delayed demographic transition, poor education and health.
2. No agricultural revolution and increased food insecurity.
3. Labour moving from subsistence agriculture in rural areas to low-end services in informal urban areas.
4. Instead of a manufacturing growth path, premature de-industrialisation and growth in low-end services.
5. Little global and regional trade integration. Instead, a reliance on small domestic markets.
6. Increased commodity dependence.
7. High and diversified debt burden with onerous repayment requirements.

Unlike the manufacturing sector, the service sector was, before COVID-19, not fully disrupted by technology. As the service sector is more labour intensive, the shift to services reduced overall productivity. But that is now rapidly changing, although more slowly in Africa given the dominance of low- rather than high-end services, often provided in informal settings such as barber shops and vehicle repair along the side of the road.

The COVID-19 pandemic will eventually be seen to have helped drag the service sector into the modern world. According to the McKinsey Institute, productivity growth could reach 2% annually over the next decade, with 60% of this increase due to digital opportunities.

Africa's already small manufacturing sector is declining, suggesting that Africa is experiencing so-called 'premature deindustrialisation'. Whereas manufacturing is often called the automatic escalator that lifts countries to higher productivity levels, Africa appears to be embarking on a low-productivity, service and commodity escalator. Africa's service escalator goes upward, but only slowly while the manufacturing window is closing. This is mainly because the share of workers employed in higher-productivity sectors such as manufacturing is declining, resulting in a drop in the average growth output per worker. In addition, it has become much harder to establish export manufacturers. The entire sector is shrinking globally, and competition is fierce with some indications of the potential relocation of manufacturing, first to surrounding Asia, then India and eventually to Africa.

The general shift in Africa seems to be that labour is moving from subsistence agriculture in rural areas to informal jobs in the urban service sector. Investment and jobs are often limited to capital-intensive commodity enclaves, such as in northern Mozambique's gas fields, with little or no forward or backward linkages into the surrounding economy. The few jobs created through these megaprojects do little to provide employment or create local value chains. They provide jobs for a few expatriates and generate large revenue streams for governments. Generally, enclave economics does not benefit broad welfare improvements within the economy. Yet, commodity-based enclave development is often the norm in commodity-rich countries. In fact, Africa is becoming even more dependent on low-value commodity exports for its foreign exchange earnings. It is the only region globally where the number of commodity-dependent countries (in terms of the value of export earnings) increases every year.

Going forward, Africa needs to seize the opportunity offered by renewable energy and the promise of the Fourth Industrial Revolution to rapidly improve productivity growth and provide more jobs. But how can that be achieved in a global economic environment where Africa is becoming more, not less, dependent on the export of commodities and where the contribution of its small but growing labour force (as a portion of the total population) is likely to decline in value? And all of this while Southeast Asia constrains the growth of the manufacturing sector as its position as the world's factory on top of the challenge of climate change? Finally, to kick-start all of the above and recover from the impact of COVID-19, many poor African countries again require debt relief similar if not larger to that provided during the 2005 Multilateral Debt Relief Initiative.

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Dr Jakkie Cilliers is the ISS's founder and former executive director of the ISS. He currently serves as chair of the ISS Board of Trustees and head of the African Futures and Innovation (AFI) programme at the Pretoria oce of the ISS. His 2017 best-seller Fate of the Nation addresses South Africa's futures from political, economic and social perspectives. His three most recent books, Africa First! Igniting a Growth Revolution (March 2020), The Future of Africa: Challenges and Opportunities (April 2021), and Africa Tomorrow: Pathways to Prosperity (June 2022) take a rigorous look at the continent as a whole.

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