West Africa's Economic Growth & Weakening Diversification: Rethinking the Role of Macroeconomic Policies for Industrialization

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Objectives of the paper

- Show that growth has been without diversification
- Link this to use of macro instruments
- Discuss the implications of empirical results showing drivers of growth
- Discuss potential role of structural economics in sustaining growth
- Conclude

Outline

- Introduction
- West Africa’s Growth Story
- The literature on Growth
  - Theory
  - Empirics
- Methodology
- Findings
- Structural Economics to the Help
- Conclusion

Introduction

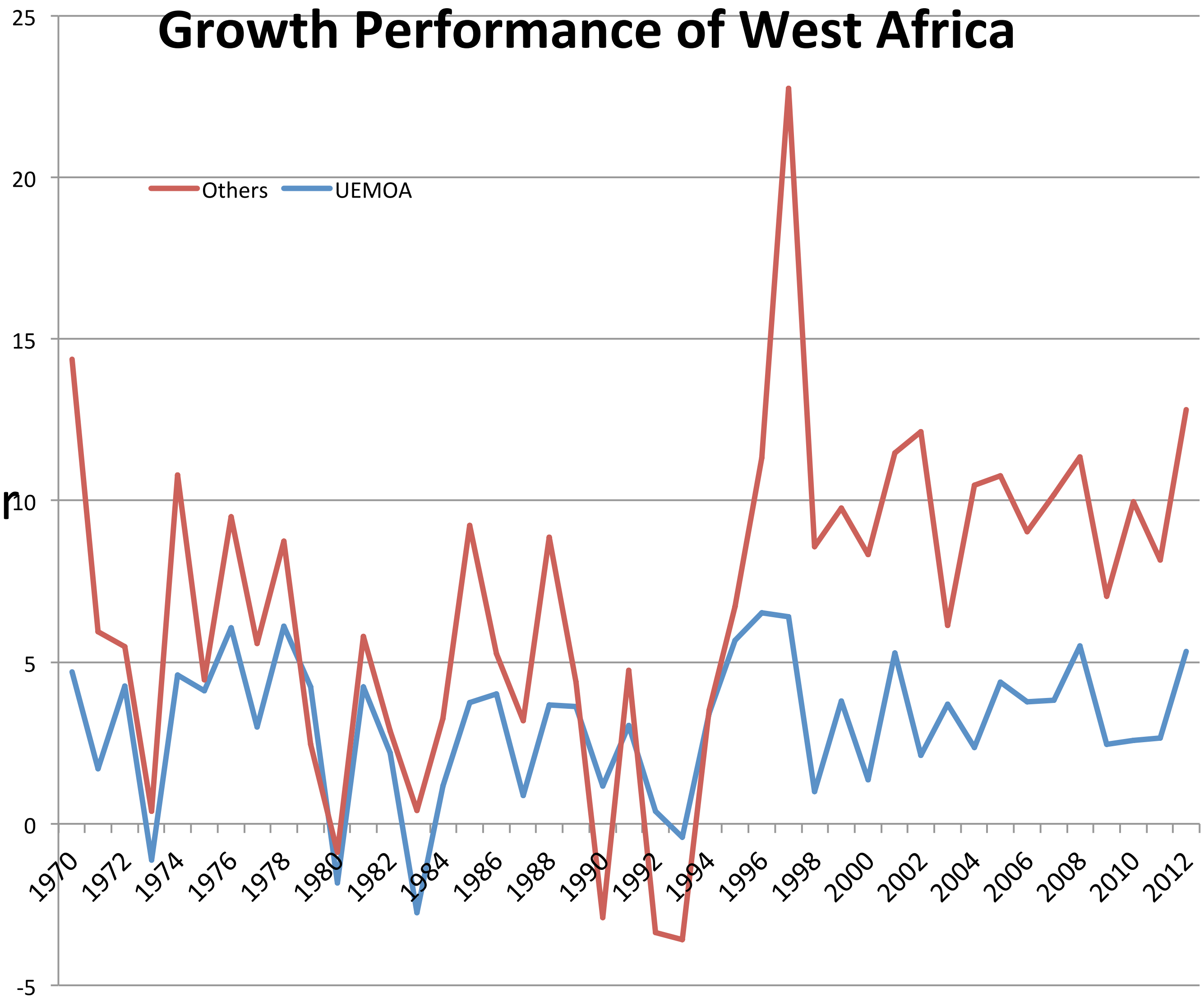
- Africa rising – PCY, falling inflation, growing private sector share, etc
  - Both resilient and buoyant
- But improvements accompanied by continued decrease in share of industrial production – globally and in output
- Nor followed by job creation and/or poverty reduction
  - Nig: Decade + over 5% growth with rising poverty – 54% in 2004 to 70% in 2010
  - Ghana – battling potential Dutch Disease
  - UEMOA & smaller countries – growth not leading to structural change
- Premise of 80s reforms: With ext stability, all that is required is removal of public sector distortions to “get prices right” and reallocate factors towards high productivity industries

Introduction Cont'd

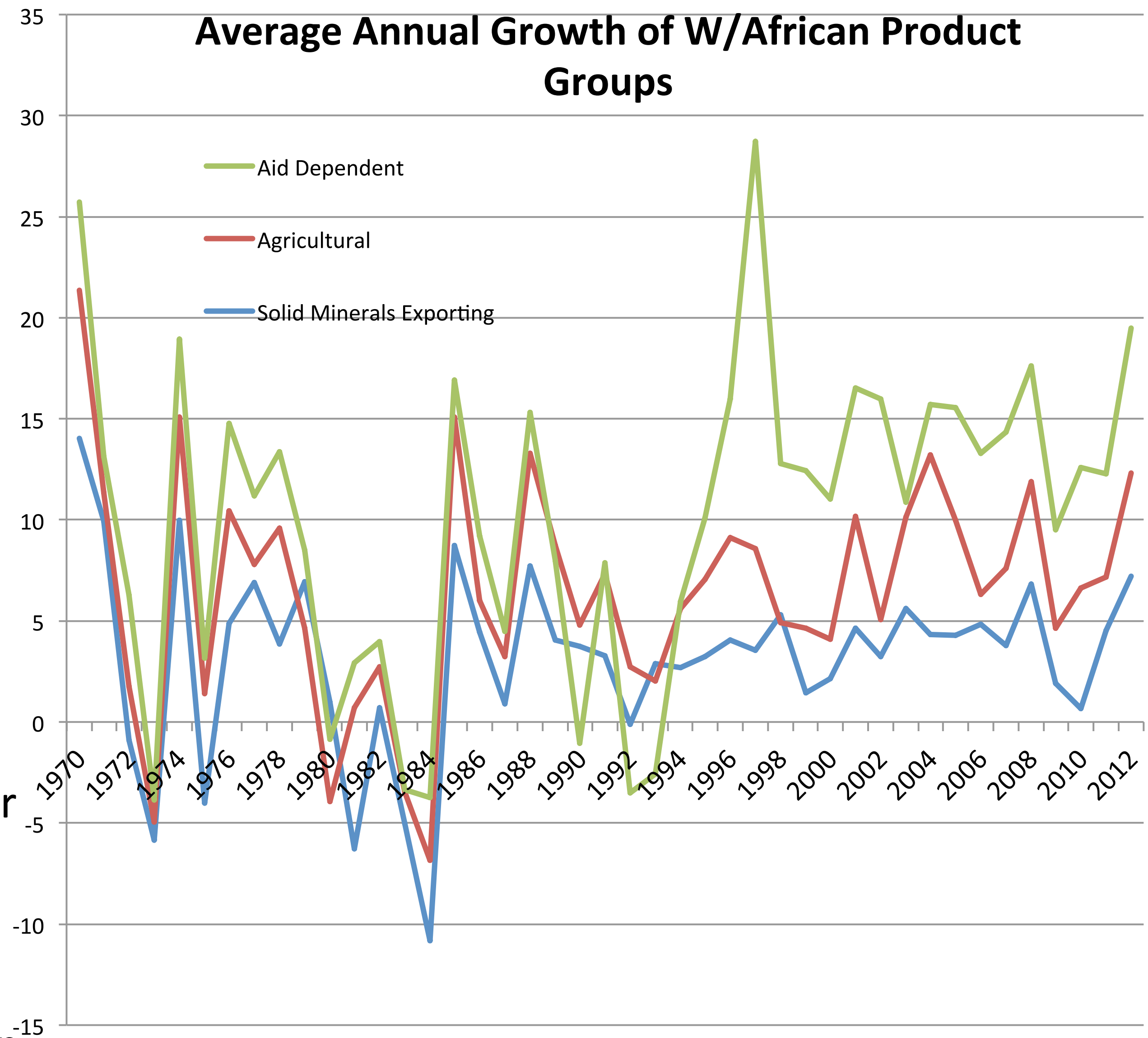
- Production concentration isn't minor, indifferent to ext sustainability; a threat to macro stability.
- So we question coexistence of improved macro stability with poor diversification.
  - Can shortfall in diversification be blamed on deficit of reforms? Have the region not reformed 'enough'?
  - Could macro policies have more roles to play in diversification?
  - Should macro policies remain neutral and leave the job of diversification to structural reforms?
- We argue dt macro policies have role in

  diversification…thru relative prices

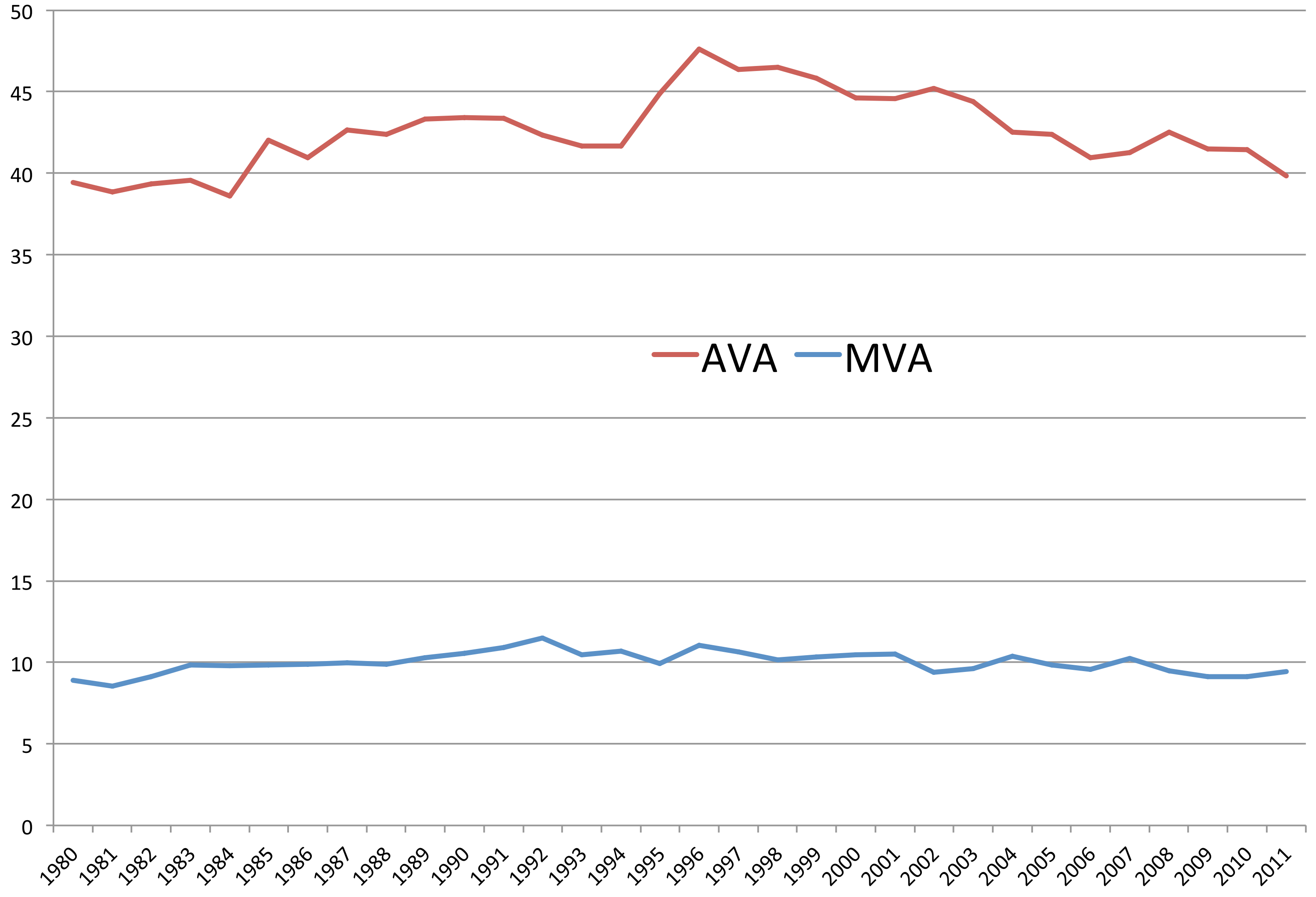
- 2 Groups–sub-regional & commodity
- Growth bn volatile & irregular
- Decidedly higher in non-UEMOA
- Follows commodity fortunes?
- Driven by structurally different factors??



- Aid dependent doing best –influenced by Liberia
- Followed by agric exporting
- Oil & solid minerals have lowest average growth
- Relatively more stable and longer for all groups in 2000s than 1970s/1980s
- Temporal divergences in growth a concern for sustainability and diversification – need for sustainable anchor
- Substantial aggregation & smoothening of numbers



The challenge is in structural changes that should follow growth



Methodology

- Classify W/Africa into three –oil mineral producing , agricultural exporting &aid dependent – 50% export for the first 2 & 50% govt budget for the rest
- Combines elements of structuralism with monetary determinants
- Specify over-parameterized model and allow DGP to establish what matters
  - Limiting imposition of restrictions
- Modify Bassanini and Scarpetter (2001) model for OECD
  - Initial specification consistent with neo-classical model plus a convergence factor and basic determinants of steady state (accumulation of physical capital & popn growth)
- Retain physical k, dom savings; drop human k (popn is inefficient proxy), modify treatment of prices & incorporate structural factors.
  - Prices include interest rate, RER, X & M value indices & int on external debt
- Structural factors – age dependency, electric power, dom credit & tax rev & ext sector variables (remittances, FDI & reserves to debt ratio

$$\Delta \ln y_{i,t} = y_{\mathrm{i,t\text{-}1}} - \phi_1 \ln sk_{i,t} - \phi_2 \ln h_{i,t} - \sum_{1-4}^{m} \phi\, nv_{i,t}^{i} + \sum_{1-4}^{m} \phi_4 P_{i,t} + \sum_{1-4}^{m} \phi_5 S_{i,t} + E_{i,t} + \varepsilon_{i,t}$$

- P, S and E vectors are prices, structural variables and external factors

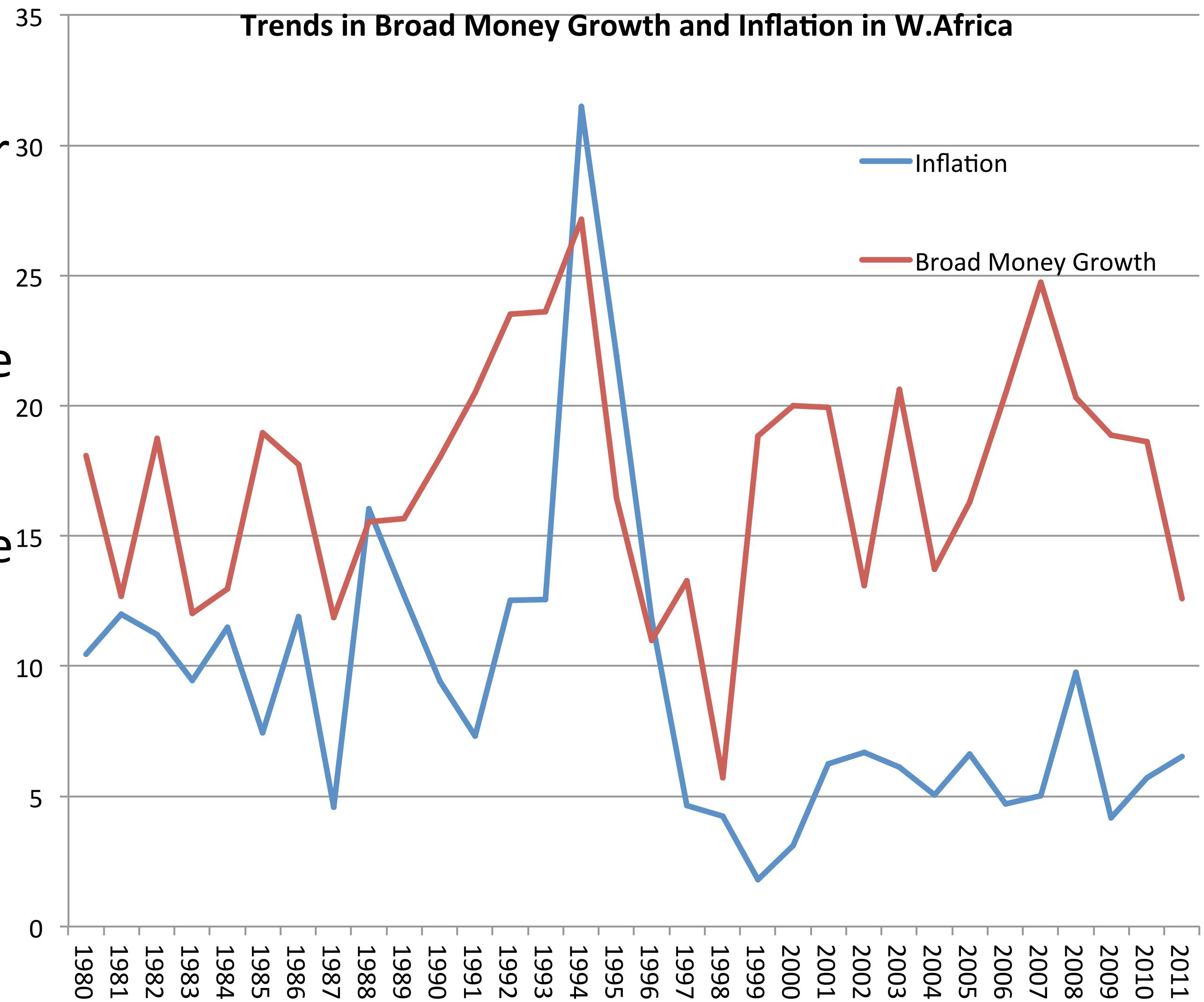
Findings – Drivers of Growth

- Pervasive variables – across 4 to 6 groups
  - Lending IR, dom credit, electricity, REER & M-value index;
  - 2 (IR & dom credit) are monetary; rest (electricity, RER & M-Value index) are relative prices and macro fundamentals
- Others, consistent for at least 2 estimations
  - FDI (for agg & aid dep), remittances & tax revenues (for agg & non-UEMOA; latter weak), X-Value index (for non-UEMOA & min) & debt serv (for UEMOA & non-UEMOA),
- What are not important
  - Broad money, IR spread, GFCF, Domestic savings, Age dep (significant only for UEMOA)
  - Net ODA (significant only for non-UEMOA), tax rev, int on debt (significant only for non-UEMOA)

Variable	W/Africa	UEMOA	Non-UEMOA	Solid Min & Oil	Agric	Aid Dep
FDI	.303 (2.57)			-.575 (-1.34)		2.643 (3.18)
Reserves			-.0383 (-0.62)			-.777 (-3.43)
B. Money		-18.06 (-2.22)				
Lending IR	-.1695 (-2.24)	-3.94 (-2.67)	-.224 (-2.85)			-4.80 (-3.90)
IR Spread	-.136 (-0.86)	3.50 (2.00)				
Net ODA	.072 (1.35)	.301 (0.70)	.168 (2.07)			
Dom Credit	-.488 (-2.79)	-1.11 (-2.22)	-.186 (-1.06)		-1.89 (-2.09)	
GFCF			.167 (1.55)			
Remittances	1.480 (2.40)	.26 (1.13)	4.611 (2.28)			
Electric Trans	.162 (2.23)			-.242 (-2.45)	.135 (1.89)	-.612 (-2.44)
Dom Savings	-.068 (-1.34)		-.0512 (-0.23)			
REER	.033 (1.67)	-.18 (-1.93)	-.0034 (-2.16)	-.0099 (-1.70)	-.003 (-3.65)	-.304 (-2.01)
Age Dep		.52 (2.61)				
X-Value			-.008 (-2.89)	.071 (2.90)		
M-Value	.024 (5.50)	.028 (1.93)	.038 (2.69)	-.063 (-3.20)		
Tax Rev	.196 (1.74)		.726 (1.62)			
Debt Service		.298 (1.69)	-1.859 (-3.44)			
Int on Debt			-1.602 (-2.18)			
Constant	-6.248 (-1.67)	563.87 (2.38)	9.449 (2.99)	16.74 (3.36)	6.41 (3.09)	144.6 (3.81)

On the monetary variables

- Inflation has significantly gone down – from over 20% in the 1990s to single digits in about 5 yrs and remained so since
- But broad money has not.
- So there is unique 'coincidence' of low inflation and rising money supply
- Any cost to stabilization?
  - Sterilization???



On Monetary Variables Cont'd

- Some went full-scale on inflation targeting; others used implicit targeting
- Stability was considered important esp for gaining access to global k mkts
- But complicated by – monetization of forex & fiscal authorities.
  - Reactionary central banking in face of natural resources & fiscal irresponsibility
  - Making inflation control a monotonous mopping up of excess liquidity (fire-fighting)
- Brunt is borne by cost of money & pricing of money market instruments
  - And affected capacity of national govts to manage structural factors that help growth
  - High lending rates coexist with low returns to saving
  - Limiting domestic GCFC & savings simultaneously
- Trading off savings & investment for low inflation
- Foreign inflows not tied to productive sector activities and investments
- So funds flow around but not to domestic real sector
- Without robust k mkt, no real sector funding; so growth rotate around sectors that can match the risk and returns available in the money market

Other Factors

- Further complications by the RER channel – Dutch Disease tied to the capital formation challenge
  - Beyond price distortions that alter incentives against tradables, it increases disincentive to give credit for long term real sector investments that are risk-laden
  - So capital formation may be ok; but sectoral distribution of such capital is skewed against the real sector
- Gaps btw agg SS & SS means rising imports
  - And structure of imports has changed in two ways – change in volume and value but also change in composition
  - ISIs of 1970s means capital import; current boom led by import of middle class 'necessities' – a class of consumers, mostly in services sub sector & very vocal
  - Thus, rise in M-Value index hurts econ growth thru the middle-income and public sector induced imports
  - These help final consumption

Other Factors Cont'd

- And so the import-export dilemma
  - Neither W/Africa's share of world X nor its X deflator has grown significantly
  - But M is diversified with increasing value; weakening incentive to x any other than raw materials; accounting for structure of West Africa's X basket
- X concentration is linked to production concentration
  - Rise in imports value deflator not unconnected to a subtle pressure from 'new partners' for 'bilateral reciprocation.
  - May be the outcome of a new and rising trend in global geopolitics – a demonization of the old masters which helps keep eyes off a new trend of unilateral (or unreciprocated) value addition from Africa to its new trading partners.
  - While X basket can, and does, indicate weak and deteriorating diversification, more profound story is in composition of dom VA
  - X-oriented economies can have huge gaps btw dom composition of output and export concentration but this presupposes differences in incentives facing production of tradables and non-tradables . Where such differences are not pronounced, export concentration mirrors dom concentration
  - Seems to be W/Africa's case

How we arrived here

- Africa’s alternative to ISI not produced as good a result as ISI
  - Esp as regards growth fragility –simultaneous existence of large booms and sterling growth with stagnant X-value index and non-diversification
  - Possible bc of divergence btw industry & manufacturing – sustained investment in natural resource extraction not translated to higher value products in other sectors leading to weak inter-industry and sectoral spillovers
  - Exrate overvaluation and ‘toxic political economy effects’
- Abandonment of ISI without an anchor led to preference of recourse to natural resources (the known devil) to any unknown angel (other industrial policy anchors)
- Cycle for industry concentration completed by availability of trading partners willing to sign Africa’s raw materials

How we arrived here cont'd

- RER appreciation benefits service sector, with capacity for quick returns
- Leading to 'servicification' of the economy
  - But service is 'derived'; draws it quality from the real sector it supports
  - Can grow to become exporting, but starts with the real sector
- Labour has merely moved from low value added agric to low value services, with little change in linkages to global value chain
- Leading up to an aspect of 'toxic political economy' issue – rise of a set of interest groups that feed upon the sectoral inefficiencies
  - Increasingly take root and spread; difficult to dislodge
- Support from domestic energy (and other infrastructure) lacking – hurt growth almost across board

Insights from Structuralism

- Commodity reliance is not a curse – it is merely the beginning; reliance on it beyond pre-take-off is the detriment just as breast milk
- Challenge is managing a transition away from it at the earliest – and the macro policy environment and the diverse micro policies that support them are critical
- Structuralism insists that diversification of the production structure matters for macro stability
- Challenge is "dualism," – arising from the fact that heterogeneous actors coexist in X and subsistence sectors, raising a gap of productivity; high productivity in the primary export sector coexisting with a relatively inefficient sector producing agricultural and manufactured goods for domestic consumption, and large informal sector
- Heterogeneity reinforced by high profits high productivity-sectors & often repatriated abroad and/or wasted thru luxury goods imports by solvent classes

Insights from Structuralism Cont'd

- Thus, attempts to industrialize via incorporation of imported technical production means, within this heterogeneous structure, reinforces the backwardness, thru generating high productivity enclaves disconnected from the rest of the economy
- Fall in trade in the 08 recession affected many developing countries because of high and growing dependence on exports; export revenue fell by about 30% in Africa compared to Asia's (more diversified) 18%; affecting growth more deeply
- Is Africa's stability reforms yielding greater diversification & increased growth? Can stability, if further deepened, also deepen and spread growth?
- But is this possible without follow up from policies targeting innovation, R&D, infrastructure, , education, etc? not likely

Insights from Structuralism Cont'd

- But stabilization could play a role in diversification
- Macro stability can be achieved in a more ways than one; some more conducive than others
- If we think of macroeconomic diversification, not just in terms of diversification of sectors, but also diversification of instruments, capacity to mix them with long term objective that balances growth between extractive and other industries.
- Country can grow by concentrating along lines of int'l comparative advantage. But it remains vulnerable if it's not externally induced
- Deliberate efforts to design a move away from original sectors that induced advantages to sectors that may have been dormant but have the capacity to even accelerate it beyond that which induced it
- Short of this, there is perpetual boom-bust cycle
- Growth inhibitions are mostly structural – supply constraints, absorptive capacity, structural imbalances, etc. so there's need for additional instruments and deeper understanding of why the instruments are used
- E.g. Depreciation is useful, but if not followed by understanding and action on the necessary channels for sustained impact like traditional manufactures and other tradables, it is ineffective
- Pursuing broadly undervalued exrate is no use; it has to be properly channeled to desired sectors – sectors that increase aggregate savings and tech change, learning by doing, etc

Conclusion

- W/Africa has managed the triple successes of disinflation, external debt reduction and reserves build-up; helped by a number of external factors
- Whether this leads to prosperity depends on more than global factors but also on domestic conditions ; inflows matter but only as a necessary condition; the sufficient condition is 'regular' macroeconomic mgt instruments be urgently complemented and enlarged to take on broader mandates of ensuring that resources from the high profit sectors are settled in the lower profit sectors – esp as the latter cannot kick-start its own growth
- *Better administration of mineral wealth, development of agric and a careful management of rapid urbanization would help*
- *Chinese demand may not always be there; so resources have to be channeled…deliberately!*

Recommendations

1. Thank you!
2. Thank you very much!!
3. Thank you very, very much!!!