

# Why Africa needs its private sector

A presentation by Professor Paul Collier



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## Africa's growth prospects

A key question for anyone thinking about Africa relates to whether and how its economies will expand. For most of the last decade or so, the global context has been benign for Africa because of the rise in commodities prices and falling global prices for many manufactures. But now the commodity super cycle is over, the question is, what comes next?

### *Natural resources*

Only a decade ago, Africa was the least prospected continent on earth but the good news is that across most of Africa (South Africa is an exception) rising commodity prices triggered the wave of investment in mineral exploration. Basic geology predicts that Africa has far more mineral resources than have so far been discovered. If prospecting continues, this gap will narrow.

Indeed, more production is already coming on stream: Ghana, Kenya and Uganda have started (or will soon start) to produce oil, Mozambique will be producing gas soon, while Tanzania will be doing so in a few more years. Wherever you look, there are new flows appearing, expanding the contribution of natural resources to African economies even as prices fall. This will underpin sub-Saharan African growth, which will probably exceed 5 per cent on a year average for the next decade.

Besides natural resources, you've got two other sources of potential growth that could raise growth above 5 per cent. In this regard, an important wildcard for sub-Saharan Africa is whether it is able to break into global manufacturing.

### *Can Africa export more manufactured goods?*

The critical thing about global manufacturing is that it takes place in clusters. One example of what I am talking about is the button industry. About two-thirds of the world's buttons are made in a single Chinese city, a city that makes buttons and not much else. Basically, what happens in 'Buttonopolis' (Qiaotou) is that lots of little firms congregate together. And what they each specialise in is not a product, but a small step in the process of making a product—in this case, buttons.

Getting to this point is very difficult but, once established, clusters of this kind can be super-competitive. So, if you're the first button factory in Africa, you're probably going to go bust. In fact, I know the guy who ran the first button factory in Africa, and he did go bust.

For the last four decades it has been impossible to break into many markets because East Asia has been super-competitive. But, of course, they too had to break in at some point, and, if you go back 40 years, all the clusters were in the developed world with only a few isolated firms in East Asia. So China got in a few decades ago, became competitive, and took off from there. But their advantages may be diminishing now: real wages are rising so fast that for the last four years China has been offshoring to low-wage Asia—countries like Bangladesh, Vietnam and so forth.

Africa also has a chance of breaking in. And it is starting to happen. In fact, Africa has one great advantage over Asia, which is better market access to Europe and America because of preferences poor countries have in trade agreements. That is why a large Chinese shoe manufacturer just moved to Ethiopia—they reckon they have a 27 per cent cost advantage there because of better market access. This is really important because I think the next decade will be one of increasing protectionism, so Africa's preferential trade arrangements could become really valuable in the medium-term.

Having said that, the Chinese shoe firm currently has a problem sourcing leather. But the first movers' decisions are premised on the assumption that other Chinese firms will come and that a cluster will develop. When that happens, they'll really be in business. So this is what I think we'll see in parts of Africa: as the first groups of firms become profitable, it will become more profitable for others to invest and suddenly we'll get explosive growth.

### *Catch-up growth*

A third potential source of growth could come from leap-frogging technologies and rapidly increasing productivity.

We've already seen one leap-frog, which is telecommunications and mobile phones. But the real leap-frogging over the next decade will be in very mundane sectors. In retailing, for example, most of sub-Saharan Africa is still basically in the 19<sup>th</sup> century, technology-wise. But there's plenty of off-the-shelf 21<sup>st</sup> century technology available (hypermarkets and shopping malls, for example) that could increase productivity considerably. Lagos, for example, has only two shopping malls for a city of 16 million people. So, the future is big productivity gains from 21<sup>st</sup> century methods of business applied to a rather mundane service sector, which is, of course, the big part of the economy.

Given what I have said about the potential sources of growth in African economies, I'd like to point out two other things. The first is the role of governance in growth based on natural resources, the second is about effective organisations.

## **Governance of extractive industries**

Africa's been through resource-based growth before, and it didn't work: the benefits were accrued by small groups of people through processes that amount to acts of plunder. The challenge for Africa, this time around, is whether it repeats that history or learns from it. In this regard, I'm more optimistic than many that Africa will, in fact, manage to avoid repeating the patterns of the past. One reason for saying so is that nowadays there's a strong awareness across the continent of the limitations of past patterns, and so there is much stronger scrutiny of government, and much more vociferous demands that they do better. The other reason is that there has been increasing global awareness that extraction industries need to meet higher standards than they have so far.

One example of this are the discussions of a recent G8 meeting hosted by Britain, the agenda of which was based on transparency in natural resource extraction; targeting corporate tax avoidance (which is a big deal in resource extraction); and cleaning up beneficial ownership of shell companies so that money laundering will be much harder. These three priorities were endorsed by all the G8 leaders. And it's not just words: practices are changing too. It is now mandatory in all of North America and all of Europe for resource extraction companies to report all their payments to governments publicly. And there is more evidence of our going through a sort of quantum leap in transparency in the form of Prime Minister Cameron's arm-twisting of the 18 heads of government of the UK's overseas territories. This resulted in agreement to implement changes that, while allowing those countries to remain tax havens, will end the practices that allow for so much secrecy in relation to who owns what assets and companies. In effect, what is going on is the building of a new global environment for governance of the extractive sector.

All of this is entirely appropriate. I like to make the argument that resource extraction companies are a bit like banks in that both are custodians of other people's assets. And if you're a custodian of other people's assets, you have to know that you're going to be held to higher standards of scrutiny than, say, a manufacturing company. For the banks, we've had 50 years of building the governance for that. But the extractive industries, which are the custodians of the natural assets that belong to citizens of very poor countries, are just at the start of building that governance process.

The bottom line is that I think African governments won't be able to get away with plunder as usual as it were.

### **'Effective organisations' and the South African private sector**

I want to say something about the private sector, and especially the South African private sector, because the other component to growth in Africa that has been really missing is what I want to call effective organisations—organisations that manage to increase the productivity of ordinary people.

Before 1750, the basic rule was that people would work hard to produce the equivalent of about \$2 per day in value. Back then, that was true everywhere, but it is still true of much of sub-Saharan Africa. In the developed world, however, people working in and with effective organisations generate \$100 a day in value.

We have known the basic principles of where productivity comes since Adam Smith, who showed us that it is the result of two things: scale and specialisation. There is a famous passage at the start of *The Wealth of Nations* about pin factories, and how scale makes people more productive, because they can reap economies of scale, while specialisation allows people to acquire specialised skills rather than having to be jacks-of-all-trades.

But both scale and specialisation come with downsides. Scale for example makes it much harder to motivate people. If you're in an organisation of three people, it is very hard to slack off without somebody noticing and complaining; if you're in an organisation of three thousand people, on the other hand, that is entirely possible. Specialisation also comes with a downside: if everybody is in a little silo, who coordinates the silos?

So effective organisations are actually management teams which have succeeded in reconciling scale and specialisation with motivation and coordination. The main technique they use for both of these is to get people to internalise the overall objectives of the organisation so they see the big picture, which motivates and incentivises people accordingly.

In the rich world, all organisations are effective because the ineffective ones have been driven to bankruptcy in the private sector, and electoral anger has eliminated them in the public sector. But in Africa, effective organisations are still scarce: in the private sector, most people work in small informal

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organisations, while in the public sector, profound inefficiency is the norm rather than the exception. Africa is desperately in need of more effective organisations.

This is an area in which South Africa, and South African business in particular, has a very big advantage in their quest for expanding into Africa. In doing so, it will bring effective organisations to African economies while also diversifying away from South Africa-specific risk. This will be good for both African economies and South African businesses. But as they expand into Africa, South African businesses can also do something else: they can carry their skills over to the public sector.

By virtue of being effective organisations, South Africa's corporates must know how to motivate people and coordinate their activities. So much so, that I bet you don't even think about it most of the time. But Africa's public sector hasn't learned how to do these things. And the results are often devastating. I saw this in Ghana, for example, where AngloGold Ashanti, a major gold mining company, discovered that there was a problem of malaria in their area and decided they'd better do something about it. They did this for purely self-interested reasons: malaria affected their workforce and reduced productivity. But the only way to deal with malaria was to run a programme for the whole area, not just for their own workers. And, over four years, they brought the incidence of malaria down by about 70 per cent.

They were so successful that the Global Fund to Fight AIDS, Tuberculosis and Malaria noticed the results and came to them and said, 'You've done this for your neighbourhood, we want you to do it for the whole of Ghana.' At which point, perfectly reasonably, the company said, 'Actually, we are a gold mining company. If you want to lower the incidence of malaria, why don't you go to the Ministry of Health?' To which the Global Fund responded, 'We tried that and it didn't work. Why don't you come with us to the Ministry of Health and see what they say?' So they went along begrudgingly to the Ministry of Health in Ghana, where the Ministry said, 'We tried, we can't do it. We just don't have the organisation to do this. Will you please do it for us, using the Global Fund money?' Which is exactly what they are now doing.

Now, in one sense this is crazy. But in another sense, what's being recognised is that an effective organisation with effective management teams can outperform an ineffective organisation even in an area for which it is not specialised. Is this a good idea for AngloGold in Ghana? Well, I don't know. But I'll say this for it, next time they get into dispute with the government of Ghana, they'll have an awful lot going for them.

More importantly, I think that what this example shows is the importance of challenging some of the premises of the model governments have for the delivery of public services.

## Government, business and public services

It's quite clear to me that states have to be responsible for the provision of public services. But what that means, really, is that they are responsible for financing it. They don't necessarily have to provide

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it. Of course, there are needs across society that have to be met: education, health, water, a range of things. The key is to realise that there is no great virtue in any particular mode of how that is supplied. It has got to be publicly-financed, indeed, but how it is supplied is not part of social democratic principles at all. It is only in the interest of public sector unions, who are a particular special interest group, to supply it within the public sector.

This isn't how it's seen in many places. In fact, a lot of sub-Saharan Africa has been in thrall of the 1950s European model of what a state should look like. But this seems completely inappropriate when their organisations are so ineffective. Indeed, we now realise that there was a very particular set of circumstances in Europe in the 1950s, and that the model of the state that emerged was an historical peculiarity, not a gold standard of how to deliver public services.

Of course, the principal social benefit that business provides lies in jobs created and taxes paid. Nevertheless, I think it is true of much of Africa that public organisations are less effective than those of corporations. Indeed, businesses' biggest asset is that they are effective organisations—that they know how to run things—much better than the government. Government struggles with motivating staff, struggles with holding other people accountable, and so on, more than businesses do. By contrast, corporates have generally cracked the big challenges of management. If those capabilities were to spread to the delivery of public services, Africa would become a much better place to live.

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