



Odili Donald Odita
Fusion, 2006
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The case for investing in Africa

The continent is now growing much more rapidly than the OECD nations. It may well be on the cusp of a reversal of fortunes.

Paul Collier

Most international businesses are still not very aware of Africa's investment opportunities. Information costs are high: Africa is fragmented into many different countries, and even in aggregate the continent is a fairly small economy. For several decades, investor ignorance did not matter: with few exceptions Africa's economies were too badly run for there to be many opportunities for firms of integrity. But there has been a sea change—Africa is on the move. There will be ups and downs, but investors from the countries of the Organisation for Economic Co-operation and Development (OECD) who remain set in their ways may be missing a giant business opportunity if they fail to pay attention to the changes afoot.

The situation in Africa quietly began to change during the period 1995–2005. Profound macroeconomic reforms tamed inflation and opened economies to international trade. More patchily, the regulatory environment facing international business also improved. Public ratings, such as the World Bank's *Doing Business* surveys, enabled African governments to benchmark their performance and began to put pressure on those that were recalcitrant. As the global commodity boom built to its 2008 crescendo, many African countries were well positioned to harness the spike in their export revenues for growth beyond the resource extraction sector itself.

That upturn in national growth rates was mirrored in the increased profitability of companies operating in Africa. Indeed, three distinct sources of data indicate that returns on investment are higher there than in other regions. One was a comprehensive study of the publicly traded companies oper-

ating in Africa for the period 2002–07, mostly in the manufacturing and services sectors. It found that these companies' average return on capital was around two-thirds higher than that of comparable companies in China, India, Indonesia, and Vietnam. Another source, on the foreign direct investment of US companies, showed that they were getting a higher return on their African investments than on those in other regions. Finally, analysis of a series of surveys of several thousand manufacturing firms around the developing world found that, at the margin, capital investment had a higher return in Africa.¹

This was the scene in the years leading up to the global crisis. Although its origins had nothing to do with the continent, the crisis did not bypass Africa. Its effect was to collapse commodity prices—for example, the price of oil initially tumbled by more than \$100 a barrel. More subtly, the international appetite for risk collapsed, and since Africa is still generally viewed as the riskiest region, investors got scared; for example, international banks curtailed letters of credit to African exporters far more drastically than to those in other regions.

These effects were severe. However, with a few exceptions—inevitable in a region with so many countries—Africa weathered the economic storms well. Led by its two largest economies, South Africa and Nigeria, most countries had built prudent fiscal positions: in a remarkable break with its past, Nigeria had freed itself from debt and built up over \$70 billion of foreign-exchange reserves. Further, the adverse impact of the crisis through commodity prices lasted less than a year for Africa. Globally, commodity prices rapidly bounced back

¹ Paul Collier and Jean-Louis Warnholz, "Now's the time to invest in Africa," in "20 breakthrough ideas for 2009," *Harvard Business Review*, January 2009.

and seem to have stabilized around levels markedly higher than those in the decades before the boom, underwritten by growing Asian economies and their corresponding need for commodities.

Revenues from commodity exports have been augmented not just by high prices but also by the resource discoveries that high prices have triggered. Yet the recent discoveries are merely the beginning: the scale of what is likely to happen is not widely appreciated. As I show in *The Plundered Planet*, Africa is the last major region on Earth that remains largely unexplored. In the long-explored countries of the OECD, the average square kilometer of territory still has beneath it around \$114,000 of known subsoil assets, despite two centuries of intense extraction. In contrast, the average square kilometer of sub-Saharan Africa has a mere \$23,000 of known sub-soil assets. It is highly unlikely that this massive difference is due to a corresponding difference in what is actually there. Rather, the difference in known assets is likely to indicate an offsetting difference in what is awaiting discovery.

It is reasonable to suppose that what is actually under the soil in the average square kilometer of Africa is at least as valuable as what is known still to be available in the OECD. An implication is that once these untapped resources have been discovered, Africa's commodity exports will be around five times their present level. In turn, this has three profound implications. One is that many of the countries in which resources are discovered will be those that currently are not significant resource exporters: the economic map of Africa will change quite drastically as new opportunities open. A second is that such a radically higher level of commodity exports across the region will support correspondingly larger economies. The final implication is that in the process of getting to this much higher level, Africa will have a prolonged phase of rapid growth.

Now for the reality check. During the commodity booms of the 1970s, Africa also had a wave of resource discoveries. With a few exceptions, most notably Botswana, these opportunities were not harnessed for transformative growth. Indeed, the more common experience was an ugly and costly political contest for control of the revenues. If history repeats itself, the forthcoming much larger wave of resource discoveries in Africa will leave a legacy of scarred landscapes and scarred lives.

Yet the contrast between Nigeria's dysfunctional management of its first oil boom of 1973–83 and its brilliant management of the second boom of 2003–08 cautions against the gloomy cynicism that until recently bedeviled investor thinking about Africa. The road to economic transformation is undoubtedly likely to be a bumpy one, but many African societies have learned both from their own histories and from the prosperity of other once-poor countries. Unlike the externally dictated structural-adjustment programs of the 1980s, the key struggles over economic policy will be internal to African societies. They will not all be won, but nor will they all be lost: some societies will decisively adopt progrowth economic strategies.

To date, Africa has lacked the spectacular regional role models of economic success that so benefited Asia. But it is now starting to get them. Even in Rwanda, a landlocked, crowded country lacking in natural resources, a leadership committed to economic transformation has been able to sustain a growth rate of 10 percent. In some of the countries with more favorable fundamentals, even faster growth rates will be sustained. Such successes will have a profound influence on the neighbors, just as occurred in Asia.

As in Asia, I doubt that there will be a close correspondence between the struggles for democracy and the struggles for economic transformation. The struggles for democracy do indeed have an impor-

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tant economic dimension: many African rulers have accumulated excessive personal power and abused it to sacrifice the common good of national prosperity for narrow sectional self-interest. But more recently, some African leaders, such as President Museveni of Uganda, President Kagame of Rwanda, and Prime Minister Meles of Ethiopia, have built strong credentials for a commitment to the economic transformation of their societies while being somewhat hesitant democrats. Some of Africa's coming economic successes will be in societies that have won the struggle for accountable democratic government. But others will be in societies in which autocratic leaders have become ambitious for national goals rather than merely for power and privilege; expect some African repetitions of Malaysia's experience.

Africa's economic potential extends well beyond commodity exporting. Per capita GDP in China is already above the global average, so its days as the low-wage factory of the world are limited. Africa will soon be the last remaining major low-wage region. It has an enormous coastline, more proximate to both European and North American markets than Asia is. Over the past three decades, offshoring

shifted labor-intensive manufacturing from the OECD countries to Asia. In the next decade, expect the same process to begin shifting these activities from Asia to Africa. Contrary to fears that the "Dutch disease"² must inevitably make nonresource exports uncompetitive, the Asian examples of Malaysia and Indonesia have demonstrated that successful exporting of natural resources can be entirely compatible with successful exporting of light manufactures.

From African independence, beginning in the early 1960s, until around the turn of the millennium, the OECD prospered while Africa stagnated. A legacy of this divergent experience is that OECD investors are skeptical of Africa's future. Their skepticism is not shared by the new entrants to international investment, who missed this sorry phase of African economic performance. It may be that Africans will use their history to learn from it, while OECD investors end up being trapped by it. Africa may be on the cusp of a reversal of fortunes. Indeed, Africa is now growing markedly more rapidly than the OECD. A future of continued rapidly rising prosperity for the OECD looks less assured than it did before the global crisis, whereas several decades of high growth look to be quite a likely scenario for Africa. At present, the typical investment portfolio has massive exposure to the OECD countries and negligible exposure to Africa. This looks unlikely to be appropriate for the coming decades. ○

² During the 1960s, the export of large quantities of newly discovered natural gas from the Netherlands led to an increase in the value of its currency and therefore made other Dutch exports less competitive in international markets.