QUOTE OF THE DAY

That some achieve great success is proof to all that others can achieve it as well.

– Abraham Lincoln, (1809 – 1865) was the 16th president of the US

To escape Brics wall, countries need reforms and political will

MIDDLE-INCOME ENTRAPMENT

George Magnus

In this last instalment of a three-part analysis on the eventual slowing of fast-growing economies, I argue that emerging economies, including China, will stall on a development plateau until they switch to more advanced economic models. If a nation does not shift from basic mobilisation models, it remains stuck in the wrong gear for a new terrain. How can a stalled emerging economy break out?

ANOTHER way of thinking about China and the Asian miracle is to consider the wider universe of emerging markets. Specifically, what happens to the dynamic of rapid growth and human development as Asia inevitably slows down?

We know growth slows with maturity, but many countries tend to stall, in terms of income per head, in a "middle-income trap".

The critical level seems to be around per capita income of about $15 000 at today's prices.

This isn't the end of growth. But to break out of the middle-income trap, or to jump over the Bric wall as we might say, countries that have exploited more basic models of growth need to adopt "smarter" economic models.

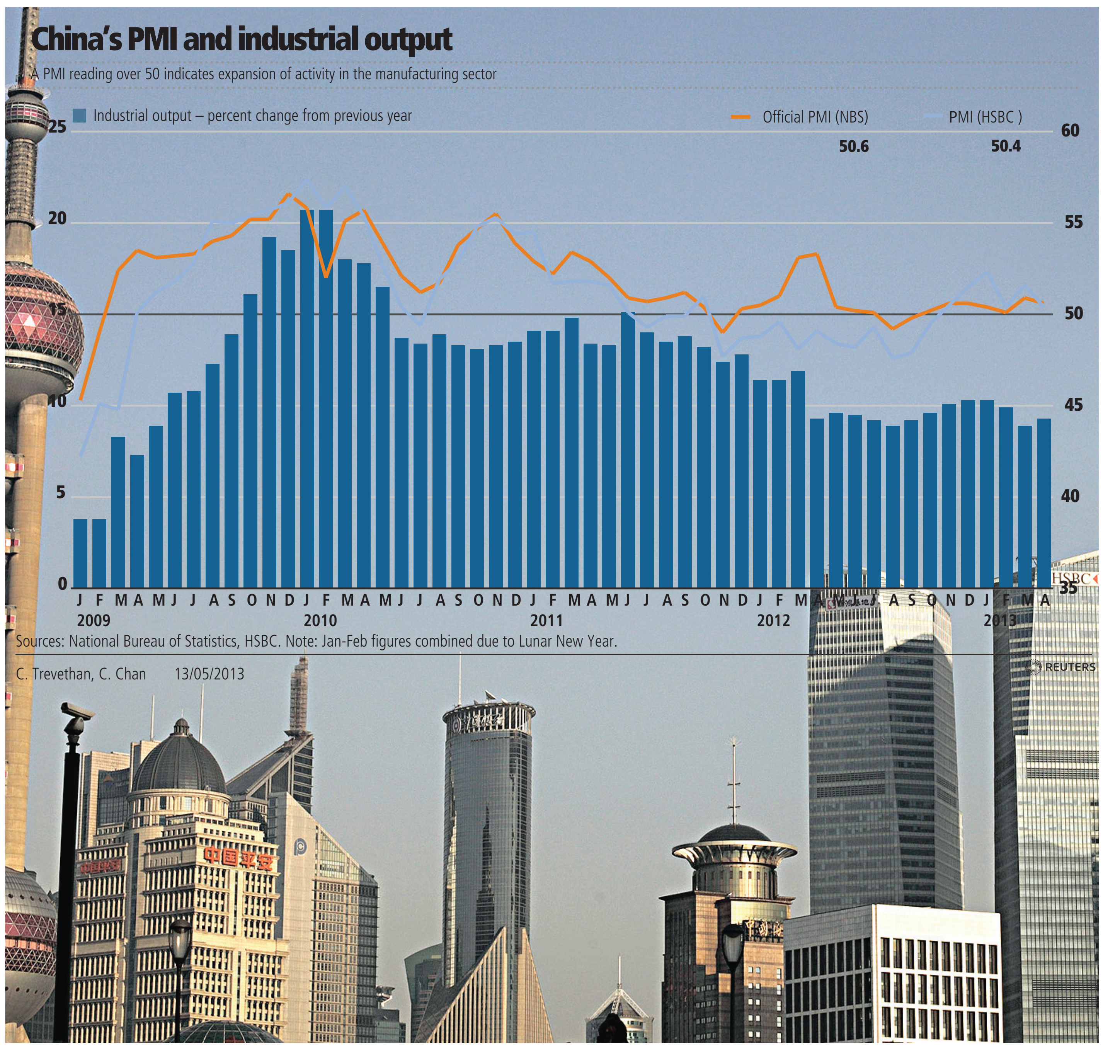
These models must be designed to nurture total factor productivity, innovation and modernity.

Scaling the wall is possible, but it isn't about spreadsheets or economic forecasting. Rather, it is about politics, rules-based systems and an array of economic and social institutions that re-energise economic growth.

By comparison, exploiting things like labour transfer to urban manufacturing and gains from importing foreign technology are the low-hanging fruit. Plus, they have been largely exhausted.

For many emerging markets, this isn't an academic challenge anymore. They realise that the rise in total factor productivity growth in the decade to 2008 has slowed considerably, notwithstanding the 2010 bounce.

In China, it has halved from about 4 percent to about 2 percent. India, though much poorer, has seen total factor productivity slow to a stall.



Indonesia and Turkey were the only major emerging countries where more narrowly specified labour productivity growth this year is expected to be comparable to the period from 2006 to 2011. But the trend pretty much everywhere is down.

By looking at the maths of economic growth and the number of years that countries have retained their status as "lower-middle income" or "upper-middle income", the Levy Institute has observed that there were 52 middle-income countries in 2010, of which 35 were "trapped".

South Africa, classified as lower-middle income, was one of those trapped nations, along with another five countries in Sub-Sahara Africa.

Three trapped countries were in Asia; 13 in Latin America; 11 in the Middle East and North Africa; and two in emerging Europe.

The Levy Institute said another eight countries were likely to become trapped.

Of the major emerging markets, trapped lower-middle-income countries included the Philippines and Brazil but not India. Trapped upper-middle-income countries included Malaysia and Venezuela but not China.

The exclusion of India and China is partly because they haven't been in their income bands for very long. And partly it is because the economic potential for progress is relatively robust.

The key point, though, is realising the potential that exists and monetising the consequences. And that's about political will and reform.

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Empirically, the chances of slower economic growth leading to "entrapment" are linked to a number of important developments. These include:

- Per capita income of about $15 000;
- A recent history of rapid economic and investment growth;
- Elevated levels of manufacturing employment;
- A rising old-age dependency ratio;
- Rising financial instability and indicators of stress on the balance sheet; and
- The exhaustion of rural-urban labour transfer and other characteristics of "catching up" (for example, educational attainment and technological capacity).

Extremes of income inequality are also increasingly viewed as a contributor to entrapment.

Political and social implications aside, extremes of income inequality may restrict consumption, especially of discretionary goods and services such as education. They may result in tensions that compromise sound macroeconomic management and lead to permissive credit conditions.

They can be associated with degrees of capital flight and sustain overly high savings and investment rates, retarding structural change and increasing risks for financial instability.

The 14 countries that avoided hitting the Bric wall over the past 50 years shared a common characteristic of relatively low income inequality.

Their average Gini index was 33, in a range between 26 and 39. In today's high-income aspiring group of emerging countries, none has an index below 40 and the average is 46.

The World Bank and the Chinese State Council's Development Research Center noted in their China 2030 report last year that, of the 101 countries or territories that were classified as middle income in 1960, only 13 jumped the so-called Bric wall. These included Singapore, Hong Kong, South Korea, Taiwan and Japan.

In contrast to such countries as Mexico, Venezuela, Argentina, Uruguay and the old Soviet Union, these countries implemented political reforms to produce desirable economic behaviour, more efficient organisation, political checks and balances, penalties, and incentives.

They built trust and rules into their national institutions, including good governance on the macro, corporate and social levels; property and land rights; and the rule of law.

And they successfully switched to "smarter" economic development models, strengthening educational attainment levels at secondary and tertiary levels.

That, in turn, facilitated their capacity to extend their technological frontiers.

They lowered levels of income inequality, strengthened social and income support for poor urban and rural workers, and realised strong gains in total factor productivity from a sharper focus on entrepreneurship and innovation.

It isn't an accident that the high-income club is small, or that jumping the Bric wall is hard. Of the International Monetary Fund's 180 members, only 35 are considered high income.

Of the World Bank's universe of 214 countries, islands and territories with populations over 30 000, a total of 36 are low income, 108 are middle income (split roughly down the middle between lower-middle income and upper-middle), and 70 are high income.

Of the World Bank's high-income economies, only 35 have incomes above $20 000 per person.

This sort of distribution hasn't changed a great deal in 60 years, and longer.

Editor's note: George Magnus is an independent economist and an adviser to UBS and other investment banks. This article is provided as a courtesy by The Globalist (www.theglobalist.com), the daily online magazine on the global economy, politics and culture. Follow the discussion on this article on Twitter: @theglobalist and @busrep

Q&A: JICA dispels myths to bring private firms to Africa

INVESTMENT APPEAL

Londiwe Buthelezi

Conversation with Dr Akihiko Tanaka, the president of the Japan International Co-operation Agency (JICA)

JAPAN is one of the Group of 8 countries that have been pledging money for the development of the African continent. JICA, in particular, provides technical co-operation and other forms of aid promoting economic and social development throughput Africa.

We caught up with Dr Akihiko Tanaka during the Cape Town seminar on the fifth conference of the Tokyo International Conference on African Development (TICAD V), which will take place in the city of Yokohama, Japan next month.

Londiwe: What opportunities are there for Japan to further contribute in accelerating the continent's development and is it aid or trade that needs to be fast-tracked?

Dr Akihiko Tanaka: There are two interrelated issues. One is the necessity of peace and stability. The other is how to create an economy and society that could really develop.

So what we can actually do is a continuation of what we have been doing. JICA is very active in the infrastructure development, agricultural development, basic education and promotion of health.

In certain countries these are helpful in the establishment of peace and stability, but in other countries these create a basis on which real economic development continues.

Londiwe: The Japanese government wants to promote private companies' investment into Africa. How do you plan on doing that? What sort of incentives do you intend to offer?

Dr Akihiko Tanaka: One basic thing that agencies like us should do is to provide funds and basic knowledge to create conditions that are conducive for investment. If a country is deficient in basic transportation, power supply, water supply, then private companies do not consider it an attractive place for investment.

So what we should do in those circumstances is to provide funds for the recipient governments to fix those infrastructure problems.

The second area to persuade a private company to come to a certain country is to provide information on that particular country. At JICA we try to disseminate information on Africa to many prospective investors in Japan. TICAD V is an opportunity to expose the Japanese private sector to the reality of Africa. We would like African governments, including the South African government, to help us disseminate the information.

Londiwe: What does Africa, and particularly South Africa, need to do to increase its appeal to Japanese firms to attract their investment?

Dr Akihiko Tanaka: Part of the current reluctance about investing in Africa is because of a lack of information. The provision of the correct information would increase interest among the prospective Japanese investors. Unfortunately, the image of Africa created in the 1990s still persists even now.

There may be some misperceptions within the Japanese private sector because of the diversity and vastness of Africa as a continent. This doesn't affect big global businesses much, but some small and medium industries may consider that coming to South Africa may be dangerous because some Japanese were killed by terrorist attacks in Nigeria.

Londiwe: In other words, you've seen it in Japan where people say that some investors see Africa as a country as opposed to a continent and they don't understand that what happens in Nigeria may be totally different from what happens in South Africa?

Dr Akihiko Tanaka: Not everyone is affected by this kind of misunderstanding, but then there are still some misunderstandings. So I think provision of the correct information is very important.

Londiwe: Which other sectors can Japanese firms invest in to diversify Japan's interest in Africa and move away from being a player only in the resources and manufacturing sectors?

Dr Akihiko Tanaka: The Japanese economy covers many industries. Resource related industries have natural tendencies to invest where resources are. Manufacturing giants like Toyota or Nissan invest in countries where the market is very big and promising.

Small and medium enterprises may find it interesting to invest if their technologies are useful for countries in Africa. So there may be some areas depending on the necessary technologies here and the existing technologies in Japan.

One possible area is water business. Purification of water, creating a water supply system that has a small amount of drainage may be an interesting area to pursue because in many developing countries, water supply system is inefficient in a way that 30 percent to 40 percent of water is lost through leakages.

In Tokyo, the leakage percentage is only 3 percent.

Japan on charm offensive, sets out to double trade with Africa

Londiwe Buthelezi

JAPANESE international relations bodies are trying to increase the country's business interests in South Africa and have set a target for Japanese business to double trade in Africa in a couple of years.

This comes amid the influx of cheap Chinese imports into Africa and a decrease in the importance of Japan as South Africa leans towards its emerging market trading partners in Brics.

In trade with South Africa, Japanese firms have lately been losing their edge to Chinese and Indian businesses. In the automotive sector, South Korean firms are fast overtaking those of Japan.

The country is now considering incentivising its private sector to invest in South Africa as a way of maintaining ties amid an intensification of trade within the Brics economic bloc, which is made up of Brazil, Russia, India, China and South Africa.

Akihiko Tanaka, the president of the Japan International Co-operation Agency, said that in order to boost the business partnership between Japan and Africa, the agency wanted to promote private sector investment into the continent, not only by big multinational companies but by small businesses too.

Tanaka said smaller private companies in Japan were reluctant to invest in Africa because of the continent's ugly image, which was painted in the 1990s when civil wars and terrorist attacks were widespread.

"But the relative lack of interest in Africa from the late 1980s to 1990s was also due to the boom of Asian economies," said Tanaka.

Akihiko Tanaka, the president of the Japan International Co-operation Agency, says that in order to boost business partnerships between Japan and Africa, the agency wants to promote private-sector investment into the continent, not only by big multinational companies but small businesses too. PHOTO: SUPPLIED

These Asian economies have grown tremendously since then, and their productivity levels have increased so much that their goods now compete with Japanese for export destinations.

Although Japan was South Africa's fifth-biggest source of imports and the third-biggest export destination last year, the trade balance between two countries decreased to R6.3 billion last year from R23.07bn in 2011 as South Africa exported less to Japan.

In 2011, there were 108 Japanese companies in South Africa, including vehicle makers Toyota and Nissan, as well as a handful others in the power generation and resources space. Japan has been providing financing facilities to South African companies in the form of export credit lines and these have amounted to more than $1.2bn (R11bn) since 2007. Export credit lines had been extended to the Development Bank of Southern Africa and state-owned companies Eskom and Transnet.

South Africa and Japan have a number of bilateral frameworks for dialogue and co-operation. The Japan-South Africa Partnership Forum has four dialogue platforms: the Japan-South Africa Business Forum; the Joint Trade Committee, which focuses on the development of small and medium enterprises; the Japan-South Africa Science and Technology Joint Committee Meeting; and Consultation on Development Co-operation.

Tanaka and the Japanese ambassador to South Africa, Yutaka Yoshizawa, said they would build on these to facilitate more investment into the country.

"Africa is valuable, not only for the world in general but more so to Japan," said Tanaka. He said that in his view, the growth centre of the global economy was beginning to shift from the Pacific region to a much broader area, which he called the "indoor Pacific region".