

# Real or “Portal” Growth: Why Businesses Are Going Bust and People Are Struggling to Make Ends Meet as the Numbers Say the Economy Is Roaring like an Asian Tiger

Did the economy really grow by 6.3 per cent last year, or is someone pulling wool over our eyes? Or as we say these days, is it real growth or the one you have to log into the #GoKDelivers portal to see? When the figure was first disclosed by Uhuru Kenyatta in his State of the Nation address last month, I received a call from a very disturbed Nairobi businessman who challenged me to explain to the public, in language they can understand, how the economy can be said to be growing as fast as it was during the Kibaki years yet businesses are collapsing and ordinary citizens can barely make ends meet. As it happens, my very first op-ed of this, my second stint as a columnist (I wrote a weekly column for the Sunday Nation in the mid to late 90s), published in January 2014 and titled *Why you are struggling to make ends meet*, was on this very subject.

One of the observations that has led people to question the 6.3 per cent growth is the poor performance of big companies. Year after year, listed companies are issuing profit warnings. There is now hardly a listed company – other than banks – that has not issued a profit warning over the last three years. Is it possible for the economy to grow while businesses are making losses? The answer is yes.

To see how this could happen, we need to understand what GDP

actually is and how it is computed. GDP is short for Gross Domestic Product, which means the quantity (not value) of all goods and services produced in an economy. Sukari Mills is a sugar producer. In 2017, Sukari produced 20,000 tonnes of sugar, down from 25,000 tonnes in 2016, due to drought.

In 2018, production recovers to 25,000 tonnes. Trouble is, during 2017, the government opens the duty-free import window, and “tenderpreneurs” inundate the country with (contaminated) sugar. Consequently, in 2018, Sukari suffers both depressed prices and depressed sales, and posts a huge loss. The GDP accountants will capture the 25 per cent increase in production, as well as the economic activities created by the imported sugar, that is, the transportation, warehousing, packaging and distribution. Sugar GDP will be up big time, even as Sukari and other millers chalk up losses.

The recovery of the agricultural sector from drought is in fact the story behind the 6.3 per cent growth figure. Agricultural sector GDP grew 6.4 per cent, just about the same rate as the economy. But it was all recovery growth since the sector had slumped from 4.9 per cent in 2016 to 1.9 per cent in 2017.

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Looking at the actual production of some principal commodities, we see that coffee, sugarcane and milk are well below 2016 levels and that tea is only 4 per cent higher. Only maize production is well above the 2016 harvest (see table). Moreover, while production increased, prices for most products were lower in 2018. Maize led the way with prices down 56 per cent, from Sh4,000 to Sh2,260 per bag. Coffee prices were down

15 per cent while tea, sugar and milk prices were down by between 6 and 9 per cent. But as observed, GDP growth only captures volume, not value – hence the fact that milk farmers are suffering from depressed prices will not be reflected.

	2016	2017	2018	2016-17,%	2017-18, %	2016-18,%
Maize (bags, million)	37.8	35.4	44.6	-6	26	18
Coffee (tonnes, '000)	46.1	38.7	41.4	-16	7	-10
Tea (tonnes, '000)	473	439	493	-7	12	4
Sugarcane (tonnes, '000)	7,151	4,751	5,262	-34	11	-26
Milk (litres, '000)	648	535	634	-17	19	-2

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Because agriculture is the single largest sector, accounting for a third of the economy, what happens to agriculture has a big effect on the overall GDP growth figure. This year’s long rains were late, and have been poor – another challenging year for agriculture. Next year the story may be the opposite.

It is readily apparent that a number that fluctuates with the weather is not an ideal measure of economic

performance. In fact, in economics this is not what we mean by economic growth – we refer to it as “change in output”. It is useful for studying macroeconomic policy on managing inflation and the like, but not as a measure of progress towards prosperity or lack thereof. For prosperity questions, we are interested in how two – often very similar – countries start out at an income level of \$500 per person and twenty years on, one is at \$1,500 and the other \$5,000. This boils down to the following simple question: how countries raise productivity. Let me illustrate.

*Land is the ultimate finite resource, and when you use it for one thing, it not available for another. Material inputs, fertilizers, tractors, irrigation systems, etc. require us to save and invest, and there is a limit to how much we can save. The whole point of saving and investing is to consume more tomorrow, but starving oneself today in order to eat endlessly tomorrow does not make economic sense.*

Nanjala, a maize farmer in Busia produced 100 bags of maize last year on ten acres of land. This year she has produced 120 bags. There are a number of ways in which she could have done this. I'll focus on three. One, she could have obtained the additional 20 bags from tilling two more acres of land. Two, she could have applied more fertilizer on the ten acres and increased her yield to 12 bags per acre. Three, she could have adopted a new high yielding variety that gives 15 bags per acre, meaning that she obtained the 120 bags from tilling eight acres. To till more land, it stands to reason that she would have had to use more labour as well. It is also the case that if she used more fertilizer, more labour and more capital were also used. But the case of adopting new high yielding seeds is different. The additional 20 bags were obtained by using less land, less fertilizer and even less seeds. The only additional input is knowledge, that is, the science and research resources that developed the new seed variety.

It is not too difficult to see that we cannot sustain growth by using more resources. Land is the ultimate finite resource, and when you use it for one thing, it not available for another. Material inputs, fertilizers, tractors, irrigation systems, etc. require us to save and invest, and there is a limit to how much we can save. The whole point of saving and investing is to consume more tomorrow, but starving oneself today in order to eat endlessly tomorrow does not make economic sense.

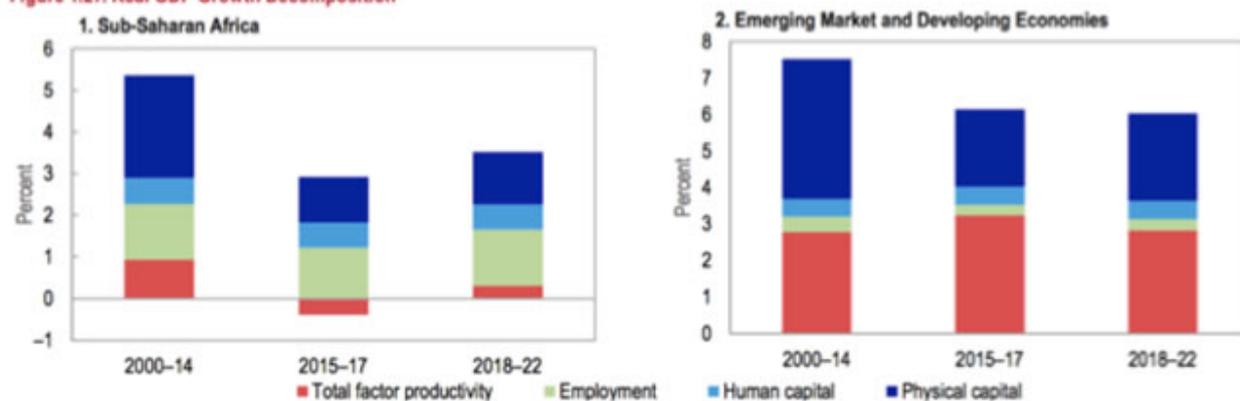
Knowledge is different. New knowledge and technology enable us

to do more with less. And once new knowledge is introduced, in this case a seed variety, its benefits will spread widely at little or no cost; word of mouth is sufficient to spread the news about Nanjala's 15 bags per acre all over Busia County. In economics, we say that consumption of knowledge is non-rivalrous. We can't farm the same land, but we can share seeds. In today's tech parlance, we say that it has high scalability.

In economic accounting, we call the growth associated with more material inputs factor accumulation. The growth that remains after we have accounted for factor accumulation we refer to as total factor productivity (TFP). TFP is the growth that enables a society to become wealthy over the long haul. If we were to rely on tilling more land to feed the burgeoning population we'd wake up one day and find that we've cleared the entire Mau forest – which is where we are headed. If we are to rely on irrigation and other material inputs we will, sooner or later, run out of water and drown in a mountain of debt – which is where we are headed.

But TFP is not reported in the GDP growth headline news, and you cannot see it in the data unless you know where to look. We need to do a number-crunching exercise we call growth accounting, which decomposes the growth into its sources, namely capital accumulation, labour force growth and TFP. I do not have growth accounting analysis of Kenyan GDP readily available but as it happens, the most recent edition of the IMF's Africa Regional Economic Outlook published this past April has just what we need.

Figure 1.27. Real GDP Growth Decomposition



The chart shows Africa's and Asia's growth decomposed into physical capital, human capital and TFP. These three components are what I defined earlier as factor accumulation. Human capital is "proxied" by the change in average years of education in the workforce. By proxy we mean that it is not the actual human capital but the closest data we have that approximates it.

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The red segment at the bottom of the bar is the TFP while the green, light blue and dark blue segments above represent growth attributable to more workers (or labour force growth), more human capital (better educated/skilled workforce) and more physical capital (infrastructure, machines, etc.) respectively, all of which add up to factor accumulation. But the IMF has its colours the wrong way round. The red ink is what corresponds to profit in a business, while the blue ink is capital expenditure, a cost. The red ink is what pays the bills.

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From 2015 onwards, Africa's productivity growth has slumped to 3 per cent per year, and productivity growth has turned negative. This translates to investing more and getting less output per unit of investment. If we go back to Nanjala's farm, it is the equivalent of increasing acreage from 10 to 12 acres but getting 108 bags, meaning that average yield has declined from 10 to 9 bags per acre. While Asia's economies have also slowed down a little, productivity growth has actually increased to 3 per cent per year and, in fact, it is investment in physical capital that has slowed down the most.

The seemingly small magnitude of this divergence in productivity growth is deceptive. An economy where incomes are rising by three per cent per year doubles its income in 25 years; the one per cent economy will take 70 years. This is precisely the difference in growth rates that has left people asking how the Asian Tigers left us behind. *Plus ça change, plus c'est la même chose.*

Kenya is typical of the Africa growth story. This analysis is making a point that I have belaboured over the last five years – that we are squandering money on vanity infrastructure projects of little or no economic value. When the government borrows domestically and invests unproductively, it deprives the private sector of the use of those domestic savings on more productive investments. We also do not produce the capital goods that go into these investments. There is no money that comes into the economy when we borrow from China to build a railway. What we are really doing is taking Chinese goods and services on credit, but as every shopaholic knows, the credit card starts burning a hole in the pocket right away. Asia on the other hand, manufactures its capital goods,

hence its infrastructure and other capital investments stimulate and create jobs domestically.

We already know that most of the capital is in public infrastructure with little or no impact on productivity – you need only think of the SGR railway. While the growth accounting analysis shows us the employment contribution, it does not tell us what the expanding workforce is doing. We know that the majority are absorbed in the informal economy where they have little capital to work with, since the government has hogged all the domestic savings, leaving little for the private sector to equip workers with productive capital. While the aggregate data will show that capital per worker is rising, in reality, it is falling since the aggregate figure includes every worker's slice of the SGR railway, for example. Moreover, we do know that our economies are not creating nearly as many jobs as they should. As the African Development Bank's (AfDB) most recent *Africa Economic Outlook* report laments, "the rapid growth achieved in Africa over the last two decades has not been pro-employment". This is a consequence of the infrastructure-led growth paradigm that this very institution bears most responsibility for promoting.

The economies may be growing, but because unemployment and underemployment are also rising, the incomes of those that are earning are supporting more people. People are not feeling the growth. They are feeling the financial burden of adult children who were expected to be contributing to family upkeep.

Next time you hear them trumpeting five, six, seven per cent GDP growth, you know what to show them.