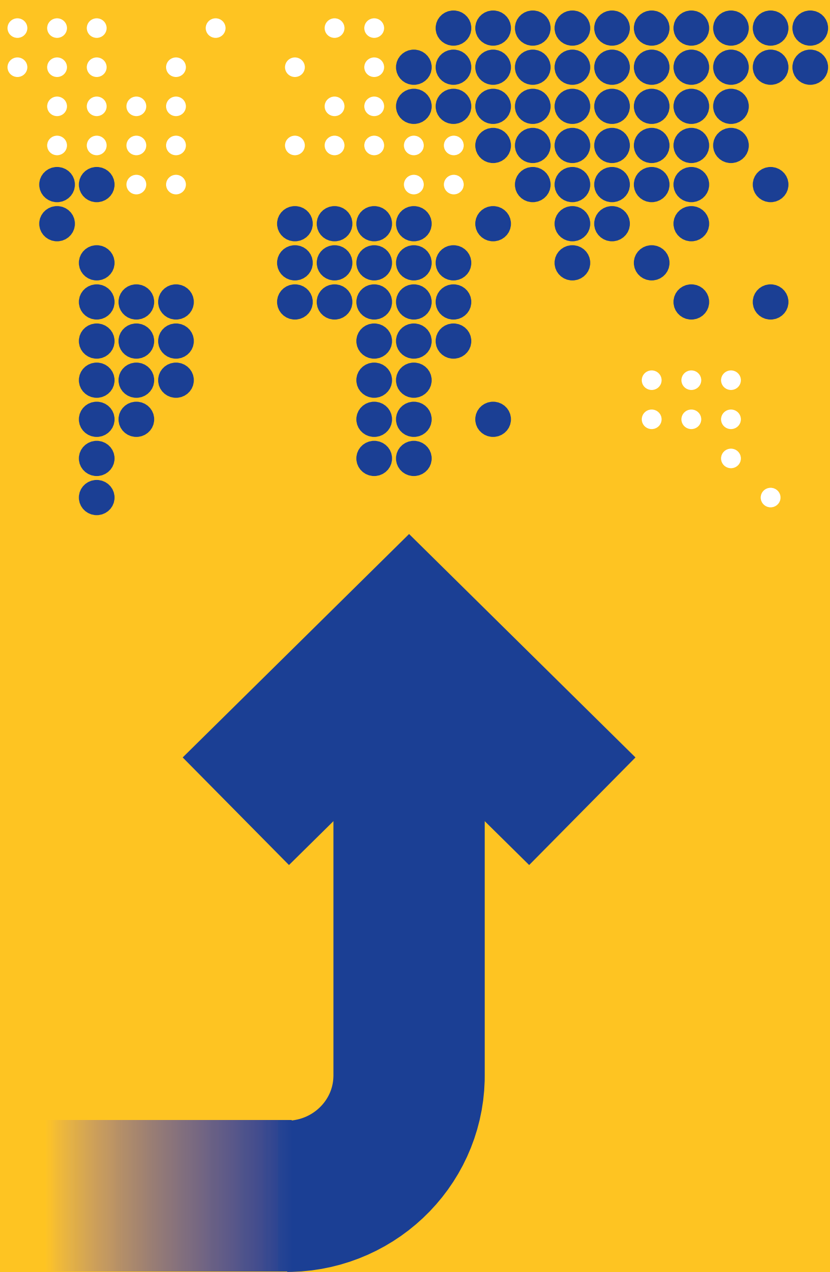


AUGUST 27-28, 2016

JAPAN INTERNATIONAL COOPERATION AGENCY

JICA TICAD VI Policy Papers

Executive Summaries

Prepared by:
Centennial Group International

Preface

The global economic environment at the time of TICAD VI (2016) is much less favorable than that prevailing at TICAD V (2013) when JICA presented a long-term vision—*Africa 2050: Realizing the Continent's Full Potential*—based on Africa's increasing convergence with the rest of the world. These changed circumstances have major implications for African policy makers.

This brochure presents the executive summaries of policy papers which were commissioned by JICA for TICAD VI to draw out these implications and suggest ways to move forward. The papers are:

- *Africa 2050 update*
- *The impact of commodity terms of trade in Africa: Curse, blessing, or manageable reality*
- *Africa's inclusive growth challenge: Reducing deprivation and creating jobs*
- *Infrastructure in Africa*
- *Economic diversification of African economies*
- *Regional economic integration in Africa*

I am confident that the papers will contribute to a fruitful dialogue among the Heads of State at TICAD VI. In addition, we hope that they will foster the concerted action by African policy makers needed to assure that Africa continues to converge with the rest of the world and, in doing so, meets the aspirations of its people.

Shinichi Kitaoka
President
Japan International Cooperation Agency

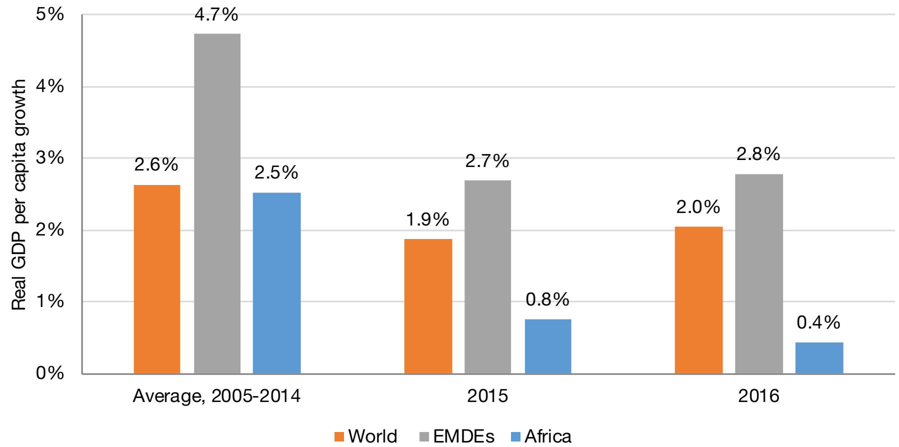
Africa 2050 update

Theodore Ahlers

At TICAD V JICA presented a long-term vision--*Africa 2050: Realizing the Continent's Full Potential*--based on Africa's improved growth performance and increasing convergence with the rest of the world in terms of income and productivity. The global economic environment at the time of TICAD VI is much less favorable and has major implications for African policy makers. This paper looks at actual performance in the three years since TICAD V, presents updated scenarios to 2050, and identifies the big policy issues to be addressed if Africa is to catch up with the rest of the world.

Africa is growing, per capita incomes are rising, and many socio-economic indicators are improving. It is, however, no longer catching up with the rest of the world—converging. As a result, it is not meeting the aspirations of Africans. Policy reforms are urgent if Africa is to converge with the rest of the world and meet the aspirations of its people. Country performance, of course, remains highly variable, and 17 countries have averaged per capita income growth above 3 percent for the last decade. But, in the aggregate, Africa is slipping—its per capita GDP growth has been below the world average since 2010 (Figure 1), and it is no longer on track to realize the results laid out in *Africa 2050: Realizing the Continent's Full Potential*. To the extent that inequality is increasing across the continent, it is largely due

Figure 1: Real GDP per capita growth, 2004-16 (%)



Source: Author's calculations based on IMF WEO (2016) to diverging country performance—some countries are catching up with the rest of the world but many are falling further behind. The performance of the first group shows that convergence is possible in Africa. The challenge is to extend African best practice to more of the continent's countries.

Africa's growth and convergence in the first decade of the century was real and built on solid reforms in many countries. It was also greatly facilitated by exceptional external circumstances: ever-increasing commodity prices, strong global growth, and highly liquid global capital markets. These three exceptional external circumstances have now ended—and are very unlikely to return soon. This is neither unexpected (although the specific timing was difficult to predict) nor necessarily the end to Africa's quest for convergence. Restarting such convergence does, however, mean a return to the fundamentals--more investment and more reform to enhance productivity growth with a focus on inclusion.

Africa's response to these changed circumstances reveals four challenges that loom larger than originally assessed in Africa 2050: commodity dependence, demographics and jobs, savings and investment, and education quality. Commodity exports contributed to fast growth of African countries through 2011 but, as commodity prices have declined, urgent adjustment to macro policy frameworks is now required. The demographic transition is proceeding even more slowly than envisioned three years ago and requires both urgent attention to fertility trends and measures to address the implications for job creation. Both savings and investment levels remain too low to sustain convergence with the rest of the world. Finally, Africa may be winning the school enrollment battle but losing the learning outcome war, which would doom efforts to converge with the rest of the world. If countries do not respond rapidly to these challenges, the gains of the last decade will be lost.

The policy implications are clear. Some countries have managed commodity dependence, accelerated their demographic transition, raised investment levels, and improved the quality of education. Urgent action is needed to generalize these African best practices across the continent. The policy implications may be clear, but success in implementation is not. Capable states and strong, pragmatic leadership will determine the outcome.

The impact of commodity terms of trade in Africa: Curse, blessing, or manageable reality?

Claudio Loser

Africa's trade links with the rest of the world are based on commodity exports. In 2014 commodities represented about 76 percent of African exports, up from 71 percent in 1995. The sharp increase in commodity prices that began in the early 2000s resulted in a marked improvement in terms of trade.

Terms of trade increased by more than 90 percent from 2000 to 2012 for Africa. Since then commodity exporters' terms of trade have declined. Terms of trade still remain higher than they were at the turn of the century, giving the false impression that conditions still favor Africa.

Commodity-driven prosperity has ended or, at best, been interrupted for a long time to come. The reversal of prices is having a major adverse impact on both disposable income and output, through the multiplier effects of lower exports.

Economic growth in Africa has slowed significantly. Average growth rates have declined from 5 percent a year during the period 2000-2012, to 3.4 percent during 2013-15, and further in 2016 (Figure 2). The decline was even sharper among the countries with higher export concentration. For these countries, the average rate of growth was cut in half to 3.1 percent.

The effect of terms of trade on real income is dramatic. For Africa, the direct effect of terms of trade changes on income over the period 2000-12 was a positive 1.3 percent of GDP a year; but in the subsequent 3 years it was a negative 1.5 percent.

In recent years, per capita GDP has risen but at a sharply declining rate and has been consistently below that of the world since at least 2010. Furthermore, per capita real disposable income, which had been growing at an annual rate of about 4 percent, has been stagnant in the last three years. For the highly concentrated exporters, the annual loss in potential per capita income has been at least 1 percent.

Some of these losses have not yet been realized fully because of unsustainable macroeconomic and foreign borrowing policies. These policies cannot be sustained, and the actual losses will catch up even if terms of trade do not deteriorate further. The complacency engendered by relatively high GDP growth rates is misplaced given the very rapid rate of population growth in Africa.

A further decline or even stable terms of trade can be expected to have a significant negative effect on African economies. If terms of trade in Africa were just to stabilize, GDP growth rates would tend to fall to the trend growth rate of 3.6 percent as the multiplier effect would disappear. A further decline in terms of trade of only 5 percent would entail an initial decline in income and a significant decline in the rate of growth in per capita GDP. Moreover, there are only limited prospects for increases in commodity prices in the near or long term.

Countries throughout Africa have reacted differently but in general have followed an unsustainable path. The slowdown in activity is becoming more marked and is being accompanied by declines in reserves and increased borrowing There has also been a clear trend of appreciation of African currencies. This policy approach needs to be modified urgently.

Many policy-makers believe they are choosing between continued growth on the basis of present policies, or painful adjustment, usually imposed from outside. However, adjustment is inevitable. The real choice is between orderly and internationally supported correction, and a disorderly and disruptive crisis if current policies continue.

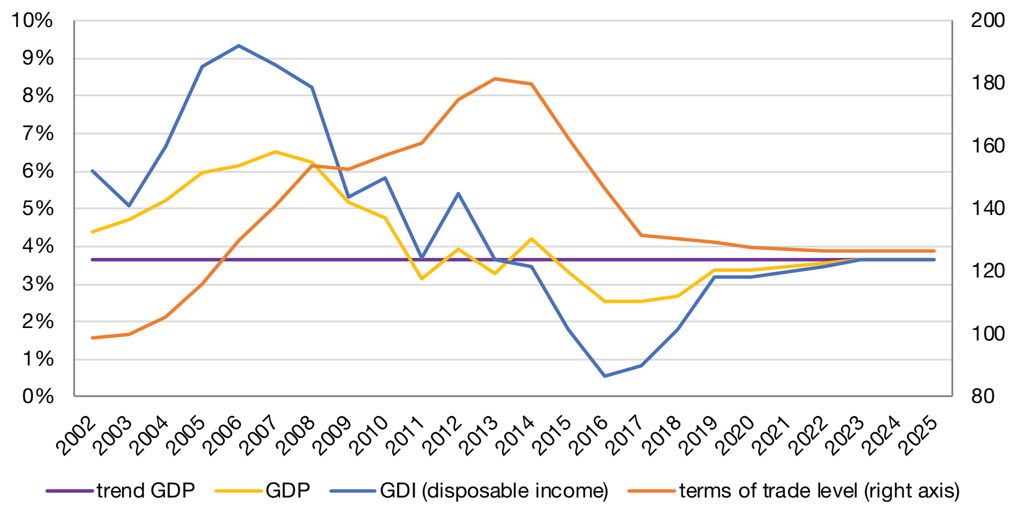
It is imperative for African countries, both highly concentrated exporters or more diversified economies, to focus on macroeconomic sustainability. It is important to promote physical investment and human capital formation. In today's adverse circumstances, and particularly given fragile fiscal positions and mounting debts, these policies are only possible if the economy adjusts to a sustainable path.

Fiscal policies must be put in place immediately to reduce existing public sector deficits and to arrest the increases in public debt and declines in foreign reserves in most of the continent. It is also essential to start designing stabilization mechanisms and wealth management funds which will help consolidate the fiscal situation in the long run.

Monetary policy will need to be highly disciplined to avoid an acceleration of inflation and a weakening of the balance of payments. In addition, African currencies have appreciated, initially on account of high export prices and subsequently from unsustainable capital inflows, so measures to strengthen competitiveness and foster exchange rate depreciation are also essential.

Time is of the essence, and a conscious break with a policy of shortsighted comfort is required. Individual African countries must recognize and address the implications of the current situation for its economy and its citizens, if a sharp and disorderly adjustment process is to be avoided.

Figure 2: Africa income growth rates and terms of trade (3-yr. moving averages)



Source: IMF WEO (2016) and Centennial Group International (2016)

Africa's inclusive growth challenge: Reducing deprivation and creating jobs

Louise Fox

Despite a decade and a half of sustained economic growth, poverty and inequality on the African continent remain high. The share of people living in absolute poverty in Sub-Saharan Africa (SSA) has fallen by about 1 percent a year since 1990, but half of the population still lives in a state of extreme deprivation. Except for households in upper-income countries, most families escaped poverty by raising the productivity of their livelihoods—in other words, by earning more in cash and kind from their economic activities. In South Africa, non-labor income (transfers to poor households) played a major role in reducing poverty even as unemployment remained high.

Most people in most SSA countries have realized tangible improvements in economic well-being. The main exceptions were in the fragile states. Expansion in social infrastructure complemented other growth policies, raising human capital and non-monetary living standards. Most of the gains came from investments in quantity—more schools and health clinics, more teachers and health workers, more books, more vaccinations, more supplies. While access problems persist in low-income countries, in middle- and upper-income countries access to primary education, water and basic health-care services are assured. But social indicators also reveal persistent quality problems, and multidimensional poverty measurements suggest high levels of deprivation continue throughout Africa, especially in rural areas and urban slums.

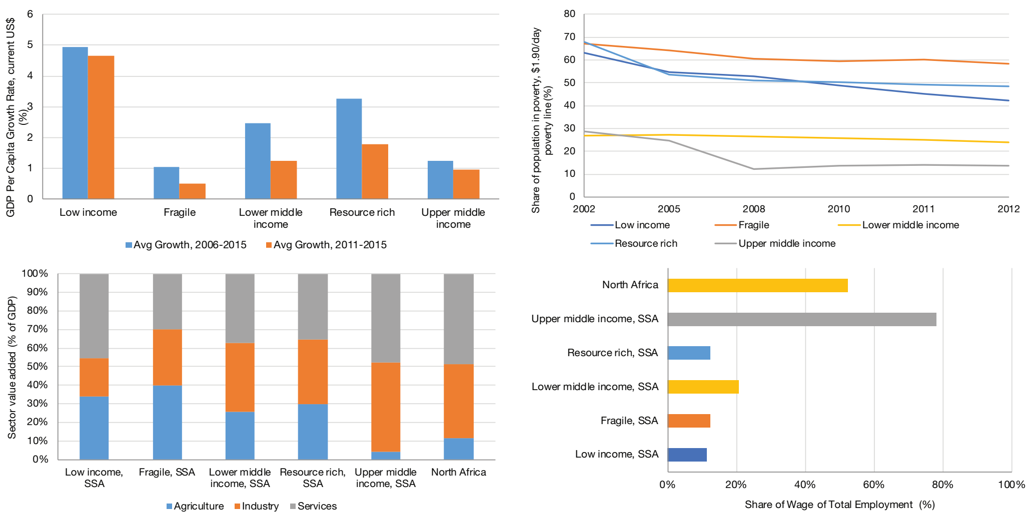
For poverty reduction to continue there must be continued growth in sectors where the poor work. In all but the upper-middle income countries, this means improving productivity in agriculture (family farms as well as larger commercial farms) and in informal household enterprise activities, because less than 20 percent of employment earns a wage. However, to accelerate poverty reduction, all countries need to create more wage employment. The fastest way to do this is by creating and growing labor-intensive non-agricultural medium and large enterprises.

Resource-rich and fragile states face special challenges to inclusive growth. The fall in mineral prices means that resource-rich countries need a policy reset. In addition to macroeconomic stabilization, the challenge for these countries is to spend public money more effectively, providing more public goods to the population. Fragile states need a political settlement in order to reignite growth. Experience suggests that once peace is restored, opportunities for inclusive bounce-back growth will be plentiful.

As the continent with the youngest demographic, Africa faces particular challenges in youth employment. High fertility is creating a major youth bulge, concentrated in the poorest countries. About 2.5 million young people are projected to enter the labor force every year between 2015 and 2025. In poorer countries, most young people live in rural areas and have to work in the same jobs their parents did—in agriculture or small nonfarm household enterprises—as they cannot afford to be unemployed. A successful youth employment policy cannot simply focus on the urban wage economy. It must ensure that young people can earn an acceptable living wherever they work.

African countries need to continue to expand and improve social and economic infrastructure services. In most countries, this means more domestic resource mobilization. It may mean new financing models. But it also means more efficiency and effectiveness in the public sector, especially in lower-middle-income countries where the number of children needing preventive and primary health care is still rising dramatically even as chronic diseases such as hypertension, heart disease and cancer are a growing cause of adult death and disability.

Figure 3: Trends in growth, poverty reduction, and employment



Source: WDI (2016); Fox and Thomas (2016) for SSA employment data

Infrastructure in Africa

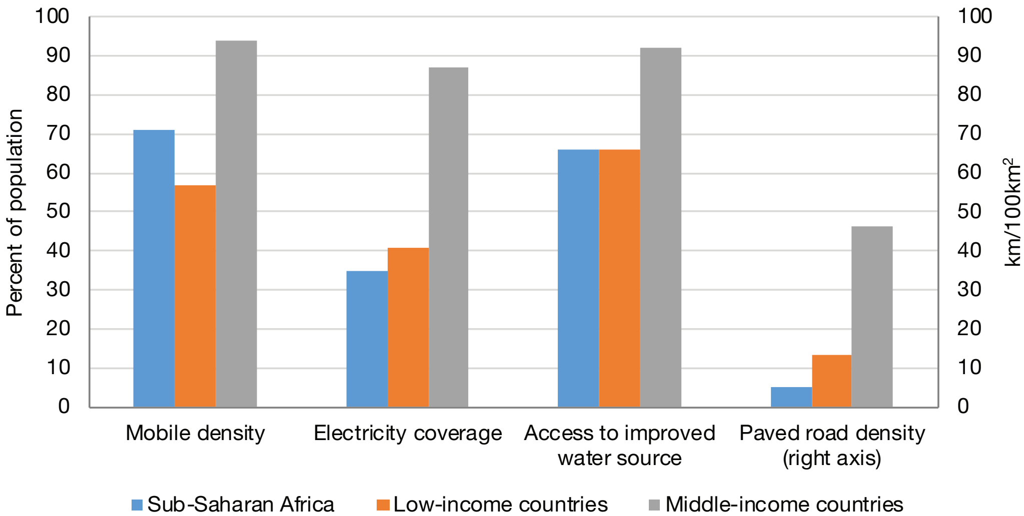
James Bond

Africa is the least endowed region in the world in terms of infrastructure. It also does not perform well on the quality of infrastructure services delivered to users. Infrastructure is scarce and its performance is generally poor: high cost, erratic, and undependable.

Africa's low infrastructure endowment is particularly prevalent in Sub-Saharan Africa (SSA) (Figure 4). Poor quality of infrastructure services results from chronic financial weakness in the sector, as users do not pay full cost for services they receive, as well as from weak operational and financial management. Spending needs are not met, assets are not well maintained, and the sector suffers from a deficit in management skills. It will not be enough simply to increase financing flowing to infrastructure investments. New sources of financing and systemic changes to the way infrastructure services are delivered will be needed to ensure that Africa's infrastructure is operated efficiently and maintained effectively.

Getting infrastructure right is essential; it underpins development of the domestic

Figure 4: Key infrastructure statistics



Source: Gwilliam et al. (2008); World Bank (2016)

economy, contributes to inclusive growth, and enables regional integration. Low cost infrastructure services are key for export competitiveness and economic diversification. Africa's combination of low infrastructure endowment and poor quality of infrastructure services relative to other regions holds back the continent economically and explains in part its lag in regional integration.

SSA is starved for electricity. Both access to electricity and per capita power consumption are lower in Africa than in other regions. Yet Africa is rich in energy resources and huge renewable resources remain untapped. The situation in North Africa is different, where the electricity sector is broadly on a par with the rest of the world; but much of Sub-Saharan Africa (with the exception of Gabon, Mauritius, Seychelles and South Africa) is a "continent in the dark."

Transport infrastructure is significantly less developed than in other regions, and transport costs are twice the level of other developing countries. Road densities are low; rail networks (with the exception of South Africa) are underdeveloped and poorly maintained; and although air transport is growing, it is expensive, connections are patchy, and safety is a problem. African ports are small, port services are costly, and shipments are often delayed.

Africa has undergone a revolution in mobile telephony due to the introduction of new technologies and private provision of services. The number of subscribers in Africa has grown at a rate more than twice the global average during this decade and mobile communications are transforming the economies of some countries through mobile banking and other services. Mobile telephony is an African success story. But internet penetration via fixed broadband links remains inadequate.

Africa still lags the rest of the world in provision of clean drinking water and improved sanitation facilities. In Sub-Saharan Africa, only two-thirds of the population enjoys access to safe drinking water, and improved sanitation reaches less than one-third of Africa's population.

African policy makers need to both increase funding for infrastructure investments and improve the quality of services delivered from infrastructure. Financing for infrastructure in sub-Saharan Africa tripled between 2004 and 2012, reaching $74.5 billion in 2014. Almost half came from government budgets, but only 4 percent from the private sector (mainly for mobile telecommunications networks). Annual spending needs are estimated to be $100 billion (2015 dollars) simply to maintain current endowment levels. If Africa's endowment is to rise to levels consistent with the rest of the world, annual spending would have to reach $250 billion in 2025 (2015 dollars).

Future financing needs cannnot be met by continuing to rely on government budgets and development assistance. Policy makers will have to call to a much greater extent on private sector financing. But private investors and lenders are wary of financing infrastructure in Africa because of the poor creditworthiness of the sector. This is the outcome of inadequate tariffs, poor payment by governments for the services they receive, and weak operational and financial management of public sector utilities.

For utilities to become financially viable, users will have to pay the full cost for the service they receive. This requires tariff mechanisms that cover costs and adjust over time and timely government payments of its bills. In addition, policy makers have to be more aggressive in the pursuit of private provision of infrastructure services (notably electricity, water supply, airports, and broadband internet) as this has been demonstrated to work elsewhere in the world to both diversify sources of financing and improve operational and financial management.

Economic diversification of African economies

James Bond

African economies have not diversified. Despite two decades of solid growth, African countries have not developed a modern export-oriented industrial sector. Compared with other regions, Africa remains weak in terms of industrialization, which can be seen in its very small share of world trade and its commodity-based export structure.

Africa's recent economic growth was driven by rising commodity prices and the move of low-skilled labor from subsistence farming into the local service sector. Africa's pattern of growth without structural change differs from many other regions, where the share of manufacturing in GDP has increased as per capita income increased.

Most African workers are engaged in informal self-employment in jobs that do not provide high wages, good working conditions or skills enhancement. African countries need urgently to diversify their economies into export sectors other than natural resources to provide for faster and more inclusive growth.

After independence, many countries adopted state-led industrialization with enterprises owned by the state and protected by trade barriers. This policy failed to create viable firms and proved to be financially and fiscally unsustainable. Subsequent trade and exchange rate liberalization, privatization of state-owned enterprises, and greater fiscal discipline led to improved economic management and renewed growth, but not to industrialization. More recently, countries have introduced policies to improve their investment climate but, to date, this has not led to the strong idnustrial growth nor integration into global value chains.

Compared with half a century ago macroeconomic management is significantly improved and regulations are somewhat more business friendly, but infrastructure has deteriorated and worker skills remain inadequate. A different approach to industrial development is needed in Africa.

To diversify their economies, African policy makers need now to focus on two things. First, they must continue to work on creating the right economic environment through pursuit of sound macroeconomic management and light-handed regulation combined with a reduction of corruption. Second, government at all levels must work hand in hand with the private sector to promote new sources of economic growth. Promotion of and support to entrepreneurs should be the new mantra.

Promotion of new sources of growth should focus on integrating into global value chains. Africa remains behind other regions in the world in this respect. A growing middle class and rapidly growing urban population also offer new opportunities for agro-businesses. Africa also has unexploited opportunities in tradable services enabled by modern information and communications technologies. Finally, policy makers should seek to develop industrial clusters, which have significant benefits for the acquisition and know-how but remain embryonic in the continent.

African countries display wide diversity and no set of policy recommendations would fit the entire continent. Depending on their country circumstances African policy makers need to address the following obstacles.

Limited regional integration. Africa has a large number of small economies which results in high fixed costs for public administration, difficulty for firms to achieve economies of scale, and little development of clusters. Despite a multiplicity of initiatives, Africa's regional integration is weak and has focused more on political aspirations than on improving the competitiveness of African firms. Regional markets are at best embryonic. African policy makers need to focus on smaller, development-corridor integration initiatives that directly benefit firms.

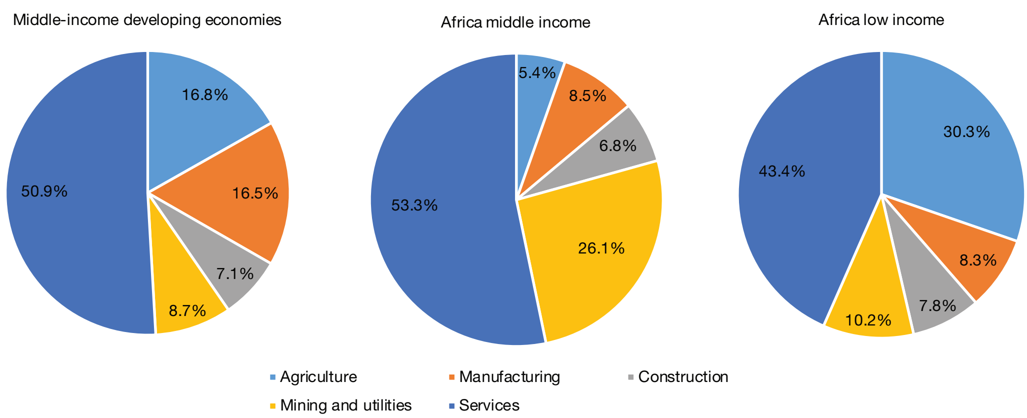
Poor infrastructure. Africa has a huge infrastructure gap and the quality of its infrastructure services is poor. This increases costs, particularly for landlocked countries. Unlike other regions of the world, Africa does not mobilize significant private financing for infrastructure (other than telecoms) because of inadequate user fees and uncreditworthy utilities. African policy makers need to rethink their approach to infrastructure development and management, focusing on how the private sector can play a much greater role.

Weak skills base. Despite significant progress in school enrollment, Africa remains the continent with the greatest number of low-skilled and unskilled workers. National education systems often do not provide the right kind of skills. African policy makers need to collaborate with the private sector on skills enhancement (literacy, numeracy, technical skills) through initiatives such as matching grants and shared financing.

Poor business environment. Despite some regulatory business frameworks remain unattractive, and African governments still penalize their firms. Regulatory systems need to be completely re-engineered, with African entrepreneurs in mind, rather than adjusted at the margin.

Economic diversification requires constant policy adjustment for countries to remain globally competitive. It also requires partnership with the private sector. The key to diversification lies in the promotion of African entrepreneurs through the creation of a much better business environment throughout the continent.

Figure 5: Africa's manufacturing deficit, 2015 (Share of GDP, %)



Source: UNCTAD (2016)

Regional economic integration in Africa

Hasan Tuluy

Regional economic cooperation and integration can be an effective means for countries to overcome constraints of size and fragmentation, and to allow small landlocked countries to more efficiently connect to larger, deeper regional and global markets. The need for scale and market consolidation is particularly relevant for the 54 African countries, many of which are small, landlocked economies with small populations. In the early years of independence, African leaders enshrined this principle as a cornerstone of the Organization of African Unity (OAU) and subsequently the African Union (AU). Founding leaders envisaged a linear sequential path, progressing from free trade areas in goods organized around Regional Economic Communities (RECs) toward common markets with free movement of goods, services and finance, and ultimately to a continental economic and political union.

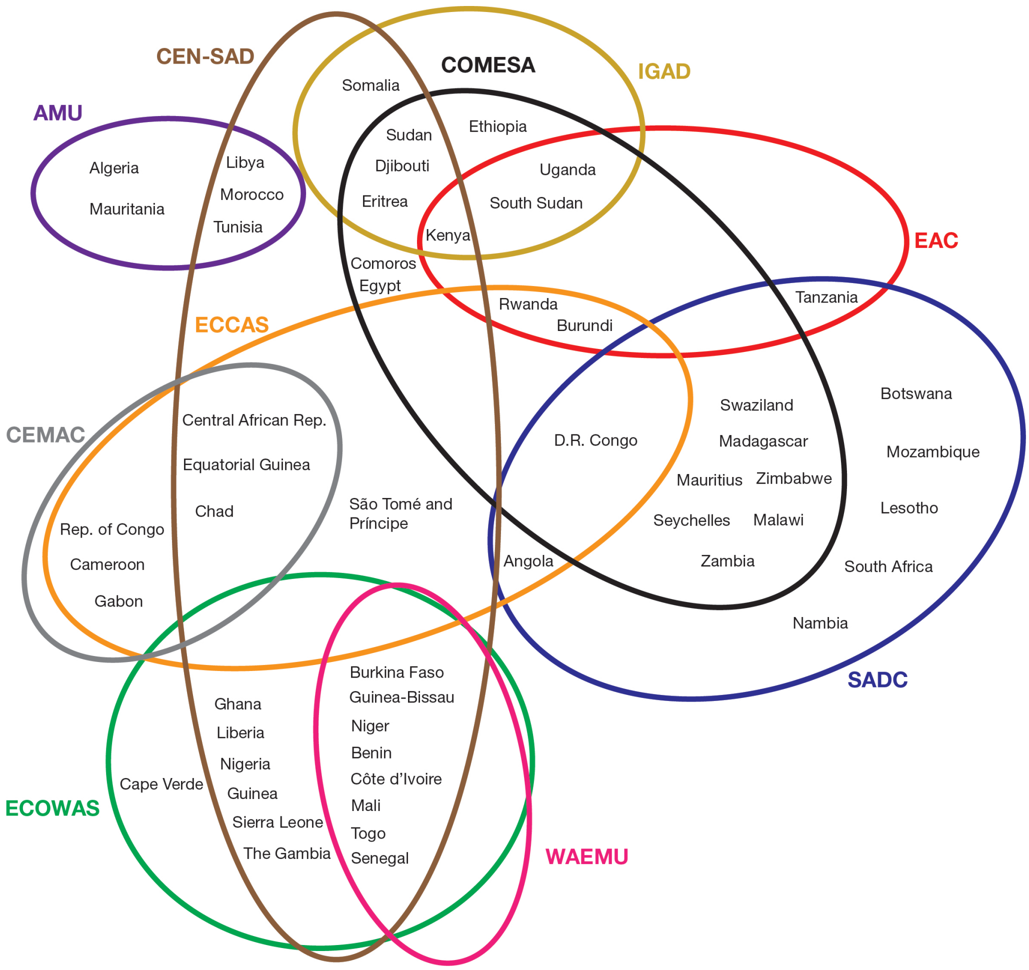
Notwithstanding frequent and strong reaffirmation of political commitment to integration by African leaders, progress on the ground has been slow and challenging. Many of the potential economic benefits from integration have yet to be realized. Today, intra-African trade remains around only 11-15 percent of total.

While there is great diversity among sub-regions, three sets of constraints typically impede progress toward greater regional integration in Africa. First, the dearth, high cost and poor quality of hard (physical) infrastructure imposes higher costs on production, transport and trade thus hurting competitiveness. Second, soft infrastructure made up of border and behind-the-border policies, regulatory measures and their implementation not only drive up costs but also introduce a considerable measure of unpredictability and unreliability. Third, implementing a top-down political approach in a complex institutional architecture is highly challenging without a strong, economically motivated coalition to promote greater cooperation and integration (Figure 6).

The Asian experience of economic cooperation suggests another approach that could advance the regional integration agenda in parallel to the traditional political process. Such an approach would: (a) favor flexible, bottom-up, "variable geometry" platforms of a few like-minded early-mover countries over the sequential, consensual and more top-down approach; (b) emphasize substantial improvements of physical infrastructure and soft constraints along a few large trade corridors and perhaps a more limited range of sectors and issues over the comprehensive, systemic reform approach involving large numbers of countries, actors and issues; (c) build strong coalitions with private producers, investors, traders and consumers with an economic interest in regional integration outcomes over (or in parallel to) primarily political drivers; (d) continue to deepen trade, facilitation and logistics reforms to significantly reduce the cost and time needed to produce and trade and build a more predictable, reliable economic governance environment that would encourage production of tradables for deeper regional markets; and (e) strengthen key national and regional institutions to provide more compelling analytics of platforms and evaluate their feasibility, funding and risk management, to address head-on dispute resolution and credible compensation of losers and to monitor and report on progress.

A number of encouraging initiatives that incorporate some of these features are underway in Africa today, and hold the promise of becoming building blocks of an increasingly integrated African economic space.

Figure 6: Africa REC membership



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