

AID, STRUCTURAL CHANGE, AND THE PRIVATE SECTOR IN AFRICA

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Rediscovering Structural Change

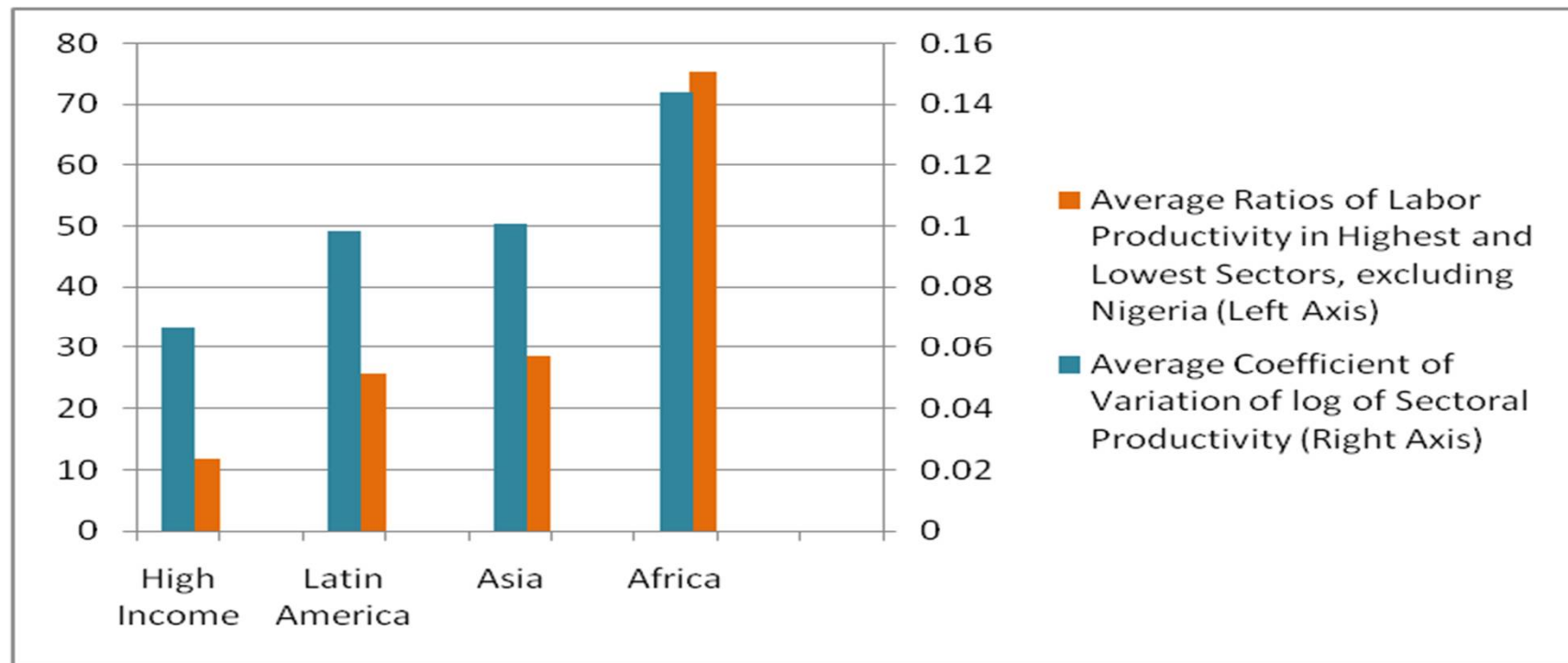
- Structural change is a founding idea of development economics (Kuznets, Lewis, Chenery)
- In countries at low levels of income productivity differences between sectors are large
- The movement of resources from low productivity to high productivity employment drives growth
- As incomes rise, productivity differences among sectors (and enterprises) tend to converge

Rediscovering Structural Change

- Academic interest in structural change waned in the 1980s
- Cross country regressions consigned it to the “residual”
- The result for public policy was a focus on “whole economy” drivers of growth such as openness, institutions, governance, etc.
- These prescriptions proved to be of little practical relevance to public policy

Why Structural Change Matters for Africa: Africa has the largest differences in productivity

Differences in Labor Productivity Between Sectors

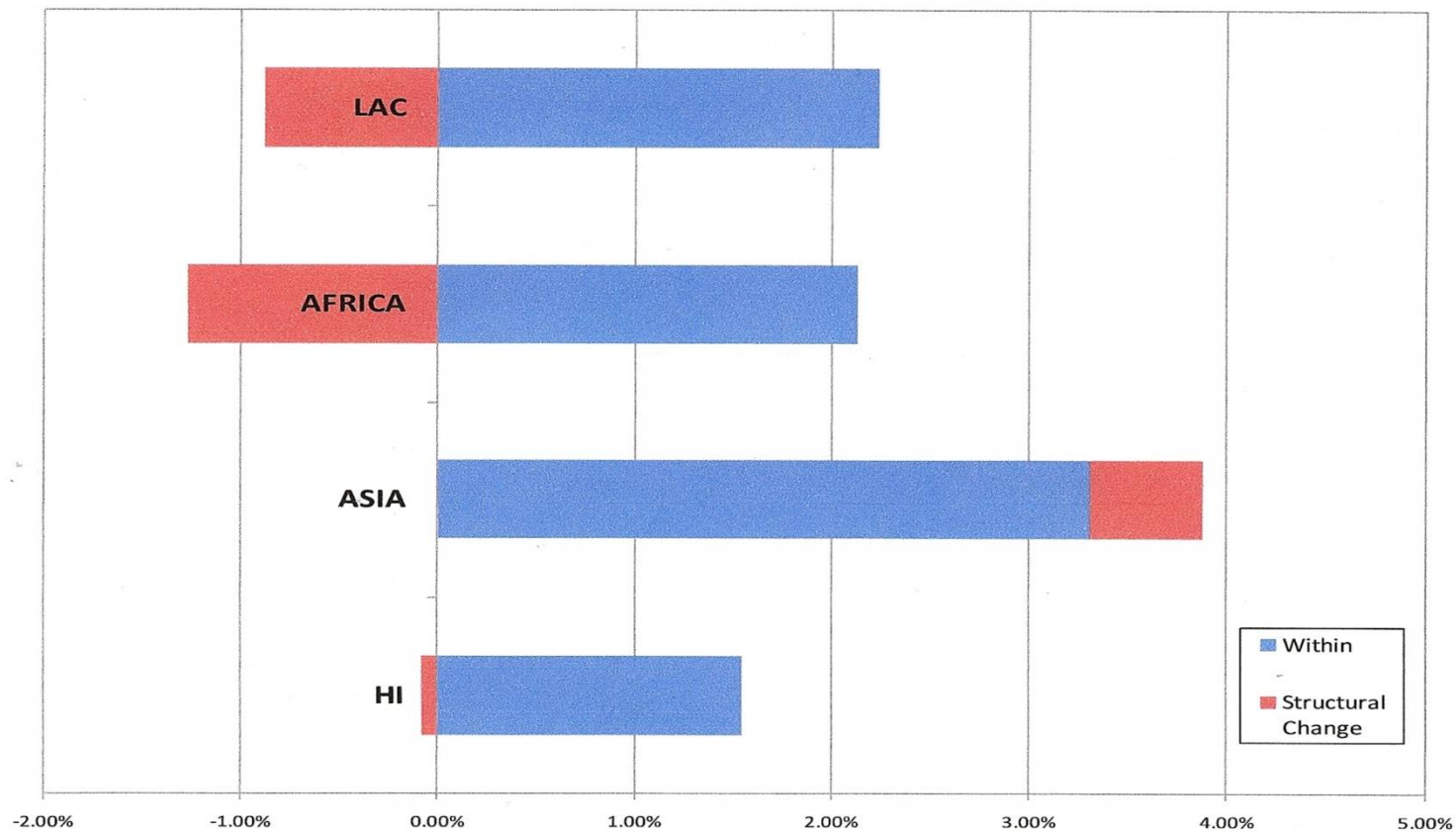


Source: McMillan and Rodrik (2011); author's calculations

Why Structural Change Matters for Africa: Africa's Structural Deficit

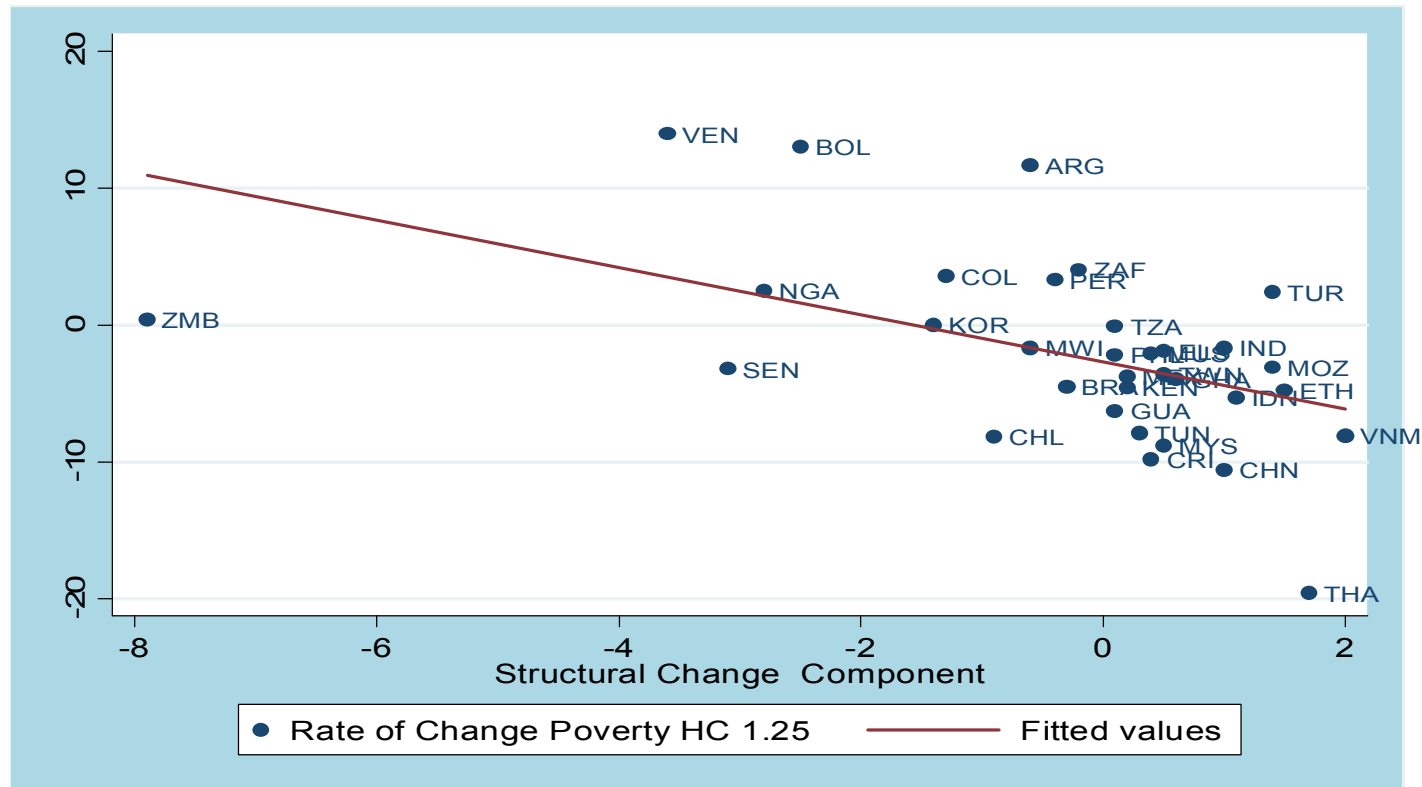
	VASH AGR	VASH IND	VASH MFG	VASH SER		LSH AGR	LSH IND	LSH MFG	LSH SER		REL PROD AGR	REL PROD IND	REL PROD MFG	REL PROD SER
BMK MIC	21.7	12.2	21.9	44.2		45.2	6.6	11.6	36.6		0.48	1.85	1.89	1.21
AFR LIC	27.8	11.8	11.1	49.3		63.1	5.1	6.6	25.2		0.44	2.31	1.68	1.96
AFR MIC	4.8	10.9	17.1	67.2		8.6	11.9	16.8	62.7		0.56	0.92	1.02	1.07
AFR RES RICH	17.8	29.6	8.3	21.1		45.4	4.8	6.5	43.4		0.39	6.17	1.28	0.49

Structural Change and Growth: “Perverse” structural change has slowed productivity growth



Structural Change and Poverty:

And may have slowed poverty reduction



$$dPHC = -1.70 - 0.46 dy - 1.52 SCC$$

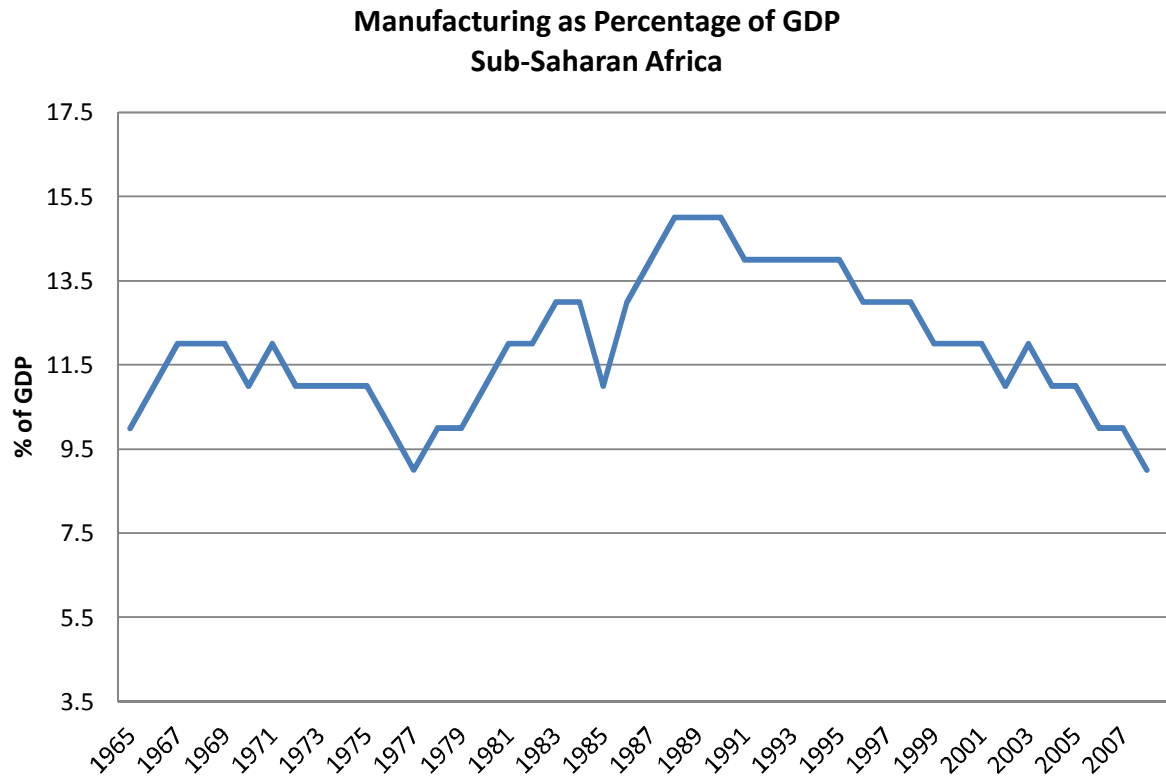
(0.97) (0.75) (2.45)

r squared= 0.25

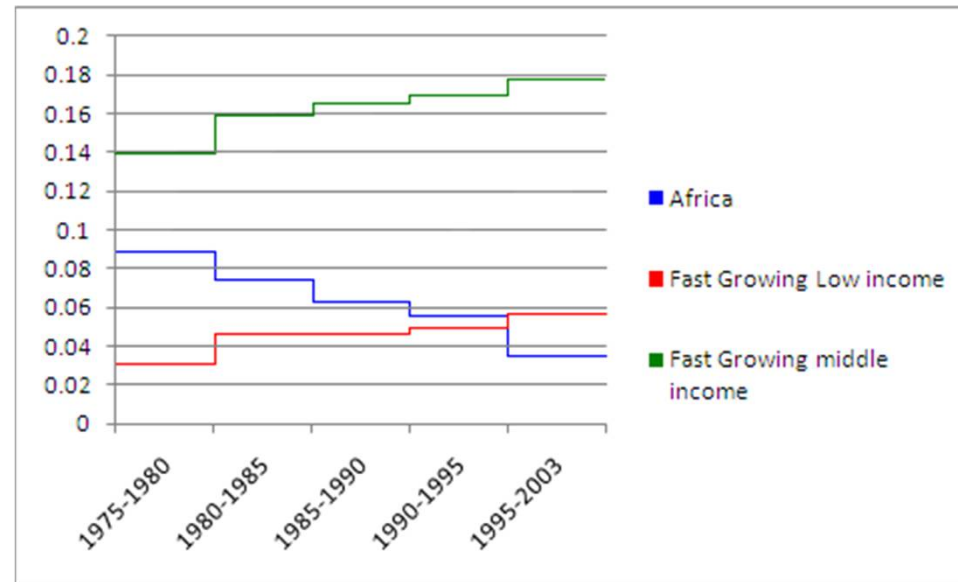
Structural Change and Industrialization

- Industry has been the main driver of structural change
 - High value added per worker (2.5:1) offers the prospect of “good jobs”
 - “What you make matters” for growth.
 - Firm size matters for productivity
- But Africa has deindustrialized since the mid ‘80s
 - A declining share of output and employment
 - Declining sophistication
 - Anemic manufactured export growth

AFRICA HAS DEINDUSTRIALIZED



AFRICA HAS DEINDUSTRIALIZED EXITING HIGH SOPHISTICATION INDUSTRIES



AFRICA HAS DEINDUSTRIALIZED

Selected Indicators of Industrial Development, 2005 — 2008

	Mfg Exports PC 2005 (US\$)	Growth Exports 00—05 (%)	PCShare Exports Total (%)	MfgShare High Tech in Total Mfg Exports (%)	Medium/ in	Mfg. Value Added PC 2008 (US\$)	Share of Mfg in GDP 2008 (%)	Direction of Change in Mfg Share of GDP 00—08
Africa Average	39.0	1.65	54.9	13.3		138.6	09.4	—
Developing Countries	487.2	10.05	75.8	57.3		412.9	21.7	+

Some Good News: “Industry Without Smokestacks”

- Falling transport and communications costs have opened up a range of high value added activities that have more in common with manufacturing than agriculture and services
 - Horticulture and cut flowers
 - Remote impersonal services
- These “industries without smokestacks” broaden the range of possibilities for growth enhancing structural change

Some Good News: “Industry Without Smokestacks”

Average Annual Growth rates of Exports of Goods and Services, 1998—2007

	Services Export Growth	Goods Export Growth
Africa Average	7.2	1.1
Coastal non—oil	14.0	13.1
Landlocked non—oil	40.8	12.4
All non—oil	14.7	13.9
Oil exporters	6.8	—0.4
Low income average	13.5	26.0
Lower middle income average	24.3	35.0

Aid and the Private Sector

- Africa's structural transformation must be driven by private investment
- Domestic private investment has lagged other more dynamic regions
- FDI is concentrated in natural resources

Aid and the Private Sector

Private Investment as a Share of GDP 1990-2009

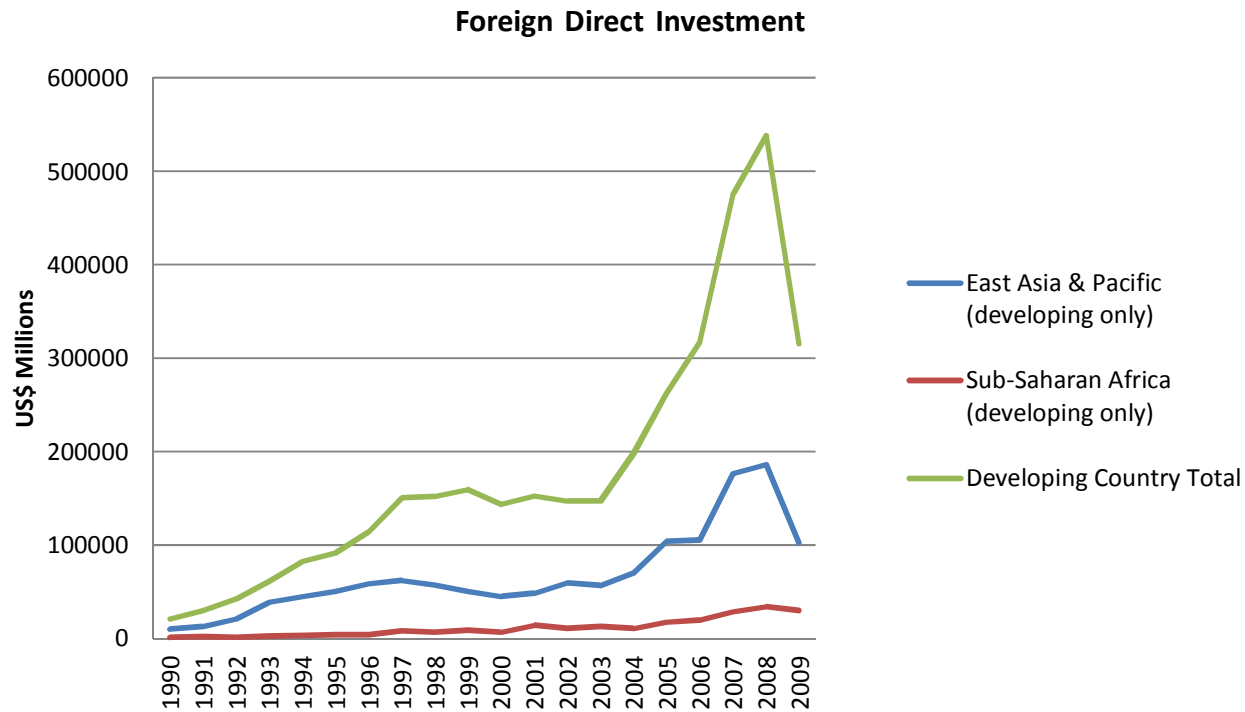
		1990-94	1995-99	2000-04	2005-09
Africa LIC		10.2	11.2	11.1	11.8
Africa MIC		14.6	14.5	13.8	15.8
East Asia		24.9	19.9	12.4	16.8
Low Income Countries		10.0	11.5	12.9	15.4
All Developing Countries		13.7	14.5	14.0	16.6

Note: Entries are 5 year averages.

Source: World Bank World Development Indicators,
World Bank national accounts data, and OECD National Accounts data files

Aid and the Private Sector

Foreign Direct Investment 1990-2009



Aid and the Private Sector

- Aid can support structural change through:
 - Reforms in the investment climate
 - A strategy for structural change
- Agriculture must also play a role
 - Productivity in agriculture has lagged
 - Shared growth

AID AND THE INVESTMENT CLIMATE: REGULATORY REFORM

- Since 1990s donors have focused on the regulatory regime in Africa.
- *Doing Business* has been the most used instrument (an easily understood league table)
 - Seven of its nine indicators “presume that lessening regulation is always desirable” (World Bank, 2008; p. xv).
 - Causal relationships are asserted without persuasive evidence
- Two things are seriously wrong with this approach
 - *Doing Business* cannot identify the binding constraints to industrialization
 - *Doing Business* has diverted attention from more serious diagnosis and policy reform
- Progress on *Doing Business* is properly seen as an outcome, not an agenda, for a properly designed program of regulatory reforms.

AID AND THE INVESTMENT CLIMATE: REGULATORY REFORM

Ease of Doing Business and Industrial Performance

Country Group	Average "Ease of Doing Business" Score (range)	Mfg Exports PC 2005	Growth PC Exports 00-05	% Mfg Exports in Total	Share of Mfg in GDP 2005	Rate of growth of Mfg Share of GDP 00-05
South East Asian new industrializers	132 (78-171)	185.3	4.49	80.2	19.0	9.57
Central American new industrializers	103 (86-125)	209	1.73	69.4	19.0	-1.27
Leading five African LIC exporters by growth	132 (67-170)	61	4.88	50.46	10.1	1.26
Leading five African LIC manufacturers	127 (76-169)	90	1.66	54.3	13.3	-0.36
Africa Average	137 (20-183)	39	1.65	54.9	07.6	-0.45

AID AND THE INVESTMENT CLIMATE: REGULATORY REFORM

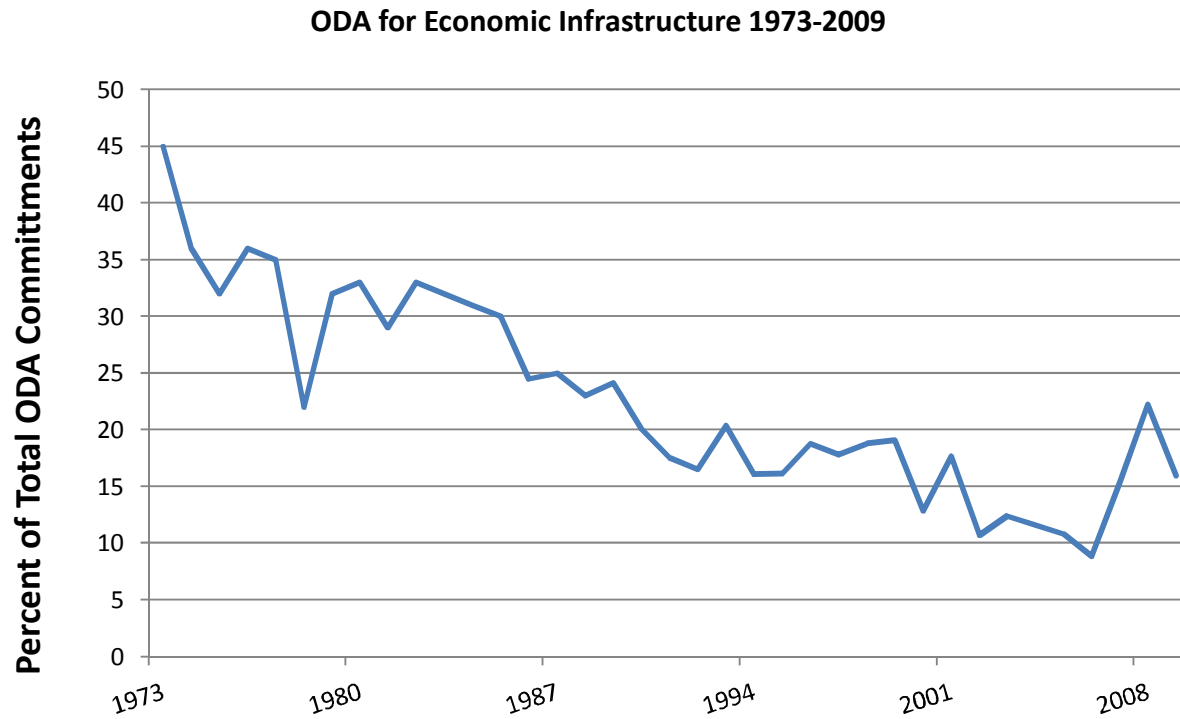
- A well designed reform agenda must come from close coordination with the private sector
- But close coordination risks capture
- Mitigating the risks of capture is one key to successful agenda setting
- Aid can help identify, adapt and transfer good practices
- But avoid the “Made in Washington” syndrome of *Doing Business* (Presidential Investors Advisory Councils)
- Africa has some “home grown” examples of success (Cut flowers in Ethiopia)

AID AND THE INVESTMENT CLIMATE: Neglected Priorities – Infrastructure

Impact of unreliable infrastructure services on the productive sector

	Sub— Saharan Africa	Developing countries
Service problem		
Electricity		
Delay in obtaining electricity connection (days)	79.9	27.5
Electrical outages (days per year)	90.9	28.7
Value of lost output due to electrical outages (percent of turnover)	6.1	4.4
Firms maintaining own generation equipment (percent of total)	47.5	31.8
Telecommunications		
Delay in obtaining telephone line (days)	96.6	43.0
Telephone outages (days per year)	28.1	9.1

AID AND THE INVESTMENT CLIMATE: Neglected Priorities - Infrastructure



AID AND THE INVESTMENT CLIMATE: Neglected Priorities - Skills

- Between 1990 and 2005:
 - East Asia secondary enrollment rates increased by 21 percentage points, Africa 7.
 - East Asia tertiary enrollment rates increased by 13 percentage points; Africa 1
- The skills gap poses a major constraint to industrial development
- A new education MDG is needed.

INVESTING IN STRUCTURAL CHANGE: TILTING TOWARD EXPORTS

- **Why focus on an export push?**
 - African firms learn by exporting
 - Beyond the border reforms are needed: Africa ranks 121 out of 155 countries ranked by the World Bank on trade logistics
 - Aid and trade policy are not coordinated
- **Aid to improve trade logistics**
 - A generous definition: about 25 percent of total development assistance
 - Share in total development assistance has fallen steadily since 1996
 - Get real about “Aid for Trade”
- **Preferential market access**
 - Reducing tariff escalation, especially in Asia
 - Harmonize and improve the EPAs and AGOA
 - A generalized system of preferences for the “least developed manufacturing countries

INVESTING IN STRUCTURAL CHANGE: Supporting Agglomerations

- **Why worry about geography?**
 - Agglomerations confer significant productivity gains
 - Starting a new industrial agglomeration is a form of collective action problem
 - Africa has few dynamic, modern industrial clusters
- **Special Economic Zones**
 - SEZs have not performed well in Africa
 - Traditional donors have lacked interest
 - China may be the answer
- **Growth Corridors**
 - Link natural resources and infrastructure with domestic production
 - Can be used to address knowledge and coordination problems (Chile, Malaysia)
 - Are very difficult to evaluate properly

INVESTING IN STRUCTURAL CHANGE: Attracting and building capabilities

- **Why focus on capabilities?**
 - Capabilities are the tacit knowledge and working practices needed for production and product development
 - Capabilities are transferred from high to low capability settings by FDI or supply chain links
 - Capabilities can spill over to other firms, although usually not horizontally
- **Attracting capabilities**
 - Building effective FDI agencies
 - Creating knowledge networks
 - Making capability building a “practice area”
- **Diffusing Capabilities**
 - Supporting vertical supply chains
 - Management training (JICA in Africa and Asia)
 - Linking to geography and skills

INVESTING IN STRUCTURAL CHANGE: Strengthening regional integration

- Why support regional integration?
 - Small countries
 - The disadvantages of the landlocked
 - The failure of collective action
- Development agencies must step up
 - Aid bureaucracies find regional investments difficult
 - Regional Economic Communities are weak
 - Cross-border projects are too few and too slow
- A new approach to regional aid
 - African governments will need to cede sovereignty
 - RECs need to take the lead on regional issues with donors
 - Link trade preferences with regional integration

Conclusions

- Africa's structural deficit imperils growth and slows poverty reduction
- Closing the gap will require a major expansion of domestic and foreign private investment in "industry"
- Investment climate reforms are essential, but too much (government and donor) attention has been invested in regulatory reform and too little in infrastructure and skills
- A new strategy for aid is needed
 - Helping create an export push
 - Supporting agglomerations
 - Attracting and building firm capabilities
 - Supporting regional integration