A NEW AGENDA FOR AID TO AFRICA

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The Priority

This year is likely to be one in which a number of hard decisions and unhappy truths will confront the international donor community in Africa. Fiscal retrenchment in the Organization for Economic Cooperation and Development (OECD) countries makes it increasingly likely that the members of the OECD Development Assistance Committee (DAC) will finally abandon their Gleneagles commitments to increase aid to Africa by $25 billion. Indeed, there is a significant risk that "programmable aid"—the aid actually available to support investments and public expenditures—may fall. 2012 is also the year in which donors are likely to have to admit that despite significant progress many African countries and the continent as a whole will fail to meet the Millennium Development Goals.

Aid to Africa remains high on the agenda of the G-8 and G-20 for 2012. But in the face of these realities, what sort of conversation should these two global "clubs" have with respect to an aid strategy in Africa? The answer is clear. After years of neglect, the international community needs to refocus aid on creating good jobs through private investment and structural change.

Why Is It Important?

Growth enhancing structural change—the movement of workers from low productivity to high productivity jobs—matters crucially for Africa. It is the key to long-term growth, high wage employment and faster poverty reduction. There is little evidence, however, that significant structural changes have underpinned the region's more rapid growth since 1995. Since the middle of the 1980s, Africa has deindustrialized. Africa's share of manufacturing in GDP is less than one-half of the average for all developing countries and, in contrast with developing countries as a whole, it is declining. Today, Bangladesh alone produces as much manufacturing output as all of low-income Africa.

As industry has moved out of Africa, private investment has made other developing countries—mainly in Asia—the "world's factory". Since the 1990s, foreign direct investment (FDI) in manufacturing and infrastructure has moved disproportionately to Asia, driving the rapid structural transformation of its low-income economies. Not surprisingly, the majority of the "good jobs"—those with high value-added and the potential for good wages—created by globalization has been in Asia.

While Africa has seen a modest increase in FDI, that investment has been almost wholly in mining and minerals. Less than 1 percent of global FDI has gone to manufacturing in Africa. Again not surprisingly, a recent paper by Dani Rodrik and Margaret McMillan suggests that it is likely that since 1990 the structural changes that have taken place in Africa have reduced the share of African workers in good jobs and cut the region's overall growth rate.

Aid and the Investment Climate: A Missed Opportunity

Although the vast majority of aid and development rhetoric over the last two decades has focused on meeting the MDGs, the international community has also attempted to support growth and job creation by the private sector in Africa. Unfortunately, it has done so badly. Since the 1990s, donor efforts to develop the private sector in Africa have focused primarily on the "investment climate"—the regulatory, institutional and physical environment within which firms operate. Around one-quarter of official development assistance, some $21 billion per year, currently supports investment climate improvements.

The centerpiece of this effort has been the World Bank-International Finance Corporation *Doing Business* surveys. In 2011, the average rank of African countries in the *Doing Business* indicators (moving from 1 as the best to 183 as the worst) was 137. Clearly, Africa can do better at *Doing Business*, but does *Doing Business* identify the binding constraints to private investment, structural change and growth?

The answer is no for at least two reasons. First, *Doing Business* was never designed to be a country-level diagnostic tool; it is cross-country "league table". Second and more fundamentally, *Doing Business* confines itself to only one part of the investment climate: it rewards changes in trade, regulatory, and labor market policies designed to reduce the role of government in economic management.

There is substantial evidence that lack of infrastructure and skills is responsible for much of the difference in costs and competitiveness between Africa and other parts of the developing world. Sub-Saharan Africa lags at least 20 percentage points behind the average for low-income countries on almost all major infrastructure measures. In addition, employer surveys report that African post-secondary graduates are weak in problem solving, business understanding, computer use and communication skills.

While regulatory reform has dominated the discussion of private sector development, donor attention to Africa's growing infrastructure and skills deficits has waned. Infrastructure financing to Africa by the members of the OECD DAC has been falling as a share of overseas development assistance since the early 1970s, while the pursuit of the primary education MDG has crowded expenditures on post-primary education out of development budgets.

What Needs to Happen in 2012?

How can the international community better support structural change and job creation in Africa? In 2012, the G-8 and G-20 need to avoid the temptation to repeat the same platitudes about Africa's "growth turn-around" and the same hollow promises to increase aid. Rather, they should clearly call on the international financial institutions (IFIs) and the OECD DAC to develop a new aid strategy for Africa—one that leverages existing aid flows for job creation and structural change.

A simple initiative would be to task the IFIs—and the World Bank in particular—with rethinking their priorities for investment climate reform away from easily understood, but low impact regulatory reforms to address the binding constraints to competitiveness. Another would be to pledge to reverse the declining trends in aid to infrastructure and post-primary education within the existing aid envelope.

Because for the vast majority of African countries the export market represents the only option for rapid growth of manufacturing, agro-industry and high value-added services, aid and trade policies need to be restructured to support an "export push". These policies should have a focused set of public investments and actions designed to increase the share of nontraditional exports in Africa's GDP. International support for an export push should work on two fronts: aid to improve trade logistics through meaningful reforms to the current, moribund "Aid for Trade" initiative; and policies to increase preferential market access for Africa's nontraditional exports.

Africa has few large-scale, modern industrial agglomerations, making it both more difficult for existing firms to compete and more difficult to attract new industries. Governments can foster industrial agglomerations by concentrating investment in high quality institutions, social services, and infrastructure in a limited area, such as a special economic zone (SEZ). Unfortunately, Africa's traditional suppliers of aid have tended to neglect special economic zones as a development instrument. Here again, the G-8 and G-20 can task the IFIs with developing appropriate SEZ strategies for Africa.

The small size of Africa's economies and the fact that many are landlocked make regional approaches to infrastructure, institutional and legal frameworks, and trade related services imperative. Africa's development partners have not aggressively helped regional integration, preferring instead to deal with individual countries rather than regional organizations and limiting financial commitments to trans-border projects. Aid implementation and disbursement are particularly slow at the regional level. Donors through the OECD DAC need to make stronger efforts to harmonize their support to regional organizations, decrease the use of their own systems to channel aid flows to regional programs, and integrate their national aid programs into their regional strategies.

Africa's development partners have devoted too few resources and too little attention to the critical constraints to job creation and structural change. The hard truths likely to confront the G-8 and G-20 in 2012 represent an opportunity to craft a new strategy—one that catalyzes private investment for structural change—as the centerpiece of aid to Africa.

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