

The 50th Anniversary of the Bank of Tanzania

Beyond Aid and Concessional Borrowing: New Ways of Financing Development in Africa and Its Implications

Justin Yifu Lin

Center for New Structural Economics

Peking University

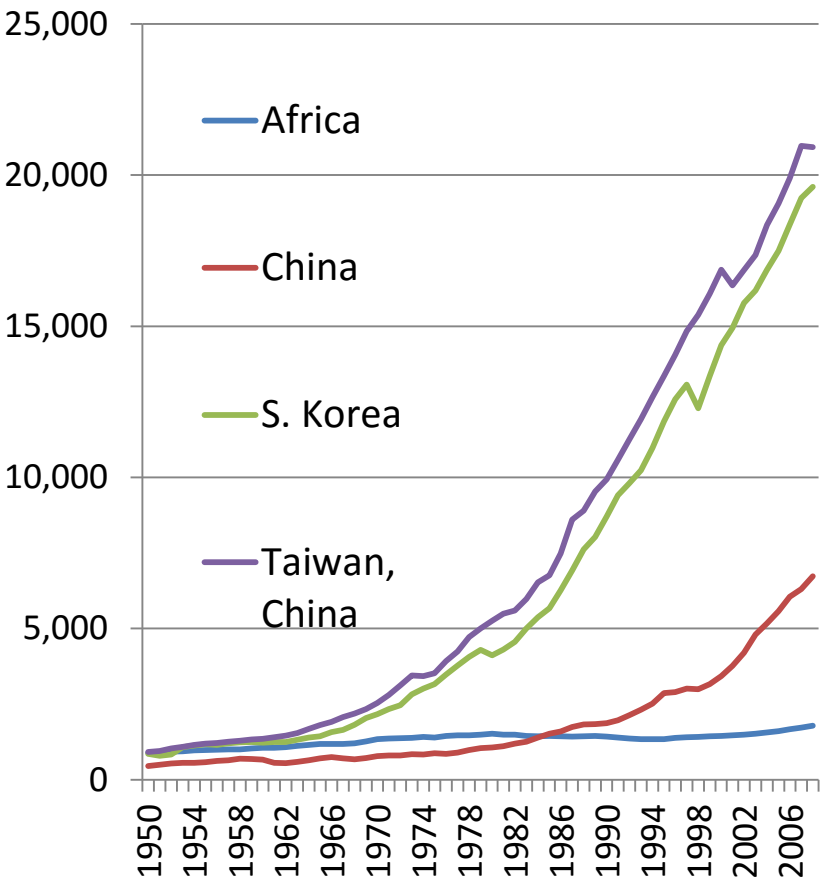
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Overview of Presentation

- **Why Go Beyond Aid and Concessional Borrowing**
- **New Structural Economics**
- **New Sources for Financing Development in Africa**
- **Opportunities for Structural Transformation from South-South Development Cooperation**
- **Concluding Remarks**

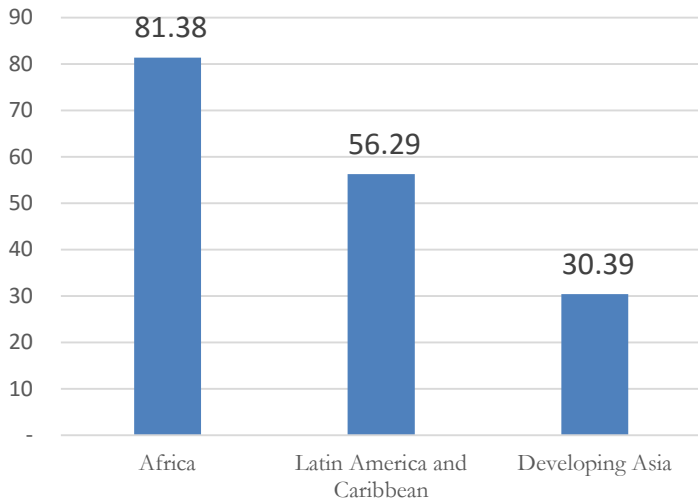
Why Go Beyond Aid and Concessional Borrowing

Per Capita GDP in 1990 International Dollar

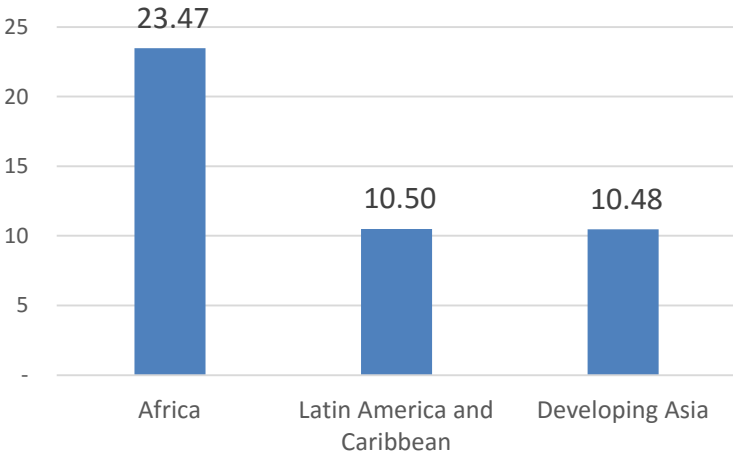


- There have been many development aids and concessional financing for Africa, but African countries are trapped in poverty
- However, poverty is not a destiny
- Africa is not alone, among nearly 200 developing economies, since WWII
 - Only two have moved from low-income to high-income
 - Only thirteen have moved from middle-income to high-income
 - Most are trapped in low-income or middle-income status
- This result is disappointing

Commodity Share of Total Regional Exports, 2013 (%)

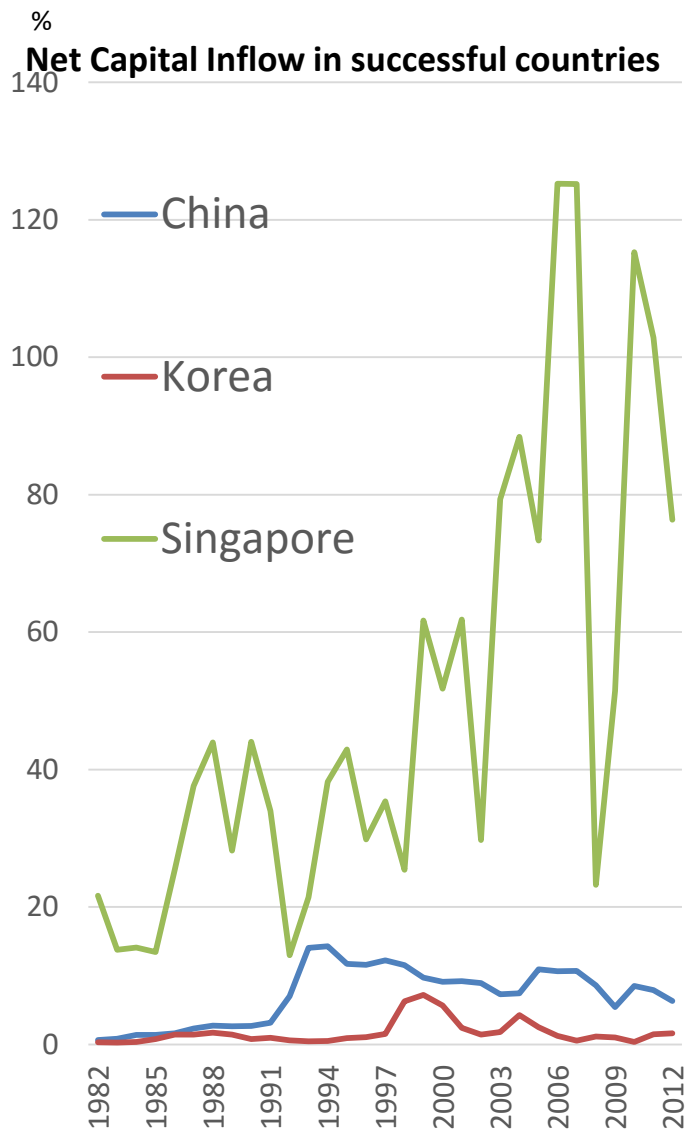


Primary Commodity Exports (% GDP), 2013



- The nature of modern income growth is a process of continuous structural change in technologies and industries, which increase labor productivity, and in soft and hard infrastructure in the economy, which reduce transaction costs.
- Africa is poor as it has not diversified from agriculture and nature resources
 - Africa's exports of primary commodities is more than 80 percent of its total export– the highest in the world.
 - Primary commodity exports represents greater share of GDP of Africa compared to other regions. Especially, in almost all oil exporting countries, crude oil exports alone account for at least 50 percent of GDP and more than 70 percent of national budget
- Developing countries have the advantage of backwardness in technological innovation, industrial upgrading and institutional innovation, potentially can grow faster than advanced countries, and achieve convergence.
- However, Africa and most developing countries have been trapped in low-income or middle-income status since WWII
- The result is puzzling

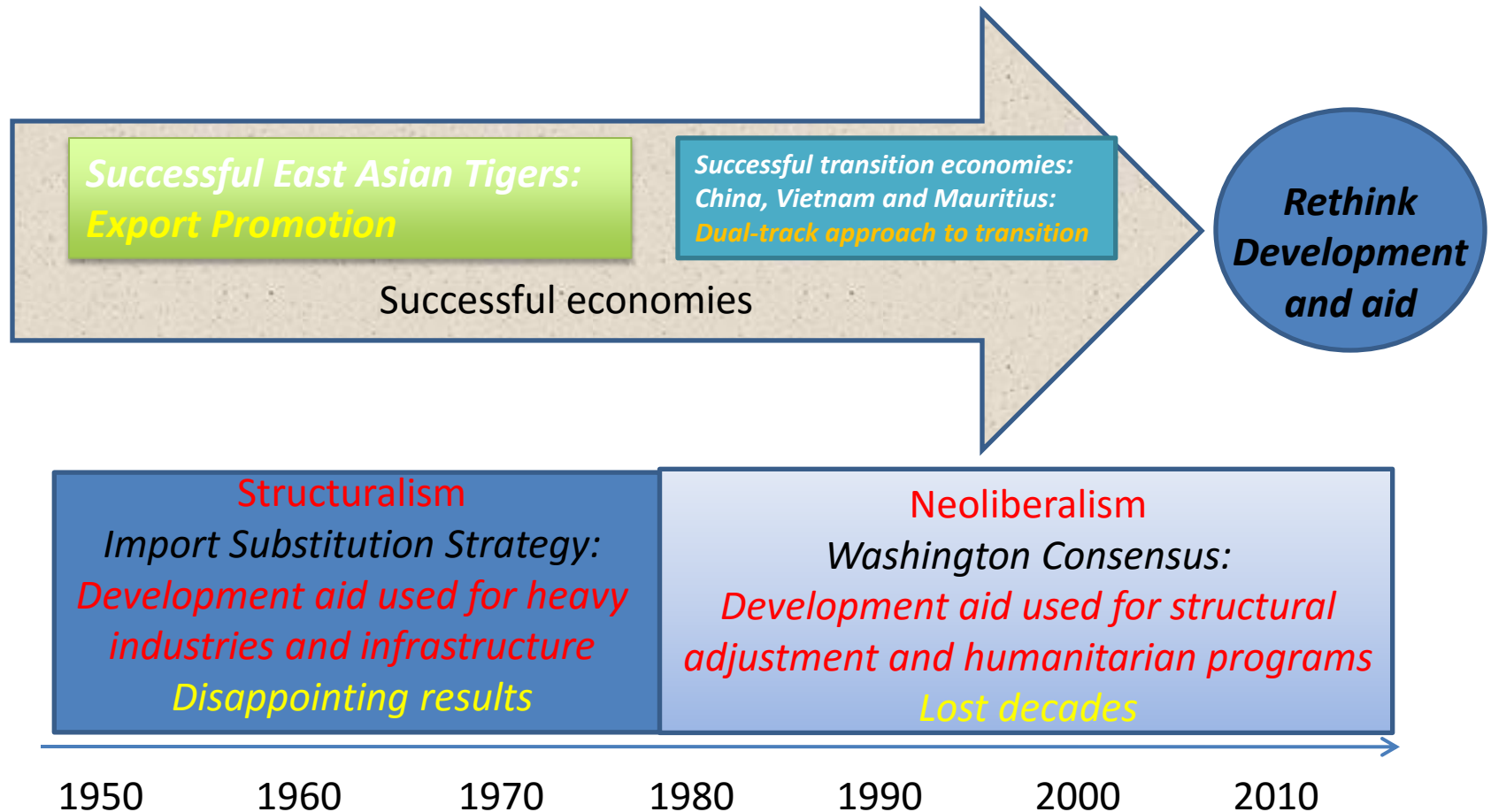
- Investment is important in modern economic growth. It is essential for technological innovation, industrial upgrading and diversification and infrastructure improvement
- After WWII, many multilateral and bilateral development institutions were set up to provide development aid and concessional loans to developing countries.
- Theoretically, the development aid and concessional loans increase the capital available for investment and should contribute to development in developing countries. However, most developing countries are trapped in poverty
- Is there a way to make development assistance more conducive to development success?



- According to the Report of Growth Commission, 13 economies were able to grow at 7% or more for 25 years or more in post WWII. They have five stylized facts:
 - Openness, using available ideas/technologies in the world and producing what the world needs
 - Macro stability
 - **High rates of saving & investment**
 - Market
 - Committed, credible & capable government
- For the successful economies, some rely mostly on domestic capital mobilization for investment, as the case of Korea and China, and for others FDIs play a crucial role in other successful economies, such as in Singapore.
- Is there a recipe for development success?

- As Keynes said, “It is ideas, not vested interests, which are dangerous for good and evil.
- The efforts of national and international development communities are guided by development thinking.
- The failure of development efforts, including development assistance from multilateral and bilateral development agencies, are due to inadequate development ideas embedded in the mainstream developing thinking

Development theory is in need of rethinking



THE NEW STRUCTURAL ECONOMICS

New Structural Economics

- An application of neoclassical economic approach to study the determinantes of **economic structure and its evolution** in development, which is the nature of modern economic growth
- **Why do I call this approach New Structural Economics?**
 - By convention, it should be called structural economics
 - Add “new” to distinguish it from structuralism

Structure, Structural Change, and Income Traps

- **The main hypothesis.** Industrial structure is endogenous to endowment structure, which is given at any specific time and changeable over time
- **Endowments** at any specific time determine the economy's total budgets and relative factor prices at that time, which in turn determine that specific time's:
 - Comparative advantages of the economy, i.e., industries that have the lowest factor costs of production in the world
 - Optimal industrial structure (endogenous) is endogenous to endowment structure
- **Dynamics.** Income growth depends on:
 - Upgrading industrial structure, which in turn depends on
 - Upgrading of endowments, that is, accumulation of capital
 - Improvements in “hard” and “soft” infrastructure to reduce transaction costs
- **The low-income trap and the middle-income trap are both the result of a country's inability to have a dynamic structural change, which makes a developing county to grow slower than the high-income countries**

Comparative Advantage following strategy and development success

- *Following comparative advantage (determined by the endowment structure) to develop industries is the best way to achieve dynamic growth and convergence:*
 - *The economy will be most competitive, produce the largest surplus, have the highest possible returns to capital and thus savings, ensure the fastest upgrading of endowment structure, and achieve the rapidest industrial upgrading and income growth*
 - *In this process, a developing country can have the latecomer advantages and thus have a faster technological innovation and industrial upgrading than high-income countries, which lead to convergence to high-income countries*

The Market, the State and Development Assistance

- Firms maximize profits...choice of technology and industries based on relative factor prices...



Need for a competitive market system

- Industrial upgrading and diversification needs to:
 - Address externalities
 - Solve coordination problems in hard and soft infrastructure improvement



Need for a facilitating state

- Development assistance will be conducive to development success if it increases a facilitating state's resources and capability to support structural transformation

NSE Growth Recipe and The Growth Commission's Stylized Facts

*Growth Report
Stylized Facts:*

- Policy Recommendation from NSE
 - **Following comparative advantage**
- Preconditions
 - Market economy #4
 - Facilitating State #5
- The results:
 - Openness and advantage of backwardness #1
 - Competitiveness and strong external as well as fiscal accounts: fewer home-grown crises and larger scope for countercyclical fiscal policies. #2
 - Large economic surplus and high returns to investment: high rate of savings and investment. #3

The Failure of Structuralism

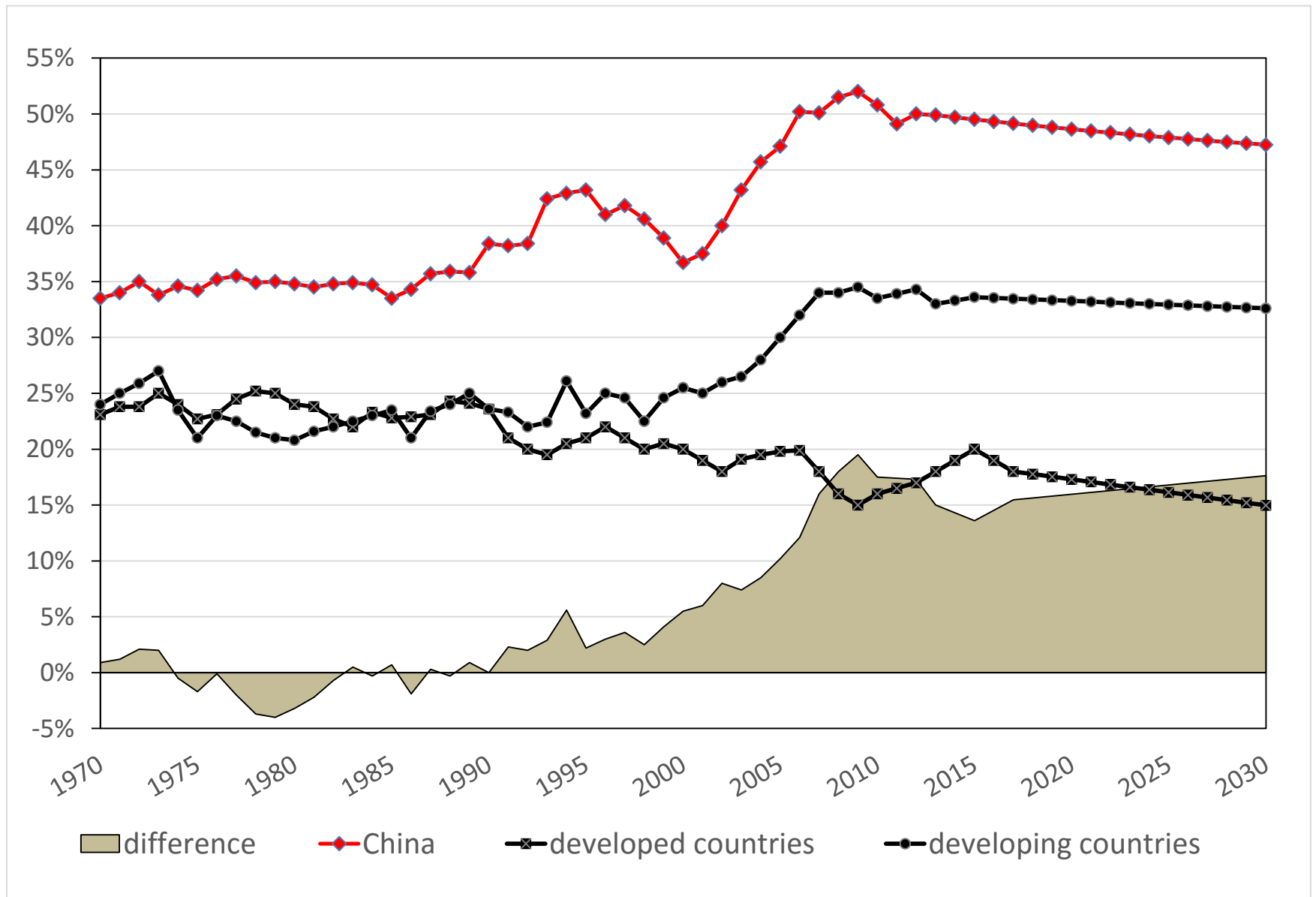
- Structuralism advised governments to develop modern industries, prevailing in high-income countries, that were **too far advanced** compared to their countries' level of development and went **against their comparative advantages**.
- **Development aid and concessional loans were used to support this strategy**
- Structuralism fails to recognize industrial structure is endogenous to endowment structure. The **firms were non-viable in open competitive markets** and required government's subsidies and protection for their initial investment and continuous operations.
- This led to misallocation of resources, **rent-seeking, corruption, and political capture**.
- The dynamic growing East Asian Economies adopted a comparative advantage following, export-oriented development strategy

The Failure of Washington Consensus

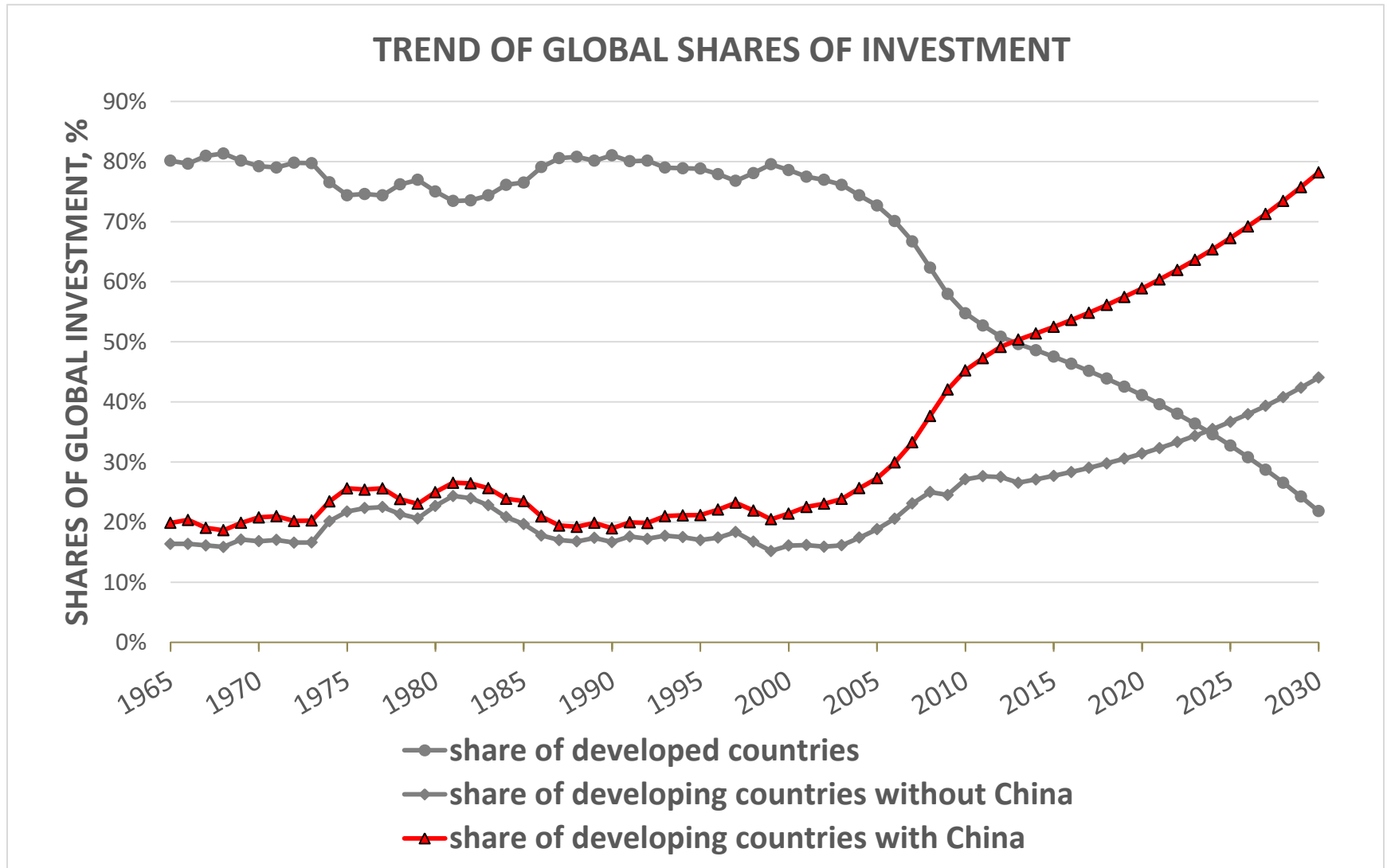
- All transitional economies started with many distortions and nonviable firms in their old priority sectors due to their **comparative advantage-defying development strategy**.
- **Development aid and concessional loans were used to support structural adjustment**
- The Washington Consensus **failed to recognize that the distortions were endogenous** when advocating for the protection of nonviable firms in the priority sectors and advised the government to eliminate all distortions immediately, which caused **the collapse of old priority sectors**.
- The Washington Consensus also **opposed that government play a proactive role in facilitating firm entry** into sectors consistent with the country's comparative advantages.
- **With failure of structural adjustment policy, humanitarian aids were used to support education, health and etc., but not for structural transformation**
- The dynamically growing transitional economies adopted **a dual-track approach**:
 - The government continued to provide transitional support to nonviable firms in the old priority sectors and removed distortions only when firms in those sectors became viable or the sectors become very small.
 - The government facilitated private firms' entry to sectors that were consistent with the country's comparative advantages, which were repressed before the transition.

New Sources for Financing Development in Africa

Projection of savings rates 2015-2030



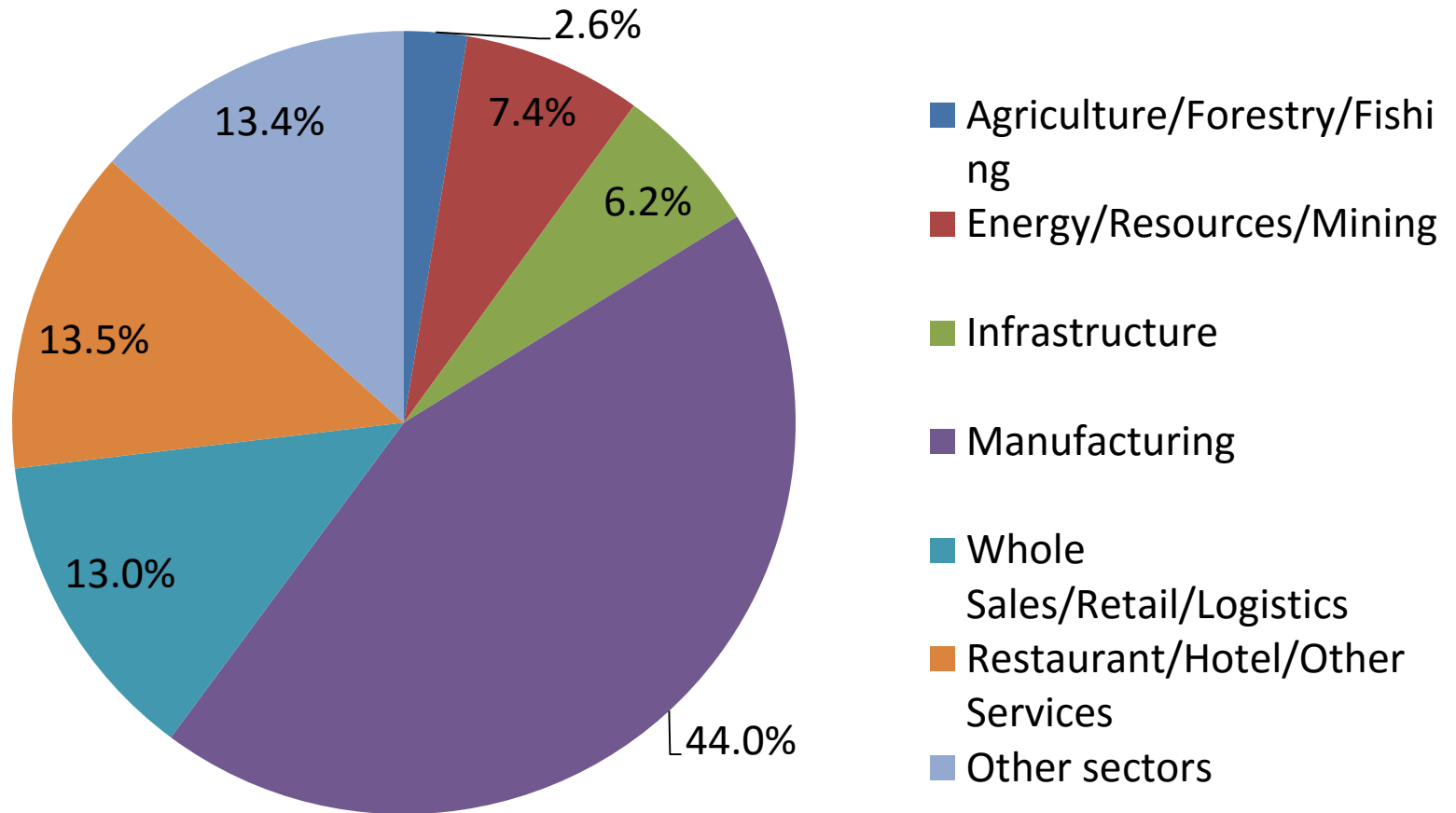
Projection of Global Investment 2015-2030



New commitments by China

- China adopts the “One belt One road” initiative in 2013, with three principles:
 - Wide consultation, joint construction, and shared benefit
- China initiates the AIIB in 2013 and is a founding country for NDB
- Xi Jinping announced in UN 2015 to set up
 - a sustainable development fund of \$2 billion, and more
 - a \$2 billion fund for South-South Cooperation.
- In the FOCAC meeting in South Africa in 2015, Xi committed to support Africa transformation by \$60 billion dollars in three years, consisting, grants, no interest loans, concessional and non-concessional loans
- China will set up a industrial capacity cooperation fund with a \$2 billion dollars

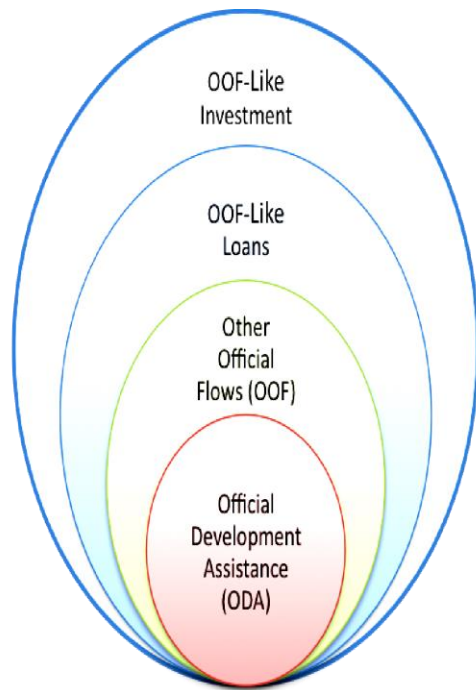
China's Private Sector Investment in Africa



Source: Shen, 2015.

There is a need for redefine development assistance

Definitions of Development Assistance



- The role of emerging donors will continue to rise, providing funding, promoting learning by doing, transferring tacit knowledge through south-south development cooperation
- ODA (official development aid) will decline in relative importance in the next decades;
- But other official flows (OOF) and other official flows-like loan (OOF-like loans) will grow.
- There is a need to expand the definitions of development assistance to include ODA, OOF, OOF-like loans (blended, like AIIB, CDB, EXIM bank), and OOF-like investments (Equity investment, SWF, and Silk Road Fund)
 - $DF1=ODA$
 - $DF2=DF1+OOF$
 - $DF3=DF2+OOF\text{-like loan}$
 - $DF4=DF3+OOF\text{-like investment}$

Comparison of North-South and South-South Development Cooperation

- Conventional North-south development aid and concessional loans are not effective for structural transformation:
 - Based on development experiences and theories in the north
 - Narrow definition of Official Development Aid and concessional loans
 - Untying aid with trade and structural transform
- South-south development cooperation are more effective for structural transformation:
 - Based on the development experiences from the South
 - **Combining Aid, Trade and public and private investment**
 - Utilizing comparative advantages of all countries

Opportunities for Structural Transformation from South-South Development Cooperation

Flying Geese and Development Success

- A key for the few successful catching economies is that their governments played a facilitating role to capture the window of opportunities arising from the relocation of light manufacturing in the world to jumpstart their industrialization and structural transformation
 - Japan in the post WWII
 - The four East Asian Tigers in the 1960s
 - China in the 1980s

China As A Leading Dragon for Industrialization in the Developing World

- **In my WIDER Lecture in 2011, I pointed out that China has absorbed its surplus labor and wages have increased rapidly**
- **The rise of wage will induce China to move up the industrial ladder from the labor-intensive industries to more capital-intensive industries.**
- **With 85 million manufacturing jobs, China's upgrading to capital-intensive industries will leave a huge window of opportunity for MANY low-income developing countries to jumpstart sustainable structural transformation through the development of labor-intensive manufacturing**

Huajian Shoes: A quick win in Ethiopia



- With the information from my WIDER Lecture, PM Meles went to China to personally invite shoe manufacturers to invest in Ethiopia's Eastern Industrial Park.
- Huajian visited Addis Ababa in October 2011, decided to make the investment on the spot and recruited 86 workers for training in China.
- Two production lines with 600 employees were set up in January 2012 with the management of UNIDO Goodwill Ambassador Helen Hai.
- The first shipment for export to the US was made in March 2012. The employment reached 2000 by Dec. 2012 and 4000 by the end of 2013.
- The quick success of Huajian produces a snowballing effect on attracting FDIs to Ethiopia. The 22 factory units in a new industrial park in Bole Lamin were leased out in just three months in 2013.

C&H Garments: A quick win in Rwanda



- Encouraged by the success of Huajian in Ethiopia, President Kagame actively attracts light manufacturing FDI to Rwanda.
- C&H Garments, under the facilitation of UNIDO Goodwill Ambassador Helen Hai, decided to invest in the Kigali Special Economic Zone in 2014
- Training of 300 Rwandan workers to produce protective clothing and T-shirts for export started in March 2015. The employment increased to 500 in July.
- The shipment of protective clothing for export started in August, 2016
- The C&H Garments' employment reached 1000 by May 2016.
- The success story is expected to have a snowballing effect on attracting FDI to Rwanda as well

Dongao Garments: A Quick Win in Tanzania



- Dongao is a leading Chinese garment factory, with 10000 worker in Changzhou, China and 20000 workers in Cambodia
- Dongao made an investment in the Export-processing zone in Dar es Salaam in 2013
- It employs 1400 workers now and plans to expand to 10,000 workers in 5 years

Concluding Remarks

- Investment is essential for successful structural transformation. A country with a strategy to develop its economy according to its comparative advantages will generate abundant savings to support domestic investment
- Development assistance will be helpful for development if they are used for expanding the government's resources for facilitating structural transformation
- Both because of conventional development aid/concessional borrowing's poor development results and likely decline of development assistance from the north countries, there is a need to go beyond conventional development aid and concessional loans to include OOF, OOF-like loans and OOF-like investments from emerging market economies in the definition of development assistance.
- There is a window of opportunity for industrialization and structural transformation arises from the pending relocation of light manufacturing from China and other emerging market economies due to their rising wages
- Tanzania and other African countries can grow as dynamically as any successful countries in East Asia and other parts of the world, if they have an enabling government to facilitate private firms to capture the window of opportunity.
- Increase of development assistance, based on the expanded definition, from the south will assist Tanzania and other countries in the south to better capture the window of opportunity for structural transformation

JUSTIN YIFU LIN

YAN WANG

Beyond Aid

Development Cooperation
for Structural Transformation