STUDY

ECONOMY AND FINANCE

G20 COMPACT WITH AFRICA

The Audacity of Hope

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The verdict on the Compact with Africa (CwA) in its third year is that private cross-border equity flows have not materialised and neither have domestic resources been mobilised. The African countries are not to blame, as their governance scores have improved.

Currently, it seems that the CwA is primarily owned by civil servants from the World Bank and the International Monetary Fund. Moreover, neither the private corporate sector nor institutional investors seem to have fully bought into the CwA.

The CwA fails to stimulate inclusive growth. The weaknesses of the CwA approach illustrate the need for a new agenda for development cooperation.

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EXECUTIVE SUMMARY

While there has been a long history of G7 initiatives relating to Africa, the Compact with Africa (CwA) is the first comprehensive initiative between the G20 and Africa.

The CwA's primary objective is to increase the attractiveness of private investment in Africa through substantial improvements to the macro, business and financing frameworks. It aims to leverage private financing for infrastructure projects via blended finance to mobilise subsequent foreign direct investment (FDI) flows. The Compact brings together selected African countries, international organisations — primarily the IMF, World Bank Group (WBG) and African Development Bank (AfDB) — and bilateral partners from the G20 to coordinate country-specific reform agendas, support respective policy measures and advertise investment opportunities to private investors. Through the Africa Advisory Group (AAG), the G20 tracks the progress of governance and cross-border flows.

In principle, any African country can join the Compact. The current group of African CwA partner countries, however, evokes the Heavily Indebted Poor Country (HIPC) initiative of the 1990s, suggesting that political ›like-mindedness‹ may have been a factor in the selection of the African CwA partners. The nine low-income countries (LICs) of the 12 CwA partner countries were part of the HIPC initiative and were granted debt relief by bilateral Paris Club creditors from 1996. Further, the Multilateral Debt Relief Initiative (MDRI) adopted in 2005 allowed for the cancellation of the claims of the International Monetary Fund (IMF), WBG and the AfDB on HIPC completion point countries. It is precisely these multilaterals who are managing the Compact Initiative today. In this sense, the CwA initiative is a *déjà vu* experience for Africa's HIPC countries.

The African CwA partners are, therefore, countries with a history of low ›debt tolerance‹. It is surprising, considering the limited capacity of these countries to mobilise tax revenues, that the Compact favours financial instruments that tend to raise infrastructure debt and implicit fiscal liabilities, such as blending and public-private partnerships (PPPs).

To monitor CwA partners in Africa, the G20 relies heavily on internationally recognised indices such as the World Bank's Ease of Doing Business (EoDB) index. However, these indicators reflect the perceptions of narrow groups of individuals, mostly educated in advanced countries, and implicitly refer to *levels* of development instead of the pace of sustainable transformation. The governance indicators promoted by the CwA do not necessarily touch on the driving forces behind institutional, economic, political and social change. As well as the governance indicators, the quality of institutions — as measured by the World Bank's Country Policy and Institutional Assessment (CPIA) — is a key component of the monitoring mechanism integrated in the CwA design. CPIA scores determine the investability of CwA countries as they form the backbone of IMF/WB debt sustainability assessments. The IMF assessment of debt sustainability provides an important signal to private portfolio investors and creditors, both domestic and foreign, and can act as a barrier to new private capital flows.

The strong negative correlation between per capita income (PCI) and the relative importance of private finance in cross-border financial flows may have been part of the impetus for the CwA, notably via instruments of risk mitigation. It would be undeniably impressive if the CwA managed to meet the challenge of stimulating private capital flows into African compact partner countries. It would also be reasonable to expect the same, ex ante, for African infrastructure funding. Traditionally, the private response to funding African infrastructure has been negligible. Nonetheless, the Compact seeks to address the trend that official development assistance (ODA) is declining and that financing for development will increasingly have to come from the private sector.

Two years is perhaps not long enough to allow for an appraisal of how effective the CwA has been in achieving its aims. Thus, the dominant approach in the official documents has been *input* orientation rather than *output* monitoring. By contrast, this study is data driven. It assembles the most recent data on governance, debt, capital flows and savings in the 12 current CwA partner countries. Governance scores have improved since 2016. However, FDI and national savings have not yet responded accordingly. In fact, both fell for the majority of CwA partners during the 2017–18 period. Thus, it often proved impossible to tame public debt dynamics. In view of the macroeconomic data discussed here, the positive tone of the CwA Monitoring Reports to date appears hollow.

In the 2019 Monitoring Report, the African Center for Economic Transformation (ACET) concluded that the reciprocal commitment of investors was not guaranteed within the CwA, resulting in an ill-defined ›value proposition‹. Consequently, the Compact is neither fully understood nor fully owned by the governments of CwA countries, even two years after it was launched. Our interviews have revealed doubts, even in Berlin, about the sequence envisaged by the CwA architecture: first African CwA partners implement reforms, then private capital flows will arrive.

It certainly isn't a given that the CwA countries will form a club of middle-income countries (MICs). Some of the CwA countries might have the opportunity to create a club of MICs, provided they are able to tap into their economic potential. This, in turn, could occur if the economic policies of African countries, and also the CwA, help to bring about structural change. At present, structural change is slow, the modernisation of agriculture is sluggish, and informality and thus poverty are prevalent. But, in the 2010s, before the Compact was launched, rising inflows of FDI, high growth rates, partly thanks to numerous reforms (industrial policy, better governance indicators and Human Development Indices or HDI) gave cause for optimism. Through their cooperation with the G20 countries, the CwA members can hope to further reduce both poverty and underemployment.

In this study, we take a more detailed look at three quite different CwA countries, with which Germany has established a special partnership: Ethiopia, Ghana and Senegal. In all three countries, the presence of China and other emerging partners has helped boost growth in the last decade by stimulating raw material prices, providing lending from non-Paris Club countries and removing some infrastructure bottlenecks to improve trade logistics. Further, all three countries are characterised by an important agricultural sector and high informality.

The contribution of manufacturing to the creation of better jobs is inadequate in all three countries, particularly given the importance of young entrants into the respective labour markets. Economic growth has, therefore, been largely ›jobless‹, failing to generate enough employment for the large number of young people. The imbalance between the increase in the supply of and demand for workers has resulted in higher and persistent unemployment. Manufacturing firms rely heavily on imported raw materials, which is generally not to their advantage given the limited availability of foreign exchange and lack of access to adequate credit — particularly for small and medium-sized enterprises (SMEs).

The CwA is a comprehensive blueprint for the development of selected African countries that aims to draw in the private sector rather than the country relying on official aid support. However, major shortcomings of the CwA architecture hinder its effectiveness. As already stated in our 2017 report, we feel that the Compact is not fit for purpose — namely to support resource mobilisation in low-income Africa.

– The verdict on the CwA in its third year is that the anticipated private cross-border equity flows have not materialised and neither have domestic resources been mobilised. Thus, it has often proven impossible to tame public debt dynamics. The African countries involved in the Compact are not to blame, as their governance scores have mostly improved. While they have fulfilled their part of the deal, there has been no strengthening of private cross-border equity flows or domestic resource mobilisation.

– For the majority of CwA countries, there has also been no tangible upswing in private cross-border flows. To revive the Compact initiative we would need to raise expectations and improve ownership, clarify the function of Compact Teams and provide better capacity support. As stressed by the ACET, the CwA model is neither fully understood nor owned by the governments of CwA countries. The value proposition of the initiative is not clear. Moreover, it is highly uneven as the CwA Country Matrices are full of stipulated government actions and quantitative monitorable targets targeting the African partner countries.

– Currently, it seems that the CwA is primarily owned (and scripted) by civil servants from the WBG and the IMF. Moreover, neither the private corporate sector nor institutional investors seem to have fully bought into the CwA. Despite occasional announcements at seminars and conferences, the proliferation of German support measures provided by the various government ministries and of policy actions required of the 12 CwA partners outlined in each of the country Policy Matrices can be blamed for the fact that CwA country governments have become confused and thus failed to actively guide the Compact initiative.

– The weaknesses of the CwA approach illustrate the need for a new agenda for development cooperation. The CwA fails to address the issues of how to achieve inclusive growth and how to eradicate poverty. The CwA currently being implemented represents a departure from the objectives set out in the Millennium Development Goals and Sustainable Development Goals (SDGs).

– It is important to recognise that FDI alone will not be able to correct jobless growth. FDI in African countries is capital- and technology-intensive, i. e., the number of jobs created is low. Since the CwA mainly focuses on large-scale investment, there are certainly labour market effects, but these are essentially rather small. On the other hand, FDI in the production of simple consumer goods — such as textiles and food — mainly aims to address the low wages. Here the number of jobs created is greater, but the labour market effects in capital-intensive production are comparatively limited. This is mainly due to the fact that proactive industrial policy would be necessary to achieve employment gains through linkages between foreign investors and local companies. However, the CwA does not envisage any labour market measures of this type.

– Policies that enhance the complementarities between FDI and domestic investment should be promoted to ensure inclusive and sustainable growth. This should be a task for the country teams. The CwA strategy assumes that a high level of infrastructure investment and FDI will automatically result in linkages. However, the development of backward linkages and local supply chains depends on (a) a favourable investment climate and (b) proactive measures to support local businesses generating growth and employment. If the backward and forward linkages increase, this can lead to a greater dissemination of knowledge, technology and know-how, and also create employment. Government efforts to promote access to credit through financial sector reform remain important for strengthening local enterprises. But governments also need to encourage foreign firms to create linkages with the domestic suppliers. This could be achieved by introducing incentive systems and/or local content requirements. Or by promoting a change in industrial policy direction, i. e., no longer focusing on developing a national industry as a whole, but rather concentrating on sector-specific measures. If these measures are introduced in sectors which already have a comparative advantage, the upgrading of local enterprises can be managed more easily. This requires moving up through the value chain of a particular commodity or set of commodities to higher value-added activities. African economies can benefit most by specialising in particular segments of a value chain. This more focused type of policy can already be identified in some African countries such as Morocco, Tunisia, Senegal, Rwanda and Ethiopia.

– Many countries are investing in the development of Special Economic Zones (SEZs) and industrial clusters to attract foreign investors. There are a few examples of success, such as in Ethiopia, Ghana and Senegal, but some of these SEZs have had and continue to have major problems. Many have not even been very fruitful in terms of job creation or technological development. Some of them remain isolated enclaves linked to the surrounding area only by labour force employment. Nevertheless, SEZs also have many potential advantages, including better transport systems, qualified labour and reliable access to electricity. Industrial clusters can also generate external economies. Although many clusters accommodate micro-enterprises and are informal, some become dynamic hubs where start-up companies also become active. Support programmes for start-up companies and medium-sized enterprises, funds for young entrepreneurs, easier access to finance, and business development services can drive innovation and job creation. This can, in turn, help to attract FDI and encourage subcontracting to local medium-sized enterprises. Although the SEZ concept is not a panacea for unemployment and poverty, the measures mentioned above can support the development of local companies in the service sector, in industry and in agriculture.

– The CwA should focus on activities promoting the developmental role of SMEs. Dismantling market entry barriers for SMEs can stimulate economic growth and, hence, boost employment and raise incomes. Although the overall environment for enterprise development has improved, the World Bank's EoDB indicators show that the situation remains critical for SMEs in many CwA countries. The German measures within the framework of the Development Investment Fund (DIF) complement the CwA agenda. Conceptually, the DIF measures have a different approach to the CwA. They provide support for medium-sized enterprises and start-up companies, promote the integration of African companies into the supply chain, and focus on vocational training measures through the Special Initiative on Training and Job Creation (SIT). The aim is to stimulate sustainable investments with a high employment impact. The DIF implements projects in the reform partner countries Ethiopia, Côte d'Ivoire, Ghana, Morocco, Senegal and Tunisia. Projects in Rwanda are in the pipeline. The special initiative is thus intended to contribute to the implementation of the G20 CwA. How effective and successful the initiative will be still remains to be seen.

– Interventions at sector level, coordinated around a targeted set of activities and embedded in a competitive framework, can be an important driver of economic transformation. This, in turn, is crucial for sustained job creation, inclusion and diversified economies. The key factor here is that sector-level interventions (and not just interventions at the company or country level) are important and have implications for actors looking to support economic transformation. Economic opportunities were identified in all the countries where transformation had been successful. This included, for instance, the identification of opportunities in rising markets (Ethiopia, Rwanda), opportunities presented by global outsourcing, such as automobiles in Tunisia, Morocco and Egypt, the pivotal role of agriculture in some African economies, such as cocoa in Ghana, Senegal and Côte d'Ivoire, and using SEZs and trade preferences in the garment sector as a first step into manufacturing in Ethiopia (which also created jobs for women).

– Although many countries still regard manufacturing as especially important, it is necessary to focus activities on the sectors with comparative advantages, including ›industries without smokestacks‹ (ICT-based services, tourism and transport), which are outpacing the growth of the manufacturing sector). The challenge is to use the opportunities in these industries in a way that sets the virtuous circle of learning, diversification of capabilities and knowledge spillovers in motion.

– The CwA agenda also seeks to improve countries' export performance. This requires the development of infrastructure and FDI inflows. However, in order to fundamentally improve export performance, more far-reaching measures must be implemented. Since Africa's ability to compete with Asian manufacturers is limited, alternatives must be found. Reports by UNIDO, UNCTAD, FAO and the World Bank present some viable options. Agricultural exports share many of the features of manufacturing, both in terms of their potential to spur growth and employment, and the institutional constraints they face in trying to achieve this potential. Agricultural products, such as cotton, coffee, cocoa and groundnuts, still dominate the exports of many CwA countries and affect the livelihoods of very large numbers of rural residents and smallholder farmers. Exports of specialty coffees, e. g., in Rwanda, illustrate the potential gains from exports of agricultural commodities through technological transfer and product upgrading. The neglect of the agricultural sector, which employs the majority of people in the CwA countries, can be addressed through the targeted agricultural modernisation associated with the development of agro-industries. This would require expanding the infrastructure not only in the urban centres but also the neglected rural areas.

– Despite the opening of African markets to a large extent, foreign trade has not developed favourably. There are still strong asymmetries, diversification in foreign trade has only progressed slowly, integration in value chains is limited and, as a consequence, knowledge and technology diffusion currently play a marginal role at best, not least because the educational efforts and research activities of many African countries lag behind those in other regions. Africa's innovative efforts are limited to initial attempts to imitate the abilities of successful countries and to use growth successes by importing modern goods to generate innovations in local companies. The start-up scene in African countries is often in its infancy and only a few countries have had breakthroughs here (Tunisia, Morocco, Senegal and Ghana). The implication could be to focus on the endogenous development that can be promoted by a developmental state through reasonable protective measures and incentive systems. This is all the more urgent since the protectionism of the USA, China, the European Union and other OECD countries, as well as the emerging economies, does not exactly offer good opportunities through integration, since the economic power constellations (large multinational corporations, subsidies in the OECD world) obviously lead to exclusion rather than inclusion and convergence. Asymmetries between the world's leading countries and Africa are increasing and technological delinking processes are deepening. Consequently, the postulate of ›endogenous development‹ will have to be revived through selective dissociation policies.

Due to its special agenda focused on developing infrastructure and promoting FDI, the CwA pursues a policy that does not trigger structural change towards the development of local entrepreneurship, industrial clusters, the modernisation of agriculture and thus broad-based employment, but instead is a model oriented towards exports. Exports can help to enable loans to be repaid and thus help to prevent countries from falling into debt traps. This strategy makes sense, but has the disadvantage that endogenous growth generated by the activities of local farms and companies is counteracted to a certain extent. Thus, the CwA strategy can have unintended consequences. These include a) the danger of pure contract processing; b) the risk that not enough new jobs will be created; c) concentration of FDI on enclaves that are poorly linked to local industry; d) FDI necessarily involving the import of intermediate products because local firms do not produce the necessary intermediaries; e) the creation of low-paid jobs; e) future profit repatriation of FDI burdening the country's balance of payments and lowering local purchasing power (this is something clearly shown by investment in the Ethiopian textile industry); f) the danger of the CwA promoting ›jobless‹ growth by focusing on large-scale projects that benefit foreign capital rather than African entrepreneurship and farms and lastly; g) the danger that the CwA may aggravate the labour market situation by diverting resources into non-sustainable and non-inclusive areas.

1

INTRODUCTION: STUDY AIMS

The Compact with Africa (CwA) is a long-term initiative. Since it was launched in 2017, it is, however, not too early to investigate what the initiative has achieved so far. So, firstly, what do we mean by ›achieved‹? On a general level, we would like to trace the extent to which the self-declared goals of the Compact have been reached: better governance, more private capital inflows and improved mobilisation of local resources to remove obstacles to African jobs and growth, particularly infrastructure bottlenecks. On a more detailed country level, we attempt to explore whether the CwA initiative is supporting sustainable structural transformation towards better jobs and lower poverty. We try to identify the policy measures that are particularly promising in this regard. Ethiopia, Ghana and Senegal have been selected as case studies. These sub-Saharan countries have negotiated special reform partnerships with the German Federal Ministry for Economic Cooperation and Development (BMZ).

After the introduction, in Chapter 2 we will provide an overview of the development trends in African countries with a special focus on the CwA countries. Chapter 3 is dedicated to the antecedents of the G20 Compact, and Chapter 4 goes on to present the architecture and original concept of the CwA. Chapter 5 highlights the governance indicators the German government used for CwA country selection and monitoring. Chapter 6 discusses the controversial role of private foreign capital in sustainable transformation. In terms of quantified results, Chapter 7 reports how governance scores, private capital flows, debt and domestic savings have developed in the 12 CwA countries over the past two years. Chapter 8 analyses the main components of structural transformation on the African continent. Chapter 9 provides a more detailed description of three different countries Ghana, Senegal and Ethiopia. Chapter 10 sheds light on the German discussion on the issue and addresses the question of the role of Germany in implementing the Compact. Policy recommendations are made in the final chapter.

2

AFRICA IS CHANGING

For some African countries, many positive developments can be reported. The African continent with its 55 countries is undergoing fundamental change. The »great transformation« is taking place[1] and it is bringing an increase in PCIs, improved access to education and health, the reduction of poverty, the rise of middle classes, urbanisation with growing inequality and informality, and employment crises in its wake. Some countries, such as the CwA partners Ethiopia, Rwanda, Ghana and Senegal, have recorded relatively high economic growth for over a decade. Many countries have been able to increase school enrolment rates. And still others have managed to increase investment. Another positive aspect is the increased commitment of the African community of states, evidenced by initiatives such as the plan to create an African Continental Free Trade Area (AfCFTA) or the many ideas for industrialising the continent. The fact that development aid no longer plays such a major role is a sign that Africa wants to make progress on its own.

Population growth in Africa is extremely high. In most countries it is above 2.7 per cent (for CwA countries, see Table 1). In 28 African countries, the population will double between 2010 and 2050. By 2050, the continent's population could reach two billion. The working-age population is set to increase even more rapidly — from about 480 million in 2013 to 1.3 billion in 2050. In most African countries, population growth over the last 30 years has, on average, been only slightly lower than economic growth and growth in food production.

Most CwA societies have become caught in the Malthusian trap. This particularly applies to the CwA countries Benin, Burkina Faso, Côte d'Ivoire, Guinea, Rwanda and Senegal, despite the fact that urbanisation has led to a decline in growth rates in all countries.

The development of the population in select CwA countries, i.e., Ethiopia, Tunisia, Morocco, Ghana and Senegal shows the extent to which demographic transition has taken place.[2]

As the first country on the African continent, the age structure of Tunisia's population is now economically favourable. To date, however the country has failed to fully exploit this potential due to the lack of jobs for the large number of people of working age.[3] From a demographic point of view, Ethiopia's recent development can be described as a success story. Although the birth rate is still very high, the decline in fertility seems to be continuing. If this trend prevails, the population of Ethiopia could have a favourable age structure by 2035. From a demographic point of view, Ghana is ahead of the pack. No other country in West Africa has a lower average number of children per woman. The comparatively high degree of urbanisation in the country had an impact on

Table 1
Demographic Transition and Population Growth Rate

	2010	2018
Benin	2.8	2.7
Burkina Faso	3.0	2.9
Côte d'Ivoire	2.3	2.6
Egypt	2.0	2.0
Ethiopia	2.8	2.6
Ghana	2.5	2.2
Guinea	2.3	2.8
Morocco	1.3	1.3
Rwanda	2.6	2.6
Senegal	2.7	2.8
Togo	2.7	2.4
Tunisia	1.0	1.1
SSA	2.8	2.7

Source: World Bank data.

1 Robert Kappel (2020): *Afrika – Die große Transformation.* Berlin (forthcoming).

2 Lilli Sippel, Tanja Kiziak, Franziska Woellert and Reiner Klingholz (2019): *Africa's Demographic Challenges.* Berlin; available at: https://www.berlin-institut.org/publikationen/studien/afrikas-demografische-herausforderung.html

3 Hans-Heinrich Bass, Robert Kappel and Karl Wohlmuth (2017): *Starting Points for a National Employment Strategy for Tunisia.* Tunis: FES (April 2017); available at: http://library.fes.de/pdf-files/iez/13336.pdf

the national birth rate. Education is another major influencing factor in Ghana's positive demographic development. By 2015, on average, more than half of Ghanaians between the ages of 20 and 64 had attended secondary education. Especially among women, the educational level in Ghana is significantly better than in many other West African countries. In francophone West Africa, in international comparison, the average number of children per woman is highest in Senegal, where each woman has an average of 4.7 children. However, the state has taken measures in two areas in particular that could contribute to declining birth rates in the future: it has improved access to education for the young population and improved access to family planning services.

Africa's great transformation is having an impact on populations and countries across the continent, creating both opportunities and uncertainties. A positive trend can be seen in the urbanisation and diversification of both FDI and domestic investments.[4] Large consumer markets are emerging in African cities, attracting both foreign and domestic investors. Some African cities are becoming urban hubs with modern industrial and service companies and growing middle classes. However, this only applies to a limited extent in a small number of hubs, as most people in the cities work in the informal economy. The gap between the rich and the poor, between urban and rural, between large cities and small towns, and between those with and those without jobs, is widening. Social conflicts are intensifying.

The low level of market integration (especially in rural areas) caused by inadequate infrastructure measures implemented over recent decades poses a major challenge, results in high transport and trade costs and contributes to limited participation of workers, farmers, women and enterprises in economic life. African agriculture in particular is marginalised.[5] Only in the last decade have some African countries seen an increase in industrial value added, whether in the agro- or textile industry. Overall, the share of manufacturing industry in Africa is very low, averaging at just 10–15 per cent (see Figure 2). The technology gap between African and Asian countries is widening rather than narrowing, something which robotisation and digitalisation has had a particularly significant impact on recently. LICs, in particular, do not have the necessary financial resources, technological skills and adaptability and thus fall behind.

One indicator of positive change is the rising internal tax revenues in African countries. These are significantly higher than FDI and remittances. Increasing investment in infrastructure and the growing interest in Africa shown by investors from China, India, the Gulf States and Turkey over the past ten years indicate that changes are afoot. The growth of a local entrepreneurial class that invests locally also makes it clear that change is taking place in some countries. Perhaps the most crucial thing is the new self-confidence of African elites and a strengthening of civil society. Africa has changed. The plethora of positive developments has led many an observer to speak of the African continent as a place of hope.

So now the question arises: Is convergence taking place and will some African countries be able to bring about catch-up development? This is not a theoretical issue, but rather a question of whether and to what extent the CwA measures contribute to a process of catching up among the African CwA countries. If the CwA agenda boosts PCI and helps to reduce the gap between its partners and countries with higher incomes and lower poverty, then convergence effects will emerge. If CwA countries grow faster than other countries as a result of CwA measures, this will see them contributing to a more positive and sustainable development path, and to poverty reduction.

If we look at developments in Africa through the prism of certain economic findings, we come to realise that catch-up development appears to be more of an exception. Studies by Dani Rodrik[6] confirm this. Some countries, such as Korea or China, have caught up and become members of the club of the rich OECD countries. But African success stories are rare and most of these countries have become stuck in the lower-middle-income trap or have simply remained LICs.

To what extent do African countries converge, what kind of convergence exists and which countries are converging? To answer these questions, we need to reveal the convergence criteria: *absolute beta convergence* means that relatively poor countries with lower capital resources grow at a higher rate than relatively rich countries with higher capital resources. This is due to diminishing marginal returns on capital. Countries with low (high) capital resources achieve higher (lower) marginal returns on capital. In the long run, this approach will lead to a catch-up process in the poorer countries, so that all economies end up on the same growth path. Absolute beta convergence means that two countries with different gross domestic products (GDP) and PCI but with the same savings ratios, depreciation rates, population growth rates and technical progress rates converge to the same capital stock and PCI levels in the long run. The implication is that, of the countries with similar parameters, in theory, the countries that were initially poorer will achieve higher growth rates.

Conditional beta convergence means that countries grow faster, the further below their own long-term equilibrium growth (as determined by the national structural characteristics) they are. The implication is that structural characteristics, and not initial national income, determine the long-run GDP per worker. Thus, foreign assistance should

4 African Development Bank, Organisation for Economic Co-operation and Development and United Nations Environment Programme (2016): *African Economic Outlook 2016: Sustainable Cities and Structural Transformation.* Paris.

5 Theo Rauch, Gabriele Beckmann, Susanne Neubert and Simone Rettberg (2016): *Rural Transformation in Sub-Saharan Africa.* Berlin: SLE Discussion Paper (01/2016).

6 Dani Rodrik (2013): Unconditional Convergence in Manufacturing, in: *Quarterly Journal of Economics*, 128, 1: 165–204; Margaret McMillan, Dani Rodrik, D. and Í. Verduzco-Gallo (2014): Globalization, Structural Change, and Productivity Growth, with an Update on Africa, in: *World Development*, 63, 1: 11–32.

focus on removing structural barriers (in infrastructure, education or the financial system), but there is no need for an income transfer from richer to poorer nations. Growth economists do not assume absolute convergence, in which all poor countries catch up equally, but instead argue that there is conditional beta convergence. This means that economies converge to different steady states,[7] provided that these have differences in model parameters.

Some African countries have absolute beta convergence and have shown higher growth than other regions of the world over a long period of time. These include Botswana, Burkina Faso, Lesotho and the Seychelles, all of which have achieved positive growth since the 1960s. Since 2000, only six countries have achieved average growth of more than three per cent (including CwA countries such as Ethiopia, Rwanda and Senegal).[8] The others continue to lag behind.

A reduction in the dispersion of levels of income across economies is sometimes referred to as *sigma convergence*. It comprises an increase in PCI and a reduction in income differences relative to other regions of the world, e. g., OECD countries. Sigma convergence measures changes in the distribution of PCI. For this purpose, the distribution of PCI between the individual states is recorded and the standard deviation at the beginning and at the end of the selected observation period is determined.

Depending on which reference countries are used, the results for Africa are sobering. The study by Ranjbar et al.[9] shows that out of 52 countries examined over the 1969–2011 period, only five were able to initiate a catch-up process with the USA while 47 fell behind the USA. The IMF (2018) comes to a similar conclusion for the 2000–2017 period. While there are comparable countries in other regions that have been able to achieve higher growth and some convergence with the USA, there are only a few African countries that are actually catching up. This picture still proves to be relatively positive compared with the 1985–2000 period, which illustrates a very clear income divergence with the USA. Nevertheless, most African countries achieve neither conditional beta or absolute beta convergence, or indeed even sigma convergence with the USA.[10]

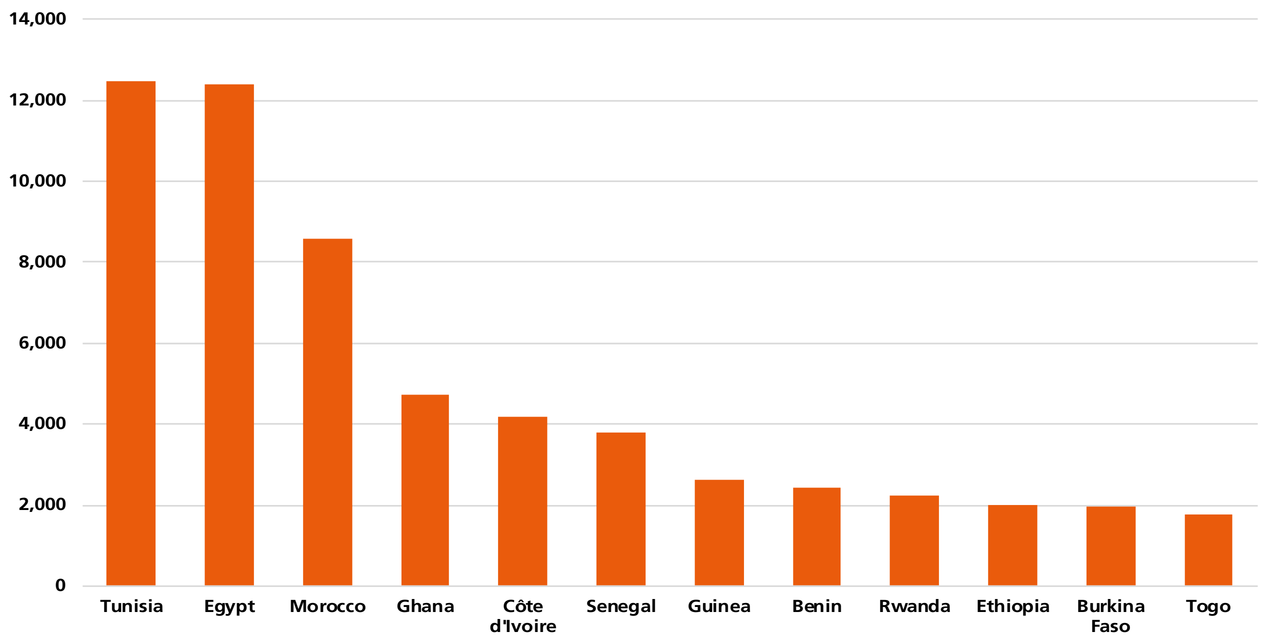
7 State of an economy in which all economically relevant variables, such as consumption, investment and workload, are constant over time or grow at the same rate (steady state).

8 Regarding poverty convergence, Ravallion (2012) documented a *lack* of cross-country poverty convergence, whereby countries starting out with higher poverty incidences did *not* subsequently experience faster poverty reduction than those starting out with lower poverty incidences. This view is contradicted in a new study by Yusi Ouyang et al., according to which »[p]overty convergence remains absent across LDCs during 1981–2014«, but »[i]n SSA, in contrast, we find strong cross-country poverty convergence«; Yusi Ouyang, Abebe Shimeles, Erik Thorbecke (2018): *Revisiting Cross-Country Poverty Convergence in the Developing World with a Special Focus on Sub-Saharan Africa*. Bonn: IZA DP No. 11388; available at: http://ftp.iza.org/dp11388.pdf; cf. Martin Ravallion (2012): Why Don't We See Poverty Convergence?, in: *American Economic Review*, 102, 1: 504–23.

9 Omid Ranjbar, Chien-Chiang Lee, Tsangyao Chang and Mei-Ping Chen (2014): Income Convergence in African Countries: Evidence from a Stationary Test With Multiple Structural Breaks, in: *South African Journal of Economics*, 82, 3: 371–391; available at: https://doi.org/10.1111/saje.12036

10 The convergence debate overemphasises growth compared to SDGs or the development of the Human Development Index (HDI). However, it can be shown that most CwA countries also have a low, albeit improving, HDI. The HDI includes income, life expectancy and education. For example, life expectancy has increased in most CwA countries, which is mainly due to improved healthcare systems.

Figure 1
CwA Countries GDP per capita, PPP (current international $), 2018



Source: World Bank data.

The best performing African countries were countries that were able to increase their PCI ($PPP)[11] by between three and six, including the CwA countries Ethiopia (4.12), Ghana (3.46) and Rwanda (4.2). Although most countries have more than doubled their PCI within 25 years, they still mostly remain in the club of LICs (such as the CwA countries Togo, Burkina Faso, Ethiopia and Rwanda). The ›best performers‹ were able to narrow the gap with the already relatively highly developed African countries and were therefore able to converge with them. They were also able to converge to the African average.

The expectation that some African countries can achieve higher inflows of FDI because of low wages in the production of simple consumer goods (T-shirts, shoes, refrigerators, bicycles, motorcycles) has long been frustrated. Most African countries have comparatively high wage costs (see Table 2), which have kept some foreign investors away. However, this is only one of the many reasons for the low inflows of FDI in most CwA countries (with the exception of some countries of North Africa). Other important explanatory factors for the absence or low inflow of FDI are the small markets, low purchasing power, high trade and transport costs and the comparably poor EoDB indicators. The extent to which low wage costs lead to a sustained inflow of FDI, such as in the Ethiopian textile industry (see Chapter 9.1), cannot be predicted at present.

There is evidence that Chinese and Indian companies are investing in African countries because of rising local wages.[12] Wages are now rising comparatively fast in China, Vietnam and Bangladesh.[13] Enterprises from China and India hope to be able to produce more cheaply due to wage differences and the opening up of new markets; their aim is to gain a strategic advantage over their competitors. China also wants to exercise strategic power. The hope that, due to rising wage costs in China, investors will now develop some African countries into ›industrial cores‹ is rather deceptive, however. Apart from a few textile and leather companies in Ethiopia and individual industrial companies in more developed Morocco, Tunisia, Egypt, Ghana and Senegal, there is not much evidence of such a trend.[14]

HOW STRONGLY DO AFRICAN COUNTRIES INDUSTRIALISE?

In principle, late industrialisers — like most sub-Saharan countries — face the problem that industrialisation can no longer be regarded as a panacea for poor growth and unemployment. Historically, sustained and high growth has been accompanied by industrialisation. This is the case in emerging economies but not on the African continent. While South Korea and Taiwan were already able to absorb about 30 per cent of the workforce in the manufacturing industry during the pre-globalisation phase from the 1960s to 1980s (35 per cent in Germany in 1970, 20 per cent in Mexico in 1990), Vietnam reached just 15 per cent (India, 13 per cent and China, 16 per cent, to date). It would be very difficult for most African countries to reach this level. Overall, the share of manufacturing industry in Africa is very low (see Figure 2), the same applies to most CwA countries (see Figure 3).

11 PCI PPP = GDP PPP (purchasing power parity) is GDP converted to international dollars using purchasing power parity rates. Purchasing power parities are the rates of currency conversion that eliminate the differences in price levels between countries.

12 Low labour costs are only one reason for investment. Other important factors include access to markets and raw materials, high growth at the investment destination and securing competitive advantages compared with other investors.

13 Helmut Reisen and Michael Stemmer (2018): Die drei Phasen des China-Schocks, in: *Blog Ökonomenstimme* (30.4.2018); available at: http://www.oekonomenstimme.org/artikel/2018/04/die-drei-phasen-des-china-schocks/

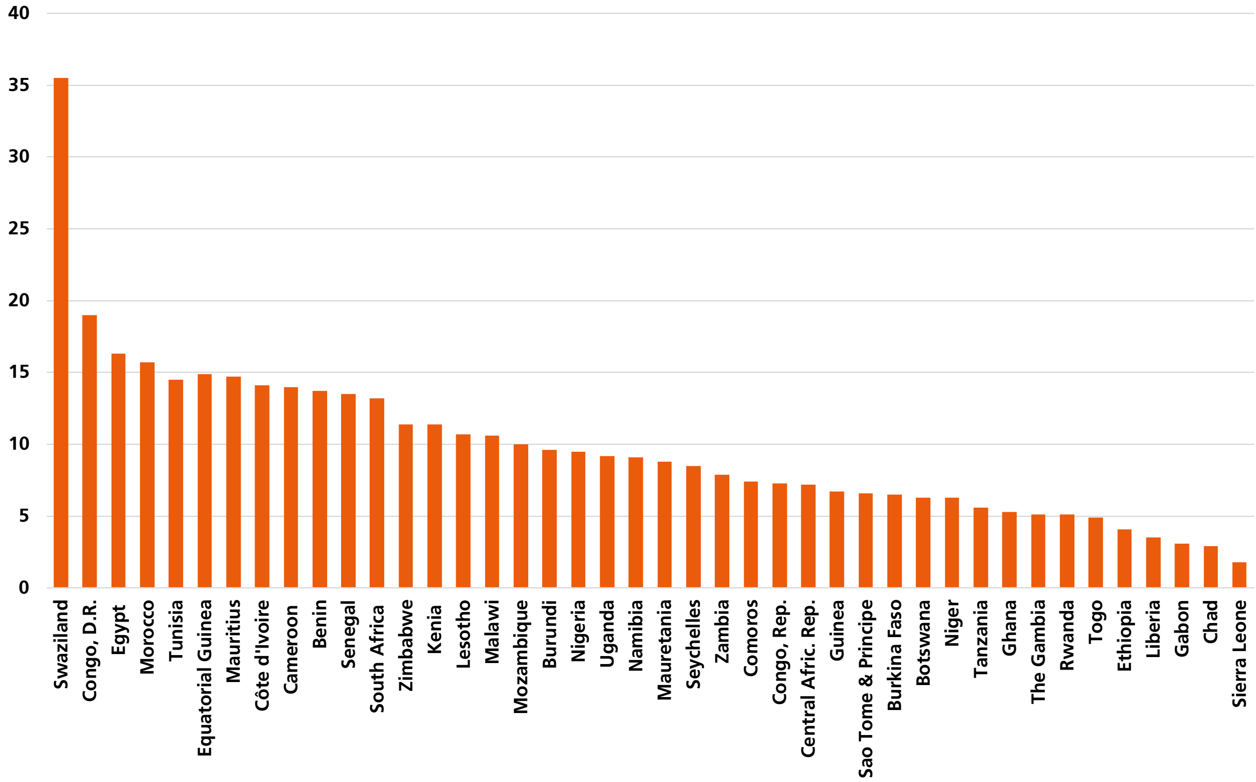
14 Jiajun Xu, Stephen Gelb, Jiewei Li and Zuoxiang Zhao (2017): *Adjusting to Rising Costs in Chinese Light Manufacturing: what Opportunities for Developing Countries?*; available at: https://www.odi.org/publications/10984-adjusting-rising-costs-chinese-light-manufacturing-what-opportunities-developing-countries; Xinshen Daio, Margaret McMillan and Dani Rodrik (2017): *The Recent Growth Boom in Developing Countries*. Washington, D.C.: IFRI Working Paper; available at: https://www.ifpri.org/publication/recent-growth-boom-developing-economies-role-services; Noah Smith (2019): *Africa Isn't Being Re-Colonized*; available at: https://www.bloomberg.com/opinion/articles/2019-07-15/africa-s-economic-development-isn-t-a-new-form-of-colonialism?srnd=opinion&utm_content=africa&utm_medium=social&utm_source=twitter&cmpid%3D=socialflow-twitter-africa&utm_campaign=socialflow-organic.

Table 2
Labour Costs and Capital Costs. Comparison of Selected African Countries with Bangladesh, 2017

	Labour costs/workers in US dollars	Capital costs/workers in US dollars	PCI
Bangladesh	835	1,070	853
Kenya	2,118	9,775	1,117
Tanzania	1,777	5,741	1,095
Senegal	1,562	2,422	775
Ethiopia	909	6,138	471

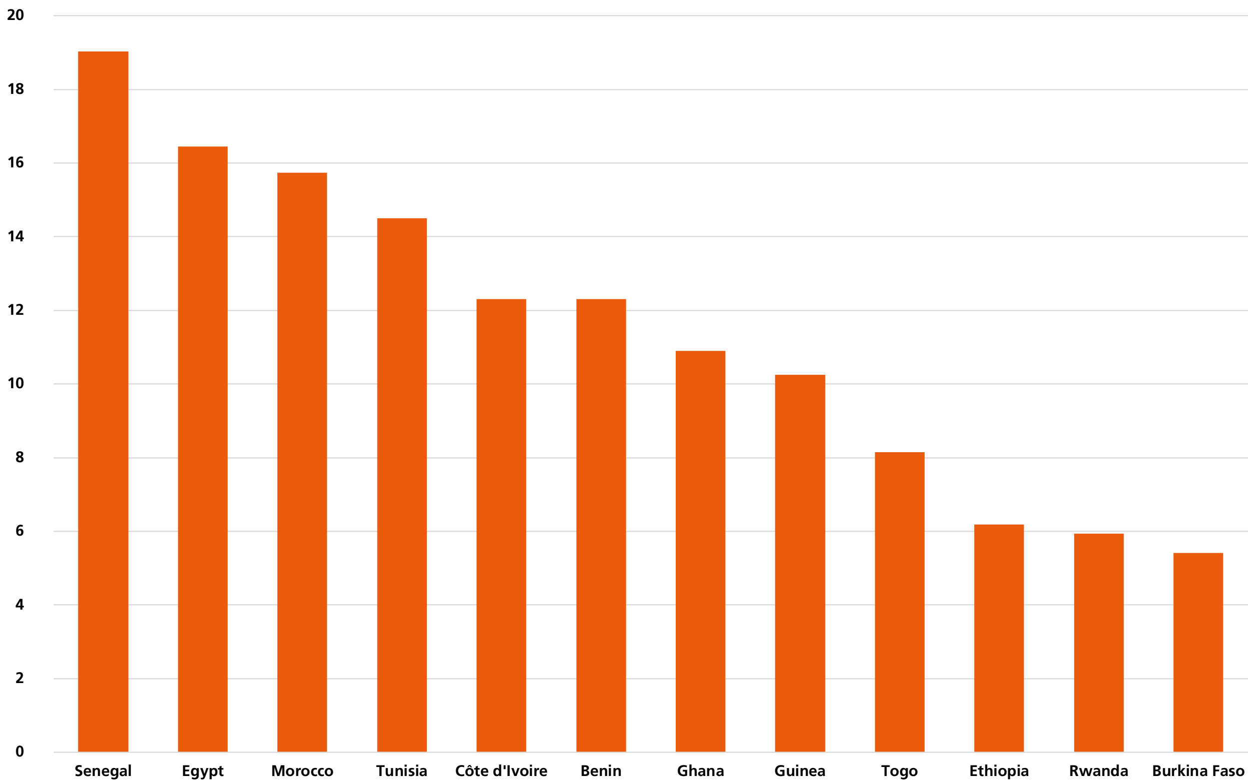
PCI = per capita income.
Source: Karishma Banga and Dirk Willem te Velde (2018): *Digitalisation and the Future of Manufacturing, London: Supporting Economic Transformation (SET) programme* (March 2018); available at: https://set.odi.org/wp-content/uploads/2018/03/SET_Digitalisation-and-future-of-African-manufacturing_Final.pdf

Figure 2
Value-Added Share of African Manufacturing Industry in GDP, per cent (most recent value available for 2014–2015)



Sources: https://www.brookings.edu/blog/africa-in-focus/2017/04/27/figure-of-the-week-manufacturing-value-added-in-sub-saharan-africa/; World Bank data.

Figure 3
Value-Added Share of CwA Countries' Manufacturing Industry in GDP, per cent (most recent value available for 2016–2017)



Source: World Bank data

With the exception of Senegal and the North African CwA countries, the CwA partners are lagging behind industrially and, in view of global competition, rapid technological change and global shifts in demand towards services, they are struggling to successfully industrialise and thus achieve any kind of significant increase in industrial employment. This is predominantly caused by globalisation.

The CwA does not address the process of industrialisation directly, but it assumes that the improved infrastructure and good governance (e.g., EoDB) will lead to higher investments, which will flow into industrial sectors, the service sector and agriculture. The implication is that higher investments — whether foreign or domestic — can also boost industrial development.

While the CwA stresses that the EoDB index and administrative competence are key criteria for investment behaviour, other aspects are equally important. Among other things, this is linked with the lower productivity in almost all CwA countries. Of particular importance, however, is the fact that most CwA countries enter the product cycle too late. Exceptions are the production of automobiles in Egypt, Tunisia and Morocco, which are operated by multinational corporations.[15] Product cycle theory describes the development from product differentiation to product standardisation. The cycle theory assumes that a good has three life phases: »new product«, »maturation process of the product« and »standardized product«.[16] The question that arises here is: Do CwA countries have comparative production advantages in a specific phase of the product cycle? This is theoretically possible. In the early phases of the cycle, the capital-rich industrialised countries have this advantage; in labour-intensive mass production, it is the low-wage countries that have the upper hand. Foreign companies themselves outsource standardised production or have local companies from developing countries that produce in the value chain. Most African countries have not been able to attract labour-intensive mass production even in countries with SEZs. Only in the past decade have we seen labour-intensive mass production emerge, be it in the agricultural sector, in the textile industry or in food production. Starting at a very low level, Ethiopia is attempting to industrialise and has managed this relatively successfully in recent years (see Chapter 9.1 Ethiopia). This success is partly due to the fact that the wages in Ethiopia's textile industry are comparatively low.

Overall, there is a very large technological gap between Africa's development process and that of the Asian countries, and the gap is widening rather than narrowing. Recently this has also been exacerbated by robotisation and digitalisation, for example. The starting scenario of the »technology gap theory« is a technological advantage in country A, which is used to produce new good x. After a certain time, a demand for this good x also emerges in country B, which, however, can only be covered by imports. However, this foreign trade, resulting from a technological gap in country B, does not last long: After a certain period of response and learning, companies in country B succeed in imitating products and consequently imports decline. The total amount of imports depends on the duration of the imitation phase. In China, Taiwan, Malaysia, Vietnam, Korea and other countries imitation has been successful, but this has not been the case in many African countries. LICs in particular, including some CwA countries with a lower PCI (Benin, Togo and Guinea, for instance), do not have the necessary technological skills and capabilities and thus fall behind.

This is also demonstrated by an analysis of digitalisation. Although Africa has seen very high growth rates in Internet use over the past ten years, it still lags far behind other regions. As Banga and te Velde (2018)[17] show, with the exception of Kenya, very few companies in the African countries surveyed use Internet at all. This is partly due to the high capital costs for digital development. Reducing the digital gap can encourage companies to invest more in Africa and help local entrepreneurship to open up new fields of business through the digital revolution. This is not the case in the majority of CwA countries as the conditions for industrialisation are lacking or only weakly developed. These conditions include sufficient infrastructure, adequate skill levels of companies and workers, and a competitive African SME sector.[18] Most African companies are small and informal and do not grow.

Currently, it is impossible to estimate the effects of robotisation in the OECD countries and China on Africa's devel-

15 Whether more recent investments or announcements of investments by corporations in Rwanda, Ethiopia, Côte d'Ivoire or Ghana suggest a revival of industrial production remains to be seen.

16 Gary Hufbauer (1970): The Impact of National Characteristics and Technology on the Commodity Composition of Trade in Manufactured Goods, in: Raymond Vernon (ed.): *The Technological Factor in International Trade.* New York.

17 Karishma Banga and Dirk Willem te Velde (2018): *Digitalisation and the Future of Manufacturing.* London: Supporting Economic Transformation (SET) Programme (March 2018); available at: https://set.odi.org/wp-content/uploads/2018/03/SET_Digitalisation-and-future-of-African-manufacturing_Final.pdf

18 The CwA does not address the dynamics of African companies. Only the business environment is factored into the discussion. The CwA's business framework primarily addresses regulatory uncertainties. Its agenda sets priorities regarding institutional and judicial bottlenecks, which include enactment of business rules, lack of access to information and discretionary treatment by government officials. Although it is absolutely necessary to resolve these basic problems, the CwA falls short when it comes to proactive strategies to support African enterprises. Robert Kappel, Birte Pfeiffer and Helmut Reisen (2017): *Compact with Africa.* Bonn: DIE Discussion Paper 13 (2017); available at: https://www.die-gdi.de/discussion-paper/article/compact-with-africa-fostering-private-long-term-investment-in-africa/; Robert Kappel (2016): Von informellen Unternehmen zum African Mittelstand? Differenzierungen im afrikanischen Unternehmertum, in: Antje Daniel, Sebastian Müller, Florian Stoll and Rainer Oehlschläger (eds.): *Afrikanische Gesellschaften im Wandel – Mittelschichten*, Mittelklassen oder Milieus?. Baden-Baden: 87–110; Oluyele Akinkugbe and Karl Wohlmuth (2016): Middle Class Growth and Entrepreneurship Development in Africa – Measurement, Causality, Interactions and Policy Implications, in: *Materialien des Wissenschaftsschwerpunktes »Globalisierung der Weltwirtschaft«*, Vol. 43. Bremen; available at: http://www.karl-wohlmuth.de/files/dateien/122_final_number_43_white_series___wohlmuth_akinkugbe_final_10_11_2016.pdf

opment. The question arises as to whether the industrialisation of Africa will face further obstacles if robotisation results in labour-intensive industries no longer being relocated to Asia or Africa, but rather remaining in Europe or even being relocated back to the EU.

To address this question, it would be helpful to first take a look at productivity. Dani Rodrik[19] assumes that there will be an unconditional convergence of labour productivity in the manufacturing industry. This means that the countries that are further away from the ›frontier‹ can grow faster and start a process of catching up. This is linked to the fact that the manufacturing industry is dependent on those commodities that allow countries to join global networks in order to implement technology transfers.

The following formula for labour productivity growth shows whether there can be absolute convergence in labour productivity

$$Gr\ LPt = \alpha + \beta\ (Log\ (LP)t\text{-}1 + ui$$

where Gr = growth and LP = labour productivity. The dependent variable is the growth of LP. The evaluations by Gelb et al. (2014)[20] show that a negative value of β leads to convergence of LP, i. e., some African countries manage to increase labour productivity. But whether this will be sufficient for them to grow industrially depends on a number of conditions. In addition, there is the fact that industrial investment creates far fewer jobs today than in previous decades due to productivity growth. In other words, even with large-scale industrial investment, demand for jobs is lagging behind, as Joseph Stiglitz[21] noted. Convergence of labour productivity does not necessarily mean more jobs.

As capital costs rise, African countries will find it harder to invest in new technology because it is expensive. As a result, many African countries — especially LICs — will not be able to easily digitise and thus will be excluded from global value chains (GVCs) or even be unable to enter them in the first place. If, on the other hand, the relative costs of capital fall (in relation to labour costs), then the production of finished goods could also be relocated towards the OECD world thus impeding Africa's opportunities for industrialisation and hence convergence. But the industrialisation measures adopted by many countries in recent years, the establishment of SEZs, support of industrialisation, investment in industrial clusters, the improved EoDB index and the measures taken to raise human capital and enhance governance are all bearing fruit.[22] This is clearly evidenced by the African transition countries, a group that also includes some CwA countries, such as Ghana, Senegal and the North African countries Tunisia, Morocco and Egypt.

GLOBALISATION REINFORCES ASYMMETRIES

Today, African companies compete with producers from all over the world. African firms no longer produce within the protective borders of their own country, but rather are exposed to competition from producers all over the world. The use of new technologies, which could, in principle, trigger a surge in industrialisation, is limited by rising capital costs, a lack of research and development (R&D) and low levels of human capital.[23] Investment in R&D could create technological externalities, but, with the exception of a few CwA countries (Morocco and Egypt), private and government R&D spending is extremely low.

The consequences of lagging behind in global competition like this are manifold:

- African countries require more FDI in their agriculture and industry and also higher local investment. This inflow of FDI could bring foreign technology and knowledge. It could also create world market access, stimulate local entrepreneurship and lead to growth in medium-sized enterprises. FDI can stimulate industrial processes and promote the modernisation of agriculture. It can also promote linkages between foreign and domestic enterprises if the appropriate economic policy measures are taken at the same time, e. g., through incentive systems to increase local content. FDI, however, still flows largely into the extractive sectors; these are large-scale investments that often have few linkages with local industries. The CwA focuses on these capital-intensive investments and thus contributes to the formation of enclaves and the development of SEZs, which also tend to have less of a positive impact on subcontracting to domestic companies. The data suggest that these investments will not facilitate any real catching up.

- Exports of manufactured goods are of marginal importance and their share in Africa has fallen rather than risen. Reducing the high trade and transport costs (ports, land transport) and the high non-tariff trade barriers in Africa, the EU, the USA and China will encourage export opportunities for African countries. The CwA rightly underlines the importance of expanding infrastructure.

19 Dani Rodrik (2013): Unconditional Convergence in Manufacturing, in: *Quarterly Journal of Economics* 128, 1: 165–204.

20 Alan Gelb, Christian Meyer and Vijaya Ramachandran (2014): *Development as Diffusion: Manufacturing Productivity and sub-Saharan Africa's Missing Middle* (Working Paper 357). Washington, D.C.: Center for Global Development; available at: http://www.cgdev.org/sites/default/files/development-diffusion-market-productivity_final.pdf

21 https://www.moneyweb.co.za/news/economy/stiglitz-the-east-asian-miracle-cant-be-repeated-in-sa/

22 Bright Simons: *Africa's Unsung »Industrial Revolution«*; available at: https://www.cgdev.org/blog/africas-unsung-industrial-revolution (21 March 2019). »There is an industrial revolution underway in sub-Saharan Africa's most entrepreneurial economies — places such as Ghana, Uganda, Senegal, and Côte d'Ivoire.«

23 Dani Rodrik (2018): *New Technologies, Global Value Chains, and the Developing Economies.* Oxford; available at: http://j.mp/2xYN1X5

– Intra-African trade[24] remains limited. The AfCFTA could boost trade inside Africa. It is a huge opportunity and a big step in the right direction. If properly implemented, it will increase Africa's economic growth and reduce extreme poverty more than any other single factor over the long term.

– The conditions for expanding local industries are severely limited, companies are mostly small and medium-sized enterprises are only just beginning to gradually emerge. But there are many ways to promote rather than hamper African entrepreneurship. This can be achieved by removing the numerous obstacles (for example, putting a stop to favouritism, providing unrestricted access to electricity, improving financing opportunities and eliminating tax disadvantages for SMEs) and by supporting start-ups, improving the EoDB indicators, fostering Business Development Services and promoting industrial clusters. Measures like this have been launched in many CwA countries, but they are far from sufficient, as all studies on the development of entrepreneurship in CwA countries show.[25]

– African companies are poorly integrated into global or regional value chains.[26] However, a slight trend reversal has been observed for some years now. African enterprises have managed to join GVCs in the apparel, food, car production and automotive industries as well as in some business services (see Tunisia, Morocco, Egypt, Senegal and Ghana). Global value integration is still constrained by traditional trade policy barriers. The AfCFTA should thus make eliminating these barriers a top priority. But African countries remain minor players in the global economy, accounting for just three per cent of global trade in intermediate goods. African countries' exports tend to feature at the very beginning of GVCs where a high share of their exports enter the value chain as inputs for other countries' exports, reflecting the still dominant role of agriculture and natural resources in their exports. If we examine countries' overall participation in agricultural GVCs between 1990 and 2015, CwA countries such as Tunisia, Morocco and Ghana stand out with increases in GVC participation.

– Industrialisation in SEZs is not really a panacea for most countries as the prerequisites for successful operations are usually lacking. But some countries, such as Ethiopia and Ghana, have shown that SEZs can be successful.

– It may be necessary to go beyond investment in the manufacturing industry with its low-skilled jobs and instead to invest in promoting qualified jobs in the service sector and in what are referred to as ›industries without smokestacks‹ (ICT, tourism, transport and banking services).[27]

A breakthrough in Africa's industrial development is unlikely to occur in the medium term. Many African countries have even deindustrialised, including some CwA countries. Most small countries, landlocked states, LICs and fragile states should not have high expectations of sufficient FDI or significant local industrial development, even if they pursue an industrial policy. Only a few larger CwA countries, such as Morocco, Tunisia, Egypt, Ethiopia, Ghana and Senegal may have the opportunity to develop industrial hubs. The stronger the local medium-sized enterprises, the better this will work. These companies will play a key role in economic growth and employment. FDI could play a complementary role in technology transfer through the integration of local enterprises into value chains.

There continues to be significant differences between the countries in Africa. There are some emerging countries, such as Ethiopia, Kenya, Rwanda and some MICs, which are converging, or at least keeping up. The majority of countries, however, face low growth and high poverty. The LICs tend to stagnate, which is partly due to particularly high population growth in these countries. A convergence club of around 20 African LICs and/or countries with high or even rising poverty is emerging. It is also unlikely that many African countries will be able to create internationally competitive industries, which is linked to the fact that productivity growth lags behind that of other regions and global competition is extremely high. When it comes to the digital revolution and robotisation, Africa is failing to catch up. Whether the CwA countries end up forming a club of emerging MICs cannot yet be foreseen. They are characterised by high growth resulting from numerous reforms (reformed industrial policy, better EoDB indicators, DBI, rising HDIs). Nevertheless, the potential of most CwA countries is far from being fully exploited. The extent to which the high growth actually indicates a structural transformation is not certain. Structural change is slow, the modernisation of agriculture is sluggish, informality and thus the poverty economy prevails.

24 Francisco Arizala, Matthieu Bellon and Margaux MacDonald (2019): *Regional Growth Spillovers in Sub-Saharan Africa.* Washington, D.C.: IMF Working Paper WP WP/19/160; available at: https://www.imf.org/en/Publications/WP/Issues/2019/07/24/Regional-Growth-Spillovers-in-Sub-Saharan-Africa-47005

25 Haroon Bhorat and Finn Tarp (2016): *Africa's Lions: Growth Traps and Opportunities for Six African Economies.* Washington, D.C.

26 World Bank (2020): *World Development Report 2020: Trading for Development in the Age of Global Value Chains.* Washington, D.C.; available at: https://www.worldbank.org/en/publication/wdr2020

27 Richard S. Newfarmer, John M. Page and Finn Tarp (eds.) (2018): *Industries without Smokestacks: Industrialization in Africa Reconsidered.* Oxford: UNU-WIDER Studies; Oyebanke Oyelaran-Oyeyinka and Karl Wohlmuth (2016): *New Investment Policies in Africa for Structural Change, African Development Perspectives Yearbook 19: Africa's Progress in Regional and Global Economic Integration, Towards New Trade and Investment Policies:* 169–206; Tilman Altenburg and Brahima Coulibaly (2018): *Meeting Africa's Employment Challenge in a Changing World.* Bonn: GDI Briefing Paper (18/2018). For additional concepts, strategies and measures stimulating FDI and supporting local businesses, cf. UNIDO (2018): *Industrial Development Report 2018: Demand for Manufacturing: Driving Inclusive and Sustainable Industrial Development.* Vienna; available at: https://www.unido.org/resources-publications-flagship-publications-industrial-development-report-series/industrial-development-report-2018; UNCTAD (2016): *Structural Transformation and Industrial Policy.* New York, Geneva; available at: https://vi.unctad.org/stind/; UNCTAD (2019), World Investment Report. New York, Geneva.

Despite the opening of African markets to a large extent, foreign trade has not developed favourably. There are still strong asymmetries, diversification in foreign trade has progressed only slowly and integration in value chains is weak. This means that knowledge and technology diffusion currently only play a marginal role at best, partly also because African educational efforts and research activities lag behind those in other regions. Africa's efforts to innovate are limited to initial attempts to imitate the abilities of successful countries and to use growth successes by importing modern goods to generate innovations in local companies. The start-up scene is often in its infancy and only a few countries have had breakthroughs here (Morocco, Senegal and Ghana).

The implication could be to focus on the endogenous development that can be promoted by a developmental state through reasonable protective measures and incentive systems. This is all the more urgent since the protectionism of the USA, China, the EU and other OECD countries, as well as the emerging economies, does not exactly offer good opportunities through integration, since the economic power constellations (large multinational corporations, subsidies in the OECD world) obviously lead to exclusion rather than inclusion and convergence. Asymmetries between the world's leading countries and Africa are deepening and, consequently, the postulate of ›endogenous development‹ will have to be revived through selective dissociation policies.[28]

To summarise: The CwA takes into account the links between macroeconomic framework conditions, business frameworks and financial frameworks. The measures envisaged by the CwA are important building blocks for the development of infrastructure, the flow of FDI and the debt situation. However, the CwA does not adequately factor in the links between good governance, EoDB and other similar indicators, and business dynamics. On the contrary, asymmetries are reinforced rather than addressed; The focus on large-scale investments leads to structural distortion rather than inclusive and sustainable growth, which would be necessary to help reduce poverty and unemployment. In order to make a more useful contribution to the catch-up process, industrialisation and the modernisation of agriculture, the CwA measures should be revised. Numerous studies and strategy papers published by international organisations such as the ILO, UNDP, FAO, UNECA and UNCTAD, as well as the World Bank's World Development Reports cited in this paper illustrate that the orthodox agenda of the CwA is not sufficiently committed to the aforementioned goals of inclusiveness and sustainability.

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28 Dani Rodrik (2015): *Premature Deindustrialization.* Cambridge, Mass.: Harvard University, Revised (November 2015); available at: drodrik.scholar.harvard.edu/files/dani-rodrik/files/premature_deindustrialization_revised2.pdf?m=1447439197; Andy Sumners (2018): *What is Premature Deindustrialisation and Does it Matter?.* London: GPID; available at: https://www.gpidnetwork.org/wp-content/uploads/2018/03/Brief_9.pdf; Justin Lin and Célestin Monga (2010): *Growth Identification and Facilitation: the Role of the State in the Dynamics of Structural Change.* Washington D.C.: World Bank Policy Research Paper 5313; available at: http://documents.worldbank.org/curated/en/438321468164948980/Growth-identification-and-facilitation-the-role-of-the-state-in-the-dynamics-of-structural-change

3

THE ANTECEDENTS OF THE G20 COMPACT WITH AFRICA

For Africa, the G7 or G20 summits have mostly evoked a mix of high expectations and disillusionment. All too often, aspirations and declarations from these groupings have fallen into oblivion once the group photos of the assembled leaders (occasionally dressed in traditional costume) have been disseminated by the world's media. Notably the G20 has displayed a tendency to launch new initiatives without following up on earlier ones.

There are noteworthy exceptions to this ›summit amnesia‹. The Cologne G8 Summit, 1999 brought a breakthrough for the HIPC initiative[29]. The Gleneagles G8 Summit in 2005 was perhaps the most productive in the 30-year history of the G7/8,[30] finally adding multilateral debt relief to the bilateral HIPC relief. The Hamburg G20 Summit in 2017 then focused attention on Africa and infrastructure finance. At the traditional meeting of G8 finance ministers before the 2005 summit, it was agreed to write off the entire 40 billion US dollars of debt owed by 18 HIPCs to the World Bank, the IMF and the African Development Fund. Its pledges for Africa by 2010 included, among others, 25 billion US dollars of aid for Africa, universal access to anti-HIV drugs in Africa, and the establishment of the Infrastructure Consortium for Africa (ICA) housed at the AfDB to monitor funding of Africa's infrastructure on a regular basis. The Gleneagles Summit was closely followed by the global financial crisis, and in 2009 the aid to GDP ratio tumbled.

The G20 started out in 1999 as a meeting of finance ministers and central bank governors. During the 2000s, the world economy saw a gradual shift towards emerging giants such as Brazil, China, India and Indonesia. Figure 4 shows that the combined G7 GDP now totals just 30 per cent of world GDP in PPP terms, while at the inception of the G20 in 1999, its share was still equal to the combined share of the group of emerging and developing countries. The G20 members account for 85 per cent of global GDP, 75 per cent of international trade and two thirds of the world's population. So the G20 seems a better equipped forum than the G7 to navigate the challenges of the global economy. The G20 now plays an important role in global standard-setting, beyond the individual interests of its members. However, Africa remains significantly underrepresented, with only South Africa a permanent member. Recently, the G20 has started to pay more attention to Africa, and the continent's future development is now somewhat higher up the grouping's agenda. According to African observers, »The G20 Initiative on Supporting Industrialisation in Africa and Least Developed Countries, launched under China's G20 presidency of 2016, and the 2017 German presidency's Compact with Africa offered unprecedented moments of engagement.«[31] Through its engagement groups[32] the G20 has brought views from different stakeholders into the forum, while in the formal participation processes of the sherpa (emissaries), finance and summit tracks it has sought to include other states.

Following the global financial crisis in 2008, the G20 convened country leaders to address not only crises and emergencies but also long-term structural challenges. A G20 Development Working Group was established in 2010. Since then, on the initiative of the Korean G20 presidency, Africa also has two observer seats, one for the AU chair and the other for the New Partnership for Africa's Development (NEPAD) chair. The G20 Action Plan on the 2030 Agenda for Sustainable Development was added in 2016 at the Hangzhou Summit in PR China. The 2016 summit also launched the G20 Initiative on Supporting Industrialisation in Africa and LDCs,[33] based on a report by the United Nations Industrial Development Organisation (UNIDO) prepared at the request of the G20 Development Working Group. The close relationship between Africa and China that had deepened over the 2000s had led to the triennial Forum of China-Africa Cooperation (FOCAC) ministerial conferences. Pressure from Africa increased Chinese willingness to include African development plans, such as the AU Agenda 2063: The Africa We Want, in China-Africa de-

29 Jürgen Kaiser (2019): *20 Jahre nach der Schuldenerlass-Initiative des Kölner G8-Gipfels: Was wurde aus den HIPC-Ländern?.* Berlin: Friedrich-Ebert-Stiftung, Globale Politik und Entwicklung (April).

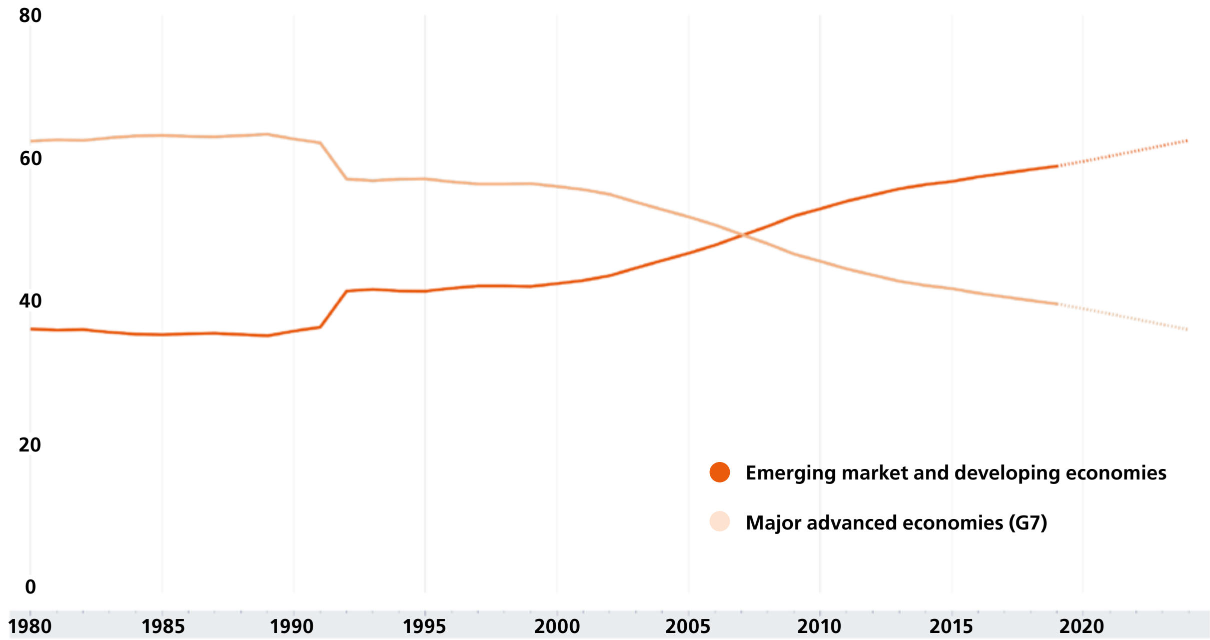
30 Russia repeatedly explained the switch from G7 to G8 and back to G7.

31 Cobus van Staden and Elizabeth Sidiropoulos (2019): *G20–Africa Engagement: Finding A Roadmap to Shared Development.* Johannesburg: SAIIA Occasional Papers No. 29 (February).

32 Business 20, Labour 20, Women 20, Think 20, Civil 20, Youth 20 and Science 20. South Africa co-chairs the AAG overseeing the Compact, but it has notably not joined the Compact itself.

33 http://www.g20.utoronto.ca/2016/supporting-industralization.html

Figure 4
The Declining G7 Share of World GDP, PPP



IMF, 2019; Source: World Economic Outlook (April 2019)

velopment initiatives. Africa's quest for a focus on industrialisation also informed the G20's enhanced engagement with Africa under China's presidency,[34] with a focus on skills transfer, notably in agribusiness.

The growing importance of Africa to the G20 was reflected in the creation of the AAG. Implementation of the CwA[35] became a focal issue for the German presidency after it presented the initiative to the G20 in early 2017. For the purpose of CwA implementation, the AAG, an informal body comprising a sub-set of G20 member countries, the African compact countries, the World Bank, the AfDB and the IMF, was created. In addition, the German government invited an African think tank, the ACET, to follow the process and provide research and knowledge and also access to networks. As well as preparing for the implementation of the CwA, an annual Monitoring Report and dedicated events to foster private investment are the core tasks of the AAG.

The AAG held its first meeting on 20 April 2017 in Washington, D.C., closely followed by another meeting on 4 May 2017 in Durban, South Africa. The Durban meeting brought together Compact countries, development partners and international organisations, and also representatives from the private sector. The representatives from Morocco, Rwanda and Senegal presented their reform programmes as well as investment opportunities for the private sector.

34 Van Staden and Sidiropoulos (2018): op. cit.

35 https://www.compactwithafrica.org/content/compactwithafrica/home.html

It is important to note, however, that African governments do not drive the preparation processes for the G20 summits despite their participation as observers during these events. Africa remains ›on the table‹ of the G20 instead of sitting ›at the table‹ for global agenda-setting and rule-making (Leininger, 2017),[36] although the AAG is co-chaired by South Africa (together with Germany) and the UN Economic Commission on Africa (with ACET and the OECD) also participates in the CwA. As to whether »countries are displaying ownership of the commitments made, unlike in the case of structural adjustment programmes that were externally imposed«?[37] ACET monitoring sheds doubts on this proposition, as will be discussed later in this study.

Compact Teams in each CwA country are set up to implement the initiative. A Compact Team coordinates in-country activities, including updating Policy Matrices, coordination among development partners and dialogue with respective governments. The Compact Teams consist of the CwA partner government, representatives from the three coordinating international organisations (World Bank, IMF and AfDB) and bilateral partners, including Germany. Originally the plan was for Germany to play the role of an important steward in the CwA process. But Germany could not really accomplish this role as the implementation of the Compact was ›outsourced‹ to the international organisations (see below).[38]

36 Jutta Leininger (2017): On the Table or at the Table? G20 and its Cooperation with Africa, in: *Global Summitry*, 3, 2: 193–205.

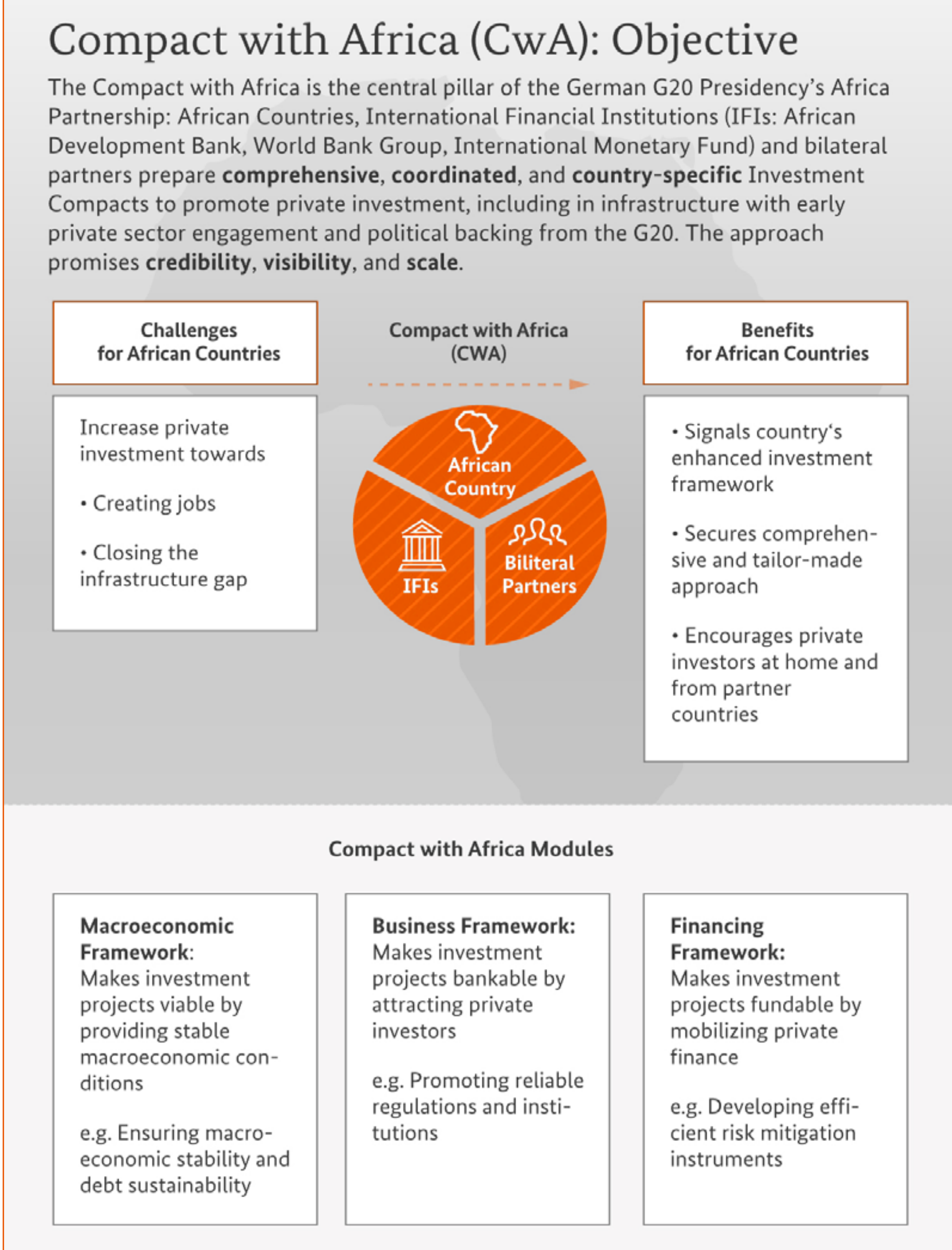
37 Elisabeth Sidiropoulos (2019): *South Africa's Changing Role in Global Development Structures – Being in Them but Not Always of Them.* DIE/GDI Discussion Paper No. 4 (2019): 30.

38 In response to inquiries from German government ministries, it was stated that Germany was very active in Tunisia's country team.

We conjecture that CwA documents seem to be first drafted in Washington, D.C., for example at the IFC (tasked to promote private capital flows for development). If this observation holds, it may well explain why Compact Teams do not seem to have worked out as planned. The Compact Monitoring Report April 2019 states: »While guidelines for Compact Teams have been agreed, in most cases the Compact Teams are not operating effectively – if at all. Of those visited, in one country there has not been a Compact Team meeting since October 2017, in two countries the first full Compact Team meeting took place in February 2019, and in numerous countries the private sector has not been invited. Likewise, leadership of the Compact Team varies across countries, both with regard to seniority and focal points.«[39]

39 G20 Compact with Africa (2019): *Compact Monitoring Report* (April): 11.

Figure 5
The G20 Compact with Africa



Source: German Federal Ministry of Finance (BMF) (2017).

4

THE ARCHITECTURE OF THE G20 COMPACT WITH AFRICA

While there has been a long history of G7 initiatives relating to Africa, the CwA is the first major initiative of its kind between the G20 and Africa. Given the wider composition of the G20, the initiative includes all of Africa's important economic partners — including China and India. The initiative is the main pillar of the G20 Partnership with Africa. The G20 initiative was launched under the Chinese presidency on Germany's initiative in October 2016. It was launched in March 2017 as an initiative of the G20 Finance Track under the German G20 presidency to promote private investment in Africa, with an initial focus on levering private infrastructure finance via blended finance to facilitate subsequent FDI flows. G20 leaders formally launched the new G20 CwA at the G20 Summit in Hamburg on 7–8 July 2017. Figure 5 provides an at-a-glance overview of the objectives, actors and modules of the CwA. Ludger Schuknecht and co-authors, then in top positions at the German Ministries of Finance and Cooperation and Development, succinctly outlined the paradigm, motivation, work mechanics and objectives of the CwA:[40]

- *Paradigm:* Acemoglu and Robinson's institutional approach *(Why Nations Fail)*[41] emphasises the importance of »good« institutions and rules for sustainable growth. It is held that countries with »good« institutions that promote the productive role of the state and the market might also be able to achieve greater development success. The concept for the Compact is (wrongly) attributed to Paul Collier in the paper by Schuknecht et al. (2018): The international community of states contributes to the development of good economic institutions by investing in a compact with »reform-minded« poor countries, to which all partners contribute, in order to improve local framework conditions for private investment.[42]

- *Motivation:* Africa's demography and emigration potential; a nuanced perception of Africa as a continent of opportunity; the need for a more coherent G20 approach in combining economic and development policy.

- *Mechanics:* African countries volunteer to join the Compact and commit to specific reforms. These reforms fall into three areas — macroeconomic stability (with a focus on tax reform and debt sustainability), business (investment protection) and financing reforms. Once these reforms have been enacted, the aim is for the CwA to facilitate Public Private Partnerships (PPPs) with potential investors. While the CwA originated under the German G20 presidency of 2017, it is conceived as a long-term G20 commitment, extending beyond the German presidency.[43]

- *Objectives:* One of its primary aims is to unlock funds that were previously inaccessible for African investment, for example pension funds and sovereign wealth funds. The CwA focuses on reforms to the local business environment and the facilitation of investment relations, rather than on the skills transfer highlighted under China's G20 presidency in 2016.

In 2017, G20 finance ministers made a commitment to continue the CwA after the end of the German presidency. Through the AAG they want to support the development of the CwA within the G20 and to track progress in the Compact countries. The current co-chairs are Germany and South Africa (with limited engagement by the latter, according to our interviews). The AAG is tasked with the overall coordination of the CwA and meets twice a year to discuss the progress made and report to the G20 finance ministers and central bank governors.

The CwA's primary objective is to increase the attractiveness of private investment in Africa through substantial improvements to the macro, business and financing frameworks. It brings together selected African countries who volunteer to participate in the Compact, international organisations — primarily the IMF, WBG and AfDB — and bilateral partners

40 Ludger Schuknecht, Johannes Wolff, Andreas Gies and Stefan Oswald (2018): *Der G20 Compact with Africa – ein neuer Ansatz der wirtschaftlichen Zusammenarbeit mit afrikanischen Ländern.* ifo Schnelldienst 4 (2018); available at: https://econpapers.repec.org/article/cesifosdt/v_3a71_3ay_3a2018_3ai_3a04_3ap_3a20-24.htm

41 Note that *Why Nations Fail* has been criticised for i) reversed causality, ii) ignorance of geopolitics and geography as well as lack of evidence and iii) presenting merely anecdotal but no hard empirical evidence.

42 Paul Collier (2018): *Meeting the Migration Challenge and Reforming Capitalism through Mutual Solidarity.* Social Europe.

43 Note that the documents from the 2018 Buenos Aires Summit fail to mention the G20 Compact with Africa; available at: http://www.g20.utoronto.ca/summits/2018buenosaires.html

from the G20 and beyond to coordinate country-specific reform agendas, support the respective policy measures and advertise investment opportunities to private investors. So far, 12 African countries have joined the initiative: Benin, Burkina Faso, Côte d'Ivoire, Egypt, Ethiopia, Ghana, Guinea, Morocco, Rwanda, Senegal, Togo and Tunisia. Nine of the 12 CwA countries are former HIPCs.[44]

Germany's bilateral contributions to the CwA comprise what are referred to as reform partnerships. Germany has entered into bilateral partnerships with selected African Compact countries, initially with Côte d'Ivoire, Ghana and Tunisia. Subsequently, Ethiopia, Morocco and Senegal have also responded positively. A parliamentary inquiry raised the question of other partnerships but received an evasive answer from the German government: »The cooperation of the G20 countries with the African Compact countries takes place in different ways and at different levels of intensity. An overview of bilateral cooperation (…) can be found in the Policy Matrices, at *www.compactwithafrica.org*. As part of the G20 Africa Advisory Group (AAG), Germany, in its role as Co-Chairman, constantly promotes the further involvement of the G20 countries in the Compact with Africa.«[45] We investigated the situation in France with the *Agence française de développement* (AFD) and the Finance Ministry but this did not reveal any evidence of French bilateral investment partnerships in the context of the CwA initiative.[46] At the Osaka G20 Summit in July 2019, leaders reiterated their commitment to follow up on the Compact initiative; yet, for all intents and purposes, the management of the CwA initiative has largely been passed to the WBG and the IMF.

The CwA website collates an array of instruments available to governments, investors and firms from multilateral development banks and the largest European Development Finance Institutions, in order to support private investment in the CwA countries. These are listed on the CwA website in two ›toolboxes‹ and presented in five groupings:

i. project preparation and advisory facilities
ii. risk mitigation vehicles and guarantees
iii. co-investment platforms
iv. project financial instruments
v. blended finance project instruments

Companies can participate in the implementation of the measures within the framework of the current tendering and award procedures of bilateral development cooperation. However, by the end of 2018, no private companies appeared to have participated financially in the framework of the bilateral reform partnerships between Germany and

44 HIPC coordinated debt relief was provided by bilateral Paris Club creditors from 1996 and was reinforced by the MDRI in 2005 to allow for the cancellation of claims on HIPC completion point countries by the IMF, WBG and the AfDB. See Jürgen Kaiser, Irene Knoke and Hartmut Kowsky (2009): *Towards a Renewed Debt Crisis?.* Berlin: Occasional Paper, Friedrich-Ebert-Stiftung (June).

45 Deutscher Bundestag (2018): Drucksache 19/5353 (29.10.2018), translated from German.

46 France maintained bilateral trade and investment partnerships with Africa on a sub-regional level long before the CwA. For a current list, consult https://www.tresor.economie.gouv.fr/Ressources/accords-commerciaux-bilateraux-

Table 3
Compact Countries

Compact Countries	GDP/Cap	Income Status	HIPC	Risk Debt Distress
	2017	**2018**		**2018**
Benin	827	LIC	X	moderate
Burkina Faso	642	LIC	X	moderate
Côte d'Ivoire	1,538	LMIC	X	moderate
Egypt	2,413	LMIC		moderate
Ethiopia	**768**	**LIC**	**X**	**high**
Ghana	**2,046**	**LMIC**	**X**	**high**
Guinea	824	LIC	X	moderate
Morocco	3,007	LMIC		low
Rwanda	748	LIC	X	low
Senegal	**1,329**	**LIC**	**X**	**low**
Togo	610	LIC	X	heightened
Tunisia	3,464	LMIC		low

Notes: Senegal was reclassified as a LMIC in July 2019; GNI/capita, Atlas method (current USD); Risk of debt distress = most recent IMF/World Bank assessments.
Sources: https://data.worldbank.org/indicator/ny.gdp.pcap.cd; Jürgen Kaiser (2019): op. cit.

Ethiopia, Ghana or Tunisia, despite the provision of a number of support measures, notably in the field of improving energy efficiency.[47]

Germany is therefore trying to develop further instruments and incentives for ›de-risking‹ to complement the CwA, beyond the 25 (!) existing measures[48] (funding instruments, programmes and other initiatives) intended to foster private investment. Part of Germany's support for the CwA is the DIF, which is financed by the BMZ and was started in June 2019.[49] The new fund consists of four different programmes: AfricaConnect – a financing solution for medium-sized European companies; AfricaGrow, which aims to promote African SMEs with venture capital; Economic Network Africa *(Wirtschaftsnetzwerk Afrika)*, which bundles support services in development cooperation and foreign trade promotion; and the Special Initiative for Training and Employment (for details, see Box 1).

The many support measures across various government ministries have been subject to recent parliamentary inquiries.[50] The main criticism from the companies being courted remains the poor coordination of measures within the German Federal Government and the large number of parallel initiatives being conducted by different departments, such as the Pro-Africa initiative of the Federal Ministry of Economic Affairs and Energy (BMWi) and the CwA initiative. Officials do insist on regular rounds of meetings between the deputy ministries involved to indicate good coordination but, nevertheless, given the overlap between these initiatives, the accusation (e. g., by the *Afrika-Verein der deutschen Wirtschaft*, AV)[51] that the German government is pursuing a diffuse Africa strategy that has not been coordinated between the ministries persists.

The German support measures are mirrored by the proliferation measures required from the 12 CwA partners in each of the country Policy Matrices.[52] Each country Policy Matrix comprises

– government actions required from the CwA partner in the macro, business and finance frameworks;

– specific (partly numerical) indicators and targets attached to these government actions;

– various multi and bilateral agencies referred to as »partners«.

Specific excerpts from the Policy Matrices are provided in the three country sections for Ethiopia, Ghana and Senegal, including a comparison of 2019 indicators to measure policy reform efforts. For all 12 CwA partners combined, the total number of required government actions and policy targets as well as foreign partner institutions in the Matrices easily added up to 300 in early 2018. In many cases, the number of required actions, targets and partners increased with each Country Matrix update. It would appear, therefore, that the Policy Matrices fail take into account the limited administrative capacity in the CwA countries, the 2005 Paris Declaration on Aid Effectiveness as well as the colonial past and subsequent anticolonial sentiments of most CwA partners.

The proliferation of policy actions required from the 12 CwA partners in each of the country Policy Matrices can be blamed for the fact that CwA country governments have been confused and thus failed to take ownership of the Compact initiative.[53] It would be more realistic to say that the CwA initiative is owned by multilateral agencies, especially the World Bank's IFC. Multilateral agencies push their themes and indicators and the G20 leaders do not seem to be too concerned about prioritisation or considering the severely limited government management capacities of most CwA partners. Multilaterals struggle to obtain mandates. It is no coincidence that each multilateral organisation has tried to shoehorn the work areas and indicators that they ›own‹ into the CwA country Policy Matrices.

47 Deutscher Bundestag (2018): op. cit.: paragraph 6: 4.

48 Deutscher Bundestag (2019): Bundestagsdrucksache 19/10272 (21.5.2019).

49 Agentur für Wirtschaft und Entwicklung (2019): *Start des Entwicklungsinvestitionsfonds* (4 June 2019).

50 Notably, Deutscher Bundestag (2018): Drucksache 19/6066, op. cit. and Deutscher Bundestag (2019): Bundestagsdrucksache 19/10272, op. cit.

51 Ansgar Graw (2018): Marshallplan für Afrika hakt, in: *Die Welt* (4.12.2018).

52 https://www.compactwithafrica.org/content/compactwithafrica/home/compact-countries.html

53 ACET (2019): *Independent Review by The African Center for Economic Transformation.* Compact Monitoring Report (April).

Box 1

The German Government's Development Investment Fund for Africa

1. AfricaConnect (BMZ).

Fund for the financial promotion of German investment in Africa by the German Investment and Development Corporation (DEG). AfricaConnect supports European companies to invest in Africa and primarily in CwA countries:

– Loans in euros or US dollars
– Terms from three to seven years
– 750,000 to 4,000,000 euros
– Risk sharing on attractive terms
– Lean financing structure
– Support for the implementation of international environmental, social and corporate governance standards
– Use of the DEG network and long-term experience with investment in Africa.

2. AfricaGrow (BMZ).

Funds from the *Kreditanstalt für Wiederaufbau* (KfW) development bank to support African enterprises. The AfricaGrow Fund is a fund of funds designed to invest in African venture capital and equity funds to support SMEs and start-ups, primarily in countries associated with the G20 CwA. As a legally independent entity, the AfricaGrow Fund is a key implementation instrument of the CwA initiative. The project is intended to support the afore-mentioned states in attracting private investment as well as technical and financial support and in return implementing reforms to improve the business climate, such as combating corruption or strengthening good governance.

Private equity and venture capital play a crucial role in promoting growth and employment. However, equity and especially venture capital funds are still very much in their infancy in Africa and companies face a large funding gap. It is estimated that, in 2015, only four per cent of all African start-ups had access to equity. The total financing gap for SMEs in Africa is expected to exceed 300 billion US dollars. Rapid population growth and urbanisation are likely to widen this gap even further. In addition, the environment for raising finance has stagnated or even deteriorated in recent years. On the other hand, amounts below ten million US dollars, i.e., typical requirements for start-ups and SMEs, represent only a fraction of the market.

The AfricaGrow Fund is designed to help close this gap by triggering a much-needed catalytic effect: As a strong and reliable anchor investor, it will enable venture and equity funds to raise private capital more easily. To achieve this goal, the AfricaGrow Fund will be launched as a structured fund. On behalf of the BMZ, KfW will provide what it refers to as »first-loss tranche« at fund of funds level, thereby leveraging additional funds from the DEG as an anchor investor and other investors for the emerging African venture and equity sector.

3. Economic Network Africa (BMWi).

Partner network of the key players in German foreign trade promotion with tailor-made support services for German companies.

The focus of the Economic Network is the CwA countries. The initiative starts with Ethiopia, Ghana and Morocco. From autumn 2019, the business network will support enterprises in opening up African markets with tailor-made consulting and support services from a single source:

– Advising companies on specific business opportunities, including foreign trade promotion and development cooperation measures, and in particular on financing, business case calculation and legal framework conditions.
– Support and contact facilitation, in Germany as well as in Africa.

4. Special Initiative for Training and Employment (BMZ).

The aim is to create more and better employment opportunities in Africa. To this end, the initiative promotes business locations and clusters and sustainable investments.

Promotion of business locations and industries (clusters)
– Promotion of industrial and business parks
– Improving export opportunities
– Addressing barriers to investment: »from training to customs clearance«.

Promotion of sustainable investments (Business & Invest)
– Collaboration with companies: for example feasibility studies and corporate finance
– Project development with companies: e. g., training and qualification
– Establishment of sustainable value and supply chains: for example, quality improvements in the supply industry
– Promotion of SMEs (›African Mittelstand‹) – Improving the framework conditions and increasing competitiveness
– Support in opening up new markets
– Stronger cooperation between African and German SMEs.

The aim of the Special Initiative is to create 100,000 jobs and 30,000 traineeships and to improve working conditions. To this end, the framework conditions and sustainability in selected locations and economic sectors (clusters) will be improved and sustainable investments leading to more employment will be promoted. The focus is on both African and European/German companies and investors.

– Fields of action: Promotion of business locations and industries (clusters); promotion of industrial and business parks; improving export opportunities; addressing barriers to investment; stronger cooperation between African and German SMEs
– Funding: From 2019, a separate budget line will be available (230 million euros).
– Country selection and instruments: The Special Initiative implements projects in the reform partner countries Ethiopia, Côte d'Ivoire, Ghana, Morocco, Senegal and Tunisia. Projects in Rwanda are in the pipeline.

Already as early as 2018, it was possible to achieve an increase in the total volume of export credit guarantees in Africa: Export credit guarantees amounting to 1.8 billion euros (2017: 1.1 billion euros) were granted for supplies and services. Africa's share of the total covered volume thus increased to nine per cent (2017: 6.3 per cent).

Sources: Reports from the respective government ministries.

5

CWA COUNTRY SELECTION AND THE USE OF GOVERNANCE INDICATORS

In theory, as the »CwA is seen as bottom-up demand-driven cooperation, African countries volunteer to join the compact and commit to specific reforms«.[54] It has indeed been claimed in official documents that the selection process is »demand driven«.[55] But it is striking that the current African CwA partner countries selected are identical to the beneficiaries of the HIPC initiative of the 1990s, suggesting a political ›like-mindedness‹ in the selection of the African CwA partners. The nine LICs of the 12 CwA countries were part of the HIPC initiative and were granted debt relief by bilateral Paris Club creditors from 1996. Further, the MDRI in 2005 allowed for the cancellation of the claims of the IMF, WBG and the AfDB on HIPC completion point countries. These very multilaterals manage the Compact initiative today.

What criteria are used to select African CwA partner countries? The answer is: good governance, or rather perceptions thereof. In a recent parliamentary session, the German government was quite specific on this: »To measure the level of good governance in the partner countries, the German government relies, in particular, on internationally recognised indices such as the Bertelsmann Transformation Index, Transparency International's Corruption Perception Index and the World Bank's Ease of Doing Business index. These three countries met the criteria.«[56] Moreover, these governance indicators not only serve to facilitate the selection of the CwA partner countries but they also keep the international organisations in the business of monitoring CwA governance outcomes.

These indicators of governance and institutional strength are composite (or ›aggregate‹) perceptions-based indicators. Indicators like this aggregate often large amounts of information from diverse sources and reduce it to a single number — a single governance score — per country, per year, to facilitate comparisons. The aggregated information consists of people's perceptions of the quality of governance, or some aspect of governance (e.g., the rule of law, control of corruption), in different countries. Most of the people whose perceptions are used are diplomats or business managers, and some live outside the countries they are rating.

– The BTI is an annual evaluation of the quality of democracy, market economy and political management using data from 129 developing and transitional countries (2018), with scores ranging from one (low) to 10 (model achieved). Its critics say that the Index reflects a »Western« model of governance. The 2018 average governance score was 4.80; this is considerably lower than the average 2018 BTI score of 5.26 (see Table 6). According to the website, the BTI »aggregates the results of transformation processes and political management into two indices: Status Index and Management Index. The Status Index, with its two analytic dimensions of political and economic transformation, identifies where each of the countries stand on their path toward democracy under the rule of law and a social market economy. Focusing on the quality of governance, the Management Index assesses the acumen with which decision-makers steer political processes.«[57] Importantly, local difficulties with policy implementation are taken into account here.

– According to its website, the CPI »scores countries on how corrupt their public sectors are seen to be.« Determined by annual expert assessments and opinion surveys, the CPI defines corruption as »the misuse of public power for private benefit.«[58] At present, the corruption index ranks 180 countries by their perceived levels of public sector corruption currently according to 13 sources and using a scale of 0 to 100, where 0 is highly corrupt and 100 is very clean. More than two thirds of countries scored below 50 on this year's CPI, with an average score of just 43. With an average CPI score of 39.25 in 2018, the 12 African CwA partners were perceived as slightly more corrupt than the world average. CPI source data capture various aspects of corruption, including bribery, diversion of public funds, nepotistic

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54 Cobus van Staden and Elizabeth Sidiropoulos (2019): op. cit.: 18.

55 Cf., e.g., IFC (2018): *Trends in FDI and Cross-Border Investments in Compact with Africa Countries* (November). On page 1 of the Foreword, it states: »The initiative is demand-driven and open to all African countries.«

56 Deutscher Bundestag (2018): Drucksache 19/6066 (28.11.2018), translated from German.

57 https://www.bti-project.org/de/daten/rankings/governance-index/

58 https://www.transparency.org/research/cpi/overview

appointments in the civil service or state capture by narrow vested interests. Importantly, the index does not capture citizen perceptions or experience of corruption, tax fraud, illicit financial flows, enablers of corruption (lawyers, accountants, financial advisors etc.), money-laundering and private sector corruption.[59] Since trade unions (via the ILO) or local/regional sources are also absent, the CPI largely reflects business and Western opinions and thus marginalises the opinions of the labour force and populations in the Global South.

– The World Bank's EoDB index[60] measures the degree to which the regulatory environment is conducive to starting and operating a local firm. The EoDB indicators were first published in 2004 and, since 2003, have been provided on an annual basis by the International Finance Corporation (IFC), the private finance arm of the WBG. Covering 190 economies, the EoDB index 2019 measures the processes for business incorporation, acquiring a building permit, obtaining an electricity connection, transferring property, getting access to credit, protecting minority investors, paying taxes, engaging in international trade, enforcing contracts and resolving insolvency. The index ranges from 0 to 100 (perfect). The EoDB score benchmarks economies with respect to regulatory best practice, showing the absolute distance from the best regulatory performance on each EoDB indicator. When compared over the years, the EoDB score shows how much the regulatory environment for local entrepreneurs in an economy has changed over time in absolute terms. The EoDB index collects and publishes data on labour market regulation with a focus on the flexibility of employment regulation as well as several aspects of job quality. However, labour market issues (such as how easy it is to fire workers) have now been removed from EoDB rankings. For some time now, the EoDB index has been subject to heavy criticism (Arndt and Oman, 2006).[61] In early 2018, the World Bank's chief economist at the time, Paul Romer, told the Wall Street Journal that he had lost faith in the integrity of the EoDB index, suggesting that it was being politically manipulated.

As well as the governance indicators presented above (BTI, CPI and the IFC's EoDB index), the quality of institutions is also of crucial importance in the design of the CwA. As already mentioned, Schuknecht et al. (2018) explicitly refer to the influential book *Why Nations Fail* by Acemoglu and Robinson (2012).[62] The core thesis of the book is that the design of political institutions has a decisive influence on the design of economic institutions. These, in turn, influence the level of technological progress, which itself is a decisive factor for economic growth. Economists find this monocausal (and anecdotal) explanation unsatisfactory, however. The most prominent rejection of the thesis has come by Jeffrey Sachs[63] who points to the complex nature of development. Many other leading social scientists have criticised *Why Nations Fail*, often for its monocausality, confusion of cause and effect or lack of statistics-based evidence.[64]

The CwA, governance indicators and debt sustainability are closely interconnected in Africa's Compact partner countries. These are, after all, post-completion-point HIPCs and so countries with a history of low debt tolerance.

– First, the Compact favours financial instruments that tend to raise infrastructure debt and implicit fiscal liabilities, such as blending and PPPs.[65] Blending, or the use of public funds to de-risk or leverage private investments in development, involves combining concessionary financing (grants or loans with a grant element) with debt finance from international financial institutions (usually development banks) or market-based sources in order to maximise the volume of resources available for infrastructure projects. PPPs are an important vehicle to incentivise private sector finance. However, their high rate of failure on the African continent underscores the need to make greater efforts to address the capacity gaps in their implementation and ensure that the public sector does not bear all the costs (Della Croce et al., 2016).[66]

– Second, an important indicator for measuring the quality of a country´s institutions is the World Bank's CPIA. This index measures the institutional strength of a country, with 1 = low and 6 = high. It scores countries against a set of 16 criteria grouped in four clusters: economic management, structural policies, policies for social inclusion and equity, and public sector management and institutions. Until mid-2018, the IMF and the World Bank had been relying exclusively on the CPIA to classify LICs' debt carrying capacity in their joint Debt Sustainability Framework for Low-Income Countries (DSF). While other economic variables have been added since then, the CPIA is still relied on to provide a composite indicator of institutional strength measured by the World Bank to assess a country's debt carrying capacity.

The CPIA assessment of institutional strength translates into one of three debt carrying capacity categories (strong, medium and weak), as indicated in Table 4.

59 Transparency International: *Corruption Perceptions Index 2018: Frequently Asked Questions*.

60 http://www.doingbusiness.org/

61 Christiane Arndt and Charles P. Oman (2006): *Uses and Abuses of Governance Indicators*. Paris: OECD Development Centre Policy Studies.

62 Daron Acemoglu and James Robinson (2012): *Why Nations Fail: The Origins of Power, Prosperity, and Poverty*. New York.

63 Jeffrey D. Sachs (2012): Government, Geography, and Growth: The True Drivers of Economic Development, in: *Foreign Affairs* (September).

64 https://en.wikipedia.org/wiki/Why_Nations_Fail

65 Kappel, Pfeiffer and Reisen (2017): op. cit.

66 Della Croce, R. M. Fuchs and M. Witte (2016): Long-term financing in sub-Saharan Africa, in J. Stijns (ed.): *Banking in sub-Saharan Africa: Recent Trends and Digital Financial Inclusion*. Luxembourg: European Investment Bank.

Table 4
Debt Burden Thresholds and Benchmarks under the DSF

	PV external debt, %		External debt service, %		PV of total public debt, %
CPIA (et al.)	**GDP**	**Exports**	**Exports**	**Revenues**	**GDP**
Weak	30	140	10	14	35
Medium	40	180	15	18	55
Strong	55	240	21	23	75

Note: Given that concessionality is an important element in financing LICs, the debt concept used in the template focuses on the present value (PV) of debt.
Source: IMF (2018): *The Debt Sustainability Framework for Low-Income Countries.*

The IMF assessment of debt sustainability provides an important signal to private portfolio investors and creditors, both domestic and foreign. Unsustainable public debt means either higher taxes, inflation, austerity or financial repression in the future. Consequently, CPIA scores are an important determinant of the investability of CwA countries: High debt (service) levels combined with weak CPIA scores tend to dampen the attraction of private capital flows to and the mobilisation of domestic resources in CwA partner countries.

6

THE CONTROVERSIAL ROLE OF PRIVATE FOREIGN CAPITAL FOR SUSTAINABLE TRANSFORMATION

Do good governance and good institutions help attract private capital flows? If they do, can we expect these private flows to stimulate sustainable transformation by promoting structural shifts towards higher productivity? As will be shown in the following paragraphs, there is no straightforward answer to this question.

– Firstly, while global private capital has been shown to be highly cyclical, driven by US monetary policy and risk aversion and thus by push factors, equity flows (both portfolio equity and FDI) have been shown to be pulled in by better governance and institutional scores.

– Secondly, private flows can be both disruptive and transformative: disruptive, often as a result of excessive and mismatched debt that eventually leads to financial crises; transformative, due to the benefits of integrating into GVCs, through the removal of infrastructure bottlenecks or, indirectly, through lowering the cost of risk capital.

The CwA would imply a positive answer to both questions (notwithstanding caveats). After all, it has given foreign private capital flows a central role as it seeks to help attract international foreign private finance and mobilise domestic resources to deliver the »billions to trillions«[67] necessary to achieve the SDGs. It is therefore important to examine the evidence to ascertain whether these a priori assumptions of the CwA are broadly justified for the African Compact partner countries. Let us first turn to the governance-flow nexus.

Pull or Push? It is not a country's framework conditions but rather US monetary policy that is one of the principal drivers of capital flow cycles to poor countries. This latter point is especially pertinent today, given that we find ourselves at the tail end of a decade of extraordinary monetary stimulus that is gradually being unravelled. Global risk aversion is another factor as it pushes money into LICs when it is low and pulls it out when heightened. VIX[68] has recently been shown to be a reliable predictor of global risk aversion and cyclical flow.[69] On an aggregate capital level, push factors such as global risk aversion and external interest rates are found to be most important for portfolio debt flows, somewhat less for banking flows and least of all for FDI.[70]

According to empirical studies, *portfolio* inflows are generally significantly affected by governance measures such as the rule of law, property rights and institutional quality. Similarly, with regards to sub-Saharan Africa (SSA), studies tend to find that the rule of law and institutional quality are significant but further report that political stability and government effectiveness are also decisive. However, even with relatively good governance indicators, portfolio flows have been deterred by the regions poor record when it comes to rule of law and political stability.[71] So the CwA's emphasis on governance and institutions to attract private cross-border capital to relatively well-run African countries was coherent with respect to its initial focus on portfolio flows from large institutional investors such as pension funds.

Natural resources and the size of national markets have generally been considered the main drivers of FDI. The quality of local institutions has, by contrast, attracted less attention but the quality of governance seems to play a not insignificant role in the distribution of FDI in SSA. It has recently been shown that factors such as political stability, government effectiveness, lower corruption, voice and accountability are important for attracting FDI to the region.[72]

Infrastructure funding is crucial for Africa's sustainable transformation. Yet, a significant infrastructure financing deficit — estimated at between 68 billion and 108 billion

67 The brazen term »Billions to Trillions« was framed by the World Bank. See World Bank (2015): *From Billions to Trillions: Transforming Development Finance, Post-2015 – Financing for Development: Multilateral Development Finance.* Washington, D.C. (April).

68 The VIX is the Chicago Board Options Exchange Market Volatility Index. It is a measure of the implied volatility of S&P 500 index options.

69 Hélène Rey (2018): *Dilemma not Trilemma: The Global Financial Cycle and Monetary Policy Independence.* NBER Working Paper No. 21162 (February).

70 Robin Koepke (2018): What Drives Capital Flows to Emerging Markets? A Survey of the Empirical Literature, in: *Journal of Economic Surveys*, 33, 2 (April).

71 Sean Joss Gossel and Andrew Beard (2018): Governance and Portfolio Flows in Sub-Saharan Africa, in: *Applied Economics Letters* (August).

72 Andrés Rodríguez-Pose and Gilles Cols (2017): The determinants of foreign direct investment in sub-Saharan Africa: What role for governance?, in: *Regional Science Policy & Practice*, 9, 2 (June).

US dollars annually — needs to be bridged.[73] Given the notorious lack of infrastructure in Africa, which acts as a bottleneck to intraregional trade, urban habitat and rural development, and hence also to transformative growth, the main sources of funding for infrastructure in Africa do not suggest that they have been held back by Western-style governance standards. CwA efforts focus on attracting private financers to infrastructure investment. Table 5, however, shows the very limited role of private funding for African infrastructure; in fact, the share actually dropped from a meagre 4.1 per cent in 2016 before the CwA launch to 2.8 per cent in 2017.[74] It is therefore questionable whether (positive) governance indicators such as BTI or EoDB are, in fact, drivers of infrastructure funding.

The fact that the response of private investors to funding African infrastructure is so negligible may partly be an inherent aspect of its drawbacks: higher funding costs than all other creditors with shorter maturities, lack of a development mandate, narrow project selectivity and risk aversion. These factors, coupled with weak institutional structures and a volatile macroeconomic environment in many African countries, make private finance less attractive.[75]

What about the flow-transformation nexus? The CwA aims to foster the conditions for long-term private investment, investment in infrastructure and also for economic partnership and employment in African countries with the objective of promoting sustained and inclusive growth. Institutional investments by both pension funds and life insurers as well as FDI can benefit Africa. Institutional investors enjoy long-term liabilities in their balance sheets (unlike commercial banks or hedge funds), which are essential to fund Africa's infrastructure and a key growth prerequisite for the continent. FDI, in turn, requires a modern infrastructure, particularly energy and connectivity, to fully utilise its external benefits. FDI can entail spillovers contributing to the modernisation of production capacity, knowledge transfer, integration into global and regional value chains, and also employment for the jobless. Unlike portfolio flows, corporate FDI reflects a long-term commitment and is hard to reverse, thus providing stability. However, in view of analytical and empirical evidence for LICs, trust in the role of cross-border private capital flows to low-income Africa is controversial.

- Although finance is needed for economic development, excessive or *unstable cross-border flows* can damage economic growth, impede poverty alleviation and exacerbate income inequality.[76] LICs continue to experience strong *pro-cyclical swings* in external financing in terms of availability, maturity and cost. Yet they lack the financial safety net provided by swap arrangements among central banks in developed countries to manage these cycles. To a great extent, the recent surge in private capital flows has also been the result of international bond issuance by national governments, which has increased the risk of debt unsustainability, particularly because the bonds have been exclusively in ›hard‹ currencies, bringing significant currency-related risks. Indeed, 40 per cent of LICs are now at high risk of or already in debt distress.[77]
- Empirical support for an *independent growth impact* of private cross-border flows has proved elusive. However, a Bank of Canada study did find evidence that capital inflows foster higher economic growth, above and beyond any effects on the investment rate, but only for economies where the banking sector has reached a certain level of development.[78] These results suggest therefore that the domestic financial sector plays a pivotal role in ensuring that international capital flows do indeed promote economic growth in developing countries. A more detailed, disaggregated view revealed that the growth effect of the various broad categories of cross-border capital flows (in particular bond flows as well as short-term and long-term bank lending) can be negative in poor countries.[79] Debt-creating flows, in the

73 AfDB (2018): *African Economic Outlook 2018.* Abidjan: Chapter 3.

74 ICA (2017, 2018): *Infrastructure financing trends in Africa 2016, 2017.* Abidjan: Infrastructure Consortium for Africa (ICA). The most recent issue for 2018 had not yet been released by summer 2019.

75 Cyril Prinsloo (2019): *The Pitfalls of Private Sector Investment in Infrastructure Financing.* SAIIA Policy Briefing No. 187. Johannesburg: South African Institute of International Affairs (June).

76 Robust research and evidence for the LIC context was provided by a recent study by Judith Tyson and Thorsten Beck (2018): *Capital Flows and Financial Sector Development in Low-Income Countries.* London: DFID-ESRC Growth Research Programme (DEGRP) (October).

77 IMF (2018): *Regional Economic Outlook for Sub-Saharan Africa: Domestic Revenue Mobilization and Private Investment.* Washington, D.C.: IMF Regional Economic Outlook 2018 (October).

78 Jeannine Bailliu (2000): *Private Capital Flows, Financial Development, and Economic Growth in Developing Countries.* Bank of Canada Working Paper 2000–15 (July).

79 Helmut Reisen and Marcelo Soto (2001): Which Types of Capital Inflows Foster Developing-Country Growth?, in: *International Finance,* 4, 1: 1–14.

Table 5
African Infrastructure Commitment Trends by Source, 2016 and 2017, per cent

	African Govts	ICA Members	China	Arab	Other bi/multilateral	Private
2016	42.0	29.8	10.3	8.8	5.0	4.1
2017	42.0	24.0	22.8	3.7	3.6	2.8

Source: ICA (2017, 2018): *Infrastructure Financing Trends in Africa.*

presence of narrow and illiquid domestic financial markets, introduce currency and maturity mismatches into corporate and government balance sheets. These balance sheet mismatches have repeatedly proved to be time bombs. The nature of equity flows, by contrast, is much more development friendly. LICs seek to attract FDI to benefit from the associated external benefits (via technology, learning, integration into value chains and global market access). Portfolio equity inflows can, but do not necessarily, stimulate long-term growth prospects. They help to develop efficient stock markets and foster economic growth by reducing the hurdle rate for investments and small business development.

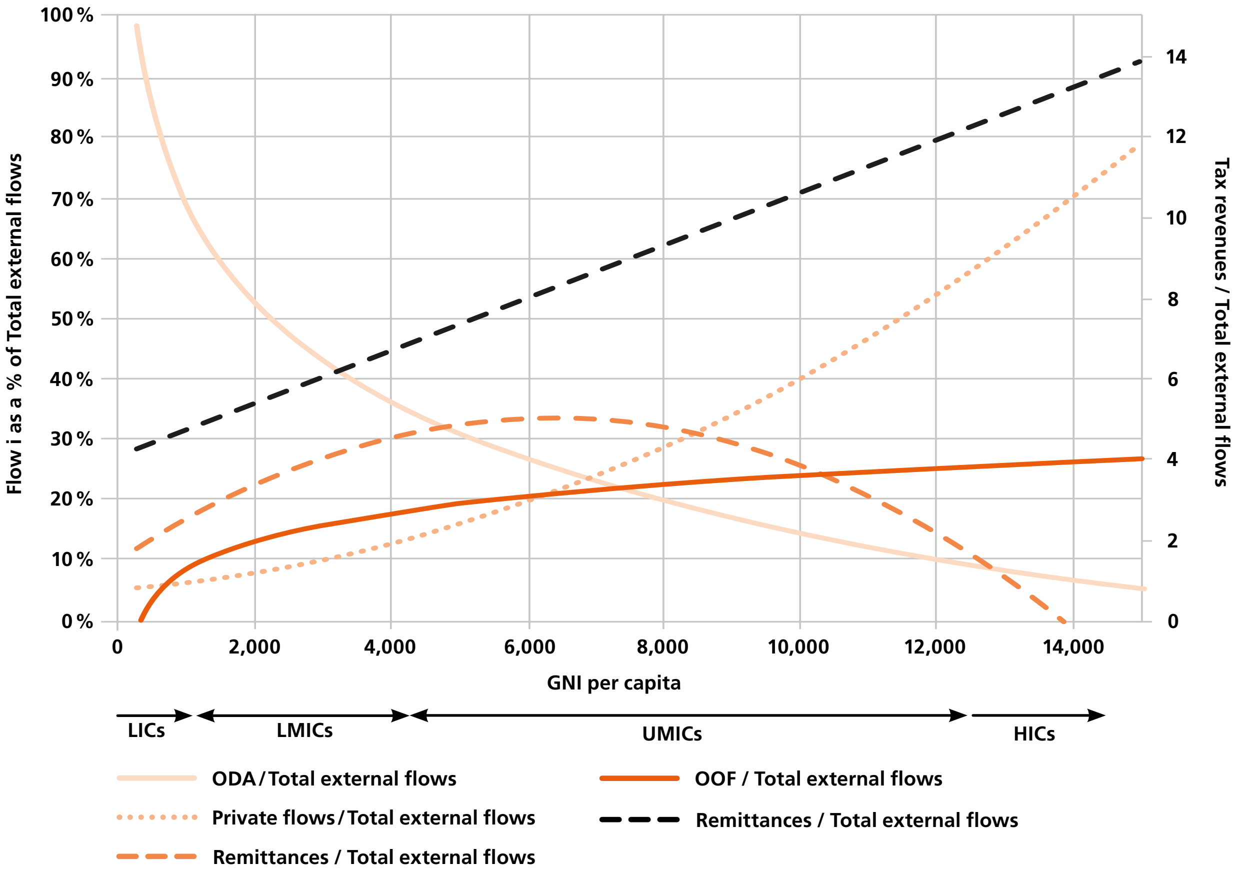
– FDI is an accounting convention[80] and not a net private capital flow (as it may be funded by local debt or by imported machinery). Large one-off merger and acquisition (M&A) deals and corporate restructurings may inflate FDI numbers, while greenfield investment counts mostly for productivity enhancement in a low-income economy. FDI statistics also reflect other factors, including tax avoidance, which makes it difficult to differentiate between FDI for ›long-term‹ investments, which serves as a source of growth, and FDI that is purely financial and has little real economic impact as it merely passes through an economy. This latter type of FDI also obscures the ultimate sources and destinations of FDI. There is emerging evidence that FDI can also be pro-cyclical, and there is mixed evidence on the relationship between FDI and productivity in different sectors. Recent research has identified a negative relationship between FDI and productivity since 2000.[81] It was found that the composition of FDI was concentrated by sector and that those sectors (such as extractives) had a negative impact on total factor productivity and for promoting transformational growth.

In a much-cited paper, Hélène Rey provides conclusive analytical and empirical evidence to this effect: »Gains to international capital flows have proved elusive whether in calibrated models or in the data. Large gross flows disrupt asset markets and financial intermediation, so the costs may be very large. To deal with the global financial cycle and the ›dilemma‹, we have the following policy options: (a) targeted capital controls; (b) acting on one of the sources of the financial cycle itself, the monetary policy of the Fed and other main central banks; (c) acting on the trans-

80 Maria Borga (2015): The OECD's Revised Benchmark Definition of Foreign Direct Investment, in: *OECDinsights.org* (19.10.2015).

81 Tyson and Beck (2018): op. cit.

Figure 6
Financing Mix During the Transition from LIC to HIC Status



Source: OECD (2019): *Transition Finance: Introducing a New Concept.* Paris: OECD Development Co-Operation Working Paper 54.

mission channel cyclically by limiting credit growth and leverage during the upturn of the cycle, using national macro-prudential policies; (d) acting on the transmission channel structurally by imposing stricter limits on leverage for all financial intermediaries.«[82]

Given this background to private capital flows, the CwA could be described as audacious. Let's not forget that the Compact postulates that macroeconomic stability, an investor-friendly business environment and effective financial sector intermediation are necessary conditions to spur private investment. Kappel and Reisen (2017) argued in an earlier FES study on the Compact that such premises are ›unsuitable‹ for LICs.[83] All 12 Compact countries produce such a low yearly income per head that they are either classified as LICs or lower-middle-income countries (LMICs), as has been shown in Table 3.

Although the mean annual PCI varies widely across the group of Compact countries — from 590 US dollars (Burkina Faso) to 3,490 US dollars (Tunisia) — they all remain significantly below income levels where a substantial contribution of private external flows can reasonably be expected. Moreover, some Compact countries (Ethiopia and Ghana) have recently been categorised as being at ›high‹ risk of debt distress in the IMF/WB DSF. Debt vulnerability is likely to further mitigate the role of external private flows to fund a country, assuming this comes in the form of debt-creating flows, including blended finance.

Figure 6 (from OECD, 2019)[84] seems to support the Kappel/Reisen hypothesis. It presents the evolution of the external financing mix for developing countries during the transition process. Its focus is on the distribution of external resources (left y axis) although it also includes the relative importance of domestic resources (right y axis) and shows the evolution of the mix as income per capita increases (x axis).

As the graph shows, the percentage share of private flows relative to total external flows for LICs and LMICs was, on average, well below 10 per cent during the 2012–2016 period preceding the Compact. Private external flows only start to dominate the external financing mix (with a more than 50 per cent share) once countries graduate from upper-middle-income (UMICs) to high-income (HICs), with an annual gross national income (GNI) per capita of 12,375 US dollars or more since July 2019.[85]

The strong negative link between PCI and the relative importance of private finance in cross-border financial flows may have driven the CwA, notably via instruments of risk mitigation. Of course the negative link works both ways: It would be impressive if the CwA managed to meet the challenge of stimulating private flows into African compact partner countries. The same expectation should reasonably also hold ex ante for African infrastructure funding. Traditionally, the private response to funding African infrastructure has been negligible (as has been shown in Table 5). Now we turn to results from the first two years of the Compact initiative.

82 Hélène Rey (2018): *Dilemma not Trilemma: The Global Financial Cycle and Monetary Policy Independence.* NBER Working Paper No. 21162 (February).

83 Kappel and Reisen (2017): op. cit.

84 OECD (2019): *Transition Finance: Introducing a New Concept.* Paris: OECD Development Co-Operation Working Paper 54.

85 World Bank (2019): *New Country Classifications by Income Level: 2019–2020.* Washington, D.C. (July).

7

GOVERNANCE, DEBT AND PRIVATE FLOWS TWO YEARS ON

This chapter aims to trace the initial results in terms of effects on governance scores, debt sustainability, recorded capital flows and domestic resource mobilisation (national savings). A mere two years since CwA inception is such a short time; arguably too short for private flows to react. Overall, governance scores have improved since 2016, the year preceding the launch of the Compact. However, FDI and national savings have not yet responded accordingly. Both in fact fell during the 2017–18 period.

A conclusive assessment will need more time (and the CwA is designed for the long haul). So it is hardly surprising that *input* orientation rather than *output* monitoring has pervaded the official documents for the first two years of the CwA. Firstly, we document important inputs provided to the CwA by governments and multilateral agencies. Secondly, we look for most recent data on governance, debt, flows and savings in the 12 current CwA partner countries. Periodic Monitoring Reports by AAG are documented on the CwA website.

– In April 2018, the AAG assessed progress in identifying policy and support actions under the headings business, macroeconomic and financing. There were 101 commitments identified in the nine countries that were participants in the initiative at that time. 23 per cent of commitments were reported as fully achieved; and 74 per cent of commitments were reported as on track.[86]

– In October 2018, the AAG assessed private sector activity in the Compact countries. The Monitoring Report signalled that investment interest in Compact countries was growing. Total FDI inflows to CwA countries amounted to 20 billion US dollars in 2017. The total annual volume of inbound FDI to all CwA countries has increased by 36 per cent over the past five years, from 14.9 billion US dollars in 2013 to 20.2 billion US dollars in 2017.[87]

In April 2019, the AAG gave an overall assessment of the first two years and included some statistical results.[88] The World Bank characterised the overall assessment of progress in the following words:

> *»The picture of the G20 Compact with Africa that emerges after two full years in existence is of member countries committed to maintaining macroeconomic stability, continuing to implement business environment reforms, positive trends in economic growth and slow but encouraging progress in investment generation.«*

And the World Bank continued with its assessment:

> *»Overall two patterns are very clear. First, Compact countries are significantly outperforming global and regional growth projections. Second, as demonstrated by Doing Business results, they remain extremely focused on continuing to undertake relevant business-related reforms. In the past few years, nearly all the Compact Countries have featured in the group of top ten reformers.«*[89]

Lastly, however, the Bank cannot (yet) describe progress with private capital flows in such rosy terms:

> *»In connection with investments, the picture is more mixed … Across all the Compact countries … the trend is downward, with $30.7 billion in 2018 down from $54.4 billion in 2017.«*

In the same document, the ACET provides what it refers to as an ›independent‹ review.[90] The ACET review points to the benefits and challenges of the CwA initiative. Among the benefits, it cites *»enhanced investor interest«*, as well as *»better donor coordination, a ›seal of approval‹ for reform*

86 G20 African Advisory Group (2018): *G20 Compact with Africa – Compact Monitoring Report* (October).

87 IFC (2018): *Trends in FDI and Cross-Border Investments in Compact with Africa Countries* (November). Obviously, this IFC statement does not monitor what has happened since 2017 as the reported rise in FDI refers to the five years before the CwA was initiated. Moreover, with the inclusion of 2018, the investment record has been slightly modified, as described later in this report.

88 G20 African Advisory Group (2019): *G20 Compact with Africa – Compact Monitoring Report.*

89 According to the World Bank, the EoDB scores equate to »relevant business-related reforms.« Despite all the shortcomings and criticism referred to earlier, the World Bank still seems to ›own‹ the EoDB. After all, the scores are important to the organisation as they enable it to secure repeated mandates from the G20 (rather than other organisations).

90 The principal author, Rob Floyd, has worked as a World Bank official and drafts from Washington, D.C. The ACET board has a strong presence of former aid officials from OECD countries.

countries, clarity to country reform programs, a forum/venue to review implementation of overall reform programs, consolidating policy objectives across government departments, and additional technical assistance.«[91]

As key challenges for the CwA in its current setup, ACET identified expectations and ownership, the role and function of Compact Teams, communications, capacity support and the role of the private sector. Importantly, ACET found out that the ›value proposition‹ was not clear to African partners as G20 governments had largely not promised direct support within the CwA:

> *»While the CwA is a ›compact‹, it is unlike traditional aid programs, as the reciprocal investor commitment is not guaranteed. Within the CwA, the G20 governments nor their business nor their institutional investors have guaranteed or promised direct support. This is the implicit model – but is either not fully understood or not fully owned by CwA country governments in many instances. This results in a value proposition that is not clear.«*[92]

Perhaps it is this lack of ›value proposition‹ for the African partners embedded in the CwA, or longstanding structural impediments to private investment, or simply the bureaucracy-driven proliferation of support measures that can be blamed for the fact that CwA country governments have been confused and thus failed to own the Compact initiative. Our interviews even revealed doubts in Berlin about the sequence envisaged by the CwA architecture: First African CwA partners reform, then private flows will come.[93]

GOVERNANCE INDICATORS 2017–19

According to a T20 report drafted ahead of the Osaka Summit,[94] by spring 2019, nine participating CwA countries had made 101 commitments, of which 43 per cent, 37 per cent and 21 per cent were related to macroeconomic stability, business and the financial environment, respectively. While 33 per cent and 22 per cent of the commitments under the macroeconomic and business environment pillars were achieved, only five per cent of the commitments under the financial environment heading have been achieved so far. Thus, on the level of policy measures taken, there has been some progress in the reform process in the Compact countries. These reform measures have translated into better governance scores.

In the CwA Monitoring Report released in April 2019 ahead of the Osaka G20 Summit, the World Bank sounded triumphant:

> *»As demonstrated by Doing Business results, they (the CwA countries) remain extremely focused on continuing to undertake relevant business-related reforms. In the past few years, nearly all the Compact Countries have featured in the group of top ten reformers.«*

Generally, given the narrow range of sources for the perceptions that enter into governance scores, both indicator changes and levels should be treated with great caution instead of being presented in CwA Monitoring Reports as irrefutable signs of progress. Firstly, tinkering with indicator changes is easier if the interviewees form a small and homogenous group. Secondly, indicator levels primarily reflect levels of per capita GDP, something which was criticised in the French Trésor/AFD study cited above; this association also holds for the group of CwA countries.

Table 6 shows the scores for three governance indicators (IFC EoDB, BTI and CPI) emphasised by the German government. The 12 current CwA countries are generally managed better than in the period just prior to the launch of the Compact in 2017. As indicated by the unweighted mean numbers (in red), governance indicators improved visibly, albeit not significantly. A series of two-tailed t-tests comparing the pre- and post-CwA sub-periods for each of the three governance indicators did not produce significant values. Although the indicators improved, we could not reject the null hypothesis that the indicators remained the same for the two sub-periods.[95] Note, however, that Benin's governance scores improved strongly on all three indicators.

CHANGES IN DEBT SUSTAINABILITY 2017–19

Countries with solid institutions are perceived as more debt tolerant in the IMF/WBG Debt Sustainability Framework (DSF), as shown in Table 4. This requires LICs to have improved CPIA scores. Lower public and corporate debt means less default risk, less exposure to currency and maturity mismatches in public and private balance sheets and better sovereign ratings. Countries with sustainable debt levels have more fiscal space and buffers to engage in PPPs and other forms of bended finance that entail contingent public liabilities. A sound debt situation is a prerequisite for portfolio and bank credit investment to fund infrastructure. As will be shown in this chapter, a solid debt situation is neither a given for all CwA countries nor has it improved anywhere.

As noted earlier, the nine LICs of the 12 CwA countries were among the so-called HIPCs in the 1990s. They were part of the HIPC initiative and were granted debt relief by bilateral Paris Club creditors from 1996. Further, the MDRI in 2005 allowed for cancellation of the claims of the IMF, WBG and AfDB on HIPC completion point countries. These very multilaterals manage the Compact initiative today. In this sense, the CwA initiative is a *déjà vu* experience for Africa's HIPC countries.

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91 ACET (2018): op. cit.

92 *Independent Review by the African Center for Economic Transformation (ACET).* Compact Monitoring Report (April 2019): 10.

93 Interview at the Federal Ministry of Finance (May 2019).

94 Rob Floyd, Kapil Kapoor and Laura Sennett (2019): *G20 Compact with Africa.* T20 Japan2019 (March). Think20 (T20) is the research and policy advice network for the G20.

95 T-values all remained below the critical value of 1.795 for 12 observations for each indicator.

Table 6
African Compact Countries Governance Scores

Compact countries	BTI 16	BTI 18	DB 16	DB 18	CPI16	CPI18
Benin	4.72	5.86	48.5	51.4	36	40
Burkina Faso	4.92	5.20	51.3	51.6	42	41
Côte d'Ivoire	5.13	5.54	52.3	58.0	34	35
Egypt	4.44	3.96	56.6	58.6	34	35
Ethiopia	**3.49**	**3.65**	**47.2**	**49.1**	**34**	**34**
Ghana	**4.44**	**6.18**	**58.8**	**59.2**	**43**	**41**
Guinea	5.83	5.82	46.2	51.5	27	28
Morocco	4.37	4.28	67.5	71.0	37	43
Rwanda	5.10	5.20	69.8	77.9	54	56
Senegal	**6.65**	**6.70**	**50.7**	**54.2**	**45**	**45**
Togo	4.84	5.10	48.6	55.2	32	30
Tunisia	5.33	5.33	64.9	66.1	41	43
Mean	**4.94**	**5.26**	**55.2**	**59.3**	**38**	**39**

Notes: EoDB = The Ease of Doing Business score is depicted on a scale from 0 to 100, where 0 represents the lowest and 100 represents the best performance worldwide. Bertelsmann Stiftung Transformation (BTI) governance comprises scores from 1 (lowest) to 10 (best), a composite of scores for steering capacity, resource efficiency, consensus-building and international cooperation. The Transparency International Corruption Perception Index (CPI) uses a scale of 0 to 100, where 0 is highly corrupt and 100 is very clean.
Sources: Bertelsmann Stiftung, https://www.bti-project.org/en/data/; http://www.doingbusiness.org/en/data; https://www.transparency.org/cpi2018.

The HIPC/MDRI initiative has clearly reduced the indebtedness of the beneficiaries and, in some cases, led to a ›reboot‹ after a ›lost decade of development‹. Debt relief has enabled most countries to return to the capital market or access it for the first time. The new borrowing that has taken place since then has already led a number of countries back into debt problems. For the risk of debt distress assessment, the IMF Debt Sustainability Analysis (DSA) classified seven of the 35 post-completion HICs as high (and none in default) at the end of 2015; by the end of 2018, 10 countries had been assessed as in high debt distress and two were in default.[96]

Table 7 provides a snapshot of the most recent indicators of debt sustainability since the launch of the CwA initiative for the 12 CwA countries. Only public debt figures are available for the CwA period; the first two columns refer to central government debt as a percentage of GDP, which excludes state-owned enterprises and subnational public authorities. While public debt ratios in CwA countries remain relatively low by OECD standards, so is their debt tolerance. The debt ratios were on an upward trend throughout the 2017–19 period, from 60.4 to 63.5 per cent of GDP. This trend was particularly pronounced in Senegal and Tunisia. Debt tolerance, as implied by CPIA scores, has remained stagnant, as have sovereign ratings by Standard & Poor's or Moody's.

96 Jürgen Kaiser (2019): op. cit.: Figure 7.

The growth forecasts and thus debt sustainability assessments of the IMF and World Bank should be treated with scepticism, as the IMF has been found to be biased, especially towards IMF programme countries for which growth estimates tend to be overly optimistic.[97] Currently, the most recent IMF/WBG assessments of CwA countries' debt sustainability would signal some scope for debt finance (including contingent liabilities implied by PPPs) only in Rwanda, given its moderate public debt ratio paired with good CPIA scores. By contrast, Ethiopia and Ghana are gauged as being in ›high debt distress‹ meaning that they should have a preference for FDI, portfolio equity finance and grants over debt finance. Senegal tops the group of CwA countries with the worst public debt dynamics as the respective debt/GDP ratio has soared by more than 14 percentage points since the launch of the Compact. Public debt ratios are largely driven by the difference between growth and interest rates[98] on public debt, the primary budget balance, and, as emerging countries were forced to learn in the 1980s, by the exchange rate.[99]

97 Indermit Gill, Kenan Karakülah and Shanta Devarajan (2019): *Stressful Speculations about Public Debt in Africa.* Washington, D.C.: Brookings Institute (June).

98 While IMF growth estimates tend to be biased, effective interest rates on public debt are difficult (or costly) to acquire. Senegal most recently paid 5.5 per cent on FCFA (=€) public treasury bonds. See https://agenceecofin.com/finances-publiques/0406-66690-l-etat-du-senegal-choisit-le-marche-des-titres-publics-pour-son-retour-sur-le-marche-financier-regional

99 Helmut Reisen (1989): *Public Debt, External Competitiveness, and Fiscal Discipline in Developing Countries.* Princeton, NJ: Princeton Studies in International Finance No. 66.

Table 7
Indicators of Debt Sustainability

Compact countries	Public debt 16	Public debt 19	CPIA 16	CPIA 17	Ratings 16	Ratings 19	IMF risk debt 18
Benin	49.7	54.0	3.45	3.50	B	B	moderate
Burkina Faso	39.2	42.5	3.60	3.60	B–	B	moderate
Côte d'Ivoire	48.4	50.9	3.35	3.40	B+	B+	moderate
Egypt	96.8	86.9	n.a.	n.a.	B–	B	moderate
Ethiopia	**56.1**	**57.4**	**3.55**	**3.40**	**B**	**B**	**high**
Ghana	**57.1**	**62.0**	**3.55**	**3.60**	**B–**	**B**	**high**
Guinea	42.0	46.0	3.15	3.20	n. a.	n. a.	moderate
Morocco	64.9	65.1	n. a.	n. a.	BBB–	BBB–	low
Rwanda	32.9	50.0	4.00	4.00	B	B	low
Senegal	**47.7**	**62.0**	**3.80**	**3.80**	**B+**	**B+**	**low**
Togo	81.1	70.4	3.00	3.10	n.a.	n.a.	low
Tunisia	62.3	81.5	n. a.	n. a.	B+	B	low
Mean	**60.4**	**63.5**	**3.49**	**3.50**			

Sources: IMF: World Economic Outlook (April 2019); World Bank: CPIA Africa (July 2018); various ratings agencies; IMF/WBG: Debt Sustainability Analysis.

PRIVATE CROSS-BORDER FLOWS 2017–19

In its initial phases, the CwA initiative conceived a sequence of private cross-border flows to the Compact countries that would first stimulate portfolio flows into infrastructure from long-term institutional investors such as pension funds, life insurance companies and sovereign wealth funds. It was hoped that, in turn, as infrastructure bottlenecks were slowly removed, FDI flows would follow. The CwA's financing framework aims to increase the availability of financing at reduced costs and risks, with a focus on infrastructure projects with long gestation periods. In particular, it targets pension funds and life insurers characterised by their long-term balance sheet liabilities, which enable them to invest in infrastructure projects with long gestation periods. Kappel and Reisen (2017) project that their asset base will reach 100 trillion US dollars by 2020.[100]

The initial emphasis on portfolio flows has, at least in Germany, been replaced by a focus on the non-financial corporate sector and its direct overseas investments in CwA countries, perhaps reflecting the relatively marginal importance of institutional savings in Germany. The second edition of the CwA investment Monitoring Report provides an update of country and sector-level trends in FDI flows and announcements in terms of cross-border investments (CBI) in CwA, covering the five-year period between 2013 and 2017. CBI draw on project-level data and therefore comprise announced, promised and planned but not necessarily completed FDI. The Monitoring Report stays silent on portfolio flows, however.[101]

By their very nature, it is difficult to trace portfolio flows arising from, say, pension fund assets as these are not earmarked, shrouded in secrecy, liquid and reversible. The IFC is trying to help countries tap into assets held by institutional investors with its Managed Co-Lending Portfolio Program (MCPP). This is a syndicated loan platform where investors can provide capital on a portfolio basis, which is then deployed by the IFC in the form of individual investments. Concurrently with the CwA, the IFC has offered an extension of MCPP specifically for infrastructure. This co-investment product enables institutional investors and private equity vehicles to leverage IFC's ability to originate and manage a portfolio of bankable infrastructure projects. The MCPP provides a credit enhancement through an IFC first loss tranche, in other words investors are attracted by a given return guaranteed for an initial period.

After an initial investment by the People's Bank of China in 2013 (through SAFE, its State Administration for Foreign Exchange), Allianz Global Investors (2016), Eastspring Investments (2017), the Hong Kong Monetary Authority (2017), Liberty Specialty Markets (2017), Munich Re (2017), AXA

100 Kappel and Reisen (2017): op. cit.

101 IFC (2008): *Trends in FDI and Cross-Border Investments in Compact with Africa Countries* (November); available at: http://acetforafrica.org/acet/wp-content/uploads/publications/2019/02/CwA_FDI_Report_IFC_Final-1.pdf

(2018) and Swiss Re (2018) have all joined MCPP. As of 2018, the MCPP had raised seven billion US dollars from these eight global investors.[102] While the amount raised by IFC via MCPP may sound impressive, the amount spent on infrastructure investments in CwA countries is so negligible that no direct data are provided. Information available on MCPP Infrastructure for the year 2018[103] reports that 1.6 billion US dollars in MCPP Infrastructure funds had been raised. Of these, 300 million US dollars of investments had been approved for nine projects in eight countries. Of the approved funds, only eight per cent had been allocated to SSA (and none to North Africa). So, just 24 million US dollars of MCPP funds had been earmarked for SSA.

As already mentioned, the political focus related to the CwA has now shifted towards FDI. Reporting on FDI must be careful not to confuse concepts. The amount and allocation of *actual* or *implemented* FDI are the litmus test of how effective the CwA has been in helping attract private capital flows to the African Compact partners. But *actual* or *implemented* FDI are easily muddled with merely *announced*, *approved* or *planned* FDI, a large percentage of which will never come to fruition.[104] The United Nations Conference on Trade and Development (UNCTAD) is the organisation officially charged with collecting international statistics on *actual* FDI, alongside the IMF which collects balance of payments statistics.

Often, when agencies or Monitoring Reports brag about large FDI numbers, these are just announced, approved or planned. This FDI may ultimately never be implemented. Project data such as from fDi Markets allow coding and thus assignment of FDI to specific industries but fDi Markets data include several approved projects which are not operational. The primary source for the fDi Markets database is announcements in the press or other media outlets about project plans. The other drawback of project-level data is that the dollar values of projects are not recorded, making it difficult to assess the relative importance of these projects.

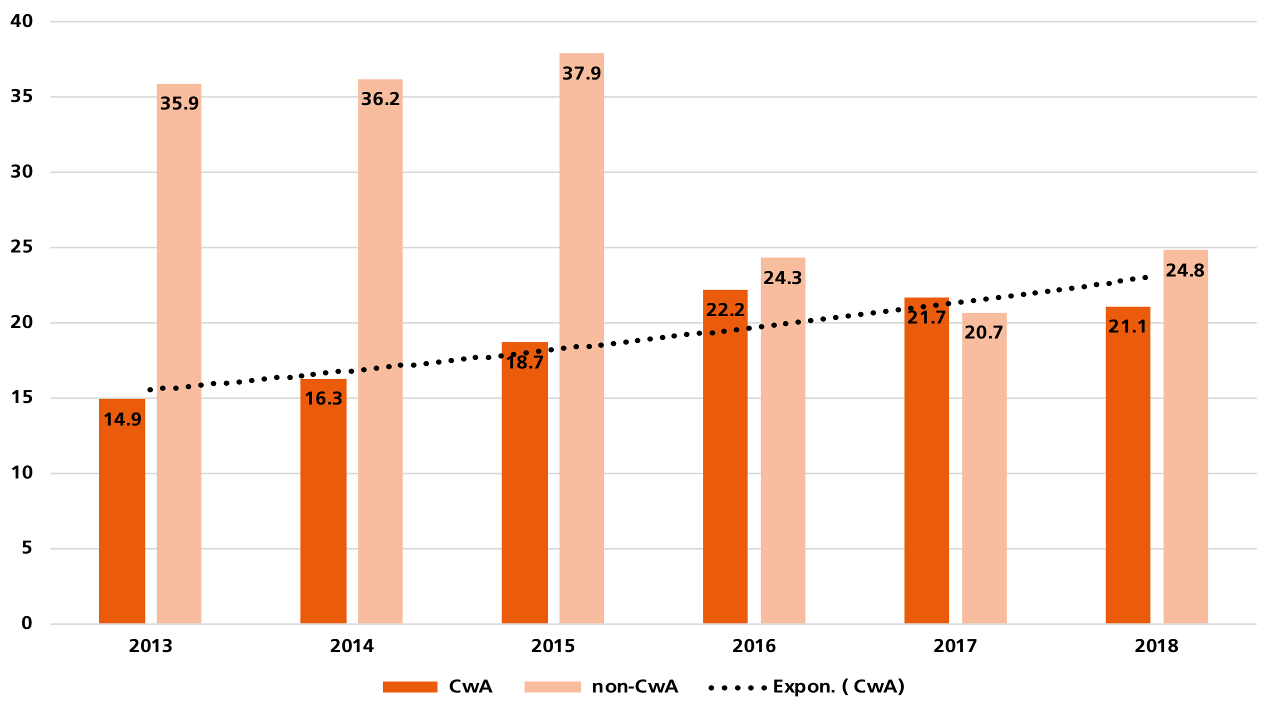
For the transformational impact of FDI, it is useful to distinguish between greenfield and brownfield FDI as well as M&As. Greenfield and brownfield investments are two different types of FDI. Greenfield investments occur when a parent company or government begins a new venture by constructing new facilities in a different country to its headquarters. Greenfield investment, which involves new facilities being built from the ground up, are generally preferred by developing countries. Brownfield investments occur when an entity purchases an existing facility to begin new production. In a brownfield investment, a company either invests in existing facilities and infrastructure through an M&A deal or leases existing facilities in the foreign country. Compared to greenfield FDI, brownfield FDI can therefore be much faster.

102 www.ifc.org/mcpp

103 https://www.ifc.org/wps/wcm/connect/a5affca5-d77d-4fec-8804-97df4f036f13/MCPP+Infrastructure+Flyer+2018.pdf?MOD=AJPERES

104 Deborah Brautigam, Xinshen Diao, Margaret McMillan and Jed Silver (2017): *Chinese Investment in Africa: How Much Do We Know?* London: PEDL Synthesis Series No. 2 (October), provide a clear account of the difference between FDI concepts. Available at: https://pedl.cepr.org/publications/chinese-investment-africa-how-much-do-we-know

Figure 7
Gross FDI Inflows, Africa, 2013–2018, billion US dollars. Compact Countries Versus Non-Compact Countries



Source: UNCTAD FDI statistics.

The most recent CwA Monitoring Report proclaimed at the end of 2018:

> »*Compact with Africa countries have demonstrated resilience as a destination for FDI in the region against the backdrop of declining FDI inflows into Africa.*«[105]

Figure 7, based on UNCTAD FDI statistics, rejects the CwA Monitoring Report as ›spin‹ related to a period prior to the launch of the CwA. The 12 CwA countries (and the rest of Africa) received more FDI in 2018 than in 2017 but the exponential upward trend of FDI (line) established in CwA countries between 2013 and 2016 has not been maintained in 2017/18.

How did gross FDI inflows into CwA countries fare between 2016, the last pre-CwA year, and 2018, the first post-CwA year? What share of gross fixed domestic capital formation (GFCF) did those gross FDI inflows account for? Finally, how did the unweighted[106] average FDI figures for CwA countries compare to the rest of Africa? Only since the release of UNCTAD's *World Investment Report* in June 2018 have we been able to provide data to answer these questions, which are so crucial to evaluating the effectiveness of the CwA. Of course, it is still early days for the CwA, and the FDI data are quite erratic due to the underlying lump sum nature, notably of M&As.

Table 8 does not give us reason for celebration when it comes to trends in gross FDI inflows since the launch of the CwA initiative. On the contrary, and with all the caveats that apply to the volatile nature of FDI data, if anything, gross FDI inflows have been on a continuous downward trend in CwA countries since 2016. This observation holds both for the volume of flows measured in US dollars (which, has certainly been rising and thus depressing the value of euro investments, for instance) and for FDI flows as a fraction of gross fixed capital investment in the unweighted average of the 12 CwA partner countries. While FDI inflows to Africa recovered from the 2017 slump over the course of 2018, in terms of investment sums and as percentage of local investment (GFCF), the upturn was less apparent.

If the CwA has not so far been successful in stimulating cross-border flows into Compact partners, have they instead managed to mobilise higher national savings to finance transformative investment via GFCF? Again, the answer tends towards the negative for the unweighted average of the 12 countries. To arrive at data on the national savings-GDP ratio as a measure of domestic resource mobilisation (DRM) for the most recent period 2016–18, we had to rely on national account identities and current account imbalances to indirectly derive the data presented in Table 9.[107]

105 IFC (2018): op. cit.: 4.

106 Given the strongly asymmetric size of the CwA countries, only unweighted numbers make sense. Weighted numbers would be heavily distorted by the inclusion of Egypt, for example. The comparison of 12 unweighted numbers for three years each, by contrast, provides a minimum of statistical confidence for initial conclusions.

107 S/Y = I/Y + CAD/Y, changes in foreign exchange reserves are not included. S = savings, I = GFCF, CAD = current account deficit; all terms expressed in per cent of GDP.

Table 8
Gross FDI Inflows, CwA Countries, 2016–2018

	$mn, 2016	$mn, 2017	$mn, 2018	%, GFCF 2016	%, GFCF 2017	%, GFCF 2018
Africa	46,482	41,390	45,902	9.8	8.7	9.4
CwA						
Benin	132	201	208	6.7	8.4	7.5
Burkina Faso	390	3	480	21.8	0.1	20.4
Côte d'Ivoire	578	973	913	8.9	13.1	9.8
Egypt	8,107	7,409	6,798	16.9	21.1	16.8
Ethiopia	**3,989**	**4,017**	**3,310**	**14.8**	**13.6**	**12.1**
Ghana	**3,485**	**3,255**	**2,989**	**23.5**	**26.8**	**22.3**
Guinea	1,618	577	483	75.2	46.5	21.0
Morocco	2,157	2,686	3,640	7.0	8.6	10.5
Rwanda	342	356	399	16.0	16.7	17.7
Senegal	**472**	**587**	**629**	**10.6**	**11.7**	**10.3**
Togo	0	88	102	0	7.0	6.8
Tunisia	885	881	1,036	11.0	11.8	13.3
CwA: Sum/Mean	**22,155**	**21,033**	**20,987**	**17.7**	**15.5**	**14.0**

Source: UNCTAD FDI statistics.

Box 2
Germany's FDI to Africa: Still Modest

The Deutsche Bundesbank published its latest inventory of FDI in 2019.[108] The publication contains data on German gross assets from active direct investment and, corrected for associated liabilities, also net assets. The key figures of the German companies investing in the target countries are also informative, i.e., number of firms, number of employees and turnover. Table 1 summarises German FDI in Africa for the last observation year of 2017.

Box 2, Table 1
German FDI in Africa, Stocks 2017

	Billion euros / number	Share Africa / world, %
Gross claims, billion euros	9.2	0.6
Net claims, billion euros	8.4	0.8
Number of companies	849	2.2
Staff, thousands	201	2.6
Annual turnover, billion euros	30.8	1.0

Source: Deutsche Bundesbank (2019).

At the end of 2017, gross claims of German companies from active direct investments amounted to 1,568 billion euros worldwide; Africa's share amounted to 9.2 billion euros, or 0.6 per cent. In terms of net claims, Africa's share was slightly higher at 0.8 per cent. The explanation for this is that direct investments can be hedged against exchange rate risks by borrowing in the host country, which is why worldwide net claims amount to only two-thirds of Germany's gross receivables. In Africa, however, local financial markets are less developed than in the rest of the world, which is why FDI made there is not hedged by offsetting loans to the same extent.

Africa's share of the worldwide turnover of German companies with active direct investments was just one per cent. Companies investing in Africa were comparatively more numerous with a share of 2.2 per cent. The proportion of people employed in Africa was even more important in comparison, at 2.6 per cent of those employed in German companies worldwide. These numbers indicate that the German companies invested in Africa are smaller and more labour-intensive than those investing in other parts of the world. This means that their developmental contribution in Africa is likely to be more significant, relatively speaking, than their percentage share of world investment stocks would suggest.

The importance even of Africa as a whole for German direct investment is very minimal; however, it tends towards zero if North Africa, South Africa and the tax haven of Mauritius (buzzword: Mauritius leak) are excluded. German companies traditionally concentrate almost exclusively on North Africa (particularly Egypt) and South Africa. Germany's development bank KfW recently stated: »There are hardly any German companies between Cairo and Johannesburg. Companies from the other major industrial nations France, Great Britain and the USA have a broader regional base. The common language and the cultural proximity due to the African diaspora are important reasons for this.«[109]

The focus of German companies outside the OECD area, on the other hand, is on Asia and Eastern Europe. The level of direct investment in these regions is more than 10 times higher than in Africa. In Eastern Europe, low-cost production was available close to the European sales markets. So far, Asia has been attractive thanks to its higher degree of industrialisation and larger middle class. Of course, the Maghreb is geographically close and Africa's middle class is growing — so an increase in German FDI in Africa can certainly be expected in the future. However, Africa's high unit labour costs act as a brake on direct investment in industrial manufacturing.[110]

Box 2, Table 2
Geographical Distribution of German FDI in Africa, 2016, billion US dollars

	Germany	France	Italy	UK	USA
North Africa	3.7	16.2	18.2	16.3	28.4
SSA	1.8	30.1	2.0	30.1	23.9
South Africa	5.2	2.0	1.6	19.7	5.0
Total	10.7	48.3	21.8	66.1	57.3

Source: Tim Heinemann, KfW.

As part of the CwA, since 2017, the German government has been trying to boost German direct investment in 12 selected African partner countries. These include three promising emerging countries in North Africa (Egypt, Morocco and Tunisia), but also nine of the poorest countries south of the Sahara (Ethiopia, Benin, Burkina Faso, Côte d´Ivoire, Ghana, Guinea, Rwanda, Senegal and Togo). Companies can participate in the implementation of the measures within the framework of the current tendering and award procedures of bilateral development cooperation.

Box 2, Table 3
German Net FDI in Africa, 2016–18, million euros
(Transaction values according to balance of payments statistics)

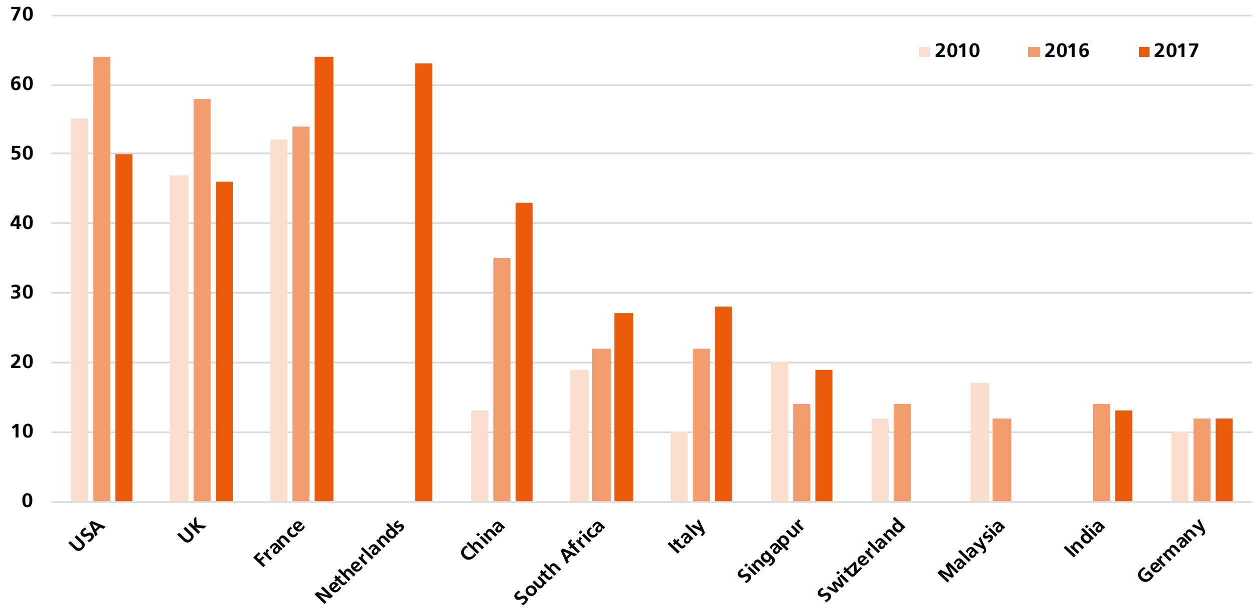
	2016	2017	2018
North Africa CwA	1,198 *1,037*	418 *–4*	1,445 *1,325*
SSA CwA	82 *23*	145 *8*	66 *15*
South Africa	445	553	429
Total *CwA*	1,725 *1,060*	1,116 *4*	1,940 *1,340*

Note: Transaction values may be negative; the positions listed are netted.
Source: Deutsche Bundesbank, Balance of payments statistics, Microsoft Excel file, 14 August 2018.

Unpublished flow data[111] provided by the Deutsche Bundesbank record German FDI in individual African countries up to 2018. Morocco as an outlier received 1,199 million euros in German net FDI in 2018, presumably due to construction investments for the Ouarzazate solar power plant,[112] which was initiated long before the CwA. Apart from the individual case of Morocco (and Ethiopia), the African CwA partners received less German FDI on balance over the past two years. So far, the CwA resembles a ›Potemkin village‹, with impressive displays in the form of declarations of intent and many conferences.

In 2017, German investors ranked 11th in Africa (12 billion US dollars). With the exception of South Africa, German companies have invested relatively little for many decades, although more companies are considering increasing their presence in African countries. About 1,000 German companies are active in the African continent, employing around 200,000 people, 400 of these are entrepreneurs with 70,000 employees in South Africa alone. Germany's relatively low level of economic involvement is mainly due to the fact that German companies have hardly any raw material interests and the African markets have so far been too small and insignificant for German investors.

Box 2, Figure 1
FDI Stocks in Africa, by Investor Country, billion US dollars



Source: UNCTAD 2019.

Table 9
National Savings Rate and Gross Investment Rate, CwA Countries, 2016–18, per cent of GDP

Countries	S/Y 2016	S/Y 2017	S/Y 2018	GFCF 2016	GFCF 2017	GFCF 2018
Benin	15.2	18.5	15.9	24.6	28.4	25.8
Burkina Faso	17.4	15.3	15.3	25	24.8	22.8
Côte d´Ivoire	17.1	17.1	17.4	18.3	19.5	20.8
Egypt	8.5	8.7	15.1	14.5	14.8	16.3
Ethiopia	**28**	**29.9**	**27.6**	**37.3**	**38.4**	**34.1**
Ghana	**21.8**	**17.2**		**27**	**20.6**	
Guinea	20.8	13.8	3.4	52.4	20.6	19.5
Morocco	24.2	26.3	15.5	28.4	29.9	19.1
Rwanda	11	16.1	15.9	25.3	22.9	23.7
Senegal	**21.5**	**17.4**	**17.7**	**23.5**	**24.6**	**25**
Togo	18.8	17.4	17.4	28.1	22.5	25.3
Tunisia	10	6.5		19.3	16.7	
Mean	**17.86**	**17.02**	**16.12**	**26.98**	**23.64**	**23.24**

Source: https://www.imf.org/external/datamapper/BCA@WEO/OEMDC/ADVEC/WEOWORLD https://data.worldbank.org/indicator/NE.GDI.FTOT.ZS?locations=BJ ; UNCTAD FDI Statistics.

Table 9 documents that, looking at the average of the 12 CwA countries, neither national savings nor gross fixed investment have risen since the CwA launch. In fact, the national savings effort tailed off, on average. The savings ratio has increased only in Egypt and Rwanda since 2016.

African countries engaging in the Compact are not to blame, as their governance scores mostly improved. While they fulfilled their part of the deal, the anticipated private cross-border equity flows did not materialise and nor did domestic resource mobilisation. Consequently, it often proved impossible to tame public debt dynamics. The positive tone of the CwA Monitoring Reports so far sounds hollow in view of the macroeconomic data recorded here.

108 Deutsche Bundesbank (2019): *Bestandserhebung über Direktinvestitionen 2019.* Statistische Sonderveröffentlichung 10 (30 April).

109 Tim Heinemann (2018): *Warum halten sich deutsche Unternehmen mit Investitionen in Afrika zurück?.* KfW Research Nr. 171 (27 December).

110 Robert Kappel (2018): *Afrika braucht einen anderen Entwicklungsweg.* MAKRONOM (29 May).

111 Deutsche Bundesbank (2019): *Inländische Netto-Direktinvestitionen im Ausland, Transaktionswerte lt. Zahlungsbilanzstatistik.* Excel file (14 August).

112 Individual details are not published by the Bundesbank for reasons of confidentiality.

8

WHAT DRIVES STRUCTURAL TRANSFORMATION?

We focus on the elements of transformation that are regarded as particularly important in the literature on African development. In this chapter, we will consider sectoral shifts within African economies (industrialisation, agriculture and the service sector), and informal sector development.

As we have learned from the previous chapters, the agenda of the CwA is focused on improving the economic environment (including governance indicators) to stimulate higher FDI in the partner countries. As we have shown, there is no direct link between, for example, better EoDB indicators and FDI inflows. The assessment of the debt situation is also important, as is financing for infrastructure expansion. The measures envisaged by the CwA have helped to improve economic stability in the CwA countries. However, the Compact lacks an analysis of trends in structural change. Thus the CwA measures overlook opportunities to exploit the potential for catching up, such as inclusive growth through the modernisation of agriculture, the development of local entrepreneurship and decent jobs.

Very different forms of structural change occur across the CwA countries. These changes illustrate the tasks facing the countries and the potential that can be exploited. If a country continues to be strongly influenced by agriculture, different strategies will have to be pursued than in countries with a high level of informality. The North African CwA countries face completely different challenges related to their proximity to the EU than the LICs. As well as the purely macroeconomic, fiscal and business-related frameworks of the CwA, it is therefore particularly important to consider developments in individual countries to work out strategic approaches.

For almost two centuries, development theory and policy has centred on structural transformation characterised by massive migration of labour from a relatively low-income rural agricultural sector to a high-wage urban industrial sector. McMillan et al.[113] define structural change or transformation as »moving labour and other resources from lower to higher productivity sectors.« An agricultural transformation defined in terms of rapid and sustained farm productivity is a necessary component of structural transformation. Development policies in many African countries were designed to encourage this type of transformation. This includes the adoption of new technologies and management practices that can increase the efficiency of production or reallocating resources away from the least productive towards more productive firms.[114] However, many African countries have not achieved this kind of transformation, even though a large number of them adopted policies in the 1970s that aimed to increase productivity through massive government support to agriculture. An analysis of changes in land and labour productivity shows that many African countries have by far the smallest increase in labour productivity.[115]

Many researchers have found that high economic growth is not necessarily accompanied by structural change leading to a transformation into a modern economy in which agriculture becomes more productive, industry creates jobs and incomes rise.[116] On the contrary, in many African countries, migrating agricultural labourers are employed in the low-productivity service sector and the informal urban sector. A number of countries depend on resource sectors (oil, iron ore, etc.) with very high productivity, which do not absorb much labour. In short, many African countries are characterised by four main trajectories: (1) resource dependence with a capital-intensive form of production and limited employment generation, (2) a small manufacturing sector and, in many countries, de-industrialisation, (3) a small medium-sized enterprise sector (›missing middle‹ phenomenon), and (4) informal labour in the service sector. This dynamic reveals a tendency not only towards large capital-intensive companies but also towards microenterprises in the low-productivity informal sector.[117]

Nevertheless, several African economies have moved from lower-income status to middle-income status owing to major structural and economic transformation policies (includ-

113 Margaret McMillan, Dani Rodrik and Claudia Sepulveda (2017): *Structural Change, Fundamentals and Growth.* Cambridge, Mass.: NBER Working Paper 23378; available at: http://www.nber.org/papers/w23378

114 McMillan, Rodrik and Sepulveda: op. cit.; W. Arthur Lewis (1954), *Economic Development with Unlimited Supplies of Labour.* Manchester School of Economic and Social Studies 22: 139–191.

115 Samuel Benin (ed.) (2016): *Agricultural Productivity in Africa: Trends, Patterns, and Determinants.* Washington, D.C.

116 McMillan, Rodrik and Verduzco-Gallo (2014): op. cit.

117 Gelb, Meyer and Ramachandran: op. cit.; Akinkugbe and Wohlmuth (2016): op. cit.

ing the CwA countries Tunisia, Egypt, Senegal and Morocco). The evidence from these countries shows that, countries that tend to undergo structural and economic transformation are characterised by conditions such as a decline in the importance of agriculture for GDP and employment (see Table 10).

Numerous analyses assume that a process of catch-up industrialisation is possible, but in contrast to the East Asian experience, none of the recent growth accelerations[118] in Africa were driven by rapid industrialisation. The African experience is particularly intriguing as growth-enhancing structural change appears to have typically come at the expense of declining labour productivity growth in the more modern sectors of the economy.[119]

INDUSTRIALISATION AND EMPLOYMENT

As labour shifts from lower- to higher-productivity sectors, value-added increases (static gains) and rapid technological change further boosts economic growth (dynamic gains). Employment and the share of manufacturing and agriculture in total employment are crucial indicators of structural change.[120] Since the mid-1990s, many African countries, including CwA countries, have recorded faster economic growth than before (see Chapter 1). However, this growth has often been with no significant diversification of production and exports, with only limited improvements in export competitiveness, with no important productivity increases (especially labour productivity), no significant technological upgrading or improvements in human well-being, and with no profound employment effects. Instead, growth has been highly skewed and non-inclusive.[121] The consequence is that not enough jobs are created to absorb rapidly expanding workforces. Instead, economic activities in many CwA countries remain concentrated in the low-productivity, low-value-added agricultural and informal sector. In the absence of significant increases in productive employment opportunities in urban areas, large numbers of internal migrants end up engaging in low-productivity informal service activities or in service jobs that offer few prospects of meaningful productivity increases.

Agriculture dominates in many CwA countries. Table 10 shows that in most CwA countries, agriculture accounts for

118 Ricardo Hausmann, Land Pritchett and Dani Rodrik (2005): Growth Accelerations, in: *Journal of Economic Growth*, 10, 4: 303–329; Olivier Cadot, Jaime de Melo, Patrick Plane et al. (2016): *Industrialisation et transformation structurelle: l'Afrique sub-saharienne peutelle se développer sans usines?.* Clerment-Ferrand: FERDI Working Paper 143; available at: https://econpapers.repec.org/paper/fdiwpaper/2537.htm

119 Xinshen Daio, Margaret McMillan and Dani Rodrik (2017): *The Recent Growth Boom in Developing Countries.* Washington, D.C.: IFRI Working Paper; available at: https://www.ifpri.org/publication/recent-growth-boom-developing-economies-role-services

120 Felix Kwame Yeboah and Thomas S. Jayne (2019): Africa's Evolving Employment Trends, in: *The Journal of Development Studies,* 54, 5: 803–832; Jesus Felipe, Aashish Mehta and Changyong Rhee (2014): *Manufacturing Matters … but It's the Jobs that Count.* Manila: ADB Economics Working Paper Series No. 420; available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2558904

121 McMillan, Rodrik and Verduzco-Gallo (2014): op. cit.

Table 10
Share of Value Added of Manufacturing, Agriculture and Services/GDP, 2010 and 2018, per cent

Countries	Share of manufacturing/GDP		Share of agriculture/GDP		Share of service sector/GDP	
	2010	**2018**	**2010**	**2018**	**2010**	**2018**
Benin	13.8	12.3	22.8	22.6	44.7	46.2
Burkina Faso	7.2	5.2	32.5	28.6	46.7	43.2
Côte d'Ivoire	12.6	12.8	14.5	19.7	53.1	32.6
Egypt	16.1	16.3	13.3	11.2	46.2	51.4
Ethiopia	**4.0**	**5.8**	**41.5**	**31.9**	**41.8**	**36.5**
Ghana	**6.4**	**10.9**	**18.0**	**19.7**	**48.2**	**42.8**
Guinea	10.6	10.0	17.5	17.8	43.4	41.7
Morocco	15.6	15.7	12.9	12.0	51.0	50.5
Rwanda	6.2	5.9	28.1	29.0	49.1	47.8
Senegal	**15.5**	**18.7**	**15.8**	**16.6**	**52.7**	**50.4**
Togo	7.2	8.0	28.7	23.6	48.9	29.0
Tunisia	16.5	14.5	7.5	9.5	56.7	60.3
SSA	9.5	10.3	16.0	15.2	50.7	52.5

Source: World Bank data.

only about 20 per cent of GDP. A special case is Ethiopia, where agriculture still plays a large, but declining, role and where the majority of the population is employed in the agricultural sector. Another case is Tunisia. Here, the share of agriculture is particularly low, while the service sector dominates. In Ghana, employment in the service sector is equal to that in agriculture. The share of agricultural employment has decreased from over 60 per cent in 1992 to a low of 40 per cent in the period 2011–2013. This is consistent with agricultural productivity growth.

In the North African CwA countries, the service sector makes a particularly high contribution to GDP and also to industry. With the exception of Senegal, the sub-Saharan CwA countries only have a low degree of industrialisation (see Figures 2 and 3). The LICs Rwanda and Ethiopia also started at a particularly low level. The number of industrial employees is also extremely low in these countries (for example, 29,000 workers in the Ethiopian leather industry and 100,000 in the textile and garment industry).[122] The share of Ghanaian manufacturing employment increased from 10 per cent in 1992 to 15 per cent in 2013. The rising share of manufacturing is consistent with the start of structural transformation, but the low share is consistent with global de-industrialisation and the observation that Africa is seeing manufacturing employment peak earlier in the structural transformation process and at lower levels. Service sector employment in Ghana increased from less than 30 per cent in 1992 to over 40 per cent from 2010 on.

Employment in the services and industrial sectors over the same period increased with rising income levels. The implication of these trends is that the rising income level in Africa has been associated with a change in the employment structure, from the agrarian sector to the industrial and service sectors.

INFORMAL SECTORS – A DRIVING FORCE?

African employment remains overwhelmingly informal.[123] African labour markets are characterised by dualism with very limited formal employment. Agricultural and urban informal sectors feature pervasive underemployment rather than open unemployment. Labour force participation rates in SSA do not differ from other developing regions. The historically unique aspect of African labour markets is the extent of informality.[124]

For sub-Saharan LICs, informal employment accounts for about 80 per cent of total employment. In many low-income SSA countries — including CwA countries — government employment exceeds formal private sector employment (Benin, Burkina Faso and Rwanda), in some other countries (Ethiopia, Ghana and Senegal), the opposite is true. In all these countries, however, both formal private and government employment are under 10 per cent, and often below five per cent of the labour force. Egypt is an intermediate case, with 60 per cent informal employment, with the bulk of the remainder employed in the public sector (30 per cent). In Morocco and Tunisia, both MICs, the informal sector is small, but unemployment is very high.[125] As the rate of informal employment and informality of households[126] varies within regions, so does the nature of informal jobs. Informal employment in sub-Saharan countries is often self-employment, for instance.

In a study of the urban informal sectors of 10 francophone countries, Roubaud and Torelli (2013)[127] confirm the dominance of informal employment even in the capital cities, finding that, on average, 77 per cent of these cities' labour forces is informally employed. Africa has the highest rate of informal employment in cities. African cities in CwA countries have a higher prevalence of informal employment, as seen in the cases of Dakar (79 per cent), Lomé (83 per cent), Cotonou (81 per cent), Ougadougou (80 per cent) and Abidjan (79 per cent). Informal employment in African cities is the norm rather than the exception and this phenomenon is more acute in African cities.[128]

Informality is generally associated with low productivity, low incomes that are just enough to live on, widespread poverty and the unsatisfactory nature of African employment opportunities. Since the era of structural adjustment, employment opportunities in the public sector have dwindled and the formal private sector has failed to grow sufficiently to absorb the vast majority of the working population. Due to rapid population growth combined with limited development of the formal sector and industries, low-income Africa is dominated by subsistence agriculture and small-scale informal enterprises, which play a particularly important role in the LICs with small middle classes. In some of the countries with larger middle classes, the share of African medium-sized enterprises is growing and formal enterprises are beginning to play a bigger role. There is evidence that, in urban centres with larger middle classes, the

122 GTAI (2019): *Äthiopien. Die Textil-, Bekleidungs- und Lederindustrie.* Berlin; available at: https://www.gtai.de/GTAI/Navigation/DE/Trade/Maerkte/allgemeine-broschueren,t=studie-aethiopien--die-textil-bekleidungs-und-lederindustrie,did=2354558.html

123 See the conceptual paper by Ravi Kanbur (2014): *Informality: Causes, Consequences and Policy Responses.* Ithaca: Charles H. Dyson School Working Paper 2014–2018; available at: http://publications.dyson.cornell.edu/research/researchpdf/wp/2014/Cornell-Dyson-wp1418.pdf

124 Stephen Golub and Faraz Hayat (2014): *Employment, Unemployment, and Underemployment in Africa.* Helsinki: WIDER Working Paper 2014/014; Leandro Medina, Andrew Jonelis and Mehmet Cangul (2017): *The Informal Economy in Sub-Saharan Africa: Size and Determinants.* Washington, D.C.: IMF Working Paper WP/17/156.

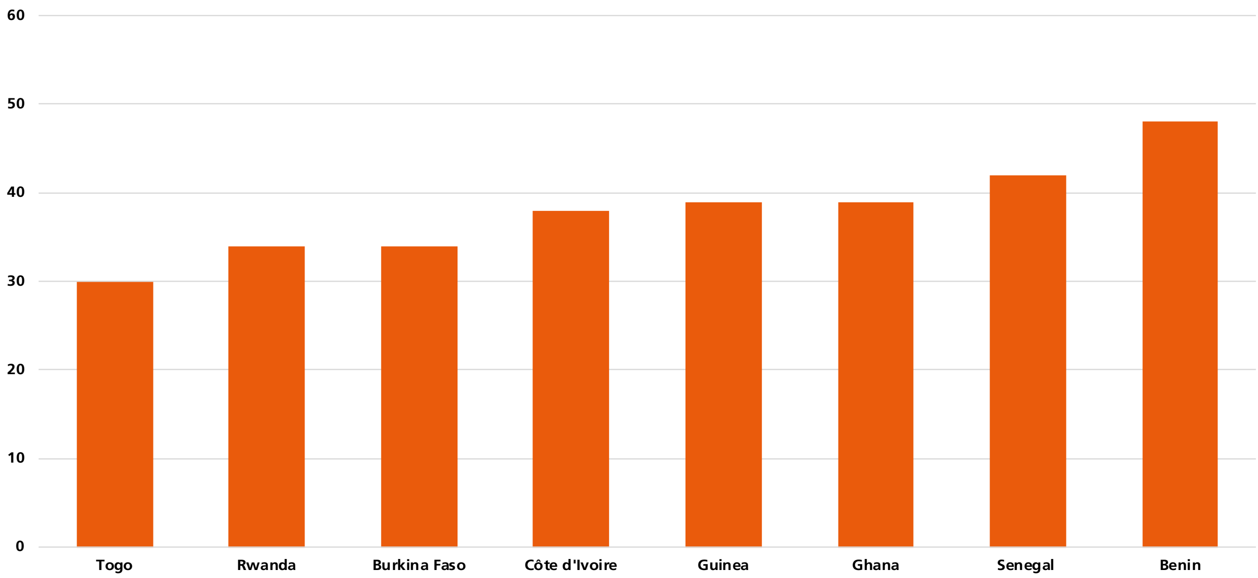
125 Bass, Kappel and Wohlmuth (2017): op. cit.

126 OECD (2019), *Key Indicators of Informality Based on Individuals and their Households* (database); available at: https://read.oecd-ilibrary.org/development/tackling-vulnerability-in-the-informal-economy_56928b69-en#page6

127 Francois Roubaud and Constance Torelli (2013): Employment, Unemployment and Working Conditions in Urban Labor Markets of Sub-Saharan Africa: Main Stylized Facts, in: Philippe de Vreyer and Francois Roubaud (eds.): *Urban Labor Markets in Sub-Saharan Africa.* Washington, D.C.: 37–80.

128 Medina, Leandro, Andrew Jonelis and Mehmet Cangul (2017), *The Informal Economy in Sub-Saharan Africa: Size and Determinants.* Washington, D.C.: IMF Working Paper WP/17/156.

Figure 8
The Informal Economy in Some CwA countries, 2010–2014, Average as a Share of GDP, per cent



Source: Leandro Medina, Andrew Jonelis and Mehmet Cangul (2017): *The Informal Economy in Sub-Saharan Africa: Size and Determinants.* Washington, D.C.: IMF Working WP/17/156.

number of African medium-sized enterprises is on an upward trend.[129] The thesis that there is a typical form of African structural change, in which an informal sector, characterised by low-productivity micro and small informal enterprises, remains dominant, is not the full story. Developments show that, in countries with higher incomes and higher economic growth, a class of medium-sized entrepreneurs is emerging that generate employment and pay higher wages.

In summary, the following statement can be made: In order to implement an appropriate policy, it is necessary to understand the ongoing processes of transformation. These processes culminate in growing inequality, with different opportunities in the modern sectors and the increasingly marginalised areas in which the majority of people in the CwA countries live. The CwA focuses on the essential building blocks of the business framework. The instruments used are suitable for promoting entrepreneurship, although a large proportion of micro and small enterprises do not benefit from the measures. Macroeconomic measures, as illustrated in the Country Matrices, are also necessary. They create a stable environment for enterprises in the service sector, industry and agriculture. Investment in infrastructure, leading to greater market integration and competition, also contributes to generating growth.

Nevertheless, the CwA concepts fail to address these issues adequately and there is a danger that the heterogeneous structure in the CwA economies will become more entrenched. On the one hand, unemployment and informality are on the rise and, at the same time, agriculture is declining. Agriculture barely benefits from the activities of the CwA. On the other hand, industrial hubs and modern service sectors with start-up companies and better-paid jobs are emerging. The heterogeneous structure is associated with inequality and differences in living conditions. The CwA does not depict heterogeneity, it reinforces it.

129 Robert Kappel (2019): *From Informal Enterprises to an African Mittelstand? Differentiations in African Entrepreneurship.* Leipzig: unpublished manuscript; Akinkugbe and Wohlmuth (2019): op. cit.

9

CASE STUDIES

9.1 ETHIOPIA

With a population of more than 100 million, Ethiopia is Africa's second most populous country and it has become a leading investment destination in SSA. Ethiopia has experienced rapid economic growth since 2005, with GDP growing at an average rate of 10.5 per cent per annum in real terms for the period between 2004–05 and 2012–13 and nine per cent since 2015. In 2017/18, Ethiopia's economic growth fell to 7.7 per cent. Political uncertainty, lower public investment and severe foreign exchange shortages dampened growth.[130] Figure 9 shows trends in GDP growth in Ethiopia since 1982.

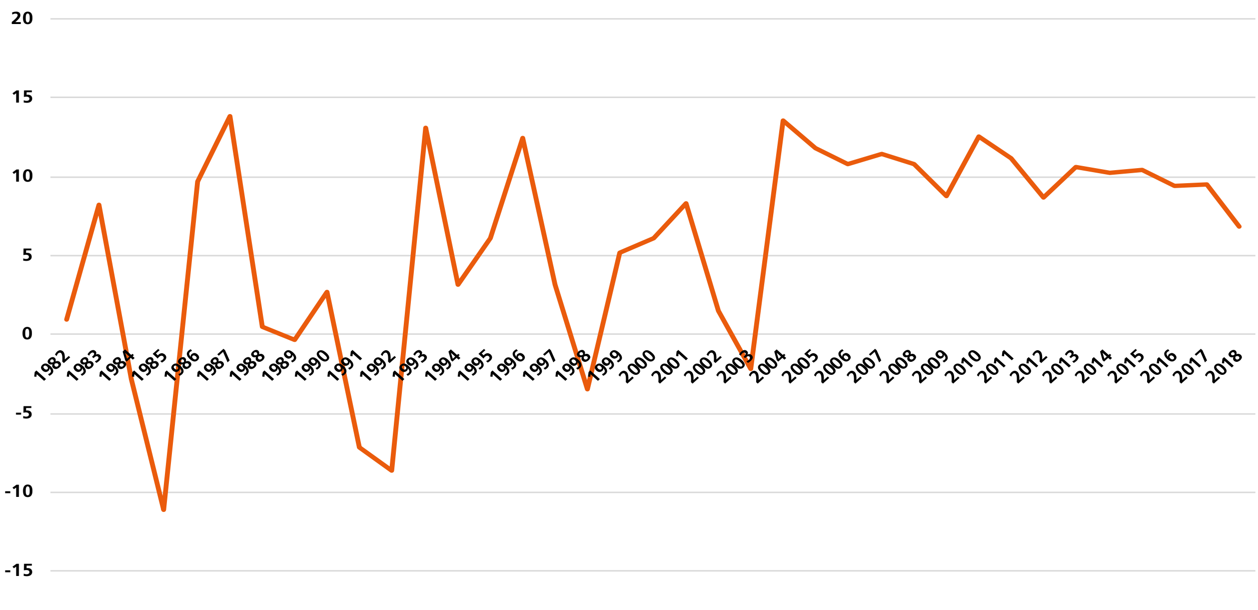
Several factors have contributed to recent economic growth in Ethiopia, including government policies focusing on market reforms. Improvements in access to health and education and major investment in roads and telecommunications have made it possible to remove some significant barriers to economic growth. Overall, growth has been accompanied by greater commercialisation of agriculture and private sector development. The rapid economic growth has had multiple effects on social, economic and political developments. Although poverty in both urban and rural areas has declined, it remains widespread. Ethiopia is one of the world's poorest countries, with about 25 per cent of its population living below the poverty line.[131] Ethiopia still belongs to the group of LICs with an average GDP per capita of 1,800 USD/PPP (see Figure 10).[132] In the HDI ranking, Ethiopia is in 174th position out of 188 countries. Although Ethiopia's HDI has improved from 0.283 (2000) to 04.63 in (2017), the country is still in the »low human development« category.

130 IMF (2019): https://www.imf.org/en/News/Articles/2018/12/04/na120418-ethiopia-remarkable-progress

131 See https://www.undp.org/content/dagethiopia/en/home/library/poverty-and-economic-growth-in-ethiopia.html

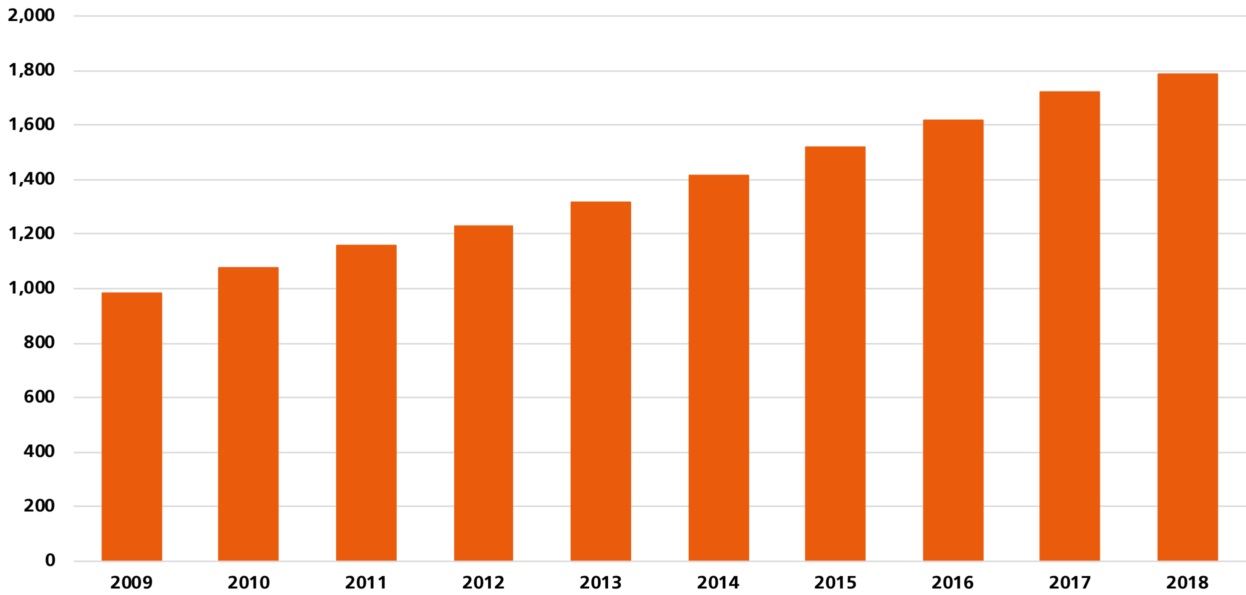
132 http://hdr.undp.org/en/countries/profiles/ETH

Figure 9
Ethiopia: Growth of GDP, 1982–2018



Source: World Bank data.

Figure 10
Ethiopia: GDP Per Capita, PPP, 1990–2017



Source: World Bank data.

Table 11
Ethiopia: FDI, 2016–2018

FDI	2016	2017	2018
FDI inward flow (million USD)	3,989	4,017	3,310
FDI stock (million USD)	14,926	18,943	22,253
Number of greenfield investments* **	16	24	29
FDI inwards (in % of GFCF**)**	11.4	n/a	n/a
FDI stock (in % of GDP)	18.9	n/a	n/a

Note: Gross Fixed Capital Formation (GFCF) measures the value of additions to fixed assets purchased by business, government and households less disposals of fixed assets sold off or scrapped.
Source: UNCTAD (2019): *World Investment Report 2019.*

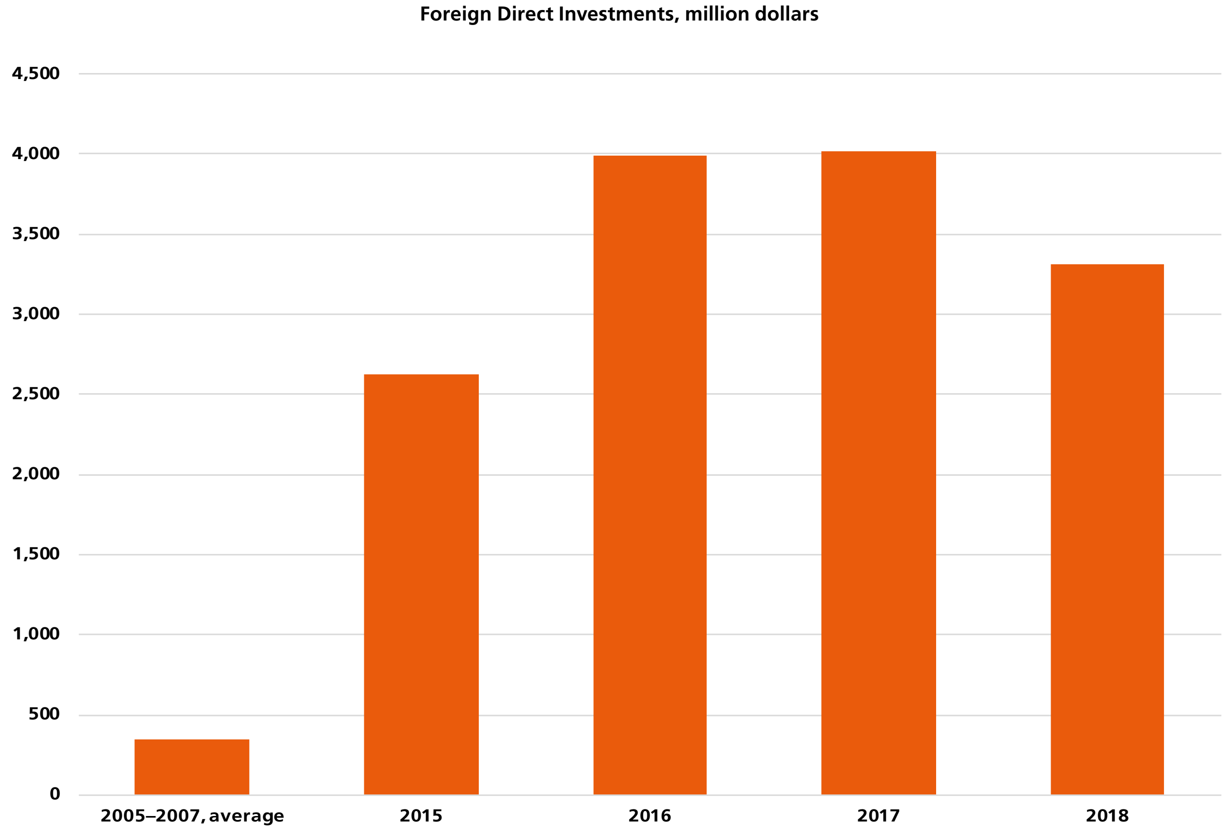
There has been a surge in local and foreign investment. Public investment has been the main driver, including investment from the many state-owned enterprises (SOEs).[133] Inflows of FDI to Ethiopia have accelerated in recent years. However, in 2018, FDI inflows fell to 3.3 billion US dollars in 2018 compared to four billion US dollars in 2017.[134] In total, FDI stocks were estimated at 27.7 per cent of GDP in 2018, or 22.2 billion US dollars (see Figure 11 and Table 11). Despite a fall in investments to 3.3 billion US dollars in 2018, Ethiopia maintained its number one position in East Africa, with investments in petroleum refining, mineral extraction, horticulture, real estate, manufacturing and renewable energy. The main investor countries are Saudi Arabia, China, USA, India and Turkey. China has significantly increased its investment in the country over the past decade, notably in the construction, textile, power generation and telecommunications sectors. There are around 400 Chinese investment projects valued at more than four billion US dollars already in full operation in Ethiopia. Chinese firms are based in industrial parks and the real estate sector. The country also took advantage of the crisis in the Bangladeshi textile sector to attract foreign companies to its textile industry.

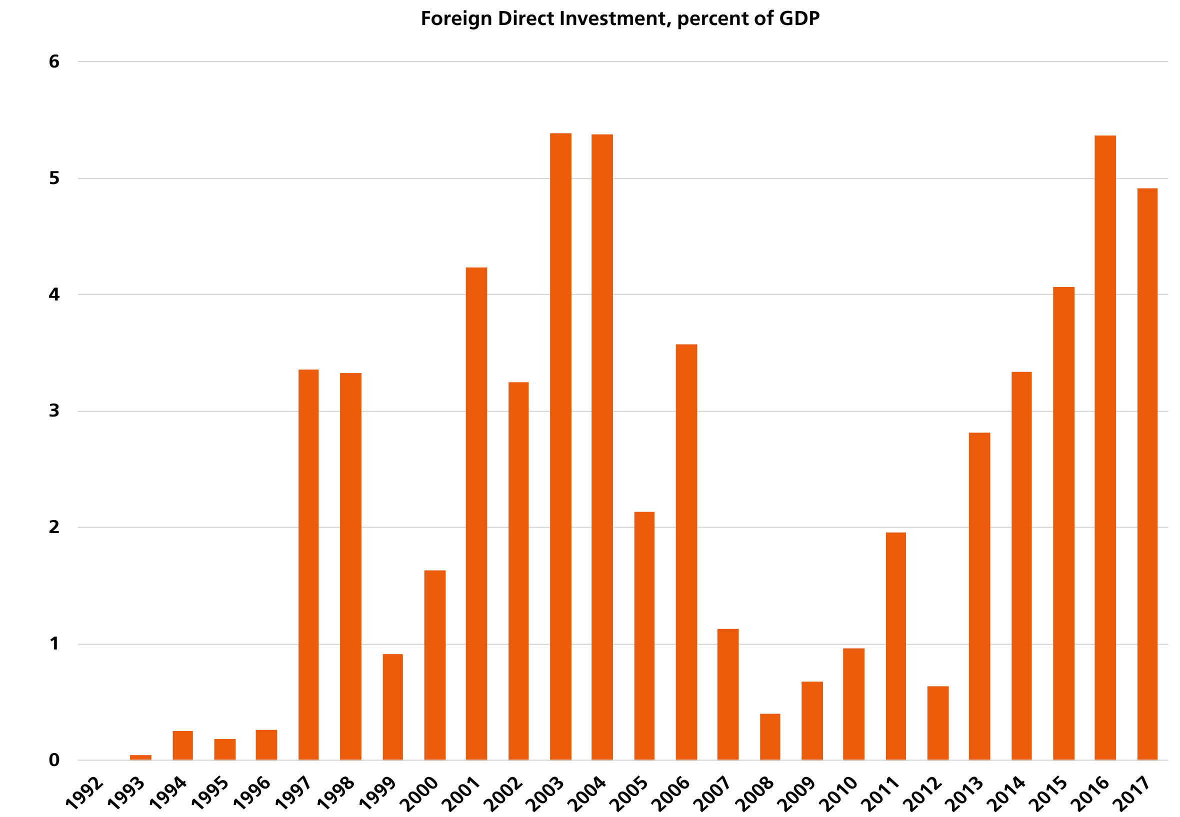
Despite the improvements achieved, the WBG, the IMF, UNDP and local associations of enterprises still complain of numerous obstacles to investment, specifically the significant interference of the state in the economy, the poor condition of infrastructure, difficulties related to land acquisition, strict foreign exchange controls, very high transportation and trade

133 Keynote address by Abebe Aemro Selassie, Director, Africa Department, IMF: *Contextualising Ethiopia's Recent Economic Performance*, 17th International Conference on the Ethiopian Economy Ethiopian Economics Association, Addis Ababa (18 July 2019); available at: https://www.imf.org/en/News/Articles/2019/07/18/sp071719-contextualizing-ethiopias-recent-economic-performance

134 UNCTAD (2019): *World Investment Report 2019.* Geneva; available at: https://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=2460; the CwA flagship list for Ethiopia contains detailed information on FDI projects in the pipeline up until the end of 2018, worth a total 2.8 billion US dollars.

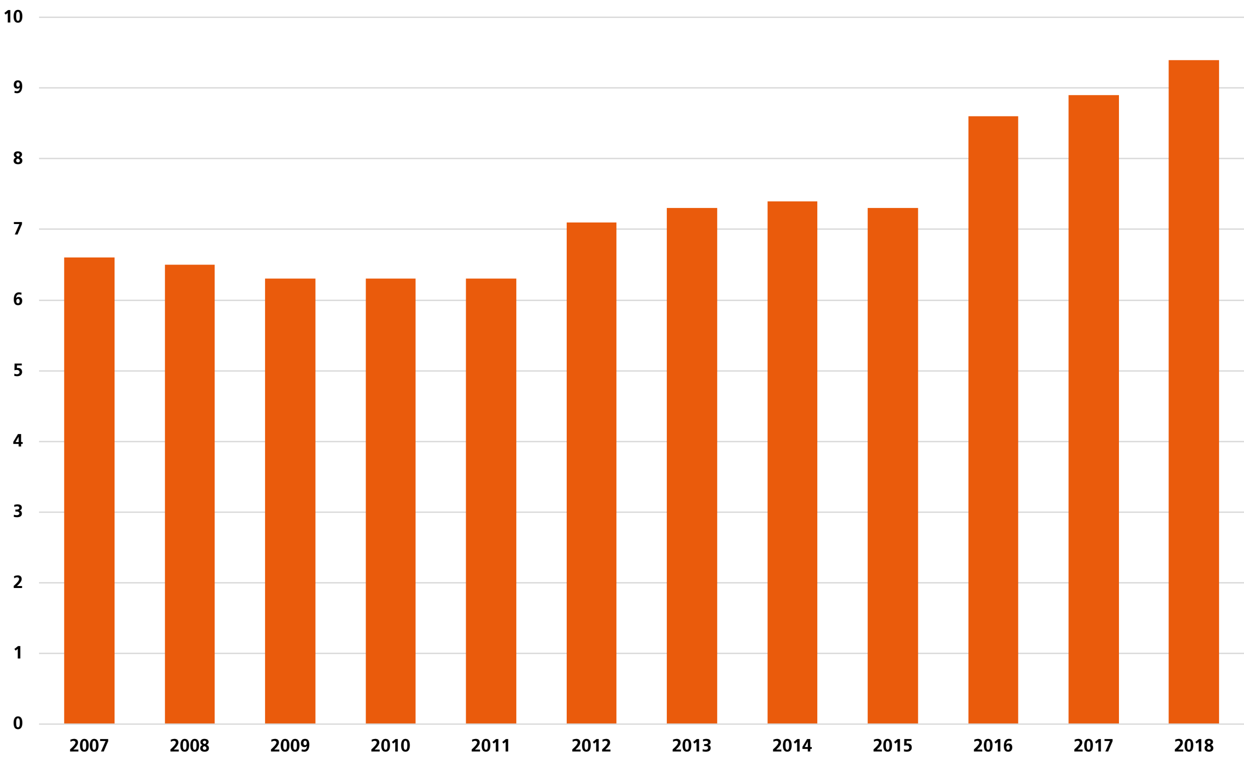
Figure 11
Ethiopia: FDI, million dollars, 1992–2017, and FDI, percent of GDP





Source: World Bank data.

Figure 12
Industrial Employment as Percentage of Total Employment



Source: World Bank data.

costs, and weak institutions.[135] The government's interventionist policies, which are not focused on developing the private sector, have also proven to be a major obstacle. Having said this, significant progress has been made in terms of transport infrastructure and access to electricity production.

Ethiopia lags behind in manufacturing and the production of technologies is yet to increase. Industrial development remains a critical step in Ethiopia's development. The industrial sector — which includes construction, manufacturing, mining and utilities subsectors — remains underdeveloped and contributed only about 15 per cent of GDP in 2017. Employment in industry (percentage of total employment) in Ethiopia was reported to be 9.4 per cent in 2017[136] (see Figure 12).

The industrial sector, which made a declining contribution to growth during the 1990s, has reversed its momentum. The increase in the industrial sector's contribution to growth is largely accounted for by the construction subsector. The contribution of the manufacturing subsector to GDP is only five per cent (see Figure 13), which is very low even against the SSA average (see Figures 2 and 3). Manufacturing firms, including foreign companies, rely heavily on imported raw materials, which generally does not play to their advantage given the limited availability of foreign exchange and lack of access to adequate credit — particularly for SMEs. There is also lack of appropriately skilled labour to support the production of high-quality manufacturing goods.[137]

Although the manufacturing sector is said to play a unique role in structural transformation, the potential of other sectors, such as natural resource-based activities and tradable services, to provide exports and drive growth should not be underestimated. These industries include tradable services (IT, tourism and transport), horticulture and agro-industry. They can provide new opportunities for export development. Ethiopia provides a suitable environment for producing horticultural products, including temperate, tropical and subtropical crops. The fruit and vegetable subsector is of major importance for improving food security (and nutrition) as well as in the development of agro-processing industries.

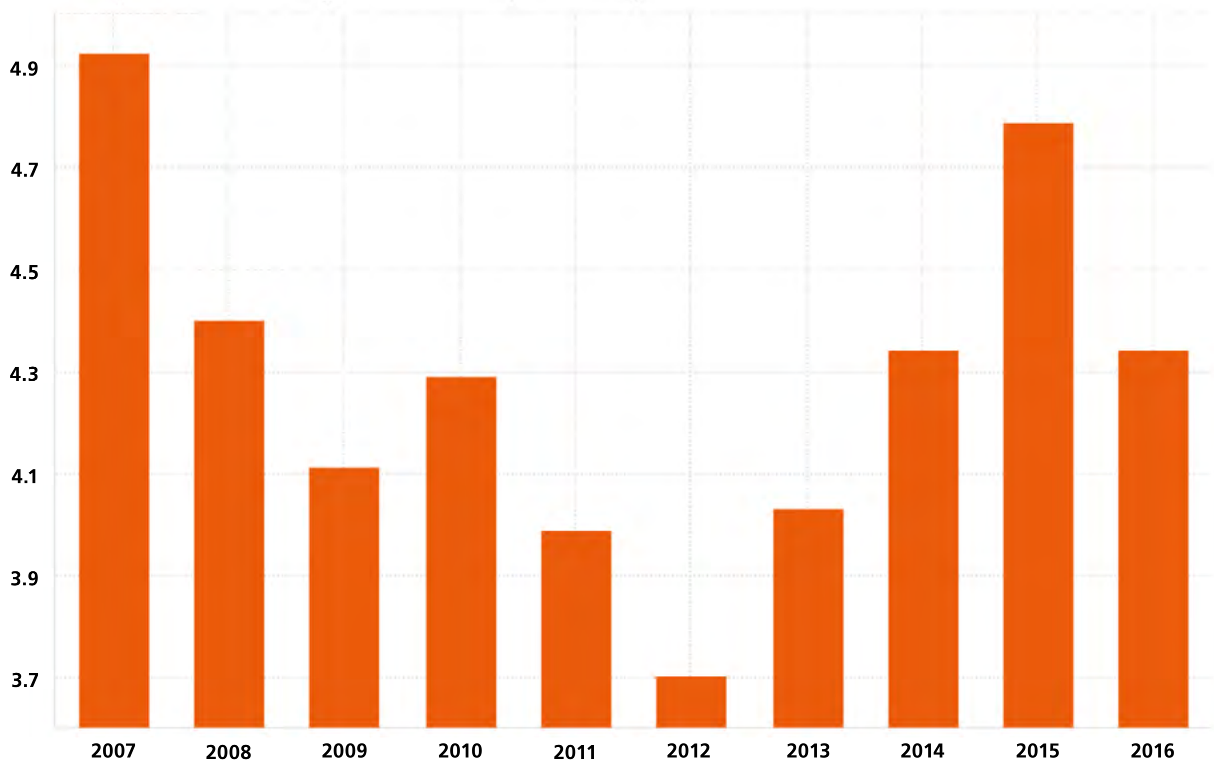
The high rate of public investment in infrastructure has generated growth in construction and related industries and also triggered growth in other sectors through linkage effects. Investment in infrastructure and buildings led to higher employment among urban youth and rural migrants in the construction sector.

135 See IMF (2018): *The Federal Democratic Republic of Ethiopia: Selected Issues.* Washington, D.C.: Country Report 18/355; see also Compact with Africa (2019): *Compact Monitoring Report* (April 2019); available at: https://www.compactwithafrica.org/content/compactwithafrica/home.html

136 https://tradingeconomics.com/ethiopia/employment-in-industry-percent-of-total-employment-wb-data.html

137 Admasu Shiferaw and Måns Söderbom (2019): *The Ethiopian Manufacturing Sector Productivity, Export, and Competitiveness.* Oxford: The Oxford Handbook of the Ethiopian Economy.

Figure 13
Manufacturing Value Added as Percentage of GDP, 2005–2017



Source: World Bank data.

Ethiopia is rapidly urbanising, but there has been little change in the structure of its urban labour markets. Shiferaw and Söderbom (2019)[138] show that the employment structure of the country has not changed significantly despite the rapid economic growth recorded recently. Non-wage employment is still dominant. The informal sector plays an important role in employment creation and poverty reduction. However, jobs in the informal sector tend to be insecure, income is low and work is less sustainable. Unemployment is generally higher in urban areas and for female and young workers. Another feature of the urban labour market is that real wages have been stagnant or decreasing.

Economic growth is largely ›jobless‹, not generating enough jobs for the large number of young people. The World Bank estimates that around 600,000 individuals[139] enter the Ethiopian labour force every year. The imbalance between the increase in the supply of and demand for workers is creating higher and long-lasting unemployment among Ethiopian youth.

THE PROMISE OF INDUSTRIAL PARKS

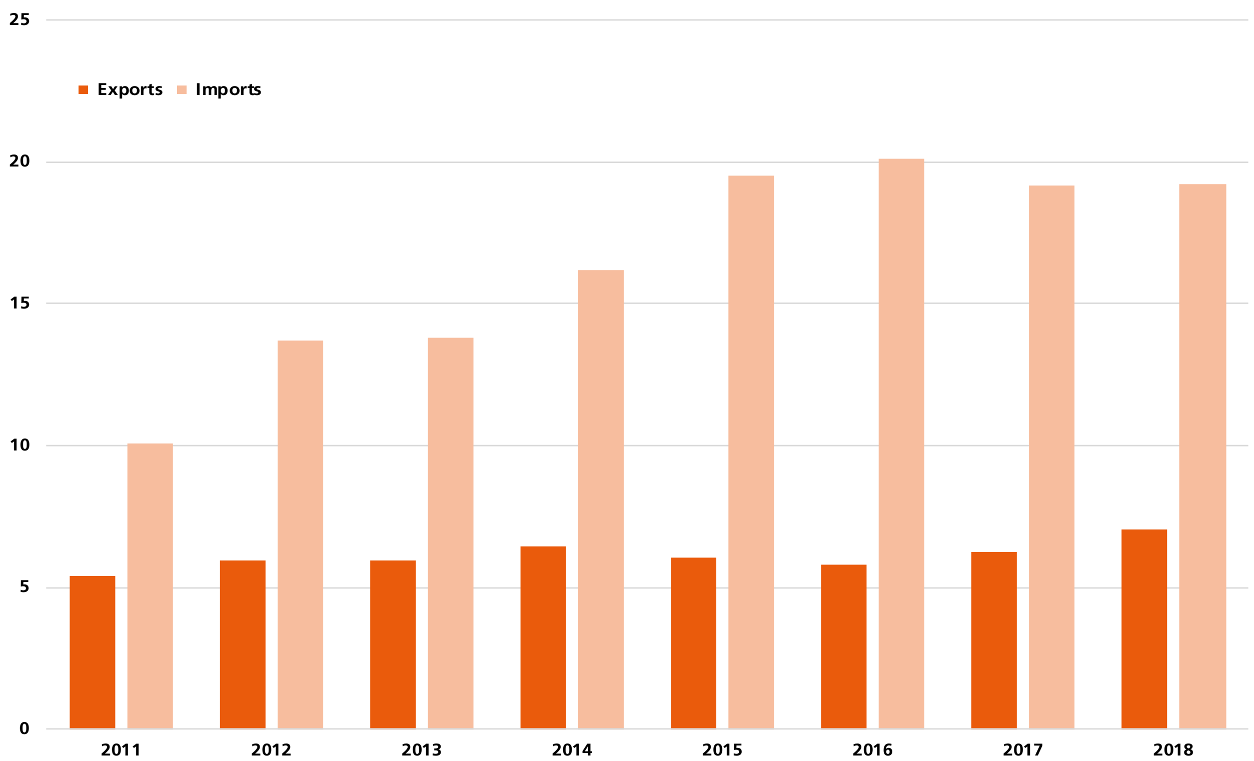
One of the government's strategies to reduce unemployment is to establish industrial parks. The goal is for the manufacturing sector to contribute 20 per cent of Ethiopia's GDP and 50 per cent of its export volume by 2025. Industrial parks have the potential to address key barriers to industrialisation and transformation, including the lack of capital, foreign exchange and knowledge, as well as specific constraints related to the manufacturing sector (including land acquisition, customs and logistic services, weak administrative capacity and a lack of coordinated efforts in the development and provision of infrastructure and public services). The government has declared the establishment of industrial zones a key measure to promote economic transformation. FDI in industrial parks is intended to contribute to knowledge transfer, technological learning, innovation and the generation of stable and decent employment.

The development and construction of industrial parks started in 2014 when the Ethiopian Industrial Parks Development Corporation (IPDC) was established. Several industrial parks were built and opened for operations. Bole Lemi I and Hawassa industrial parks were inaugurated in 2016, and in 2017, two additional parks were opened in Kombolcha and Mekele. Together, these two new sites are expected to create around 40,000 new jobs. Around 10 more parks are under construction and expected to be operational in 2019.

138 Shiferaw and Söderbom (2019): op. cit.

139 https://www.worldbank.org/en/country/ethiopia/publication/fifth-ethiopia-economic-update-why-idle-wages-employment-crowded-labor-market. Other World Bank sources mention the figure of two million young people entering the labour market. Available at: https://ieg.worldbankgroup.org/blog/can-ethiopia-create-2-million-jobs-every-year

Figure 14
Ethiopia: Trade, 2011–2017, billion dollars



Source: World Bank data.

A study on garment enterprises in the industrial zones[140] shows that the government assured Asian and European suppliers that Ethiopian sewing machine operators would happily accept extremely low wages, set at 26 US dollars a month. On an annual basis, this entry-level salary amounts to just 312 US dollars, or 40 per cent of the average PCI. Ethiopia has no legally mandated minimum wage for the private sector.[141] There are also problems with raw materials, almost all of which need to be imported into Ethiopia.

CRITICAL TRADE BALANCE

Despite its substantial efforts, the Ethiopian export sector has so far made only a limited contribution to structural change. This is mainly due to the fact that relatively few jobs have been created, there are hardly any forward and backward linkages and the number of employees falls far short of the target figures. Furthermore, exports are not increasing as strongly as planned. The consequence is that imports are significantly higher than exports. Most of the intermediates used in the industrial parks come from outside Ethiopia. There are hardly any linkages to local producers. In 2018, imports far outranked exports by more than 400 per cent (see Figure 14). The trade deficit is increasingly high and unsustainable. Even more worrying is that the export basket has remained less diversified despite efforts to diversify over the past two decades. More than three quarters of the merchandise export revenue in Ethiopia still comes from agriculture. The surge in imports and sluggish export growth has led to a shortage and, thus, rationing of the foreign currency that is crucial for importing capital goods and intermediate inputs.

DEBTS ARE RISING

Ethiopia is classified as being at risk of debt distress. Ethiopia's rapid economic growth has been driven by public investment that has mainly relied on Chinese loans. However, economic growth has not enabled the country to increase its debt service capacity. To mitigate these risks, restrained public sector borrowing — particularly on non-concessional loans — will be key, say IMF economists.[142] By 2018, the country's external debt stock had reached 28 billion US dol-

140 Paul M. Barrett and Dorothée Baumann-Pauly (2019): *Made in Ethiopia: Challenges in the Garment Industry's New Frontier.* New York.

141 The Labour Proclamation of 2019 does not establish a minimum wage standard in industrial parks, leaving wages to be determined by the employer or by collective agreement between the employer and workers' union. While the Constitution and the Labour Proclamation set specific legal parameters, a range of policy and strategy plans and frameworks establish areas of government commitment to address the development challenges identified.

142 IMF (2018): *The Federal Democratic Republic of Ethiopia: 2018 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for The Federal Democratic Republic of Ethiopia.* Washington, D.C.; available at: https://www.imf.org/en/Publications/CR/Issues/2018/12/04/The-Federal-Democratic-Republic-of-Ethiopia-2018-Article-IV-Consultation-Press-Release-Staff-46434

lars.[143] The level of public debt increased from some 40 per cent of GDP in 2008 to 60 per cent of GDP in 2018. About half of Ethiopia's external debt is owed to China,[144] which has invested in several huge projects in the country. Analysts estimate that, since 2000, Ethiopia has borrowed over 12 billion US dollars from China. For some decades now, Ethiopia has been struggling to manage its debt service obligations. Because the government was not in a position to repay the loans to China, negotiations were started between the two states. These ultimately led to China dissolving all interest-free contracts granted to Ethiopia. At the same time, the government began to seek financial and technical support from the World Bank, and to look for new investment from Gulf States and Western partners.[145]

THE ETHIOPIAN CWA AGENDA

Ethiopia is under great pressure to facilitate the necessary reforms in difficult times of transformation, rising debt and an extremely unequal trade balance. Foreign partners can support the government's reform process and help to stabilise the country.[146] While the IMF is pursuing a stabilisation programme for Ethiopia (macroeconomic stability, the fight against corruption, a balanced government budget, measures to reduce debt, privatisation, an export offensive), the measures being implemented by the CwA, the World Bank and other international organisations go one step further. The reform programme, supported by the World Bank,[147] includes strengthening competition in the industrial and agricultural sectors and inviting foreign and domestic private investors to acquire stakes in SOEs. The unbundling of regulatory, infrastructure operation and service provision functions in sectors currently dominated by SOEs would encourage competition and create the conditions necessary for increased private sector participation. The government intends to introduce reforms to promote SMEs, which possess the potential for growth and employment, rather than hindering them as it had done in the past. So far, Ethiopia has provided little support to the private sector, as is evident from its poor ranking in the EoDB index, which shows that the country has a lot of catching up to do. Ethiopia is ranked 159th among 190 economies in the EoDB index (2010: rank 104). The Compact Monitoring Report from April 2019 notes that the EoDB index has improved slightly since 2017 from 47.25 to 49.06 but with no impact on its ranking.[148]

Table 12 juxtaposes the major CwA targets for Ethiopia with implementation deficits . Note that this is just a selection of an array of 16 government actions required of the Ethiopian authorities.[149] Given the urgency of Ethiopia's external current account deficit and low inflows of FDI, the stipulated actions and indicators are more macroeconomic in nature than about stimulating sustainable transformation and the creating decent jobs.

A look at the CwA Monitoring Report reveals the main measures being pursued.[150] Regarding the macroeconomic framework, the report states that Ethiopia is at high risk of debt distress. As regards the business framework, it is recommended that Ethiopia prioritise its reforms. Ethiopia was urged to pay attention to reforms that would promote diversification.

The Monitoring Report calls for more attention to be paid to financial sector reforms. Ethiopia should embark on financial sector reform, including the creation of a legal regime to regulate PPPs. The IMF is one of the main actors supporting the CwA process. Ethiopia's 2018 Article IV Consultation with the IMF highlighted the government reforms that aimed to mobilise private investment.

The CwA flagship list for Ethiopia[151] shows that real GDP growth remained strong despite slowing somewhat to 7.7 per cent in 2018 due to weak commodity export prices, public spending restraint and political unrest. The external current account deficit fell to 6.2 per cent of GDP in FY17/18 from 8.1 per cent in 2016/2017 due to reduced imports as well as increased services and manufacturing exports. The report also states that FDI had declined. As the most important challenges and constraints, the flagship list identified forex shortages that adversely affect private sector activities, delaying critical public projects and signalling an absence of buffers against external shocks. The lack of support for the private sector is criticised as a major problem to be addressed. The complex and restrictive regulatory environment for starting and operating businesses is also identified as a major constraint. Regarding the finance market, the report said that financial repression, notably negative real interest rates and the discretionary allocation of credit to selected sectors, remains a key challenge. The report also outlines which key tasks currently have to be carried out:[152]

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143 See National Employment Policy and Strategy (2017); Business and Employment Creation Strategy (2016); UNDP (2018): Ethiopia – Human Development Report; available at: hdr.undp.org/sites/default/files/ethiopia_national_human_development_report_2018.pdf

144 In February 2019, Prime Minister Abiy told parliament that his government had successfully renegotiated the repayment period for 60 per cent of its external debt.

145 https://www.theafricareport.com/11080/ethiopias-china-challenge/ ; https://qz.com/africa/1634659/ethiopia-kenya-struggle-with-chinese-debt-over-sgr-railways/. At the same time, the government abolished the model of the developmental state, which had controlled economic and social processes.

146 International Crisis Group (2019): *Managing Ethiopia's Unsettled Transition.* Report 269 (21 February 2019); available at: https://www.crisisgroup.org/africa/horn-africa/ethiopia/269-managing-ethiopias-unsettled-transition

147 World Bank (2019): *Ethiopia's Steady Economic Growth Leads to Poverty Reduction.* Washington, D.C.; available at: https://www.worldbank.org/en/country/ethiopia/publication/ethiopias-steady-economic-growth-leads-to-poverty-reduction

148 https://www.compactwithafrica.org/content/compactwithafrica/home.html; https://tradingeconomics.com/ethiopia/ease-of-doing-business.

149 https://www.compactwithafrica.org/content/compactwithafrica/home/compact-countries/ethiopia.html#tab_ (2 January 2018).

150 https://www.compactwithafrica.org/content/compactwithafrica/home/documents.html

151 Compact with Africa (2019): *Compact Monitoring Report* (April 2019); available at: https://www.compactwithafrica.org/content/compactwithafrica/home.html

152 Ethiopia is now one of the signatories of the AfCFTA. The treaty was ratified in July 2019.

Currently, meetings of the CwA country team on Ethiopia do not seem to be taking place. This finding confirms the ACET statement in the most recent 2019 CwA Monitoring Report.[153]

While the CwA does not provide a framework for reciprocal obligations and no accountability mechanism is in place for G20 countries, CwA partners are monitored by international organisations via country Policy Matrices.

Ethiopia's Policy Matrix is full of government actions required from the CwA partner in the macroeconomic, business and finance frameworks; specific indicators and targets attached to these government actions, and a list of various multi- and bilateral agencies. This chapter will thus only present the key CwA targets for Ethiopia, point to implementation deficits and identify inconsistencies as well as policy conflicts within the CwA Policy Matrix for Ethiopia. Let us recall the central goal of all CwA Policy Matrices: »Improve framework conditions for private investment (domestic and foreign).«

Table 12 juxtaposes the major CwA targets for Ethiopia with implementation deficits. The CwA concluded that key reforms needed in Ethiopia are:

– Macroeconomic reforms in the area of SOEs, governance to narrow the budget deficit and domestic resource mobilisation (primarily focusing on strengthening tax administration capacity)

153 ACET (2019): *Independent Review by The African Center for Economic Transformation. Compact Monitoring Report* (April): 11.

Table 12
Ethiopia Policy Matrix (31.01.2018)

	Government action	Targets 2020–25	Indicators 2019
1. Macro	Prudent monetary policy	Inflation < 10 % in 2020	Growth 9.3% p. a.
	– Improve external debt distress rating and – govt budget deficit.	– IMF/WBG debt distress rating low or moderate by 2020; – Deficit = 3 % by 2020	Risk of debt distress: high Debt % of GDP = 57.4 % Deficit = 4.5 % (ex grants)
	Improved tax collection	– Ratio of domestic tax revenue to GDP (17.2 % by 2020)	12.4 % of GDP
	Strengthening public investment management	PEFA scores in 2020 better than 2015	PEFA assessments not available since 5/2015
2. Business	Enhance EoDB in Ethiopia through trade logistics and business regulation reforms	– Average time to import down by 20% to 40 days by 2025 – Average time to export down by 20% to 14 days by 2025 – Increased investor satisfaction with business regulation and administration	Trading across borders unchanged from 2018 to 2019, according to the World Bank DB: Rank: 154/190 Score: 56
	Expand productive infrastructure for business	Number of industrial parks fully developed (10 by 2020)	15 parks planned by 2020 as part of GTP-II. But: rising worker turnover and unrest show limits of low-wage frontier (NYU Center)
	Targeted investor recruitment in priority sectors of manufacturing, industrial park development, energy generation and logistics services	– Investment promotion strategy adopted and implemented (in 2020) – Average annual percentage increase in FDI (20%)	No bonds, capital controls. FDI, % rise p. a.: negative since 2017
	Introduce a comprehensive legal regime (Proclamation) that governs PPPs	– Number of public-private dialogues organised (5 by 2020) – Number of legal reforms on PPPs (1 by 2020)	PPP law introduced 3/2018

https://www.compactwithafrica.org/content/compactwithafrica/home/compact-countries.html

– Ensuring EoDB by revising the commercial code and investment law and by modernising business service delivery

– Accelerating financial development to support private sector activities. An important focus here is a policy that contributes to reducing the serious debt problems.

Another key issue is improving the business environment (EoDB) for local and foreign companies so that higher FDI will flow into the country. This is because the desired increase in private investment is lagging behind the expectations outlined in the economic plans. FDI is stagnating, despite substantial effort by the government to promote the attractiveness of the investment location. The government considers the further development of the industrial parks to be particularly important, as they are intended to advance the planned industrialisation process. Here, tens of thousands of new industrial jobs are to be created. However, the model is controversial to the extent that wages for workers are classified as low, so low that they are not sufficient for them to make a living.

The CwA is encouraged by the institutions involved, such as the IMF and the IFC, to further advance the reforms of the business framework. Country Private Sector Diagnostics (CPSDs) are the main focus here.[154] CSPDs should deal with the key policy and structural issues hindering private investment. The WBG is also funding growth and competition projects to the tune of 1.2 billion US dollars. The IMF and the Ethiopian authorities jointly organised a High-Level Forum on Private Sector-Led Diversification and Growth that took place in Addis Ababa in July 2019. The objective of the Forum was to discuss and propose guiding principles for the design of a comprehensive strategy for sustained growth, diversification and private sector development, a task that is particularly difficult to tackle in Ethiopia, where SOEs are a major economic power.[155] Prime Minister Abiy Ahmed announced that reforms to step up private sector activities are key for robust growth. Consistent with the Ethiopian authorities' strategy, public sector retrenchment needs to be combined with reforms to crowd in private resources: privatisations, PPPs with adequate safeguards, private concessions, and removal of obstacles to domestic and foreign private investment.[156] Abebe Aemro Selassie, Director, African Department, IMF Addis Ababa, stated on 17 July 2019: »that macroeconomic stability, access to credit, good infrastructure, a conducive regulatory environment, a skilled workforce, and more equality have been associated with higher economic diversification.«[157]

CWA – GERMAN ACTIVITIES IN ETHIOPIA

From an economic point of view, Ethiopia has so far been of marginal significance for Germany, but Germany is an important partner in development cooperation.[158] In 2017, Germany imported goods worth 172 million euros from Ethiopia and exported goods worth 328 million euros in the opposite direction. Germany is one of the largest purchasers of Ethiopian goods, especially coffee and textiles. German exports to Ethiopia consist primarily of finished products such as machines, engines, motor vehicles, chemicals and medicines. More recently, German companies have also begun to invest in Ethiopia. In 2016, companies such as MAN, Siemens, DHL and Volkswagen began investing in the country.[159]

Ethiopia is a priority area for German development cooperation. Since bilateral cooperation began, 55 years ago, Ethiopia has received a total of more than 1.25 billion euros from Germany within the framework of technical and financial cooperation. In consultation with the Ethiopian government and international development partners, development cooperation focuses on three priority areas: education (vocational school and higher education), food security (agriculture) and protection and sustainable use of natural resources (biodiversity).

During government negotiations in November 2017, new commitments totalling 126 million euros were made for state development cooperation for the period up to 2020. Approximately 48 million euros will be made available for the priority area of education until 2020. The German Federal Government is supporting the establishment and expansion of a vocational training system. Cooperation in the priority area of agriculture and food security will be expanded with a new commitment of 66.5 million euros for the years from 2017 to 2020 to strengthen drought resilience and increase agricultural productivity. This focus is complemented by a cooperation project in agricultural policy (seed development, training and agricultural dialogue). The BMZ's Special Initiative is implementing additional measures focused on industrial clusters for the development of the textile industry and agriculture and food processing. Fields of activity for the German Federal Enterprise for International Cooperation (GIZ) in Ethiopia are the promotion of industrial parks, social and environmental standards in the textile industry and health. In addition, GIZ is involved in local development partnerships with the private sector.

Germany's activities should also be seen in a European context. The EU has numerous programmes supporting Ethiopia's structural change. The European Development Fund supports measures for the development of sustainable agriculture and food security, targeting vulnerable population

154 *Creating Markets in Ethiopia* (April 2019); available at: https://www.compactwithafrica.org/content/compactwithafrica/home/compact-countries/ethiopia.html#tab_2

155 G20 Compact with Africa Peer Learning Workshop on Private Sector-led Diversification and Growth. Available at: https://www.compactwithafrica.org/content/compactwithafrica/home/compact-countries/ethiopia.html#tab_2

156 IMF (2018): op. cit.

157 https://www.imf.org/en/News/Articles/2019/07/17/sp071719-g20-cwa-peer-learning-workshop-on-private-sector-led-diversification-and-growth

158 https://www.bmz.de/en/countries_regions/subsahara/aethiopien/index.jsp#section-30021283

159 See, among others, the CwA's *Flagship Investment List*; available at: https://www.compactwithafrica.org/content/compactwithafrica/home/compact-countries/ethiopia.html#tab_2

groups. Additional support to Ethiopia is channelled through other EU initiatives. France pursues its own bilateral agenda,[160] but, so far, none of these activities are integrated into the CwA strategy.[161]

The following critical remarks should be made regarding activities in Ethiopia: 1. The German commitment to development cooperation is — if at all — only weakly linked to the CwA. The actors operate side by side. 2. The CwA agenda is obviously largely steered by the IMF and the World Bank. The Monitoring Report on the agenda of the G20 CwA in Ethiopia and the statement by the IMF representative in Ethiopia show that the IMF and the World Bank are largely pursuing a traditional agenda, focusing on structural adjustment and stability measures, while the challenges of inclusive growth, poverty reduction and employment policies are not prioritised. 3. The implementation of the DIF (AfricaGrow, AfricaConnect etc.) did not start until 2019. It is, therefore, too early to conduct an evaluation. The extent to which the vocational training concepts in Ethiopia, which have been pursued for many years, will be integrated into a government-led concept in the country, remains to be seen. 4. The coexistence of various bilateral initiatives shows that German soft power to integrate the G20 states into a more coherent strategy has not, or at least not yet, taken place in Ethiopia. 5. The effectiveness of the governance of the measures necessary for the CwA agenda by the country teams remains unclear. It would be an unmistakable sign that the CwA agenda had failed in Ethiopia if the country team, consisting of actors from Germany, Ethiopia, South Africa and the IMF, the World Bank, the IFC and the AfDB, did not meet regularly. 6. Within the framework of existing cooperation, the Federal government should evaluate German activities in order to arrive at a focused new agenda on the basis of findings from the process of transformation. 7. The European countries and the EU should work together on a strategy based on Ethiopian approaches to development. France and Germany can be mutually supportive partners as they share similar approaches. They could also bring other actors on board.

With its measures within the framework of the DIF, the German government has taken a comprehensible approach. A focus on measures to promote German enterprises, support for local start-up companies, measures to foster African SMEs and a focus on vocational training fit in with Ethiopia's transformation strategy. These initiatives complement the measures of the G20 CwA, but at the same time also contradict their more orthodox approach.

CWA'S CONTRIBUTION TO ETHIOPIA'S REFORM CHALLENGES

The question arises as to how far the CwA is able to contribute to the most serious challenges in Ethiopia.

Economic growth in Ethiopia has been accompanied by a structural shift away from traditional and primary sectors towards secondary and tertiary ones. The danger is that the structural transformation now taking place in Ethiopia involves a shift from a low-productivity agricultural sector to an even lower productivity service sector which is predominantly informal. Nevertheless, agriculture remains of critical importance: Farmers and agricultural workers make up roughly three quarters of the country's labour force. Ethiopia remains largely rural and agrarian.[162]

The reform measures are undoubtedly fully justified, but they are not really suited to promote Ethiopian structural change and to offer economic prospects to the majority of people, especially the rural and youth population. In particular, there is a need to respond to the fact that an increasing number of individuals, including well-educated people, are entering the labour market. The model of credit-financed growth with large-scale government investments in infrastructure and the development of industrial parks is clearly reaching its limits. The rising debt, the very high trade deficit, stagnating inflows of FDI, an insufficient number of jobs in the industrial parks and rising unemployment are clear indicators of the impasse Ethiopia has reached.

The focus on the tasks outlined in the CwA Matrix cannot boost structural change as long as they do not address the fundamental challenges. These are the extreme poverty, the high unemployment, the neglect of agriculture, the lack of property rights for private farmers, the lack of support for SMEs and their lobbying associations, and the lack of measures to enable cooperation between foreign and domestic companies. The progress achieved so far, e. g., through the massive expansion of infrastructure and significant industrialisation efforts, has not been sufficient to lift the country out of poverty. The labour market situation may even deteriorate. The CwA instruments will ultimately encourage development in favour of large investors, while SMEs and the rural economy will be marginalised due to the lack of measures implemented by the CwA and the Washington institutions. This will make it impossible to achieve the goal of inclusive growth, which ultimately can only come from within. Ethiopia's serious challenges must be solved, above all by re-

160 For France-Ethiopia cooperation, see: http://addisstandard.com/news-ethiopia-france-to-sign-space-economic-cooperation/. Via the Choose Africa initiative, France has decided to spend 2.5 billion euros on funding and supporting African start-ups and small businesses by 2022, including Ethiopian start-ups. Available at: https://www.afd.fr/en/choose-africa-french-initiative-accelerate-growth-small-businesses-africa

161 This also applies to emerging economies and members of the G20, such as India and China. China is heavily engaged in bilateral cooperation. China plays a particularly important role in the expansion of infrastructure and the development of industrial parks in which Chinese companies operate. These do not comply with international standards on suitable work and minimum wages. Chinese — as well as multinational corporations — take advantage of the extremely low wage costs. They have purely commercial interests and some strategic interests. They are, in no way, interested in inclusive growth, minimum wages and the development of forward and backward linkages with local industry.

162 Yared Seid, Alemayehu Seyoum Taffesse and Seid Nuru Ali (2015): *Ethiopia – an Agrarian Economy in Transition.* Helsinki: WIDER Working Paper 2015/154.

forming agriculture and rural areas, because this is where the majority of the population lives. A major challenge in the urban centres and medium-sized towns is to provide prospects to the informal sector.

While the CwA's actions focus on institutional measures and one goal (»Improve framework conditions for domestic and foreign private investment«), the measures planned by the government and other international organisations go beyond stabilisation and reform measures. The national strategy papers focus on the following measures, which do not necessarily conflict with the CwA.[163] As we have seen from the reforms outlined above, the focus is on providing support in several main areas: 1. Jobs for millions of job-seekers who are unable to find employment in the industrial parks and with foreign companies and SOEs. To support this, first and foremost, SMEs must be promoted because the necessary jobs can only be created by this type of enterprise. 2. The enabling environment for SMEs must be upgraded so that they can act as subcontractors for foreign companies in value chains. In other words, a holistic approach is required that focuses on vocational training and the removal of constraints on firms. Therefore, not only the EoDB is important but also an industrial and agricultural environment that contributes to the development of Ethiopian entrepreneurship. 3. Ethiopia is generally lagging behind technologically, which is why measures for tertiary education and for the development of management capacities are of particular relevance. The promotion of start-up companies can provide a technological boost and knowledge transfer in the urban centres and also contribute to the development of local companies. Only dynamic and growing local companies will be able to act as subcontractors, i. e., only then will horizontal and vertical linkages to major foreign and local companies be achieved. Incentive systems, e. g., in the form of tax exemptions, can be used as instruments and the German DIF can be used to promote industrial clusters or industrial parks. 4. The agricultural sector in Ethiopia has great economic potential. Ethiopia is a producer of export goods such as coffee and, due to country's growing cities, there is also demand for food that can be produced by Ethiopian agriculture. The modernisation of agriculture is of crucial importance as the majority of the population lives in rural areas. 5. The Ethiopian model of the developmental state involving initiating an industrialisation process through large foreign investors initially brought investors into the country. This is because the investors primarily sought to exploit the large wage differences with other countries. This strategy is, however, not sustainable and leads to structural heterogeneity, which can be overcome by the aforementioned measures. These can, in turn, only be successful if adequate wages are paid and sustainable labour and environmental standards are respected.

9.2 GHANA

THE CHALLENGES AND POTENTIAL OF THE ECONOMY

Formed through a merger of the British colony of the Gold Coast and the Togoland trust territory, in 1957, Ghana became the first sub-Saharan country in colonial Africa to gain its independence. Today, Ghana is an emerging economy (GNI/Cap 1,875 US dollars) and a trade hub for much of West Africa. The country sits on the Atlantic Ocean and borders Togo, Côte d'Ivoire and Burkina Faso. It has a population of about 29.6 million (2018). Agriculture is the mainstay of its economy: it accounts for around 20 per cent of GDP and employs more than half of the workforce, mainly smallholders. Owing to its ability to produce a wide variety of tropical and subtropical crops, Ghana has the potential to be an important supplier of fruit and vegetable products to both its neighbours in Africa and to the EU.

In the past two decades, Ghana has taken major strides towards democracy under a multi-party system, with its independent judiciary winning public trust. Ghana consistently ranks among the top three countries in Africa for freedom of speech and press freedom, with strong broadcast media, and radio the medium with the greatest reach. Factors such as these provide Ghana with solid social capital, according to the WBG.[164]

Recently, a marked improvement has been seen in the country's international competitiveness. Ghana ranks 106th out of 140 countries in the World Competitive Report (2018), published by the World Economic Forum. The competitiveness rank in Ghana reached an all-time high of 119 in 2016, just ahead of the CwA launch, so it has climbed 13 ranks since then. Ghana's total exported goods represent nine per cent of its overall GDP for 2018 (in PPP). Ghana also provided exports-related services to global customers for an addi-

163 *National Employment Policy and Strategy* (2017); *Business and Employment Creation Strategy* (2016); *Second Growth and Transformation Plan* (2016–2020); *The Plan for Accelerated and Sustained Development to End Poverty* (PASDEP). The five-year *National Development Plan* for 2005/2006 to 2009/2010 underscored the challenges of unemployment and underemployment, especially for youth and women. *Growth and Transformation Plans* (GTP I: 2010/2011 to 2014/2015 and II: 2015/2016 to 2019/2020) aim to address unemployment and labour market issues. Private sector development and improving access to and the quality of education remain important strategies for employment generation. As emphasised in GTP II, industry is given priority as an engine of growth. Within industry, light manufacturing is prioritised, partly because the sector is believed to generate significant employment opportunities. Job creation is usually mentioned as one of the justifications for the government's efforts to promote the manufacturing industry by establishing industrial parks. See Arne Bigsten, Mulu Gebreeyesus and Måns Söderbom (2015): Tariffs and Firm Performance in Ethiopia, in: *The Journal of Development Studies* 52, 7: 986–1001; See Kappel, Pfeiffer and Reisen (2017): op. cit; Tilman Altenburg and Wilfried Lütkenhorst (2015): *Industrial Policy in Developing Countries.* Cheltenham.; Altenburg and Coulibaly (2018): op. cit. Cf. IFC (2019): *Creating Markets in Ethiopia: Country Private Sector Diagnostic.* Washington, D.C.; available at: https://www.ifc.org/wps/wcm/connect/publications_ext_content/ifc_external_publication_site/publications_listing_page/cpsd-ethiopia; UNDP (2018): *Ethiopia – Human Development Report*; available at: hdr.undp.org/sites/default/files/ethiopia_national_human_development_report_2018.pdf

164 Presentation by the WBG, available at: https://www.worldbank.org/en/country/ghana/overview#1.

tional four per cent of GDP. So, with total exports making up a combined 13 per cent of GDP, Ghana can be called semi-open.

Gems, gold, oil and cocoa still provide the bulk of Ghana's exports, a combined 85 per cent in 2018.[165] Ores, slag and ash were the fastest-growing among the top 10 export categories, led by manganese or aluminium ores and concentrates. In second place when it comes to improving export sales was fruit and nuts which rose 45.4 per cent. It is interesting to note that South-South trade dominates: India (21.5 per cent of its global total), China (11.9 per cent) and South Africa (10.2 per cent). A total of 48 per cent of Ghanaian exports by value were delivered to Asian countries, while almost a third (31.4 per cent) were sold to importers from Europe (primarily Switzerland). Ghana shipped another 15 per cent worth of goods to African nations.

Small farm operations account for the bulk of total agricultural production and are largely dominated by rain-fed production of crops for local consumption. With a small average farm size, agricultural productivity is limited by low cropping intensity, few market linkages, and limited use of fertilisers, insecticides, high yielding varieties or irrigation-based techniques. Additionally, high transport costs have restricted access to major domestic and international markets, and poor access to basic services in rural communities has reduced the ability to attract and retain entrepreneurs or workers.

According to the last CPSD,[166] Ghana has achieved significant poverty reduction and ›shared prosperity‹ in the last 25 years, and has been at the forefront of poverty reduction in Africa since the 1990s. The country achieved the goal of reducing the poverty rate by half in line with the first target of the Millennium Development Goals (MDGs). Between 1991 and 2012, the national poverty rate fell to less than half, from 51.7 to 24.2 per cent. In 2012, Ghana's poverty rate, at 1.90 US dollars a day, was down to 13.6 per cent, which is much lower than not only the mean poverty rate of SSA but also lower than LMICs. Although inequality in household consumption increased slightly during the 2000s, Ghana still compares favourably with other LMICs in Africa as its Gini coefficient is still below the median of these peer countries.

The impact of growth on poverty has slowed since 2012. This challenge reflects the declining contribution of agriculture, in which the majority of poor households are engaged, the limited opportunities for higher-productivity jobs in the service sector and largely capital-intensive industrial development. Ghana's major structural shifts have only marginally contributed to labour productivity growth and as a result have had a minimal impact on poverty reduction. In ›traditional‹ structural change, labour and economic activity move from agriculture to higher-productivity sectors such as manufacturing. In Ghana, however, labour moved into the service sector, low-productivity wholesale and retail trade (productivity in these sectors is less than in agriculture). Spatial inequalities persist, notably the traditional economic and social inequality between the north and south of Ghana (a result of geography and colonial legacy).

Arguably Ghana's most acute challenge (and a barrier to blended finance approaches with contingent liabilities) is the country's debt overhang. Growing natural resource dependency and weaknesses in fiscal governance have increased economic volatility and complicated macro-management. In 2015, natural resource rents reached 20 per cent of GDP, thus political consensus on sustainable fiscal management has been difficult to achieve, weakening Ghana's nominal fiscal rules. Fiscal volatility increased markedly, with deeper deficits followed by stabilisation measures and then further slippage. This cost Ghana about 0.3 per cent of its annual growth during 2000–2015, with the heaviest toll in the early 2010s (0.7 per cent per year). Over time, these cycles have resulted in public debt increasing from 39 per cent to 73 per cent of GDP between 2011 and 2016. This compares with the 50–53 per cent average range for SSA, LMICs and structural peers, and 39 per cent for aspirational peers. Ghana has been at high risk of external debt distress since 2014. With the current stabilisation efforts, the recent decline of gross financing needs has benefited from measures to lengthen domestic debt maturities and active debt management, but any »derailment from the planned fiscal adjustment path could seriously jeopardize debt sustainability.«[167] In fact, Ghana's fiscal situation has not been sustainable for several years with comparatively low revenue mobilisation and high public wage costs. Tax revenues are below potential by an estimated five percentage points of GDP and far below regional comparators.

IMPLEMENTATION OF THE CWA AND EVALUATION OF THE INDIVIDUAL CWA MEASURES

On assumption of office in early 2017, President Nana Addo Dankwa Akufo-Addo espoused his government's desire to manage the country's natural resources in a manner that would allow the country's development agenda to be financed without recourse to external assistance — encapsulated by the slogan *Ghana Beyond Aid*.[168] Rather than the CwA (according to local observers virtually unknown in Ghana), it is *Ghana Beyond Aid* that sets the strategic economic framework. It has since come to represent an entire initiative for the development of national resources designed to lift more people out of poverty. The strategy em-

165 http://www.worldstopexports.com/ghanas-top-10-exports/

166 World Bank Group (2018): *Systematic Country Diagnostic.* Report No. 132010-GH (November). More recent poverty data are not available.

167 G20 (2019): *CwA Monitoring Report 04/19*, op. cit.

168 Cf. *Ghana Beyond Aid: Charter and Strategy Document.* Accra (April 2019).

phasises i) industrialisation through increasing refinement of natural resources (especially for job creation); ii) agriculture (irrigation and the food sector); iii) tackling corruption; and iv) education (of the workforce).[169]

Nonetheless, the CwA aligns rather well with Ghana's current needs. In the 2019 budget statement, the government reiterated that support for the private sector was a top priority. Like all West African countries, Ghana needs decent jobs for the young. On the demand side of the jobs equation, the economy will require more space and a better environment for a more dynamic private sector. Key reforms up until early 2019 focused on business facilitation.

Measures of macroeconomic progress are distorted by redefining the GDP, an important denominator of fiscal and debt ratios. However, Ghana's tax ratio still remains below target, at 16.5 per cent of GDP. Macro balancing has improved with the conclusion of Ghana's IMF-supported programme. This paved the way for significantly improved macroeconomic performance. »Various reforms have also seen critical progress. The implementation of the 2016 Public Financial Management Act has brought greater discipline and transparency; memorandum of understanding between the Ministry of Finance and the Bank of Ghana (BoG) to refrain from central bank financing to the budget has significantly helped reduce inflationary pressures; debt management has improved; substantial banking sector reforms (with nine banks resolved in 18 months) has enhanced financial stability; and greater oversight of the inefficient energy sector is taking hold.«[170] In fact, the Bank of Ghana resolved seven banks, approved three bank mergers and oversaw an increase in statutory capital for banks.

Table 13 juxtaposes the major CwA targets for Ghana with implementation deficits. Note that this is just a selection of an array of 22 government actions required of the Ghanaian authorities, along with 34 quantitative indicators.[171] Given the urgency of addressing Ghana's external constraint, the stipulated actions and indicators are more macroeconomic in nature than about stimulating sustainable transformation and creating decent jobs.

Ghana has been at high risk of external debt distress since 2014. With the current stabilisation efforts, the recent decline in gross financing needs has benefited from measures to lengthen domestic debt maturities and active debt management. Notwithstanding the CwA, Ghana currently has a severe financing constraint. Aware of the risks of excessive debt accumulation, the authorities have decided to respect severe debt limits for new external borrowing following the completion of the recent IMF program. It is important to note in this context that the Public Private Partnership Bill has not yet been passed. Yet Ghana's capital account still appears to be debt-addicted as »Ghana has emerged as an attractive destination for portfolio investment in 2018, with the corresponding vulnerabilities to shifting investor sentiment. Ghana has had two very ›successful‹ Eurobond campaigns, in May 2018 and March 2019, with the latter being oversubscribed by a factor of six.«[172] Even though Ghana's current FDI inflows of 3–4 per cent of GDP outperform its peers, these inflows are predominantly in capital-intensive sectors, providing little labour demand.[173]

Ghana's authorities completed five of the seven targets in the business framework. Ghana's EoDB score improved by 0.4 points between 2017 and 2019 although its EoDB ranking has deteriorated slightly over the past two years. Ghana currently ranks 9th among the sub-Saharan countries in the EoDB rankings. Ghana's lowest scores in the EoDB indicators are in registering property, trading across borders and resolving insolvency. The financing framework has already advanced quite substantially: De-risking instruments to leverage private finance were recently introduced in the housing and agriculture sectors. Lengthening debt maturities is a top priority in view of Ghana's debt profile (see Table 13).

Despite financing constraints, major infrastructure investments are being made, notably in fossil energy (oil and gas), electricity power and transport. An important port expansion project, which began in October 2016 and was completed in June 2019 at a cost of 1.5 billion US dollars, is expected to boost trade in Ghana and the West African region. The authorities have also been working on a large off-balance transaction. This would involve the provision of infrastructure by China's Sinohydro against refined bauxite proceeds. Sinohydro will provide two billion US dollars in infrastructure (including roads, bridges, interchanges, hospitals and affordable housing) in exchange for Ghana's refined bauxite.

So, what measures have proven to be particularly viable in terms of promoting structural change towards more (and more sustainable and better) employment and poverty reduction? Ghana faces the traditional economic and social inequality between the north and south of the country (due to geography and colonial legacy). The impact of growth on poverty has slowed dramatically since 2012, according to the World Bank (2018).[174] This reflects the declining contribution of agriculture, in which the majority of poor households are engaged, the limited opportunities for higher-productivity jobs in the service sector, and largely capital-intensive industrial development. Ghana's major structural shifts have only marginally contributed to labour productivity growth and as a result have had a minimal impact on poverty reduction.

169 Fatuma's Voice (2018): *Ghana Beyond Aid Agenda – An Independent Africa: Is the Proposed Policy Feasible?.* Accra (26 November).

170 *IMF Country Report No. 19/97* (April 2019).

171 *Report to G20 Compact with Africa – Ghana's Policy Matrix* (March 2018).

172 G20 (2019): *CwA Monitoring Report* (April).

173 World Bank (2018): *Ghana – Priorities for Ending Poverty and Boosting Shared Prosperity, Systematic Country Diagnostic (SCD).* Washington, D.C. (November).

174 World Bank (2018): op. cit.

Table 13
Ghana Policy Matrix (15.03.2018)

	Government action	Targets 2019–21	Indicators 2019
1. Macro	Fiscal restraint	Fiscal deficit < 5 % of GDP Public debt < 70 % of GDP by 2019	(GDP redefined + 24.6 %) Fiscal deficit = 5.6 % Public debt = 62 % of GDP
	Improved tax collection (non-oil)	Share of domestic tax revenue to GDP > 19 %	16.5 % of GDP
	Enact the PPP Law	PPP Bill submitted to parliament by 2018	
	Increase share of renewable energy in the energy mix	> 10 % by 2030 526 MW by 2020.	Renewable generation capacity 2019 = 45 MW (only solar), i. e., 8.9 %
2. Business	Create the Ghana Business Registry	Establish electronic registry of business and investment laws, regulations procedures and administrative notices by end of 2019	Done
	Review and reduce number of steps in the acquisition of the various business operating permits. Automate and integrate processing and issuance of licenses and permits	Ghana to rank among the top five (5) countries in SSA for the WBG DB by 2020/2021	114/190 = 9th SSA
3. Business	Develop de-risking instrument to leverage private investment	Increase number of de-risking instruments used by government to leverage private capital by 2019	Active policy. Examples: – affordable housing and mortgage scheme – Ghana Amalgamated Trust (GAT) for agricultural credit
	Normalise and extend the yield curve in domestic debt market	Maintain normal yield curve — a positive spread between the longer dated instruments and shorter dated instruments	The govt securities yield curve extended to 7 years with benchmark points along the curve (3–6 months, 1, 2, 3 and 5 years)
	Introduce a wider spectrum of instruments in domestic debt market	Introduction of the 20-year bond	Lengthening the domestic maturity profile to 7 years. Short-term domestic debt constitutes 59.4 % of total borrowing

https://www.compactwithafrica.org/content/compactwithafrica/home/compact-countries.html

In ›traditional‹ structural change, labour and economic activity move from agriculture to higher-productivity sectors such as manufacturing. In Ghana, however, labour has been moving into the informal service sector, low-productivity wholesale and retail trade (productivity in these sectors is less than in agriculture) since the 2000s. This subsector has very low productivity, which, over time, even experienced negative labour productivity change. In fact, the wholesale and retail trade sectors had the lowest productivity in the economy (even lower than agriculture) over the period 1990–2010. This suggests that the capacity of the service sector to absorb labour in a higher-productivity sector (higher than agriculture) has decreased since the 1990s, as wholesale and retail trade has come to predominate in the service sector and absorbs most labour from other sectors. Its share of total employment had risen to 24.3 per cent by 2010, and the wholesale and retail trade constitute more than half of all employment in the service sector.[175]

The Labour Intensive Public Work (LIPW) programme, under the Ghana Social Opportunity Project (GSOP) is a social protection programme initiated by the Government of Ghana to offer jobs and income-earning opportunities to specific targeted rural communities by applying labour intensive technology in the construction of a community infrastructure. This has the potential to generate secondary employment.[176]

175 Geiger, Michael, Jan Trenczek and Konstantin M. Wacker (2019): *Understanding Economic Growth in Ghana in Comparative Perspective.* Washington, D.C.: Policy Research Working Paper Series 8699, The World Bank.

176 https://journals.co.za/content/journal/10520/EJC-155ff31fb0

9.3 SENEGAL

THE CHALLENGES AND POTENTIAL OF THE ECONOMY

Senegal can rely on a number of advantages: its democratic tradition, its geographical position on Africa's western Atlantic coast, a young population, huge agricultural and mining potential, and the dynamism of its diaspora of migrants. Senegal is often celebrated as a symbol of democracy and peace on the African continent. It frequently participates in peacekeeping throughout the region. The second largest economy in francophone West Africa has been experiencing strong growth since 2012, exceeding an annual real rate of six per cent over the past years. Recent growth has been driven by significant improvements in agricultural production, but also by the implementation of infrastructure projects, which have supported domestic consumption.[177]

Senegal aims to be an emerging country by 2035. To achieve this objective, the country has put in place a ten-year development strategy for the period 2014–23, the *Plan Sénégal Émergent* (PSE). This plan is based on three strategic orientations or axes: the structural transformation of the economy, the population's living conditions and good governance. After implementing the first part of the Plan (PSE I) during 2014–2018, the second part (PSE II) started in 2019 for another five-year period, up until 2023.

International competitiveness has improved since the late 2000s, according to the WBG (2018) Systematic Country Diagnostic of Senegal. The country's share in global exports rose from 0.015 per cent in 2008 to 0.025 per cent in 2017. Senegal is a relatively closed economy but unrecorded (natural) trade seems important. Its exported goods represented 4.4 per cent of its overall GDP for 2018 (59.5 billion in PPP US dollars). Exports of services (remittances, tourism) added another 2.4 per cent of GDP in the same year. In 2018, the bulk of merchandise exports was earned from inorganic chemicals (phosphoric or polyphosphoric acids) — 526.1 million US dollars (20.2 per cent of total exports) —, gems and precious metals — 510.2 million US dollars (19.6 per cent) — and fish — 502.6 million US dollars (19.3 per cent).[178]

The Economic Complexity Index (ECI) aims to infer information about countries' productive capabilities by making relative comparisons across their export baskets. The ECI captures the diversity and sophistication of the productive capabilities embedded in the exports of each country. The index has been successful in explaining cross-country differences in GDP/capita and in predicting economic growth. According to The Observatory of Economic Complexity, the economy of Senegal has an ECI of –0.519, making it the 93th most complex country in 2017, out of 133 (similar to Australia).[179] Over the last decade, Senegal's ECI has oscillated but trended downwards, putting it into the country group of biggest fallers. Consequently, growth projections derived from the country's productive capabilities place it in the middle of African peers in the coming decade, at just about four per cent a year in real terms.[180] These projections fall short of the ambitious GDP growth targets (7–8 per cent) set by the PSE.

Poverty in Senegal is mainly rural and principally affects large, poorly educated households. In 2011, nearly 70 per cent of the poor and 84 per cent of the extreme poor lived in rural areas, accounting for 57 per cent of the total population. Apart from geography, the main correlates of poverty are education, the size of the household and sector of occupation. Higher growth is estimated to have reduced poverty.[181] Compared to its neighbouring countries of Ghana (13.6) and Côte d'Ivoire (27.9), Senegal is poor(er). However, since 2011, when extreme poverty stood at 38 per cent based on the international poverty line,[182] poverty is estimated to have decreased to 35.4 per cent by 2016 (latest estimate available).

Agriculture appears to have been one of the main drivers of this reduction, as it has registered low but positive expansion with two exceptionally good years during 2015–17. At the same time, rural areas have witnessed some job reallocation out of the primary sector, as households diversified their livelihoods by tapping into a growing rural non-farm economy. Moreover, moderate improvements in general value added per agricultural worker reversed a negative trend that had prevailed for more than a decade, pointing to signs of nascent structural transformation. In urban areas, labour income among the poor has been supported by growth in labour-intensive sectors, such as commerce and construction.

Although inequality as measured by the Gini coefficient is relatively low when compared to SSA at 0.38 in 2011, the current level of inequality of consumption in Senegal still indicates that the top 20 per cent of the distribution enjoys almost 45 per cent of the total wealth. Recent data based on asset indicators also suggests that the economic growth between 2011 and 2015 may have been disproportionately captured by the better-off. The provision of basic public utilities is another determinant of inequality. Uneven provision may intensify with climate change. The challenges here are to upgrade the power grid, ensure access to drinking water and prevent floods.

One of Senegal's major challenges is to provide sustainable high-quality (decent) jobs. As a result of the current fertility rate of 4.8 — which is high even by SSA standards — 260,000

177 OECD (2017): *Examen multidimensionnel du Sénégal: Volume 1. Évaluation initiale, Les voies de développement.* Paris: OECD.

178 http://www.worldstopexports.com/senegals-top-10-exports/.

179 http://atlas.cid.harvard.edu/rankings/2017?country=senegal.

180 http://atlas.cid.harvard.edu/rankings/growth-projections/.

181 World Bank Group (2018): *Systematic Country Diagnostic of Senegal.* Dakar (October).

182 Percentage of the population living below the international poverty line of 1.90 US dollars (in PPP terms) per day. See http://hdr.undp.org/en/composite/MPI

young Senegalese people enter the labour market every year. Overall levels of education in Senegal are low — according to the United Nations Development Programme (UNDP) it was three years in 2015 (and about five years for the population under 20 years of age), compared to an average of seven years in SSA. Low quality of education (including high drop-out rates for girls in secondary school due to early marriage and pregnancy) exacerbates the fertility problem.

By contrast, the IMF has assessed Senegal as having achieved macroeconomic stability since PSE I (2014–18).[183] It remains to be seen, however, whether macroeconomic stability can be maintained during PSE II. PSE II aims to get Senegal onto the road to development by 2035. Senegal remains at low risk of debt distress, but public debt has risen in recent years. This reflects a combination of factors, including accelerated public investment spending and the inclusion of the debt of public entities outside central government.

IMPLEMENTATION OF THE CWA AND EVALUATION OF THE INDIVIDUAL CWA MEASURES

The Government of Senegal has fully committed to its ambition to use all available resources — public, private, domestic and international — to finance its development vision under PSE I: »An emerging Senegal in 2035 with an inclusive society in a state of law« (OECD, 2018),[184] Senegal's financing ambition corresponds well to a new metric — total official support for sustainable development (TOSSD). TOSSD measures official flows and private flows mobilised (including from China and other emerging providers) to support sustainable development. Senegal was the first TOSSD pilot study, and gives us a good grasp of financial flows from all sources as revealed by the authorities. Table 14 provides a detailed and comprehensive overview (for 2014 only), by including China and remittances, two financing sources that are notoriously hard to trace.

Table 14 provides some interesting information — not just about Senegal but also beyond — on the providers and structure of cross-border finance to poor countries (and thus CwA motivation):

– *Remittances* by Senegal's diaspora of migrants topped the ranking of cross-border flows and providers, with more than a third of total inflows in 2014. This is still the case. During the 2010s, remittances constituted the most important inflow in Senegal's current account, exceeding ten per cent of GDP.[185] In view of the importance of remittances, it is striking how little emphasis has been

183 IMF (2019): *Senegal Staff Report for the Article IV Consultation.* IMF Country Report No. 19/27 (January).

184 OECD (2018): *Senegal's Perspective on Total Official Support for Sustainable Development (TOSSD).* OECD Development Co-Operation Working Paper 43 (February). The OECD quotes Senegal's finance ministry but the hyperlink has been removed (as sometimes happens in official Senegalese documents).

185 IMF (2019): *Senegal Staff Report for the Article IV Consultation.* IMF Country Report No. 19/27 (January).

Table 14
TOSSD Gross Inflows to Senegal in 2014, million US dollars

Bilateral official			**>2090**	**43.4 %**
West	DAC grants	567		
	Concessional loans	224		
	Non-concessional	17		
East/South	Emerging lenders	> 1,282		–26.6%
Multi official			476	9.9%
	Grants	164		
	Concessional loans	192		
	Non-concessional	120		
Private			301	6.3
Hybrid	De-risked private	60		
	Export credits	11		
Investors	Market term flows	99		
	FDI	31		
	Securities, bonds	68		
	Charitable grants	32		
Migrants	Remittances	1,644	1,644	34.2
Total			**4,812**	**100.0**

Sources: OECD (2018): *Senegal's Perspective on TOSSD.* Annex 1; own calculations placed on this type of financial flow in the CwA initiative.[186] Perhaps, the CwA initiative has given remittances such a low profile so as to avoid conflicting messages because another aspect of the rationale for the CwA is to avoid excessive migration. This is all the more astonishing as the June 2017 international conference »G20 Africa Partnership – Investing in a Common Future« had featured a group entitled »Remittances for Investments«, which focused on bundling and leveraging remittances with ODA funds, particularly to foster economic development in rural and marginalised areas.[187]

– Loan commitments from China (estimates based on interviews) were the second most important flow in 2014, making up at least 26 per cent of total inflows. China's lending is shrouded in secrecy as China has so far refused to join the Paris Club of official (mostly Western) creditors. Until recently, China's investment in Africa took the form of loans in exchange for infrastructure development. Future finance could increasingly be administered via new China-led multilateral development banks, such as the AIIB and the NDB. A recent scientific Kiel Working Paper[188] lists the world's top 50 recipients in terms of external debt stock as a percentage of GDP, with Senegal just short of 10 per cent in 2017.[189] Ghana, assessed as being at high risk of debt distress, is, unlike Ethiopia, not listed among China's top debtors in the Kiel study.

– In contrast to remittances and China loans, corporate FDI and private portfolio flows were negligible in 2014 (with around one per cent of gross inflows each). According to recent IMF data these remained low, at barely two per cent of GDP for the period 2015–17; in 2018, however, the IMF recorded Eurobond issuance worth almost 9 per cent of GDP among portfolio flows.[190] Private equity flows to Senegal have been very low indeed. Portfolio equity flows are predicted to remain modest in the future, assuming there are no major stock market listings. However, annual corporate FDI inflows could triple, according to IMF projections for 2020–23.

FDI inflows may well be boosted in future years. The PSE II growth strategy aims to develop clusters of economic activity, with SEZs now up and running. Planned investments in the three established SEZs Diamniadio, Diass and Sandiara amount to about 3.7 per cent of GDP, with investors coming from several countries, including China and Tunisia, and representing different sectors including plastics, food processing, bank cards, medical services and research. In view of modest CwA results concerning private flows, the BMZ started co-financing CwA initiatives with grants of up to 100 million euros per country, and implementation has already begun in Côte d'Ivoire, Ghana and Tunisia. Discussions are under way for initiatives in Senegal, Ethiopia and Morocco. This increased cooperation seeks to improve the environment for private sector investment, boost economic growth and create sustainable jobs, especially for young people.

As for employment targets, both planned and achieved, 770 jobs have been created so far in the three SEZs mentioned (compared with a planned total of 11,679), according to data provided by Senegal's authorities for the last Article IV Consultation of the Fund. Thus there seems to be a significant gap between ambition and reality. This may also hold for Senegal's start-up plan, administered by *Entrepreneuriat Rapide*, which is committed to creating 275,000 jobs (of the one million included in the PSE II objective) within the 2013–2019 period.[191]

In the agricultural sector, three integrated agricultural growth poles or ›agropoles‹ are being launched to help the sector increase the value added of agro-business and reduce reliance on imported foodstuffs. A similar approach is planned for the tourism sector. All these initiatives contribute to advancing economic activity outside Dakar. The development of the *plateformes d'investissement*, which aims to give enterprises and households access to administrative services outside of Dakar, is also consistent with this strategy.

The national development plan *Senegal Emergent* (PSE I) had put the private sector at the heart of the country's financing strategy for sustainable development and has placed »public-private financing at the heart of its growth strategy.« This ambition has also recently been reflected in modestly improved scores and rankings on the IFC EoDB indicator, as reported in Table 15. However, progress was much less impressive than in CwA country peers Côte d´Ivoire, Rwanda or Togo.

However, as noted in the OECD report on Senegal's TOSSD, PPPs were used much less frequently than expected, despite the law governing PPPs having been revised in 2014. PSE II aims to rectify this, with potential financing and technical assistance also coming under the CwA framework.

The CwA flagship list for Senegal contains detailed information on the FDI pipeline by the end of 2018,[192] worth a

186 Remittances are not counted as capital flows by the IMF; they are categorised as unrequited transfers in the current account of a country's balance of payments. Yet, they do constitute cross-border financial flows.

187 G20 (2017): *G20/Chairs_Summary_G20_Africa_Partnership_Conference.* Berlin (June).

188 Sebastian Horn, Carmen Reinhart and Christoph Trebesch (2019): *China's Overseas Lending.* Kiel Working Paper No. 2132 (July).

189 Ethiopia's external debt stock to China was almost 20 per cent of its GDP, according to the Kiel paper cited above.

190 IMF (2019): *Senegal Staff Report for the Article IV Consultation,* op. cit., Table 2. Senegal: Balance of Payments, 2015–23.

191 Papa Amadou Sarr (2019): Nous sommes en train de créer le plus grand centre d'incubation d'Afrique de l'Ouest, in: *Jeune Afrique* (15 July).

192 Senegal Agriculture Kagome's Agriculture Business of Tomatoes for Processing 1.0 Japan Implementation Established (December 2017) Senegal Infrastructure Room2Run 57.0 EU Pipeline AfDB Senegal Infrastructure Resilient City Development 115.0 EU Pipeline AECID Senegal Other sectors (Energy) Senergy 2 S.A.S – Solar PV Project 15.1 Implementation Signed on 13th of November 2017; planned to be commissioned in June 2018 Senegal Other sectors (Energy) Tobene Power SA 31.6 Senegal Other sectors (Energy) Gauff Engineering Germany Pipeline Electrification of 300 villages, MoU signed Senegal

Table 15
Doing Business: Progress in Senegal, April 2019

DB 2017 Rank (of 190 countries) / EODB Score	DB 2019 Rank (of 190 countries) / EoDB Score	+/– Change in Rank / EoDB Score	✓ DB 2019 Reforms
147/50.68	141/54.15	+6/+3.47	✓ Registering property ✓ Enforcing contracts

Source: G20 (2019): *Compact Monitoring Report* (April).

total 244.6 million US dollars. Investment opportunities, as advertised in the investment prospectus of Senegal's country page on the CwA website, highlight:

– Energy; to improve the energy mix through: (i) the development of new electricity production capacities, (ii) diversification of energy generation sources, and (iii) enhancement and development of the transmission and distribution network.

– Agriculture, fisheries and food; to reduce Senegal's dependence on imported food (cereal corridors for rice, millet and maize) and to promote Senegalese agriculture (aquaculture industry, horticulture) as a growth driver.

– Services; to establish Dakar as the region's service hub in areas such as corporate headquarters, health services, education facilities and tourism (after years of neglect).

Currently, meetings of the CwA country team on Senegal do not seem to be taking place. This finding confirms the ACET statement in the most recent 2019 CwA Monitoring Report: »While guidelines for Compact Teams have been agreed, in most cases the Compact Teams are not operating effectively – if at all. Of those visited, in one country there has not been a Compact Team meeting since October 2017, in two countries the first full Compact Team meeting took place in February 2019, and in numerous countries the private sector has not been invited. Likewise, leadership of the Compact Team varies across countries, both with regard to seniority and focal points.«[193]

ASSESSMENT OF THE CWA AGAINST THE BACKGROUND OF ECONOMIC AND SOCIAL DEVELOPMENT

While the CwA does not provide a framework for reciprocal obligations and no accountability mechanism is in place for G20 countries, CwA partners are monitored by international organisations via country Policy Matrices. President Macky Sall's government, which aims to get Senegal onto the road to development by 2035 recently posted on the presidential website: »Fighting inequalities and social injustices are the President's main objectives. President Sall believes that politics has meaning only if it effectively tackles social discrepancies.« In the view of Senegal's government, this goal sets the major policy objectives of the PSE II: structural transformation of the economic framework, promotion of human capital, good governance and rule of law.[194] How does Senegal's CwA Policy Matrix align with the broad priorities set out by its president?

Each country Policy Matrix has a long list of government actions required of the CwA partner in the macroeconomic, business and finance frameworks. There are also specific indicators and targets attached to these government actions, and various multi- and bilateral agencies labelled as »partners«. The Senegalese authorities are faced with 28 government actions, 28 targets and 37 foreign agencies (Senegal Policy Matrix, September 2018). The Policy Matrix covers four narrowly spaced pages, too long to be replicated here. (As mentioned in Part 1, international agencies shoehorn their themes and indicators into the Matrix and G20 leaders do not appear to care much about prioritisation. It is also important to note here that the governance indicators are more World Bank centred and differ from those emphasised by the German government in Bundestag hearings.) This chapter will thus only present the major CwA targets for Senegal, point to implementation deficits and identify inconsistencies as well as policy conflicts within the CwA Senegal Policy Matrix. The central goal of all CwA Policy Matrices, once again is to: »[i]mprove framework conditions for private investment (domestic and foreign).«

Table 16 juxtaposes the major CwA targets for Senegal with implementation deficits. Note that this is just a selection of long list of 28 government actions required of the Senegalese authorities, accompanied by 28 quantitative indicators. In 2018, implementation, even by the darling of the donor world Senegal fell short of the ambitious targets in all focus areas (macro, business and financing). The IMF assessment (most recent Article 4 Consultation, p. 13) provides the following explanation of these shortcomings: Constraints to private sector development persist, despite

Other sectors (Energy) Novis GmbH Germany Implementation Within the framework of international development cooperation Novis has completely electrified the village of Kalom (Senegal), start-up 02.2012 Senegal Services Bitzer GmbH 2.9 Germany Implementation Sales, marketing, support, industrial machinery, equip. and tools Senegal Other sectors Pasteur 22.0 France Implementation The Pasteur Foundation is investing EUR 22M in a new vaccine manufacturing facility.

193 ACET (2019): *Independent Review by The African Center for Economic Transformation, Compact Monitoring Report* (April): 11.

194 https://www.sec.gouv.sn/dossiers/plan-s%C3%A9n%C3%A9gal-emergent-pse

Table 16
Senegal: Policy Matrix Targets and Implementation Deficits

Focus areas	Government action	Implementation
Macroeconomic stability	– Reduce fiscal deficit to 3 % – Ensure debt sustainability – Reduce current account deficit	– The 2018 draft budget shows a deficit of 3.5 % of GDP – Joint IMF/WBG DSA: »debt risk low«. »But debt dynamics will need to be closely monitored« – Widened in 2017, projected to remain > 7 % of GDP
Domestic resources mobilisation	– Increase tax revenues to at least 20% of GDP over the next three to five years based on rebased GDP – Rapid refund system: put in place in 2018 or in 2019 budget	– 18.7 % in 2018. Need to raise additional tax revenue of 4 % of GDP – transfer pricing regime submitted to parliament and approved
Performance of public services	– Improve citizen and stakeholder access to economic and financial information – Upgrade public administration	– »Improve from 10th to 8th in the Ibrahim Index of African Governance (IIAG).« In fact, the portal notes »slowing improvement« and Senegal's rank has remained at 10 (http://iiag.online/) – »Improve to at least 50 in all percentile rankings of the WB Governance Indicators.« On government effectiveness, Senegal fell slightly in the WGI ranks from 36.5 in 2016 to 40.4 in 2017
Business framework	– Facilities for project preparation and use of standard clauses in PPPs – Accompany pilot countries in PPPs – Finalisation and harmonisation of the institutional and legal framework on PPPs	– Double the share of FDI: from 3 % of GDP in 2015 to 6 % in 2020.« Last observation in 2017: FDI = 2.4 % of GDP. Projected for 2020: 4.1 % of GDP (IMF, 2019)
Financing framework	– Attract institutional investors by supporting the regional pilot project for market development (in CFAF) for long-term bonds – Create a risk mitigation fund by issuing bonds	– WBG: Ongoing work by J-CAP initiative with the BCEAO to improve regulatory framework for capital market/bond issuances – »Fully functioning mitigation fund, with a USD *** million initial capital, by end 2018«

Sources: *Senegal Policy Matrix* 09/18; IMF (2019); *IMF Senegal Staff Report for the Article IV Consultation* (April).

PSE I. Constraints include: (i) access and cost of energy, (ii) heavy procedures in the tax system and the judiciary, (iii) labour regulations, (iv) access and cost of credit, (v) efficiency of public investment, and (vi) weak human capital.

How do all the government actions and indicators stipulated by the Policy Matrix align with Senegal's priorities? First, Senegal's PSE II seems to align more or less fully with the Senegal Policy Matrix as far as good governance and rule of law are concerned and the same applies to the authorities' quest for private funding. Second, interests only seem to align indirectly when it comes to the goal of strengthening human capital, especially via SME vocational training — an important AFD project. Third, there are very few initiatives in the Policy Matrix in support of the need for structural transformation via sectoral, rural-urban or informal-formal shifts.

Finally, it is also important to point out the potential inconsistencies and policy conflicts in the most recent Senegal Policy Matrix (09/18):

– Macroeconomic stability trumps social cohesion in the CwA design. But is this a sustainable reform sequence?

– One objective is to raise post-tax business profitability to attract private inflows. But how does this policy target correspond with increased tax revenues postulated to mobilise domestic resources?

– The policy target of slimming down Senegal's bureaucracy sits uneasily with the overload of ›government actions‹, ›indicators and targets‹ and ›partners' support‹ (a euphemism for international organisations and bilateral aid agencies) stipulated in the Policy Matrix.

- Safeguarding Senegal's public debt sustainability could interfere with the required bond market development to attract institutional investors. Similarly, promoting PPPs (and other blending instruments, such as guarantees) to facilitate infrastructure lending to the private sector could undermine sustainable fiscal space through the build-up of public contingent liabilities.[195]

Three major policy streams not highlighted in the CwA seem, in our view, to be very promising avenues for the promotion of structural change towards more (sustainable and decent) employment and poverty reduction, at least in Senegal:

- The CwA should emphasise longer and better schooling for girls to upgrade human capital and dampen fertility.

- Remittances should play a central role in the CwA as the most sizeable, developmental and equitable form of private cross-border flow.

- Rather than mimicking former Asian industrialisation strategies, which put the focus on urban development and the manufacturing sector, structural transformation and higher productivity in Senegal require a focus on the primary sector and services as well as rural development.

Overall, levels of education in Senegal are low — according to UNDP average length of education was three years in 2015 (and about five years for the population under 20 years of age), compared to an average of seven years in SSA — which exacerbates the fertility problem. Girls' completion rates in secondary education and enrolment in tertiary education are still substantially lower than those of boys. Secondary education is especially important as it provides crucial skills for the job market. The gender gap in tertiary education is also wide. Authorities could play an important role in encouraging girls to continue their studies. Measures to achieve this objective include: (i) reducing the indirect costs of studying, (ii) investing in safe transportation so that children can travel to school, (iii) providing transfers to families who keep their teenage daughters in secondary school until completion, (iv) campaigns for the prevention of child marriage and pregnancy, and (v) enforcing civil, rather than customary laws.

Remittances should play a much greater role in the CwA, rather than unrealistic FDI promises and debt-building portfolio flows. More than half a million Senegalese live outside their homeland, sending back more than 1.64 billion US dollars a year in remittances to their families, according to International Organization for Migration figures. With a sizeable diaspora providing skills, networks in Europe and North America, and remittances, all these assets should be conducive to solid socio-economic development. To avoid large-scale money laundering, compliance with the FATF standards have to be ensured. This would prevent pressure on correspondent banking relationships, which could increase financial intermediation costs, including for trade and remittances.

Senegal's agricultural sector has shown signs of structural transformation due to incipient diversification and a growing role of irrigated products. In effect, sales of fresh horticultural produce for exports multiplied almost ten times in ten years, while irrigated rice production has also sustainably increased. Rural-urban migration only played a minor role in poverty reduction, as migrants remained poor across all periods analysed. Senegal's urbanisation rate has almost doubled since 1960, increasing from 23 to 44 per cent by 2016 (against the 38 per cent SSA average). However, Senegal's cities, and Dakar in particular, have failed to fulfil the hopes of the migrating population, who left the countryside in search of better living conditions. Almost two thirds of the poor in Dakar are internal migrants, with a poverty incidence of up to 72 per cent.

Senegal has the potential to become a diversified economy, mostly driven by services, if it can support the expansion of its most productive and competitive sectors. Currently, Senegal's strongest comparative advantages are identified as being linked to its primary sectors.[196] Apart from recently discovered oil and gas resources, the largest natural endowments in Senegal are cropland, forestry and pastureland. Marine fishing stocks are also substantial. A recent IFC product space analysis, which identifies industries where a country has well-developed capabilities in terms of the skills and technologies required to be a globally competitive exporter, emphasised fishing, food and forestry as the three top sectors with the highest global competitiveness for Senegal. Agriculture, defined broadly as including crops, forestry and livestock, employs more than a third of the Senegalese workforce and the largest share of the poor, and could therefore have a significant and direct impact on poverty reduction. Food products identified by the IFC product space analysis include horticultural goods, prepared foods (e.g., soups and malt extract) and nuts.

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195 Kappel and Reisen (2017): op. cit.

196 World Bank Group (2018): *Systematic Country Diagnostic of Senegal.* Dakar (October).

10

CONCLUSIONS

THE IMPACT OF THE CWA

Two years is perhaps not long enough to allow for an appraisal of how effective the CwA has been in achieving its aims. With this caveat in mind, we will nevertheless attempt to draw some conclusions from the study.

– The concept of the CwA is well designed. The frameworks for macroeconomic stability, finance and business have indeed set the necessary course in many countries. The fact that economic development in particular has been placed at the top of the agenda can also be seen as a positive shift. The recognition that Africa has a lot of catching up to do in two areas, namely a severely inadequate infrastructure and too few local and foreign resources to fund it, prompted the G20 to establish the CwA.

– The verdict on the CwA two years on is, however, that the anticipated private cross-border equity flows did not materialise and neither did domestic resource mobilisation. Consequently, public debt dynamics frequently remained untamed. The African countries involved in the Compact are not to blame, as their governance scores have mostly improved. While they have fulfilled their part of the deal, there has been no improvement in private cross-border equity flows or domestic resource mobilisation.

– For the majority of CwA countries, there has also been no tangible upswing of private cross-border flows. To revive the Compact initiative, we would need to raise expectations and CwA partner ownership, clarify the function of the Compact Teams and provide better capacity support. As stressed by ACET, the implicit CwA model is neither fully understood nor owned by the governments of the CwA countries. The value proposition of the initiative is not clear. Moreover, it is highly uneven as the CwA Country Matrices are full of stipulated government actions and quantitative monitorable targets while G20 countries do not assume immediate responsibility for the Compact.

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– Currently, it seems that the CwA is primarily owned (and scripted) by civil servants from the WBG and, to a lesser extent, the IMF. African governments do not drive the preparation processes for the G20 summits despite their participation as observers during these events. Africa remains ›on the table‹ of the G20 instead of sitting ›at the table‹ for global agenda-setting and rule-making. The assignment of CwA implementation and lack of African voice is reflected in a choice of governance indicators that keep the World Bank and other organisations involved in monitoring outcomes. Importantly, however, governance indicators promoted by the CwA focus less on the driving forces behind institutional, economic, political and social change than on the level of development.

– The CwA Policy Matrices impose a bewildering array of government actions and specific targets on the African partner countries. For all 12 CwA partners combined, the total number of required government actions and policy targets as well as foreign partner institutions involved easily added up to 300 in early 2018. In many cases, the number of required actions, targets and partners rose with each update of the Country Matrix. As multilaterals struggle to obtain mandates, they push their themes and indicators without G20 leaders prioritising or even considering the severely limited government management capacities of most CwA partners. Clearly, the intentions and postulates of the *2005 Paris Declaration and the Accra Agenda for Action* have been ignored. The proliferation of policy actions required of the 12 CwA partners can be blamed for the fact that the CwA country governments have become confused and thus failed to own the Compact initiative.

– Potential inconsistencies and policy conflicts may harm the Compact’s effectiveness and durability: Macroeconomic stability trumps social cohesion in the CwA design, a reform sequence which is likely to fail. One objective is to raise post-tax business profitability to attract private inflows, a policy target that is not really in keeping with the increased tax revenues postulated to mobilise domestic resources. Promoting blending instruments, such as guarantees, to facilitate infrastructure lending to the private sector can undermine sustainable fiscal space through the build-up of public contingent liabilities. Public debt sustainability can interfere with the bond market development required to attract institutional investors.

- On a fundamental level, the Compact fails to directly address the most serious challenges: the fight against extremely high unemployment, especially among young people, and against widespread poverty, which is particularly serious in rural areas and for women and children. Structural deformation, to borrow a term from geology, is not on the CwA agenda. These weaknesses in the CwA approach illustrate the need for a new agenda for development cooperation and for the CwA. Priority issues on this new agenda should be how to make growth inclusive and sustainable and how to eliminate poverty. The CwA currently being implemented represents a departure from the earlier focus on poverty reduction and neglects the empowerment goals (health and education) set out in the MDGs and SDGs.

- The number of jobseekers continues to grow as the population rises. The transformation process is creating a growing urban informal sector, which is largely generated by rural-urban migration. Only very few CwA countries (Morocco, Egypt) have a significant and dynamic medium-sized enterprise sector. In most countries, informal micro-enterprises dominate. Since the mid-1990s, many African countries, including CwA countries, have recorded faster economic growth than in the past. However this growth has often been with no significant diversification of production and exports, with no improvement in export competitiveness, with no productivity increases (especially labour productivity), and with no technological upgrading or improvements in human well-being. Instead, growth has been highly skewed and non-inclusive. The consequence is that not enough jobs are created to absorb rapidly expanding workforces or generate sustained increases in income. Instead, economic activities in many CwA countries remain concentrated in the low-productivity, low-value-added agricultural and informal sector. In the absence of significant increases in productive employment opportunities in urban areas, large numbers of internal migrants end up engaging in low-productivity informal service activities or in service jobs that offer few prospects of meaningful productivity increases.

- The institutions of the WBG involved in the CwA are deploying significant financial resources to pursue their agenda; they are relying on large-scale investment in infrastructure and, above all, they are attracting major investors so that they can invest in the CwA countries. In doing so, they are quite possibly exacerbating existing problems rather than contributing to solutions. The focus on capital-intensive investment leads to an increase in productivity in the sectors or hubs where the investment is made. Investments tend to target urban hubs, while the countryside is neglected. They can also contribute to the expansion of well-paid jobs, but this does not always happen (wage dumping in Ethiopia, for instance). However, high population growth and rural-urban migration are also reinforcing the trend towards further informalisation of living conditions in cities. This process can only be counteracted if economic policy adopts an integrative approach. Strengthening local entrepreneurship and farmers, for instance, will facilitate inclusive growth.

- The boost in investment intended by the CwA agenda could bring technological change, digitisation and knowledge transfer as exports increase and hard currency flows into the country. But, as we have shown, it does not increase the inflow of FDI. The potential can only be exploited if the necessary conditions are created. This, in turn, is only possible if, on the one hand, the well qualified can get jobs and, on the other hand, the less well qualified and the companies and farmers excluded from transformational processes can be integrated through supporting measures and thus also contribute to value added. Minimum standards and norms, such as decent work, minimum wages and security in companies, are on the agenda of national governments, the ILO, UNIDO and UNECA, and can accelerate the process.

- Policies that increase the complementarities between FDI and domestic investment should be promoted to ensure inclusive and sustainable growth. By inviting African participants to represent their interests (e. g., UNECA), the CwA country teams should devote more attention to these investment complementarities by including FAO (agriculture), UNIDO (industry) and UNCTAD (transformation) in the process. The CwA strategy assumes that high infrastructure investment and FDI will automatically result in linkages. However, the development of backward linkages and local supply chains depends on (a) a favourable investment climate — which is addressed by the CwA — and (b) proactive measures to support local businesses generating growth and employment. An increase in backward and forward linkages can lead to greater dissemination of knowledge, technology and expertise and generate employment.

- Many countries, such as Ethiopia, Ghana and Senegal, are investing in the development of SEZs and industrial clusters to attract foreign investors. However, some SEZs have had and continue to have major problems, either with regard to job creation or technology development. Some of these SEZs remain isolated enclaves linked to the surrounding area only by labour force employment. Nevertheless, they also have many potential advantages, including better transport systems, qualified labour and reliable access to electricity. Industrial clusters can also generate external economies. Although many clusters accommodate micro-enterprises and are informal, some also become dynamic hubs where start-up companies also become active.

- The CwA measures show that some of the most fundamental developments have been conceptually ignored. The solutions pursued by the CwA and much of G20-CwA policy conversations neglect to factor in the source of the problem. The kind of structural deformation of the African economies that is of concern (poverty, high unemployment, informality) is not addressed by the

CwA's management. The current situation in some CwA countries is, on the one hand, characterised by a concentration of industry in industrial hubs and the capitals, which exacerbates inequality by allowing foreign investors to use their power in labour markets to drive down wages. On the other hand, the transformation process of most other African CwA countries, characterised by strong rural-urban migration, does not create enough new jobs, but rather leads to large and growing informal economies, as is the case in all CwA countries. One of the reasons for this is that there is a ›missing middle‹ of enterprises. The phenomenon of unlimited supply of labour is pronounced in both country groups.

– The CwA should focus its activities on the developmental role of SMEs. Dismantling market entry barriers for SMEs can stimulate economic growth and thus boost employment and raise incomes. Although the overall environment for enterprise development has improved, the World Bank's Doing Business indicators show that the situation remains critical for SMEs in many CwA countries. Dual vocational training schemes, such as those supported by GIZ and the German Chambers of Commerce in Ghana, assure employability of young labour market entrants in CwA countries. For its part, the recently established German DIF for Africa provides incentives for German SMEs to invest in Ethiopia, Ghana, Senegal and elsewhere on the continent — a precondition for creating decent jobs and providing training opportunities. Whether it will turn out to be an efficient and successful initiative still remains to be seen.

– Interventions at sector level, coordinated around a targeted set of activities and embedded in a competitive framework, can be an important driver of economic transformation. This, in turn, is crucial for sustained job creation, inclusion and a diversified economy. The key factor here is that sector-level interventions (and not just interventions at the company or country level) are important and have implications for actors looking to support economic transformation. Economic opportunities have been identified in all the countries where transformation has been successful. This includes, for instance, the identification of opportunities in rising markets (Senegal, Ghana, Ethiopia, Rwanda), opportunities presented by global outsourcing, such as automobiles in Tunisia, Morocco and Egypt, or the pivotal role of agriculture in some African economies, such as cocoa in Ghana, Senegal and Côte d'Ivoire. Other positive examples are the garment sector as a first step into manufacturing in Ethiopia, which has also created jobs for women.

– Remittances should play a central role in the CwA as the most sizeable, developmental and equitable form of private cross-border flow. In view of the importance of remittances, it is striking how little emphasis has been placed on this type of financial flow in the CwA initiative. Perhaps, the CwA initiative has given remittances such a low profile so as to avoid conflicting messages because another aspect of the rationale for the CwA is to avoid excessive migration. Bundling and leveraging of remittances with ODA funds, particularly to foster economic development in rural and marginalised areas, is strongly recommended. Low-income Africa's main source of foreign finance is remittances. With a sizeable diaspora providing skills, networks in Europe, the Middle East and North America, and remittances, all these assets should be conducive to solid socio-economic development.

REDEFINING GERMANY'S AFRICA POLICY

German Africa policy has undergone significant changes in the years since the G20 CwA decision. Never before in the history of Germany's policy towards Africa has there been a broader discourse or a larger number of public events with a focus on Africa. With the CwA, the DIF and the MPA, a gradual departure from the development aid strategies of previous decades has been initiated. On the one hand, German policy has pursued an agenda within the framework of the CwA that has focused on implementation and, above all, been in cooperation with the WBG, IMF and the African states. On the other hand, the German government has strengthened its bilateral agenda by taking significant decisions (buzzword: DIF). German decision-makers have focused more strongly than before on Germany-Africa business relations and developed an agenda that is more interested in economic cooperation with Africa. The reasons for the large number of German initiatives can be traced back to geostrategic challenges (especially China's rise on the African continent) and the challenges of migration from Africa to Europe (and thus also Germany).

By supporting the CwA agenda, Germany has made it clear that the emphasis on the business framework, the macroeconomic framework and the financial framework will result in the introduction of important reforms in CwA countries and that these will be supported by Germany. The main objective of the additional measures conducted by the DIF that complement the CwA has been, on the one hand, to improve the basic conditions for German investors and exporters (see Box 1). On the other hand, the activities described above (special vocational training initiative) also contribute to Germany's Africa policy, not only with German interests in mind, but also actively contributing to shaping structural change in Africa.[197]

The extent to which the ambitions of the CwA and the DIF are suited to cope with the structural changes taking place in the CwA countries cannot yet be fully assessed in view

197 Henning Melber (ed.) (2019): *Deutschland und Afrika. Anatomie eines komplexen Verhältnisses.* Frankfurt/Main; Robert Kappel (2016): German New Africa Policy: Time for a Change?, in: Geert Castryck, Silke Strickrodt and Katja Werthmann (eds.): *Sources and Methods for African History and Culture: Essays in Honour of Adam Jones.* Leipzig: 629–650; Peter Molt (2014): *Ein Rückblick auf die (west)deutschen Beziehungen zu den Entwicklungsländern in Afrika südlich der Sahara.* KAS Mitteilungen 11/12: 47–69; Denis Tull (2014): *Deutsche Afrikapolitik – ein Beitrag zu einer überfälligen Debatte.* Berlin: Friedrich Ebert Stiftung. Cf. Stefan Oswald (2018): Zehn Jahre Afrikapolitik, in: *Zeitschrift für Außen- und Sicherheitspolitik* 11: 603–610.

of the short period for which they have been in force. As we have already shown in the section on the architecture of the G20 CwA (see Chapter 4), the conceptual ideas tend to have a traditional agenda, clearly defined by framework measures. The question therefore arises as to the extent to which Germany is giving new impetus to the CwA agenda:

– Germany's soft power is gaining profile. Together with the WBG, the AfDB and other international organisations, and the G20 countries themselves, it carefully developed a detailed concept for the CwA for the G20 summit in Germany.

– The German government envisaged a formative role for the Country Teams, an essential instrument for shaping the agenda of the CwA. Germany planned to work closely with other actors in influencing the tasks to be taken on. As was reported in the participating ministries, this was seen as a criterion for the success or failure of the German participation in the CwA. Following more than two years of experience with the implementation of the CwA, it can now be said that Germany's commitment, with the exception of Tunisia, has in fact proven to be relatively modest. Only KfW, DEG and GIZ actually exert a certain amount of influence.

– The support of German enterprises through an improved set of instruments for hedging risks are designed to contribute to the promotion of German investment in the CwA countries. It can be assumed that, also in the future, German companies are not likely to invest in large numbers in North Africa and SSA. The reasons given are that the African markets are too small, the demand for German industrial companies is modest and the basic environment is regarded as suboptimal. To what extent the improved environment for German businesses to invest in African countries will lead to more investment remains to be seen, as AfricaGrow and AfricaConnect did not start operating until 2019.

– With its various instruments, the German Federal Government has greatly improved the incentive system for German investment in Africa. The set of measures adopted constitutes subsidised support for German companies. However, there are no or hardly any conditions or incentive systems to induce German companies to increase their cooperation with African enterprises (for example, by deepening linkages). The extent to which the advantage enjoyed by German companies investing in African countries over those operating in Asia or Latin America represents a distortion of competition would have to be examined in more detail.

– The DIF could contribute to inclusive development if AfricaGrow and AfricaConnect were to be readjusted. So far, they lack coherent policies and instruments capable of improving complementarity between infrastructure development, foreign and domestic investment, and the development of local industry and agriculture, e.g., through targeted incentive systems.

– It would also be beneficial to refocus on a European agenda. As the EU's most important economic power, Germany could bring its soft power into play to tie other European countries and other G20 members into the CwA agenda. So far, efforts to achieve a coherent Africa policy at the European level have not been successful. The new French initiatives for economic cooperation with African countries and the EU's plan for »International Partnerships« may contribute to a shift away from the mainly bilateral and competitive activities of the individual European countries. Germany could spread the discourse to the rest of the EU and thus contribute to the EU jointly developing a cooperative partnership with African countries that differs markedly from the orthodox agenda of the CwA.

To conclude, we note that the high expectations that the German government placed in the CwA have (so far) barely been fulfilled. Numerous promises were made which could not be met. Above all, it shows that Germany has hard power with its bilateral measures (financing of programmes, deployment of experts), but its soft power is not well developed. Moreover, it been possible to convince additional partners of the value of the Compact process, and nor has Germany managed to play an important and visible role in implementing the WBG agenda. As an overall G20 concept, the CwA has failed. The Compact is now being continued under the direction of the WBG in cooperation with the African countries.

Thus, we are faced with two conflicting concepts. The CwA is an updated version of credit-financed growth strategies (debt-cum-growth). However, these are also at risk of failure in the new model, i. e., of making no sustainable contribution to solving labour market problems or reducing poverty. The bottom line is, therefore: The CwA in its basic form is at odds with inclusive and sustainable growth. In addition, there is a danger that the countries involved will fall back into a debt trap. German Africa policy should therefore examine the extent to which cooperation with the powerful and experienced WBG needs to be reviewed. The same applies to the G20. With its focus on large-scale investment, the CwA undermines African strategies rather than supports them. Stronger German (and European) engagement in the WBG would be necessary to prevent adverse effects and to convince the Washington institutions to put inclusive growth and sustainable development at the heart of cooperation with Africa. This requires concerted European action. Given the power of the Washington institutions, this option is rather difficult, but not impossible. The second option — certainly no easier than the first — would be to pursue a separate agenda with other well-intentioned partners from Europe. This would certainly be more effective in a) giving priority to inclusive growth, b) deepening cooperation between European and African companies through incentive systems, and c) providing targeted support of medium-sized enterprises as a useful bridge between European and African companies, for example through an integrative approach to vocational training.

LIST OF ABBREVIATIONS

AAG	Africa Advisory Group
ACET	African Center for Economic Transformation
AfCFTA	African Continental Free Trade Agreement
AfDB	African Development Bank
AU	African Union
AV	Afrika-Verein der deutschen Wirtschaft (German-African Business Association)
BCEAO	Banque Centrale des Etats de l'Afrique de l'Ouest (Central Bank of West African States)
BDI	Bundesverband der deutschen Industrie (Federation of German Industries)
BTI	Bertelsmann Stiftung Transformation Index
BMF	Bundesministerium der Finanzen (Federal Ministry of Finance)
BMWi	Bundesministerium für Wirtschaft und Energie (Federal Ministry for Economic Affairs and Energy)
BMZ	Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung (Federal Ministry for Economic Cooperation and Development)
CFAF	Communauté Financière Africaine Franc (CFA franc)
CPI	Transparency International Corruption Perception Index
CPIA	Country Policy and Institutional Assessment
CwA	Compact with Africa
DIE/GDI	Deutsches Institut für Entwicklungspolitik (German Development Institute)
DIF	Development Investment Fund
DSA	Debt Sustainability Analysis
DSF	Debt Sustainability Framework
ECI	Economic Complexity Index
EoDB	Ease of Doing Business
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FDI	Foreign direct investment
FES	Friedrich-Ebert-Stiftung
G7/8	Group of Seven/Eight
G20	Group of Twenty
GDP	Gross domestic product
GNI	Gross national income
GTAI	Germany Trade & Invest
GVC	Global value chain
HDI	Human Development Index
HIPCs	Heavily Indebted Poor Countries
IIAG	Ibrahim Index of African Governance
ICA	Infrastructure Consortium for Africa
IFC	International Finance Corporation
IMF	International Monetary Fund
IZA	Institute of Labor Economics
J-CAP	WBG Joint Capital Markets Development
LDCs	Less developed countries
LIC	Low-income countries
LMIC	Lower-middle-income countries
NBER	National Bureau of Economic Research
MIC	Middle-income countries
MDRI	Multilateral Debt Relief Initiative
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development
PCI	Per capita income
PPP	Purchasing power parity
PPPs	Public-private partnerships
PSE	Plan Senegal Émergent
PV	Present value
R&D	Research and development
SDGs	Sustainable Development Goals
SEZ	Special Economic Zone
SIT	Special Initiative on Training and Job Creation
SME	Small and medium-sized enterprises
SSA	Sub-Saharan Africa
TOSSD	Total official support for sustainable development
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNECA	United Nations Economic Commission for Africa
UNIDO	United Nations Industrial Development Organisation
UNU-WIDER	United Nations University World Institute for Development Economics Research
USA	United States of America
VIX	Chicago Board Options Exchange Market Volatility Index
WBG	World Bank Group
WGI	WB Governance Indicators

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G20 COMPACT WITH AFRICA

The Audacity of Hope

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The CwA has the objective to increase the attractiveness of private investment in Africa through substantial improvements to the macro, business and financing frameworks. It aims to leverage private financing for infrastructure projects via blended finance to mobilise subsequent FDI flows. The verdict on the CwA in its third year is that private cross-border equity flows have not materialised and neither have domestic resources been mobilised. The African countries involved in the Compact are not to blame. Governance scores have improved since 2016. However, FDI and national savings have not yet responded accordingly. In fact, both fell for the majority of CwA partners.

→

The Compact brings together selected African countries, international organisations and bilateral partners from the G20 to coordinate country-specific reform agendas, support respective policy measures and advertise investment opportunities to private investors. Currently, it seems that the CwA is primarily owned by civil servants from the World Bank and the IMF. It is neither fully understood nor fully owned by the governments of CwA countries. The value proposition is not clear. Moreover, neither the private corporate sector nor institutional investors seem to have fully bought into the CwA. To revive the Compact initiative we would need to raise expectations and improve ownership, clarify the function of Compact Teams and provide better capacity support.

→

At present, structural change in most African countries is slow, the modernisation of agriculture is sluggish, and informality and thus poverty are prevalent. One major issue is that economic growth has been largely »jobless«. FDI alone will not be able to correct jobless growth. In its current form, the CwA fails to address the issues of how to achieve inclusive growth and how to eradicate poverty. The CwA strategy assumes that a high level of infrastructure investment and FDI will automatically result in linkages. Policies that enhance the complementarities between FDI and domestic investment should be promoted. The CwA currently being implemented represents a departure from the objectives set out in the MDGs and SDGs.

Further information on the topic can be found here:
www.fes.de/en/africa-department