Financing for Jobs in Africa: Creating Fiscal and Policy Space

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The crisis has shown that economic policies in developed countries, in developing countries, and globally, need rebalancing. The Global Jobs Pact (GJP) and the Decent Work Agenda (DWA) contain calls to do this and a policy framework to do it.

Albert Einstein famously said: "We can't solve problems by using the same kind of thinking we used when we created them", and he was known to be quite smart. The GJP and the DWA are invitations to do things differently in policy terms, and also in political and governance terms, based on social dialogue, as was amply discussed yesterday in the 2nd Social Partners Forum.

This note deals with two fundamental questions:

1) What should be done different in Africa? What is the required rebalancing of development agendas?, and
2) How can African countries pay the costs of the necessary investments?

A. Growth, employment and development before and after the crisis

To tackle the first question one should start not where Africa is now, but from where it was before the crisis. This is more representative of the long term trends and challenges.

According to certain economic indicators, Africa was performing quite well before the crisis. GDP growth averaged 4.1 per cent between 2002 and 2007, increasing to more than 6.0 in 2007 and 2008. The high-growth episode involved many more countries than earlier episodes and it lasted longer. Growth was driven by many factors, not just high commodity prices.[2] In many instances growth was triggered by the cessation of conflict, the establishment of basic rule of law, macro-economic stability and debt relief. [3] Openness to trade played a role, but also the growth of domestic demand.

Financial flows to Sub-Saharan Africa increased sharply since 1980. Between 1980 and 2006 net aid (including debt relief) increased fivefold, remittances ninefold, and FDI fiftyfold. This, plus higher growth, enabled some countries to scale up public spending, including in social policies. Education and health spending increased in absolute terms and in relation to GDP, with some positive results: Net enrolment in primary education increased from 53% in 1991 to 70 % in 2007. Infant mortality fell from 183 per thousand in 1990 to 146 per thousand in 2007.

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[1] I would like to thank Per Ronnas and Yan Islam for their inputs and suggestions for this note.
[2] IMF *Regional Economic Outlook: Sub-Saharan Africa, October 2009*; p. 5.
[3] Excluding Fragile countries

However, these increases in social spending fell short of what was needed. And, even more fundamentally, poverty and employment creation were insufficiently responsive to economic growth.

So even before the crisis, with a few exceptions, African countries were not on track to make poverty history. Why? Several reasons come to mind:

1) Growth had been volatile and, again with few exceptions, below the estimated 7% a year necessary to reduce poverty to achieve MDG 1.
2) The growth sectors have mostly been the traditionally capital-intensive extractive sectors, with low labour absorption. Agriculture and the non-agricultural informal economy, that employ most people were not receiving sufficient policy attention. There has also been underinvestment in infrastructure.
3) While investment rates in Africa picked up during the boom years, they are much lower than in most other developing countries. And low investment is behind the slow growth of jobs in the formal sector.

The crisis exacerbated these problems:

- It reduced growth to an average of no more than 2 per cent in 2009, implying negative per capita growth.
- It reduced revenues, increased fiscal deficits and reduced fiscal space.
- It brought higher unemployment, underemployment and working poverty.

The IMF argues that on the whole the prospects for a relatively quick recovery are good in most of Africa. Many countries entered the crisis with a strong fiscal balance, large external reserves, low levels of external debt and an established record of macro-economic stability, all of which has provided space for counter-cyclical economic policies, not in all but in an important number of countries.[4]

Whether this optimistic outlook for recovery in the short term is justified or not, the fundamental point is that the long term social and employment challenges facing Africa are more daunting than in any other region and require major policy attention and financing. Consider the following:

- From now to 2015 the rate of growth of the labour force is forecast to be higher in Sub-Saharan Africa than in any other region of the world.[5]

- Between 1999 and 2005 productive employment increased by some 6 to 7 million jobs per year. This number will have to more than double – to some 16 million new productive jobs per year – if the MDG 1 is to be met in Sub-Saharan Africa.

[4] IMF *Regional Economic Outlook: Sub-Saharan Africa, October 2009.*
[5] The labour force in the region is expected to increase by 18.8 per cent between 2009 and 2015, as against 8.4 per cent for the world as a whole. *Source: KILM.*

For this to happen, high and sustained growth is essential but it is not the panacea as the recent high-growth episode showed. The pattern of growth and its employment content also matters.

What needs to be done? What is the right policy package?

Studies by the African Development Bank, the Economic Commission for Africa, the ILO and other institutions have suggested key ingredients and priorities to promote job-rich, inclusive growth, that is, growth that puts employment and social protection as central concerns, as the GJP and the DWA do. These ingredients include:[6]

- Structural transformation to promote more industrialization as well as agricultural modernization.
- Export diversification and better harnessing of the forces of globalization.
- More investment in education and in upgrading skill levels to increase the employability of the African Labour force and maximize its potential to innovate, use Information Technologies and be a major asset to increase private investment.
- Embarking on a "big push" in infrastructure, including energy, telecommunications and roads, to better physically connect not only African countries with the world but internally, so that the expanded internal African market can fully function as an engine of growth.
- Support to sustainable enterprises via not only more favourable enabling environments, but also via smart industrial policies, promoting sector and industry links, and better linkage of small enterprises and small farmers to global value chains.
- Strengthening labour market policies and institutions
- Extending and strengthening social protection schemes
- Improving governance, transparency, accountability and the rule of law and reducing corruption.

Many of these items were included as priorities in the Plan of Action for Promotion of Employment and Poverty Alleviation agreed in the Summit of Heads of State of the African Union held here in Ouagadougou in Sept 2004.

Let us now proceed to the second question: how can investment in all these priorities be financed?

B. Financing for job-rich, inclusive growth

Financing growth and development can come from different sources: taxation, aid, FDI, reducing debt, increasing borrowing, remittances, etc. All these sources of financing are important, and countries should have a strategic approach to balance them and use them wisely.

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[6] ECA Economic Report on Africa 2005 "Meeting the Challenges of Unemployment and Poverty in Africa"; Benno J. Ndulu et al Challenges of African Growth, The World Bank, 2007; African Economic Research Consortium's Explaining African Economic Growth Project.

Aid.

There is no doubt that African countries should hold donors accountable to their commitments to increase aid. But it is also very important for African countries to reduce extreme levels of dependency on foreign aid. For instance, in the 9 years from 1997 to 2006 the share of current spending financed by aid increased from 16% to 36% in Ghana, from 22% to 40% in Tanzania and from 60% to 70% in Uganda.[7] The problem with excessive reliance on external finance is that it exposes a country to high degree of volatility. Such volatility of aid flows has gone up in recent years and its cost is estimated at 2% of developing country GDP.[8]

Taxation

Domestic resource mobilization by enhancing the tax-to-GDP ratio in countries with a low tax burden is key to finance development, and decent work and to allow countries to reduce dependency on aid and foreign debt.[9]

The average tax-to-GDP ratio increased moderately in Sub-Saharan Africa from 15% of GDP in 1980 to 18 % in 2005. But most of this increase came from natural resource taxes, while non-natural-resource-related revenues increased by less than 1% of GDP in 25 years. In many low-income African countries, domestic revenues have not kept pace with rising public spending and as a result a growing share of spending is financed by aid. This is cause for worry, not least because aid flows can be quite volatile. In low income African countries the tax revenue is around 14% of GDP which is below the 15% benchmark that is regarded as a reasonable target for low-income countries.

Increasing the tax-to-GDP ratio does not mean that tax rates should be increased. In fact the best is to broaden the tax base, including through gradually bringing the informal sector into the tax net by promoting the transition to formalisation, as several African countries are indeed doing. Also important is more effective tax collection as well as rationalizing tax incentives that are often excessive and even ineffective to attract investment, as the binding constraints on investment attraction often lie elsewhere, in deficient infrastructure, low education and skills and costly regulations.

Taxation has a series of social and political advantages: it increases incentives for public participation in the political process, creates pressures for more accountability, better governance and improved efficiency of government spending.

A number of studies by the ILO show that with a relatively modest increase in tax revenues it is possible to finance a basic and universal social security floor. Several countries have also shown that 1 or 2 percent of GDP can go a long way in financing conditional cash transfer programmes with wide coverage and impressive benefits, like the Bolsa Familia programme in Brazil and the Oportunidades programme in Mexico. [10]

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[7] Gupta, S and Tareq, S (2008) "Mobilizing Revenue", *Finance and Development*, 45(3).
[8] Kharas, H (2008) "Measuring Aid Volatility", Wolfensohn Center for Development Working Paper 3, Washington D.C.: Brookings Institution.
[9] This section draws on Gupta and Tareq (2008).
[10] ILO (2009) Social Security for All, Social Security Policy Briefings, Paper No 7, Geneva.

Awareness of the importance of this agenda of domestic resource mobilization is growing in the region. There is now a network of the Commissioners of the Senior Tax Administrators of 39 African countries that are working on this agenda including the strengthening of Tax Administrations. Donors can actually do more to support revenue raising efforts. Of the USD 7.1 billion spent in 2005 on bilateral aid for government administration, economic policy and public sector financial management, only 1.7% was directed to tax-related assistance.[11]

Capital repatriation

Another potential important source of finance is capital repatriation. Capital flight is a perennial problem in many developing countries. Africa is not immune to such a problem. Capital flight could be curbed of reversed if the country in question generated enough investment opportunities by improving the investment climate and raising skills.

Remittances.

Some African countries are among the world's top 20 countries in terms of receipt of remittances as a proportion of GDP. The aim should be not just to increase remittances, but to ensure their efficient utilization in investment and not just consumption.[12]

Development banks and microfinance.

Two other major tools to increase financing and put the financial sector at the service of employment generation are development banks and microfinance. Bad experiences with development banking in the past do not mean they are a bad idea. They can be a major tool to bring credit to agriculture, non-farm rural areas and SMEs and to promote economic diversification.

Microfinance is a well tested tool in Asia and Latin America, with a record of tremendous success. Financing for decent and productive jobs in Africa should make the most of it.

Trade.

Trade barriers and subsidies in developed countries, but also within developing countries, can act as a major break on growth. The case of cotton is a clear and extreme example. Removing access barriers to markets, including subsidies to products in which African countries have comparative advantages, can be seen as a way of financing development. Both trade and aid are important for African growth and decent work prospects.

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[11] See African Economic Outlook, Public Finances in: www.africaneconomicoutlook.org

[12] This means (a) encouraging the use of formal channels in tapping remittances and (b) increasing the share of remittances allocated to investment. One good example, with respect to (a), is the use of an innovative and cost-effective remittance-related financial services by a bank in Burundi. UNCTAD (2007) Economic Development in Africa: Reclaiming Policy Space, Geneva.

C. Policy space

Let me close with a brief comment on the concept of policy space. Policy space includes the issue of fiscal space but it is broader, it also refers to the implementation capacities of the public sector, its capacity to deliver public goods and services, the transparency and governance mechanisms of government programmes. Now that the crisis is contributing to rebalance economic paradigms, it is important to discuss the concept of the "developmental state".

A strong developmental state can be a much better partner to sustainable enterprises and to put employment and decent work at the centre of policy frameworks, than a weak minimalist state, particularly if it is combined with strong institutions for social dialogue. Such an approach can make the most of the Decent Work Agenda and the Global Jobs Pact, for instance. But the developmental state has several lethal enemies: corruption, lack of finance, weak public administrations.

Financing for jobs in Africa requires both expanded fiscal space and but also expanded policy space in this sense.