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**Research Report**

## The Triple Crisis : What development prospects for Africa?

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## The Triple Crisis: What development prospects for Africa?

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On May 13 and 14, 2010, Wider invited at its headquarters in Helsinki some 200 development economists from all over the world to celebrate its 25<sup>th</sup> anniversary, assess the implications of the unfolding triple crisis—Food, Finance, and Climate Change—, and correspondingly map its future role in development economics. This was an appropriate time as the crises and the responses to the crises are major turning points, contributing to the emergence of a new order for international economic development.



.../... This new order needs to be clearly understood by Wider and the development economics profession if they are to effectively assist international economic development in the years to come.

What the anniversary presentations and discussions confirmed is that development economics—at least as represented by participants to the event—has importantly changed its focus away from the macro-market-public goods perspective that emerged in response to the debt crisis of 1985 toward giving greater attention to the structural transformation of the developing economies with a strong role for state guidance, regulation, and public-private partnerships. With the greatest development challenge today found in Africa, the main question discussed was how will countries in that continent diversify their economies away from agriculture and achieve sustainable industrialization? This is, to a significant extent, the same fundamental question that was asked in the 1960s and 1970s by the pioneers in development economics such as Hirschman, Kuznets, and Chenery before the debt crisis led development economists to address questions of stabilization and adjustment under the guidance of the Washington Consensus. Returning to the question of structural transformation—the process through which countries transform from poor agrarian to wealthy industrial economies—, calls upon recognizing that markets are essential for growth but have many failures, and that the state has a key role to play in complementing and guiding markets, though it may also fail in fulfilling this function. But, how will this be done in the context of the triple crisis, and what is the likelihood of success for Africa? These were major questions debated in Helsinki, with answers that are still controversial and incomplete but that helped better understand where Wider and the development profession should now be headed.

What is clear from the current situation is that the large emerging economies—mainly China, India, and Brazil—were both the least

affected by the crises and the first to recover. The main, and still incompletely recognized, consequence of this happening is that it accelerated the rise in importance of these countries as the locus of future dynamic growth and technological innovations for the world as a whole. Still marred into recession, high fiscal deficits, and record high unemployment, the OECD countries, and especially the US and the EU, are unlikely to be again the main sources of effective demand for world manufactured exports, able to propel export-led growth in the emerging economies without a corresponding development of their internal markets. Due to both the crises and domestic social pressures, China, India, and Brazil are increasingly seeking to sustain growth by turning toward their own large domestic markets, with rising wages for at least part of their populations fueling effective demand. While rapid growth in these countries implies strong import demand for energy and mining products, benefiting Africa and helping it emerge surprisingly unscarred from recession, they will not become major sources of demand for industrial imports from the rest of the world, and thus will not assume the role of demand engine formerly played by the US and the EU. What does this mean for structural transformation in Africa? Will it be able to diversify and industrialize under these conditions?

Demand for energy and mining products by the emerging countries is a source of growth and rents for Africa, but it is unlikely to be a driver of industrialization. This is because energy and mineral exports are highly capital intensive, with few linkage multipliers and learning externalities with the rest of the economy. Southern foreign aid—a new phenomenon—coming from the emerging economies is largely motivated by investment in infrastructure to facilitate resource extraction for export, or by land acquisition to produce food for export, likely under capital intensive conditions. It is not oriented at promoting the emergence of domestic industrial entrepreneurs.

It is important to recall how the emerging economies of Asia and Latin America achieved their own industrialization. None of them has done it without using either trade protection—following import substitution industrialization policies—or targeted subsidies to potential winner firms—following export-led industrialization policies. The problem for Africa in following these approaches is that price policy instruments have largely been lost to adjustment policies. Trade protection is no longer an option, and depreciated real exchange rates, as pursued by China, could not be applied by all countries at the same time without creating a massive disequilibrium on the international capital market. Picking the winners—be they firms, sectors, or locations—to target subsidies requires fiscal and ODA resources that are in scarce supply, particularly as the OECD countries struggle with high fiscal deficits. Besides, how will the rents from energy and mineral exports be allocated to supporting potential winners and social expenditures without a strong civil society able to put checks on state temptations to capture rents? The resource curse in development risks being unleashed by the current energy and mining export booms if not accompanied by progress in civil society empowerment and greater accountability of elected governments, a progress that is clearly lagging behind the booms.

In the context of the triple crisis, there is an emerging dimension of social policy that needs to be recognized. During the last 25 years, governments and international development agencies have done a relatively good job at identifying and managing chronic poverty and chronic food insecurity, but they have gained little experience in dealing with transitory poverty and food insecurity: how to recognize the “new poor” and the “new food insecure” for social assistance, and how to help them bounce back out of poverty instead of letting them join the ranks of the chronic poor? In the context of crises, vulnerability to uninsured shocks and the associated risks of irreversibilities—due to loss

of productive assets, deterioration of maternal and child health, and children dropping out of school to save on costs or provide child labor—must be addressed by a pro-active state to avoid poverty traps. Dealing with transitory poverty and transitory food insecurity urgently needs to be learned to cope with the negative productive and social consequences of the crises.

So, how will Africa industrialize under these conditions? Experience has shown that there are huge economies of scale in industry, with required lumpy investments on products (even if they are only task components of a final product to be assembled elsewhere), on locations (to benefit from spillovers in clusters of complementary economic activities), and in time (following the “big push” approaches advocated by the pioneers in development). For this, foreign direct investment (FDI) and foreign know-how are needed, requiring a strategy of open-economy industrialization. Will mainland Africa make itself attractive to FDI, as did the island of Mauritius that showed that it can indeed be done in Africa? This is unlikely without several preconditions: infrastructure to reduce transactions costs, a semi-skilled labor force endowed with more than primary education (as opposed to the prescriptions of the second Millennium Development Goal calling for universal primary education, perhaps at the cost of postponing higher education), and the rule of law for contracting and managing conflicts. It can happen, but it is unlikely to be massive enough with weak OECD import demand, insufficient demand for manufactured goods imports from the inward-looking emerging economies, and lack of foreign aid to build these conditions beyond what it takes for Southern donors to secure the primary exports that are so much in demand to fuel growth in their economies. In spite of offering the chance of technological leapfrogging, the status of second-generation late comer does not help attract FDI in a crowded world of well established first-generation late comers (the now emerging economies) and with limited effective demand

for manufactured goods in the world market.

Is there room for optimism? Yes, but neither through the road of mineral export-led industrialization nor through that of large scale open economy industrialization. What is needed is a return to the basics of structural transformation: a productive agriculture that can generate savings and foreign exchange earnings for investment in industry, and where labor intensive agricultural produce feeds into agro-industry and agro-exports for regional and international markets. Learning to industrialize in agricultural high value chains and agro-processing may be the most credible path to move up the ladder of successful industrialization and travel the course of structural transformation. For this, investing more and better in agriculture must be given priority, and adding value to agricultural goods through product transformation must be used as a stepping stone toward gradually more sophisticated and diversified industrialization. Back to structural economics, as discussed in Helsinki, is thus also back to the pioneers in development for whom agricultural revolutions

were recognized as the mother of industrial revolutions, a lesson from history that continuously needs to be recalled and is too often forgotten by development economist.

Wider, in its wisdom, must indeed recognize the major turning points implied by the triple crisis, and the new economic order and constraints on production—none the least incurring the huge costs of adaptation to climate change—that are emerging from responses to these crises. The road to structural transformation for Africa is not hopeless. It can be done. But it will require more than expectations that industry can simply be driven by energy and mineral exports or parachuted from outside under open-economy industrialization strategies. Back to the future from the pioneers is also back to agriculture as an instrument for industrialization, building selectively on the economic sectors and regions with competitive advantages, and supported by social safety nets capable of dealing with vulnerability to the shocks of the triple crisis.



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