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► Towards a transformative macroeconomic policy framework for employment generation in Africa

Background paper

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Background paper

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Towards a transformative macroeconomic policy framework for employment generation in Africa

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Foreword

Over the past two decades, the African continent has experienced solid growth oscillating between about 3 – 6%, yet this growth has not translated in the creation of sufficient – let alone decent – employment opportunities for most Africans. It is widely known that a major reason for this ‘jobless’ growth is the continent’s dependence on primary commodity and low value-added sectors, which typically are not able to create mass employment in decent conditions. To change this, African countries must undergo a process of structural transformation. This is clearly recognised and articulated by ILO’s African tripartite constituents, as documented in the 2019 Abidjan Declaration on Shaping the Future of Work in Africa. The Declaration provides the guiding framework for ILO’s work on the continent and confirms the organisation’s clear commitment and support for this important work across Africa.

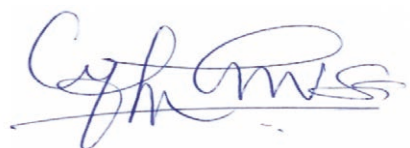
The COVID-19 crisis has only added to this need for structural transformation and employment creation, as it further aggravated the employment situation across the region, and it has hit hard many African women and men, especially youth, women and those working in the informal economy. Often, the loss in working hours because of the crisis has not translated to outright unemployment, but many people have experienced increased underemployment, loss of income, and job insecurity. The heavy impact of the crisis on people’s lives is best demonstrated by looking at the extent of working poverty: the share of employed Africans who live on less than USD 1.90 a day has increased from an estimated 31.8% in 2019, to 34% in 2020 according to recent ILO estimates. It is the first time that the working poverty rate has increased across the region since the turn of the century.

This tragic employment crisis requires decisive and commensurate policy response. It is broadly accepted that times of economic shock require significant fiscal stimulus and anticyclical spending in order to protect livelihoods and support economic recovery. Similarly, accommodative pro-employment monetary policies have an important role in driving structural transformation and a human-centred recovery. While the majority of African countries have responded well and swiftly within their means, the overall fiscal response still lags behind global averages. As highlighted by the Global Call to Action for a human-centred recovery, this situation puts in plain sight that economic policies should be more employment responsive. The African Union and the ILO acknowledge this, and hence the promotion of pro-employment macroeconomic and sectoral policy guidelines for African countries has been identified as the first output in their joint operational plan.

In order to develop the foundations for these policy guidelines, the present background paper “Towards a transformative macroeconomic policy framework for employment generation in Africa” was commissioned by the ILO and authored by distinguished policy

experts based at the Institute of Economic Justice (IEJ). It provides a profound and rigorous argument for alternative economic policy frameworks for African countries. It confirms that the currently dominant policy approaches in many African countries are not sufficient to elicit and drive the structural transformation that is needed for better employment outcomes. Hence, it argues for an alternative economic policy framework that integrates pro-employment macroeconomic, sectoral and labour market policies to stimulate an investment shift towards higher value-added production.

It is the ILO's explicit wish and hope that this study may stimulate debate, support and policy action among its African constituents, in order to achieve the sustainable development and human-centred recovery that we all committed to.



Cynthia Samuel-Olonjuwon
ILO Assistant Director-General
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Glossary

Recommended references are Krugman, Obstfeld and Melitz (2018); Caves, Frankel and Jones (2007); International Monetary Fund (1993, 2010); and Samuelson and Nordhaus (2009).

- ▶ **Accommodative monetary policy:** Monetary policy which accommodates increases in money demand in the economy. In doing so, it may also ensure that interest rates do not rise as a result of increases in government spending or changes in the money supply resulting from the trade balance.
- ▶ **Aggregate demand:** The total demand measured as total realized expenditure for domestic goods and services. In an open economy this includes domestic demand for imports (which subtracts from aggregate demand for domestic goods and services) and foreign demand, which is added to domestic demand through exports. Expenditures are limited by income and income growth. For any single point in time this is based on GDP and GDP growth.
- ▶ **Aggregate supply (increases):** Measures which increase the availability of inputs in the economy, consisting of natural resources, labour and machinery. Increasing the supply of fixed capital (machinery and tools) is a long-run challenge and is the primary determinant of the rate of growth of productivity and living standards. Aggregate supply is different to a “supply-side” approach to the economy, which entails measures to reduce costs (especially taxes) and minimize prices in an effort to benefit consumers, encourage firms to invest more and encourage households to supply more labour.
- ▶ **Balance of payments (Deficit/Surplus):** A record of a country’s annual (or quarterly) international transactions presented in the form of double-entry bookkeeping. It reflects the budget constraint for the entire economy, defined as **Current Account + Capital Account = Financial Account**. While the current account is the difference between sales of goods and services to foreigners and purchases of goods and services from them, the financial account measures the difference between acquisitions of assets *from* foreigners and the build-up of liabilities *owed to them*. The capital account is less relevant and records non-produced non-financial assets and capital transfers between residents and non-residents. Changes in a country’s current (and capital) accounts result in a change in a country’s net foreign assets. Under a floating exchange rate, this change necessarily equals the difference between a country’s purchases of assets from foreigners and its sales of assets to them, which equals the financial account: **Current Account = Financial Account**. Under a fixed exchange rate, a surplus or deficit on the balance of payments *overall* (rather than for a single account) can be run, as the central bank will accommodate persistent deficits in combined accounts via official reserve (namely foreign exchange) transactions, such that: **Current Account + Financial Account = Δ Reserve Assets** (see also IMF 2010, 229).

- ▶ **Capital controls:** Capital controls are capital account restrictions to control the volume and composition of inflows (and outflows) directly. They are much debated (Taylor 2018). In theory and practice, their advocacy and use has increased post-crisis, including in countries under IMF lending programmes (Gallagher and Tian 2017). A full list of capital control and macroprudential measures are discussed in Forbes, Fratzscher and Straub (2015).
- ▶ **Current account:** Recording of trade flows between domestic and foreign countries. The current account also includes the investment income balance from portfolio (equity and debt) and direct (FDI) investments. The latter is increasingly the driver of current account deficits in emerging markets (Strauss 2017). The current account is also equal to the gap between domestic private and public savings and domestic private and public investment, or $(S_p + S_g) - (I_p + I_g)$.
- ▶ **Current account sustainability:** Trade is balanced or in surplus when exports are greater than imports ($X \geq M$). This is the goal of current account sustainability. A country is able to finance a current account deficit (usually driven by a trade deficit) through external borrowing and the drawing down of domestic foreign reserves. If imports are capital goods, or the trade deficit is financed by highly productive foreign direct investment inflows, then this can help reduce the current account deficit in the future. As the current account also equals the gap between domestic savings and investments ($S - I$), the IMF frequently proposes reducing domestic spending (absorption) and increasing domestic savings in order to reduce the current account deficit.
- ▶ **Fiscal policy:** State spending and income policies. State income comes from taxes and debt. State spending policies consist of the level and composition of state spending. Taxes may also be used as an instrument to redirect production and inputs as well as to achieve a desired distribution of income. As a result, it is not purely a revenue-generating mechanism. State spending consists of investment spending and consumption spending.
- ▶ **Decent and productive employment:** Decent work is productive work for women and men in conditions of freedom, equality, security and human dignity. It involves opportunities for work that deliver a fair income; provide security in the workplace; and social protection for workers and their families. It offers better prospects for personal development, which also encourages social integration; gives people the freedom to express their concerns, to organize and to participate in decisions that affect their lives; and guarantees equal opportunities and treatment for all. Productive employment is one of the key mechanisms for ensuring effective distribution of economic development since a major portion of family income, and the livelihood of individuals, essentially stems from earnings generated in the labour market.

- ▶ **Domestic expenditure/absorption:** $A = C + I + G$, where absorption A is equal to domestic spending consisting of household consumption, fixed capital investment spending by firms and government spending. As a result, some policy recommendations focus on decreasing government spending in order to reduce trade deficits and achieve current account sustainability. This will come at the cost of reduced domestic demand and, therefore, employment.
- ▶ **External balance:** External balance reflects the overall balance of payments (BOP). It is significant because it indicates a country's international payment gap that must be financed by the government's official reserve transactions or additional borrowing through the financial account through debt issuance or emergency IMF and multilateral borrowing.
- ▶ **Expenditure switching:** One of two main approaches to achieving a balanced current account ($CA = 0$), along with full employment (such that $Y = Y^*$). These policies aim to shift expenditure away from foreign and towards domestic goods. Most prominently, this involves adjustments in the exchange rate. Direct trade controls (export subsidies and import taxes, namely tariffs) and multiple exchange rates¹ may also be used.
- ▶ **Expenditure level (increasing/reducing):** One of two main approaches to achieving a balanced current account ($CA = 0$), along with full employment (such that $Y = Y^*$). Measures to increase or decrease the level of domestic spending, such as through changes in taxes and government spending (or in monetary policy), with the goal of changing the current account balance, as some expenditure would have resulted in imports. For countries with underdeveloped domestic supply capabilities, much domestic spending goes to imports, potentially worsening the trade balance, limiting the effectiveness of employment-enhancing increases in aggregate demand. This measure reduces employment and income when $CA < 0$ (namely a deficit) and increases employment and income when $CA > 0$ (namely a surplus).
- ▶ **Financial account:** The financial account records transactions that involve financial assets and liabilities, and that take place between residents and non-residents.²

¹ For example, the government could charge a higher price for foreign exchange when it is used to purchase luxury consumer goods, which suck in imports, than when it is used to purchase essentials or capital goods imports, such as fuel and spare parts.

² The net balance on the financial account has the opposite sign in BPM6 compared to BPM5, such that a net inflow in the financial account is now represented with a minus sign in BPM6, whereas it has a positive sign in BPM5. The new terminology and sign convention for the BoP financial account are such that a positive sign represents an increase and a negative sign represents a decrease, in the asset or liability to which it relates. Thus, for "net acquisition of assets" in the financial account of the BoP, a plus sign denotes a net increase in financial assets, while a minus sign refers to a net decrease in financial assets. The net amount is calculated as net acquisition of assets - net incurrence of liabilities and may be positive or negative.

- ▶ **Fixed exchange rate:** Local currency is fixed in value to one or more foreign currencies. Central bank participation in the foreign exchange market to meet demand for foreign exchange equals supply at the fixed exchange rate level. Monetary policy independence is lost since central bank monetary policy tools are unable to affect the economy's money supply or its output. Monetary policy is ineffective as any increase in the money supply or decrease in the interest rate will have to be met by counteracting foreign exchange interventions by the central bank to maintain the value of the currency. Monetary policy is devoted to maintaining the relative nominal value of the peg. As a result, a trade deficit (for a given level of capital inflows), or a balance of payments deficit as a whole, must be met by the central bank continuously buying local currency and selling foreign exchange reserves (as unwanted domestic currency must be purchased to maintain its relative value). Since a central bank only has so much reserves, this cannot continue indefinitely. This also means that no automatic adjustment mechanism in trade imbalances exists via exchange rate depreciation. For countries with fixed exchange rates, interest rates also cannot be used to reduce inflation, making policy-induced reductions in inflation the result of controls on capital flows, trade flows, macroprudential measures, and adjustments in tax rates and spending. Fiscal policy may be more effective under a fixed exchange rate regime than under a floating one since, in theory, it should be accompanied by an increase in the money supply to maintain the value of the exchange rate (Krugman et al. 2018).³
- ▶ **Floating exchange rate:** Local currency fluctuates in value according to market forces of demand and supply. Exchange rate adjustments are undertaken via the market to ensure demand for currency is equal to supply of currency. The central bank does not participate in the foreign exchange market. Exchange rate adjustments can be used to bring the trade account into balance. Changes to domestic inflation relative to global inflation are reflected in nominal exchange rate market adjustments. Monetary policy independence may exist but, in reality, will also be limited: countries may be forced to move their interest rates in line with the global credit cycle and US interest rate movements (Edwards 2015). Under these conditions, independent monetary policies are possible only if the capital account is managed, according to Rey (2015). Fiscal policy may be less effective if it leads to currency appreciation in response to an increase in spending (Krugman et al. 2018, 545).

³ Traditionally, to hold the exchange rate fixed when output rises, the central bank must purchase foreign assets to raise the domestic money supply (Krugman et al. 2018). If the central bank does not purchase foreign assets when output increases but instead holds the money stock constant, the exchange rate cannot remain fixed. Krugman et al. (2018, 542) notes: If the central bank did not satisfy the excess demand for money caused by a rise in output, the domestic interest rate would begin to rise above the foreign rate to balance the domestic money market. Traders in the foreign exchange market, perceiving that domestic currency deposits were offering a higher rate of return (given expectations), would begin to bid up the price of domestic currency in terms of foreign currency. In the absence of central bank intervention, the exchange rate thus would fall below the fixed level. To prevent this appreciation, the central bank must sell domestic currency and buy foreign assets, thereby increasing the money supply and preventing any excess money demand from pushing the home interest rate above the current equilibrium rate.

- ▶ **Gross domestic product:** Equal to the total market value of final production produced within the borders of a nation within a given year: $Y = C + I + G + X - M$. A trade deficit ($X - M$) is a deduction from GDP and domestic demand, since domestic income is being spent on foreign production. GDP includes production within the borders of the economy by foreign firms. Subsequent income flows of profits or wages back to the home country of the foreign firm or worker acts as a deduction from GDP when calculating gross national product (GNP).
- ▶ **Internal balance:** Full domestic employment as permitted by the level of supply in the economy, at $Y = Y^*$. This is the level above which inflation is higher than desired or can be tolerated by the participants in the economy for a reasonable period of time.
- ▶ **Macroeconomic trilemma:** An embodiment of the ideas of the Mundell–Fleming open economy model with capital flows, discussing the relative effectiveness of fiscal and monetary policy under different macroeconomic regimes in the open economy. The trilemma resulting from this proposes that of the following three objectives only any two can be achieved concurrently: (i) a fixed foreign exchange rate; (ii) free capital movement (absence of capital controls); and (iii) an independent monetary policy.
- ▶ **Monetary policy:** Consists of tools that manipulate the money supply, interest rates and, increasingly, the yield on all financial assets. Sterilization and reserve accumulation policies are also monetary policy tools. The money supply might be directly targeted, as in the past ("Monetarism"). More recently, the inflation rate is directly targeted via manipulation of the short-term interest rate. A number of measures can be used to manipulate the money supply and interest rates, such as reserve requirements and repurchase agreements. With "quantitative easing" policies, non-traditional monetary policy tools aim not to directly target an interest rate level but instead inject electronic money into the economy directly and reduce the yield of long-term financial assets. Monetary policy focuses on maintaining a nominal anchor to the exchange rate for most African economies with fixed exchange rates. Further goals of a monetary policy, especially when countries have an independent monetary policy, relate to the stability and growth of gross domestic product to achieve and maintain low unemployment and low inflation. Inflows and outflows of money can have a sizable impact on the domestic money supply. As a result, capital controls are also an important part of policy measures which look to control domestic interest rates, asset prices and growth in monetary aggregates.
- ▶ **Progressive taxation:** A progressive tax is a tax in which the tax rate, defined as a percentage of income, increases as the taxable amount increases. The term "progressive" refers to the way the tax rate progresses from low to high, with the result that a taxpayer's average tax rate is less than the person's marginal tax rate.

- ▶ **Real effective exchange rate:** The real effective exchange rate is the nominal effective exchange rate (a measure of the value of a currency against a weighted average of several foreign currencies) divided by a price deflator or index of costs.
- ▶ **Reserve assets/official reserves:** Official reserve assets are those financial assets that can be used as international means of payments. Official reserve assets consist of gold, foreign exchanges, special drawing rights (SDRs) and reserve positions with the IMF. Foreign exchange reserves are by far the most important official reserves.
- ▶ **Sterilization:** Sterilization is the process by which monetary authorities ensure that foreign exchange interventions do not affect the domestic monetary base, which is one component of the overall money supply. Foreign exchange operations may need to occur due to a country running a balance of payments deficit, which sends currency out of the country in net. This will contract the domestic money supply as foreign exchange reserves fall, unless sterilization is undertaken to offset this through buying financial assets. Foreign exchange operations may need to occur due to a country needing to maintain a fixed exchange rate level against a currency appreciation or depreciation. For example, in the face of a rapidly falling (depreciating) currency the central bank may use some of its foreign exchange reserves to buy the domestic currency. Without offsetting sterilization, this will reduce the domestic money supply as some of the nation's currency is removed from circulation as it buys it up.
- ▶ **Sterilization policy:** Policies undertaken to reduce the deflationary or inflationary effects from changes in the domestic money supply arising from changes in foreign exchange reserves. A lower money supply, arising from net currency outflows (due to a trade imbalance, exchange rate management or net foreign capital flows), risks creating deflation. On the other hand, a higher money supply, arising from net currency inflows, risks creating inflation.

1. Introduction: Advancing a transformative macroeconomic agenda and framework

1.1 Overview: Employment targeting through macroeconomic, labour market and sectoral policies

Creating employment opportunities for all in developing economies is commonly (mis)conceived as only being a challenge of increasing economic growth and fixed capital investment. The evidence from the past 17 years in Africa shows that while higher economic growth and investment are very important to achieve employment targets they are not enough (ILO 2018; Rodrik 2016). The employment problem in Africa can only be comprehensively addressed by reassessing how we think about macroeconomic policy and combining macroeconomic, labour market and sectoral policies within an integrated employment policy framework.

Africa's relatively strong economic growth since 2002 saw a modest improvement in employment dynamics (see textbox 1), limited by massive growth in the labour force and a lack of structural transformation (see below) (Page and Shimeles 2015).

Textbox 1: Labour trends in African countries

Figure 1 shows that a large portion of African workers, in 2018 approximately one third of workers, are still in extreme poverty, despite some important gains made over the last decade; a further 22 per cent were moderately poor (ILO 2019a).⁴ This is the highest out of any continent or region globally. According to the ILO, the African working poor represented more than half (56 per cent) of the world's working poor in 2018, while African employment represented only 14 per cent of global employment.⁵ Most employment in Africa is still in precarious, informal and low productivity work. The African region has the highest level of informal employment at 86 per cent.⁶ Women were more exposed to informal employment in more than 90 per cent of sub-Saharan African countries (ILO 2018), with a gender wage gap of 13 percentage points.



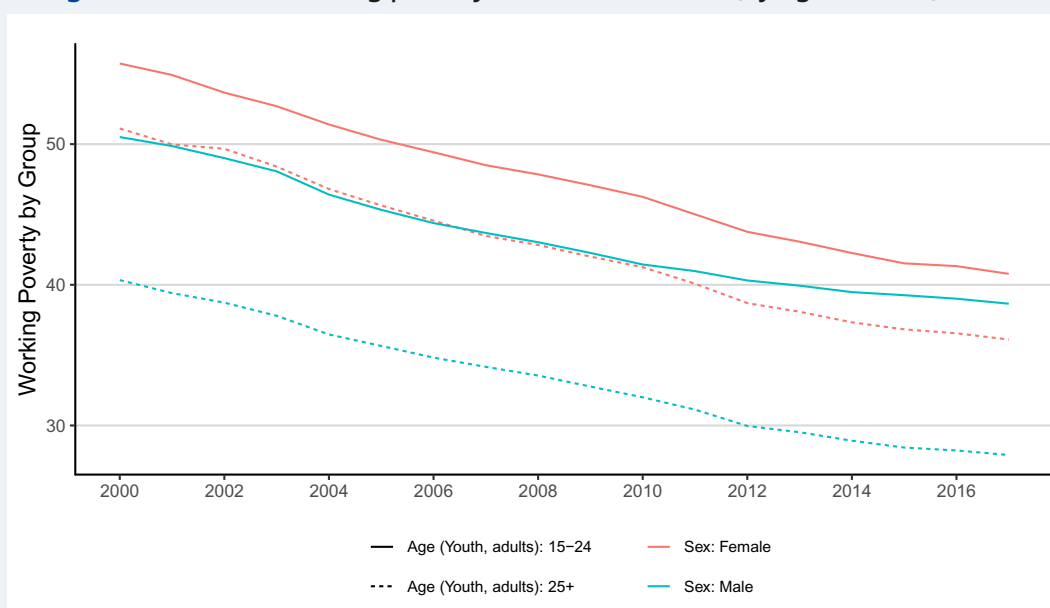
⁴ Persons are defined as extremely poor if living in households with a per capita income under US\$1.90 in purchasing power parity (PPP) per day; moderately poor if the household daily per capita income is between US\$1.90 in PPP and US\$3.10 PPP; and not poor if living on more than US\$3.10 PPP per day.

⁵ Defined as employed persons living in extreme poverty despite being employed. Extreme poverty is defined using the international poverty line of US\$1.90 per day in PPP.

⁶ According to the ILO, even though Sustainable Development Goal (SDG) indicator 8.3.1 refers to the proportion of informal employment in non-agricultural employment, the incidence of informality in agriculture may be large in some countries. Thus, in order to have a comprehensive picture of workers' working conditions and the overall extent of informality, especially in developing and emerging countries, indicator 8.3.1 should be supplemented by other measures of informality covering the whole economy (agriculture and non-agriculture).

Since 2002, “own account” (namely self-employed) workers, largely informal-sector workers, as a percentage of total employment has remained steady in Africa, despite economic growth, at around 47 per cent of total employed workers (ILOSTAT 2019). At the same time, labour force participation rates for ages 15 to 64 declined slightly, from 66.3 per cent to 64.8 per cent between 2002 and 2017. For women, participation rates are lower than for men, at 56 per cent in 2017, remaining roughly constant since 2002. Youth and women are particularly vulnerable to poor working conditions, as illustrated in Figure 1: 39 per cent of Africa’s employed youth lived in extreme poverty compared to 31 per cent of Africa’s employed adults in 2018; and 37 per cent of employed women were poor in 2018, compared to 30 per cent of employed men. Of Africa’s nearly 420 million youth, one third are unemployed or discouraged, another third are vulnerably employed, and only one in six is in wage employment. Youth face roughly double the unemployment rate of adults, with significant variation by country. This highlights the importance of employment policies which directly advance inclusion. At the same time, Africa’s population is expected to double by 2050, increasing pressure to ensure job-rich growth in order to keep up with the large flow of new labour market entrants.

► **Figure 1:** Extreme working poverty in Africa over time (by age and sex)



Note: Working poverty rates in Africa have declined between 2000 and 2017. They remain considerably higher for women (red lines) and youth (solid lines).

Source: ILO (2019a).



While directly comparable data is not available, working poverty rates have no doubt worsened during the COVID-19 period. For example, the ILO estimated that in the first month of the crisis (March to April 2020), the overall earnings of informal workers globally may have declined by up to 60 per cent and relative poverty among workers in the informal economy worldwide may have increased from 26 to 59 per cent (ILO 2020). In Africa, the African Development Bank (AfDB) reports that the crisis has had a disproportionate impact on vulnerable groups such as women, youth and low-skilled informal sector workers. Those with lower levels of education, few assets and working in informal jobs have been most affected. It is estimated that about 39 million Africans could fall into extreme poverty in 2021 with disproportionate effects on women. Women and female-headed households could represent a large proportion of the newly poor (AfDB 2021).

Acknowledging the vast employment challenges across the African continent, growing consideration has been given to the coordination of economic policy and to the role of macroeconomic policy in moving African countries off a trajectory of “jobless growth”. At the African Union (AU) Summit at Ouagadougou on Employment and Poverty Alleviation in Africa in 2004, the Heads of State strongly asserted their commitment and resolve to address the employment challenges in the region. Key emphasis was placed on the need for “integrated economic and social policies ... for increased production and decent employment opportunities to achieve socio-economic development”. This commitment was reaffirmed at the Ouagadougou +10 Summit in 2015, where key strategies were proposed, chief among which was the need to “[r]ealize policy coherence through the development and implementation of pro-employment macroeconomic and sectoral development policies as well as employment and labour market policies to promote broad based inclusive growth and poverty eradication through enhancing their employment and productivity-growth outcomes” (AU 2015). The question becomes then twofold: how employment challenges can be addressed through sectoral policies and how employment goals can be integrated into macroeconomic frameworks.

This paper is concerned with addressing these questions with a particular focus on the role of a comprehensive macroeconomic policy framework in promoting productive employment growth, a question that receives too little attention in current policy debates and practice. In particular, it makes the following argument. First, achieving decent and productive employment growth (defined below) requires coordination of, and integration across, macroeconomic, sectoral and labour market policies under a shared integrated employment policy *framework*. Second, within this, macroeconomic policy – a specific focus of this paper – has a leading role to play. Third, and consequently, macroeconomic policy should aim to stimulate employment through both demand- and supply-side measures in the short and long run. Fiscal expenditure, for example, can directly raise employment through increased public sector employment and

indirectly expand employment through supporting structural transformation (see below). Fourth, macroeconomic policy must directly target these employment objectives while supporting the sectoral and labour market policies that seek the same outcome. Currently macroeconomic policy works sometimes at odds with such an agenda.

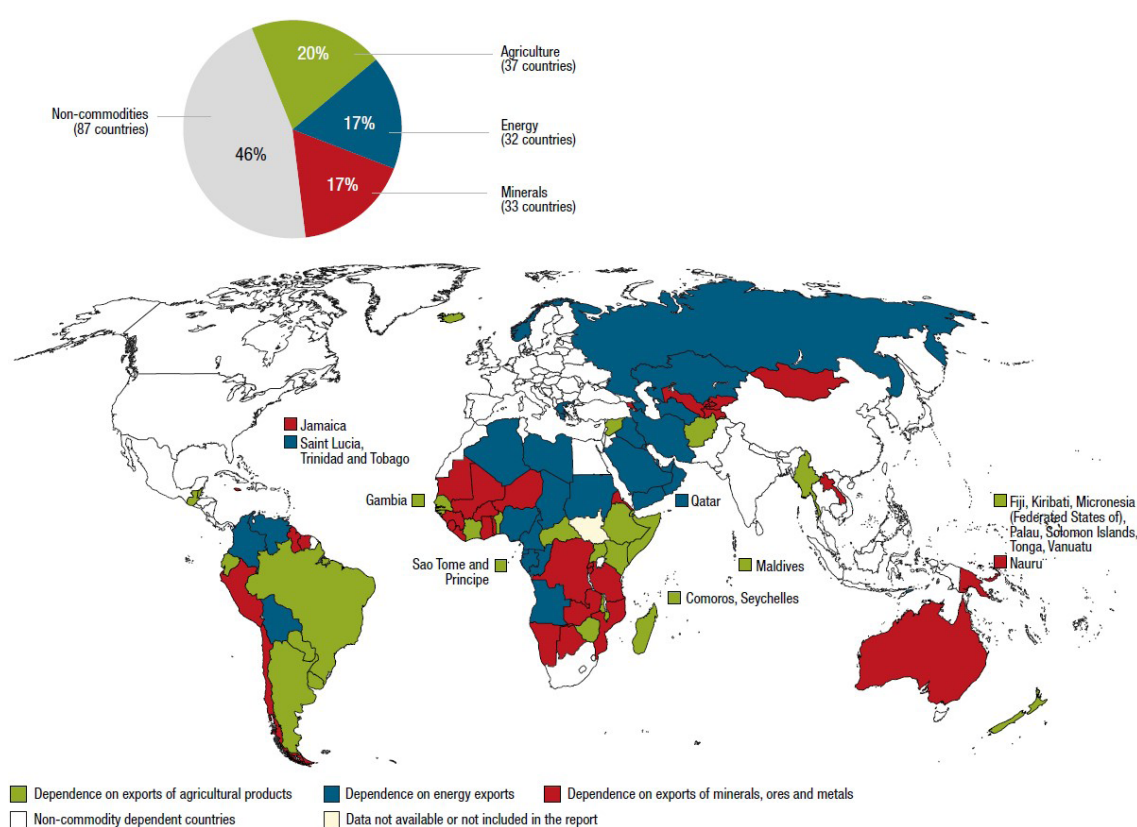
1.2 The centrality of structural transformation

We consider the role of this employment policy framework in achieving structural transformation as particularly important. We define structural transformation broadly to mean production shifting towards higher value-added and higher productivity activities, often in combination with an increased share of higher skilled work. This is not simply about manufacturing and industry though, narrowly conceived, but includes shifts across and within primary, secondary and tertiary sectors. This is central because what a country produces expands or limits the possibilities for decent and productive employment opportunities. The higher the *domestic* value added in production is, the greater the potential to upgrade domestic employment conditions (including wages, training, hours and so on) as domestic productivity rises. An over-reliance on commodities, and the consequent susceptibility to external commodity prices, retards this. Diversifying sources of output (production) leads to a diversification of domestic sources of employment. This adds resilience against commodity shocks. This requires, first, rebalancing aggregate demand away from a *sole reliance* on commodity export demand. In general, this also helps an economy increase its resilience against external shocks, thus indicating the importance of expanding domestic demand and diversifying exports. Second, rebalancing economies away from an over-reliance on low productivity sectors, in particular primary sectors, is essential for more resilient and sustainable domestic employment opportunities. Some of the gains made in reducing working poverty in Africa, as shown above, can be attributed to structural transformation.

Poorer African countries tend to be more commodity dependent (reliant on smallholder agriculture, as well as primary commodity, mining and energy exports) and there is a strong correlation between levels of commodity dependence and levels of development. That is, diversification of the economy is often essential to achieving development (with some exceptions) (UNCTAD 2019b). Figure 2, drawn from UNCTAD's *The State of Commodity Dependence 2019* report, shows that the overwhelming majority of African countries are commodity dependent (89 per cent in sub-Saharan Africa and 65 per cent in the Middle East and North Africa) (see table 4 and figures 31 and 32 in the appendix on the structure of commodity exports). It also shows that commodity dependence and income (except in some oil-producing countries) are inversely related so that as countries diversify their income increases exponentially (Figure 3). In fact, more than two thirds of all sub-Saharan Africa countries fall within the group of poorest and least diversified economies (UNCTAD 2019c). Compared to global norms, agriculture is disproportionately important in sub-Saharan Africa and manufacturing disproportionately underdeveloped (see table 3 in the appendix).

Commodity dependence has important impacts on employment. First, despite commodity dependence, employment in mining and energy remains small – in low- and lower-middle-income African countries it sits at below 2 per cent of total employment (ILOSTAT 2019). This indicates the capital-intensive nature of these sectors and their limited capacity for employment generation. Second, as elaborated on below, this leads to a number of macroeconomic imbalances that retard employment growth. Third, these jobs tend to be hazardous. Countries reliant on primary sectors (agriculture and mining) often have low productivity employment. Figure 4 shows that labour productivity has improved more strongly in countries and regions with more diversified economies. Figure 26 (in the appendix), shows that countries with higher manufacturing exports have much lower levels of vulnerable employment⁷; this indicates the importance of diversification and structural transformation in achieving desired employment outcomes. By contrast, in Africa working poverty rates and wage growth have been closely tied to commodity prices and external demand (UNCTAD 2019b; ILOSTAT 2019), making them vulnerable to downturns in commodity cycles, as seen by the 5 per cent shrink in real wages between 2015 and 2017 (ILO 2018).

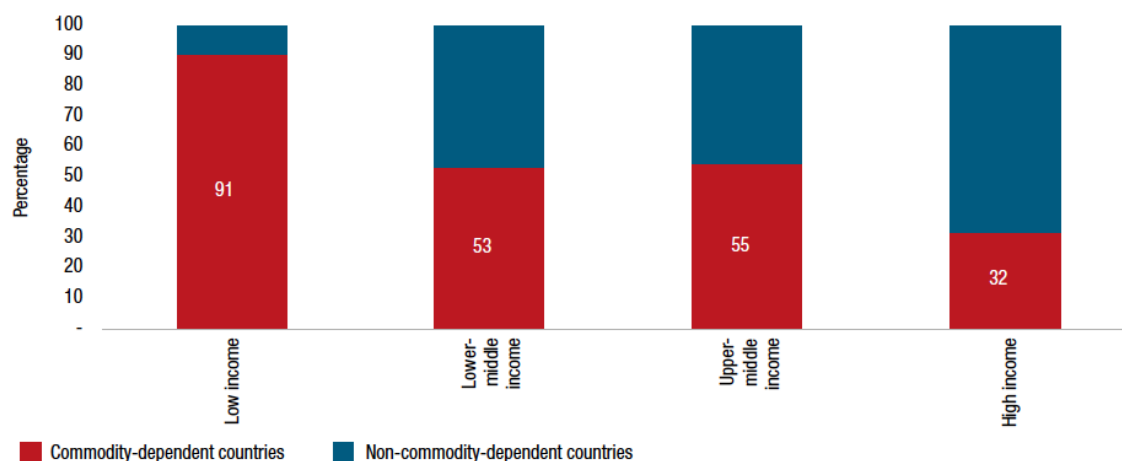
► **Figure 2:** Distribution of commodity-dependent and non-commodity-dependent countries by commodity group, 2013–2017



Source: Adjusted version, based on UNCTAD 2019.

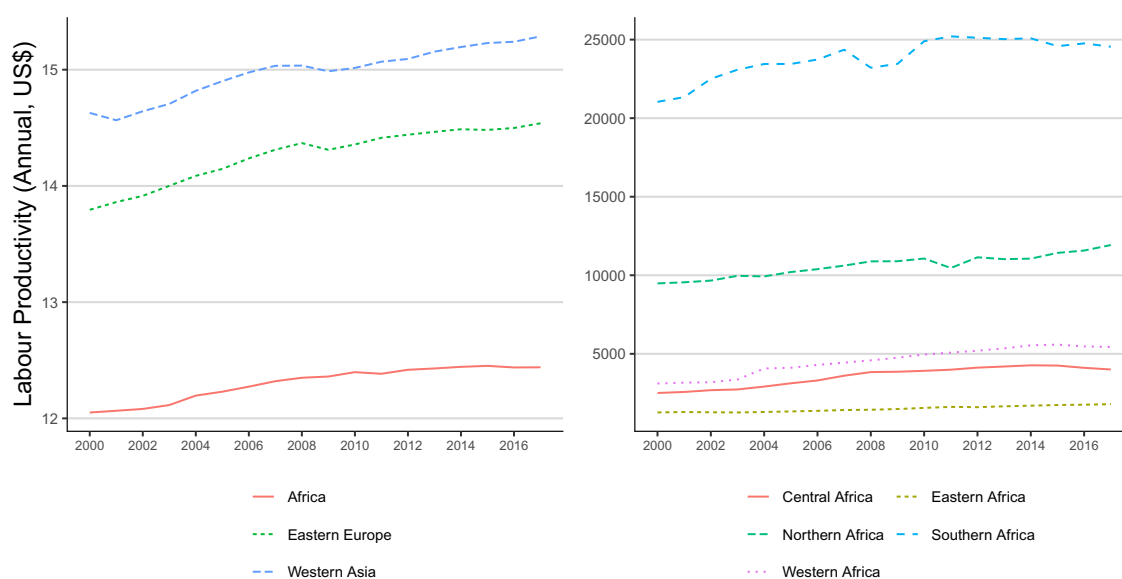
⁷ Vulnerable employment is defined as the sum of own-account workers and contributing family workers.

► **Figure 3:** Distribution of commodity-dependent and non-commodity-dependent countries within each income group, 2013–2017



Source: UNCTAD (2019).

► **Figure 4:** Labour productivity by region

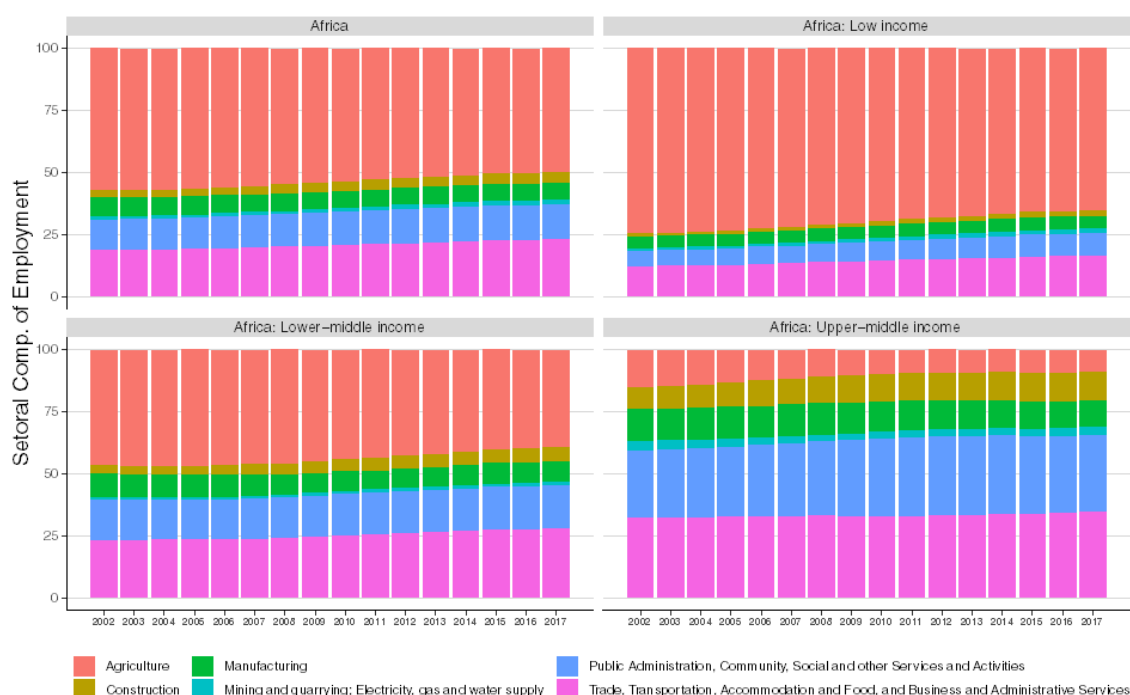


Note: Labour productivity has improved in Africa. Left-hand graph: Labour productivity levels in Africa remain well below those in other parts of the world (on log2 scale for comparison). Right-hand graph (normal scale): Labour productivity is highest in Southern Africa and Northern Africa, the two richest regions of the continent, although important gains have been made across the continent. Central African economies are the most dependent on oil production and show the weakest gains in labour productivity.

Source: ILO (2019a).

These trends illustrate the importance of moving away from commodity dependence.⁸ They do not however give a nuanced picture of the relative benefits gained from expansion in industrial and service sectors. A vast body of literature (Haraguchi et al. 2017; Rodrik 2013; UNIDO 2018; Chang et al. 2016) highlights the importance of manufacturing as a vehicle for structural transformation and more job-rich and inclusive growth (because – among others – manufacturing goods are tradable, and their production often is labour intensive and offers economies of scale). Africa’s manufacturing sector’s contribution to GDP and employment remains small (less than 10 per cent for most economies) and is dominated by small, not particularly productive, firms.⁹ This hampers the ability to advance domestic linkages, both horizontally and vertically, and value addition. It also limits the ability to reduce reliance on imported manufactured goods, both for consumers and firms. In Africa, countries which saw their employment share of industry grow significantly saw the largest labour productivity growth. However, as shown in Figure 5, the employment share of industry has not been growing for most countries (IMF 2017). Worryingly, export diversification declined during the 2000s for Africa’s major economies (African Center for Economic Transformation 2019). In contrast, countries have tended to see their service sector share of employment grow.

► **Figure 5: Sectoral composition of employment over time and by income level**



Note: Employment in Africa is shifting away from commodities (particularly agricultural) and towards services, and to a lesser degree towards industry. To the extent that this allows for more productive employment opportunities, this can help reduce working poverty. There is a strong link between production structure and income level. Poorer African economies are largely agricultural in employment while richer economies are defined by having a much larger share of both services and manufacturing employment.

Data Source: ILO (2019a).

⁸ UNCTAD defines a country as dependent on commodities when these account for more than 60 per cent of its total merchandise exports in value terms.

⁹ Industry accounted for 11.19 per cent of employment in 2017 and agriculture 57.37 per cent (World Bank 2019c).

In recent decades, service sectors have come to play a dominant role in the global economy. The service sector accounted for 31.4 per cent of employment in Africa in 2017, up from 20.5 per cent in 2000 (World Bank 2019c). These sectors can contribute towards decent and productive domestic employment in the formal sector if they work to advance domestic productivity, value addition and intersectoral linkages. However, too often this is not the case. In Africa, although the evidence is partial, much of the growth in service sector work was in low-paying, often informal, work (De Vries, Timmer and De Vries 2015; Rodrik 2016). Retail, for example, makes up the largest share of service-sector employment (and the second largest share of employment overall), and remains predominately informal and low productivity with poor work conditions and a large gender pay gap (ILO 2015b; McKinsey Global Institute 2012). It is worthwhile to note, however, that with technological advancements enabling some market services to be tradable, the line between market services and manufacturing is becoming increasingly blurred.

Structural transformation has therefore been both limited to particular regions and countries, and limited in impact due to the relatively small expansion of manufacturing and the type of service sectors which have grown. This could indicate why the limited structural transformation to date has not dramatically boosted productivity in Africa. Despite this, structural transformation remains effective in diversifying sources of growth and therefore sustaining domestic employment amid the present downturn in global commodity prices (African Center for Economic Transformation 2019).

1.3 Pro-employment macroeconomic policies: From “stabilization” to “transformation”

In the last four decades the objectives of macroeconomic policy have generally been limited to achieving “macroeconomic stability” (Isaacs 2014). Macroeconomic policymakers have seen market integration and the ability of prices for goods and services to adjust within the market – with little or no intervention – to be the best way to arrive at the optimal level of macroeconomic “aggregates”, including employment. Policy has thus focused predominantly on price stability, low or moderate debt and deficits, economic prices, and specific market-centric labour and capital market regulatory regimes.¹⁰ However, the market “getting prices right” has been inadequate to achieve developmental goals. Further, in most African economies, many market structures are absent and price signals are weak and often highly destructive (creating phenomena such as “Dutch disease”¹¹). As a result, relying purely on present market forces and market prices is insufficient to ensure all resources can be mobilized, allocated and upgraded. Such spontaneous forces are absent except in very advanced economies – and even then they can be disequilibrating. In the African context, some level of centralized government action is required to connect

¹⁰ “Neutrality” is actually a misnomer here and a focus on “stability” tends to reinforce existing structural dynamics, which is not a neutral outcome.

¹¹ The reduction in export price competitiveness of the non-resource sector as resources flood into the resource sector, leading to exchange rate appreciation.

markets, advance resource utilisation and stimulate aggregate demand in order to increase the level of employment.¹²

The considerable employment challenge facing the continent, as Africa's labour force and youth population grows rapidly, necessitates that macroeconomic policy widens its focus from merely a stabilizing role to a "transformative" role which actively targets decent and productive employment which is inclusive and sustainable. This needs to be married with labour and sectoral policy instruments. Such an approach was advocated for in a recent SADC joint sector workshop, which stated: "fiscal policies that are geared towards investment in key economic and social infrastructure are necessary to compliment monetary policies on inflation, interest rates and exchange rates in a balanced manner that supports economic policy more broadly, including through industrial and labour market policies aimed at expanding the economy".

For macroeconomic policy this requires a three-pronged – and interrelated – approach that sees macroeconomic policy directly spur employment where policy space allows, resolve macroeconomic imbalances that retard employment generation, and advance structural transformation while supporting complementary sectoral and labour market policies.

The ability of African economies to finance pro-employment policies, increase aggregate demand and invest in expanding supply remain limited by macroeconomic imbalances (themselves often reinforced through the insufficient use of available policy options). These have strong connections to Africa's imbalanced and narrow production structure since this creates macroeconomic booms and busts in exports, employment, foreign exchange, capital inflows, current account deficits, exchange rate values and domestic inflation, all largely linked to changes in global commodity prices. Macroeconomic constraints on increasing aggregate demand, diversifying aggregate supply and implementing employment-enhancing policies include: current account deficits when commodity prices are low; a reliance on net capital inflows to fund the current account deficit; debt build-ups when commodity prices decline, which limits aggregate demand; a low tolerance for inflation; high exchange rate volatility and pass-through to inflation; limited government financing; low tax intake from commodity production; procyclical capital inflows; overvalued exchange rates; limited monetary policy independence; and a higher propensity to import such that policies to stimulate domestic demand struggle to gain traction.

Despite this, appropriate macroeconomic policies have the potential to support the creation of decent and productive employment which is sustainable and inclusive. For example, in addition to those cited above, a major reason why working poverty rates have fallen in Africa is due to public expenditures being redirected away from debt repayments and into inclusive and productivity-enhancing investments in health, education, transport,

¹² To some extent this follows from the notion that full employment is not determined in the labour market but in the goods markets, by the level of expenditures through the level and distribution of incomes.

housing, sanitation and other infrastructures. Supporting figures can be seen in the appendix. According to the IMF, before the Heavily Indebted Poor Countries (HIPC) Initiative, eligible countries were, on average, spending slightly more on debt service than on health and education combined. Such social spending is now about five times more than debt service payments. As a result, life expectancy has increased across Africa by around 20 to 45 per cent for almost every country between 2000 and 2017 (Johnson 2016).

1.4 Employment targets and macroeconomic, sectoral and labour market policies

The framework advanced here shows that supporting the creation of decent and productive employment which is sustainable and inclusive requires a comprehensive approach including macroeconomic, sectoral and labour market policies that are mutually supporting and reinforcing. Each of these three policy areas contributes in complimentary ways.¹³ Resolving macroeconomic imbalances, such as excessive imports or inflation, sets a basis for decent and productive employment but does not achieve this on its own – it is necessary but insufficient. Rather, employment growth occurs through macroeconomic and sectoral policies that directly create employment and target sectors that are able to sustain employment in the long run (structural transformation). This growth is sustainable and inclusive if it takes due cognizance of environmental limits and occurs through targeting sectors that benefit marginalized groups. Decent work is further ensured through labour market regulations that simultaneously ensure human capital development and labour conditions that meet the ILO’s Decent Work Agenda (ILO 2015).

Each of the three policy areas act on different combinations of these elements.

Macroeconomic policy, primarily fiscal and monetary policies, target aggregate demand and aggregate supply. Aggregate demand works to increase the level of employment through changing the level and composition of expenditures. Aggregate supply works to remove bottlenecks in the economy and can generate future conditions for decent and productive employment. Ameliorating potential imbalances that can arise as aggregate demand increases – such as unduly high inflation, unduly high debt accumulation, imbalances in the balance of payments or, more directly, a large current account deficit – is an important element of macroeconomic policy management or else employment growth cannot be sustained. This advances a balanced macroeconomic environment,

¹³ This argument, originally made by Jan Tinbergen, is the same as saying that the transmission mechanisms underlying the various policy tools in our macroeconomic framework operate on employment through different though overlapping channels. As a result, different and multiple tools are needed to ensure that the various overlapping employment objectives can be simultaneously achieved. For example, macroeconomic aggregate demand does not directly target inclusive employment growth by itself, since the primary impact of aggregate demand increases is on employment growth, operating through growth in GDP (so-called Okun’s Law). This does have secondary impacts on the labour market through potentially increased worker bargaining power or drawing the rural population into the urban workforce, for example, but these secondary impacts are highly conditional on a range of highly uncertain factors and, as such, cannot be taken as given.

employment growth and structural transformation, and can be geared towards inclusion and sustainability while supporting labour market policies.

At the same time, macroeconomic policy must support sectoral policies – which diversify supply and support demand – in sectors that are more skilled, productive, sustainable and inclusive, and with higher domestic value added – to structurally transform African economies. This ensures employment growth does not rely on a handful of export-orientated commodities. Such employment growth is sustainable and inclusive when that growth takes place in sectors that generate employment for all parts of the population, including youth, women and other marginalized groups, and occurs in an environmentally sustainable manner.

Concurrently, labour market policies and institutions allow for direct interventions to benefit workers and enterprises, improve the match between supply and demand within labour markets or influence the structure of labour markets differently in order to enhance the ability of the economy to absorb labour and spur the economy towards decent and productive employment for all who want it. They both facilitate human capital development and ensure fair and equitable working conditions. In addition to promoting workers' wellbeing, these upgrade productivity and balance demand conditions through setting limits on how firms are permitted to compete. This sets up the economy for better long-run growth conditions.

Despite their relative areas of focus, it is critical to appreciate that the objectives of these policy areas cannot be achieved in isolation from one another. For example, diversifying supply in the economy through sectoral policies requires fiscal support but is also able to expand and change the composition of output thus managing inflation and the trade balance, or generating much-needed foreign exchange. Structural transformation can reduce inequality and relax the balance of payments constraint, which limits the ability of African countries to enact growth and employment driving policies without unduly impacting the current account. This highlights how the manner in which macroeconomic policy has been narrowed to achieving “stability”, as discussed above, is counterproductive to economic development and employment creation. This underpins clearly why our approach requires the combining of a broad range of macroeconomic management tools with sectoral and labour policy tools (ILO 2019b). We refer to this as a transformative macroeconomic policy framework, rather than one narrowly focused on stability.

1.5 Outline

The paper proceeds in four further sections. Section 2 contains a description of current macroeconomic conditions in Africa, as well as a review of existing approaches to macroeconomic policy. The latter focuses particularly on investment patterns and exchange rate management, although a range of issues are tackled. Section 3 then lays out the transformative macroeconomic policy framework that this paper proposes African

governments adopt. This explains how macroeconomic, sectoral and labour market policies work in tandem to expand both the demand and supply sides of economies and how they advance decent and productive employment growth. Section 4 details policy measures. These highlight the transformative macroeconomic policy framework in action and how these can improve employment outcomes; they are not an exhaustive list of policies. The policies addressed are: government expenditure to increase aggregate demand while advancing supply capacity; expenditure switching methods; rebalancing expenditure; raising Africa's inflation tolerance through balanced inflation policies; fiscal space and revenue mobilization; production linkages; employment-promoting public investments; and minimum wage policies to support and advance sectoral and macroeconomic policies. Following this, in section 5, we discuss facets of policymaking processes and institutions, with a particular focus on inclusivity and policy coherence. Specifically, we look at social partners and labour representation in the macroeconomic policy framework; national planning commissions; and coordination across government departments. Section 6 concludes this paper.

2. State of play: Policy approaches and challenges in Africa today

It is important to assess existing macroeconomic policies and conditions prior to proposing policy recommendations. These are described below and support the general approach taken in this paper to advance employment through a combination of macroeconomic, sectoral and labour market policies. Appendix B.1 contains supporting descriptive data, which can be drawn on as necessary.

This work was originally undertaken prior to the COVID-19 pandemic. The macroeconomic circumstances have naturally been altered by the pandemic. To an extent this is accounted for. More important, however, is that in many instances the pandemic has simply reinforced existing macroeconomic fragilities – external debt, slowing GDP growth, resource dependence and so on. In this respect, the trends originally described remain salient.

2.1 Stylized facts

Macroeconomic policies play a pivotal role in sustained GDP growth, advances in inclusive public infrastructure and decent and productive employment. However, progress has been uneven. This is highlighted by the following facts:

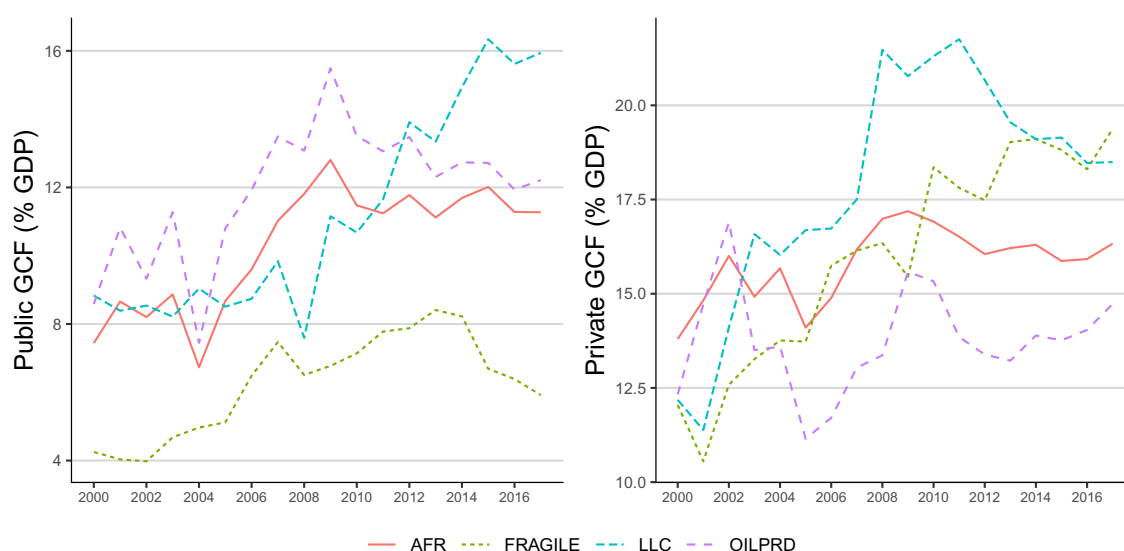
- I. **Maintaining positive rates of real GDP growth remain challenging** across the continent (figure 33 and figure 34 in appendix), owing to high population growth, frequently high levels of inflation, volatile movements in the exchange rate and production, and continued commodity dependence for many economies.
- II. **Growth is weaker in resource-dependent economies.** In 22 non-resource intensive African economies,¹⁴ growth was projected at around 6 per cent in 2019, while for resource-dependent economies growth was projected to be 3 per cent in 2019.
- III. **Prior to COVID-19, investment rates increased strongly across the continent.** As seen in figure 6, this has been driven by both private and public investment, though public investment rates tend to be around half of private investment rates (see also figure 35, figure 36 and figure 37 in the appendix).
 - a. **Public investment rates in Africa are high compared to other regions in the world** – though a considerable portion of the public investments in many African economies go into supporting enclave commodity extraction. Total investment rates in fixed capital remain low in Africa compared to other regions though, owing to lower private rates of investment. Landlocked African countries have shown

¹⁴ Benin, Burundi, Cabo Verde, Comoros, Côte d'Ivoire, Eritrea, Eswatini, Ethiopia, Gambia, Guinea-Bissau, Kenya, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Rwanda, Sao Tome and Principe, Senegal, Seychelles, Togo, Uganda

considerable gains in investment rates driven by East African economies. Major oil producers show the most volatility in investment rates – both public and private.

- b. **Private investment rates** have fallen post the 2007/8 crisis but not by much (figure 6 above), indicating a degree of economic diversification in Africa.
- c. **Private investment by itself is not sufficient to raise levels of decent and productive employment.** The impact on working poverty, for example (see figure 34 in the appendix), is conditional on the type of investment. Countries which are less commodity dependent show a much stronger negative relationship between private investment rates and working poverty, such that more investment sees working poverty go down. This is not the case for commodity-dependent economies. This highlights the link between structural transformation and working poverty.

► **Figure 6:** Public and private investment rates (gross capital formation as a percentage of GDP) by groupings



Note: AFR = All Africa. LLC = Land Locked Countries. FRAGILE = Fragile States. OILPRD = Oil Producers. See appendix for list of countries.

Source: African Development Bank (2019a).

- IV. **Africa has made large gains in human development (HDI index) and life expectancy (figures 18 and 20).** Underlying this has been a large expansion in investment in vital public goods. Education spending in GDP has increased significantly across Africa (figure 44 in appendix); better sanitation has been driven by improvements in rural areas (figure 46 and figure 47 in appendix); and improved water access has risen significantly across regions (figure 45 in appendix). Urban areas show large population growth (figure 16 in appendix), making it more difficult to keep up with investments and living conditions.
- V. **Africa's inflation remains higher than in other developing country regions, although this still sits at historically fairly moderate levels of 12.6 per cent in 2017**

and 10.9 per cent in 2018 (AfDB 2019b). Inflation in Africa is responsive to changes in domestic demand, agricultural prices due to climatic change, and commodity prices (exchange rate) (Nguyen, Dridi, Unsal and Williams 2017; Razafimahefa 2012). Countries within the CFA franc zone tend to have the lowest inflation in Africa. Inflation increased steadily during the 2000s as domestic demand increased and procyclical capital flows entered African economies. Lower commodity prices post-2014 have helped to depress domestic inflation (see figure 54, figure 55, figure 56 and figure 57 in appendix).

VI. Current account, trade account, financial accounts and public fiscal positions remain tied to commodity prices and both have deteriorated since 2008 (figure 38, figure 39, figure 40 and figure 41 in appendix).

- a. Africa's current account balance has been consistently negative since 2008, falling to -7.3 per cent of GDP in 2016 (AfDB 2019a). There is a strong link between a country's composition of exports and its long-run current account balance, indicating that countries with more diversified exports tend to have less negative current account balances in the long term (AfDB 2019b).
- b. Africa's trade balance began deteriorating even before commodity prices collapsed in 2014 owing to falling global demand and Africa's high propensity to suck in imports; the elasticity of imports with respect to income is exceptionally high.
- c. To fund its current account deficit when commodity prices fall, Africa remains highly dependent on procyclical inflows through its financial account (a "negative" value since it reflects an increase in current and future obligations to non-residents).
- d. Government fiscal balances in Africa deteriorate in line with global demand and commodity prices (figure 52 in appendix), turning negative after 2008 as foreign exchange revenues declined and non-tax revenues fell dramatically (AfDB 2019b) while government spending remained constant. This has continued to the present, with mild corrections more recently. It was the most volatile for oil producers (many of whom are in Central Africa), who saw government revenues increase the most during the commodity price boom and then decline the most during the commodity price bust. North Africa's fiscal balance has deteriorated the most.

VII. Public debt accumulation is tied to the commodity price cycle, rising strongly for most regions since 2014 and earlier (figure 52 in appendix). Figure 51 (in the appendix) shows that sovereign debt payments on interest and amortization paid amounted to around 20 times the value of exports for the average representative African region in 2017. The IMF is now lending to 16 sub-Saharan African countries.¹⁵

VIII. The composition of exports and GDP remains highly cyclical, driven by external conditions (figure 30 and figure 31).

¹⁵ The total agreed amount of the IMF's outstanding programmes with sub-Saharan African (SSA) countries rose nearly fivefold between end-2014 and end-2017 from \$1.8bn to \$7.2bn. In 2017, nine out of 21 Fitch-rated African sovereigns – the highest number since 2010 – were under disbursing financial arrangements with the IMF.

IX. The COVID-19 pandemic has accentuated a number of these underlying trends.

- a. The cyclical nature of GDP growth and current account balances, driven by external conditions, has been starkly highlighted. Real GDP in Africa is estimated to have contracted by 2.1 per cent in 2020 – tourism-dependent economies (-11.5 per cent), oil-exporting economies (-1.5 per cent) and other resource-intensive economies (-4.7 per cent) were the most significantly hit by the pandemic (AfDB 2021).
- b. External positions of countries have deteriorated during the crisis. The overall current account deficit for Africa is estimated at 5.5 per cent of GDP in 2020. According to the AfDB (2020), “the current account has been driven primarily by trade deficits and net factor payments abroad and propped up by current transfers, including remittance inflows and foreign aid”.
- c. Public debt has risen significantly. Fiscal deficits are estimated to have doubled in 2020 to a historical high of 8.4 per cent of GDP. Debt-to-GDP on the continent had stabilized at 60 per cent between 2017 and 2019 but is projected to increase by 10 to 15 percentage points by 2021, as a result of COVID-19 (AfDB 2021).
- d. Commodity dependence has meant that countries have been impacted through three channels during the crisis: price channel, supply chain channel and financial channel. At the outset, there was a collapse in commodity prices. Lockdowns meant that there were disruptions to global commodity-based supply chains. Lastly, “the overlap of financial and commodity price cycles resulting in pro-cyclical capital flows and debt servicing costs” (Asante-Poku and Huellen 2021). The more recent commodity price recovery is driving growth and exchange rate appreciation in many instances.

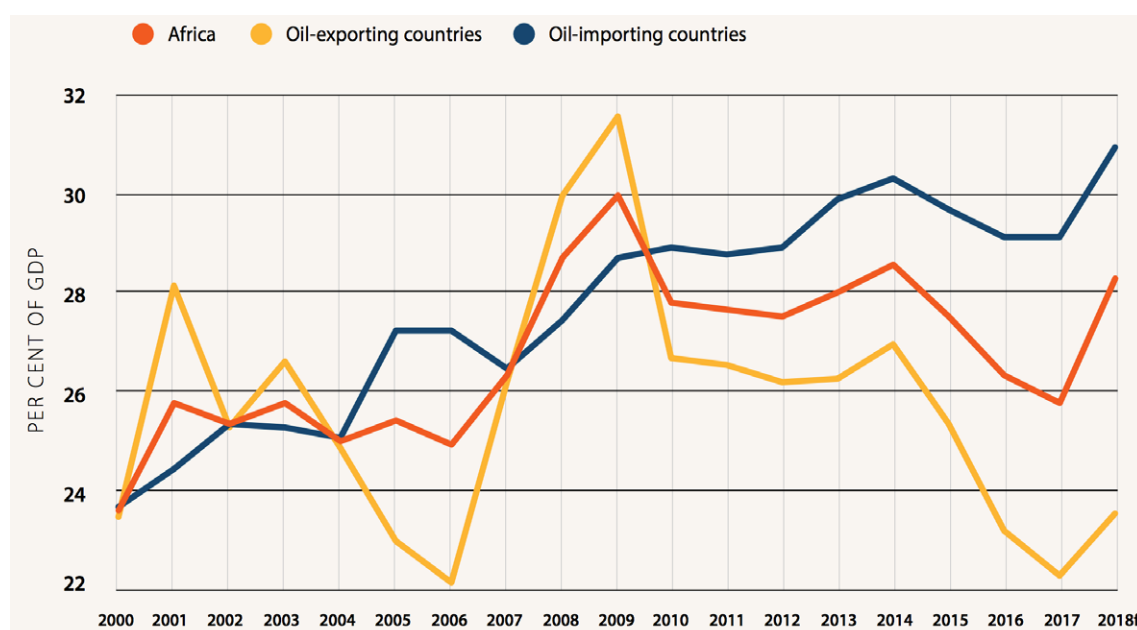
2.2 Existing fiscal policy regimes in Africa

Existing fiscal policy regimes in Africa can be assessed along several lines.

- I. **Fiscal policy was largely procyclical in Africa during the commodity price upswing although government spending continued during the downturn, introducing a countercyclical element.** As visible in figure 7, resource dependent exporters, especially oil exporters, are more likely to have highly procyclical spending and tax policies (Leibfritz 2015; UNECA 2019). Spending during the downturn, however, largely went into consumption expenditure rather than fixed capital investment spending, leading to further current account deteriorations for most African countries (Deverajan et al. 2019). According to one study, one third of African countries saw government fiscal stimulus post-2008 stimulate almost exclusively domestic consumption and not domestic investment (Coulibaly, Gandhi and Senbet 2019).¹⁶ Government spending also increased during the downturn even as tax revenue dropped significantly, leading to a notable increase in government debt (Deverajan et al. 2019).

¹⁶ As noted above, a high import propensity and a relatively undiversified productive structure will mean that fiscal policy becomes less effective in stimulating demand or new supply in the economy if not accompanied by measures to upgrade and diversify supply capacity, including human capabilities.

► **Figure 7: Government spending in Africa by country group**

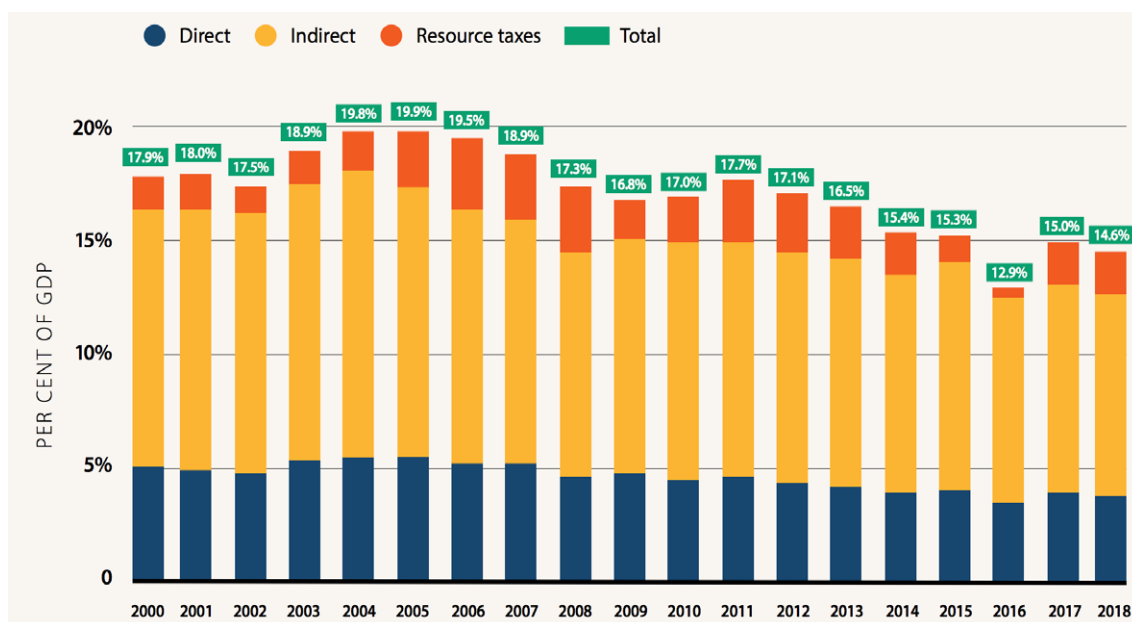


Source: UNECA (2019).

- II. **Prior to COVID-19, many African countries had additional fiscal space but preferred not to use it.** External debt as a percentage of GDP increased in Africa as a whole from 21.5 per cent in 2015 to 37.6 per cent in 2018 but remains modest. Despite this increase, fiscal space to advance expansionary fiscal policy remains. On the conservative 50 per cent debt limit scenario used by UNECA, 40 per cent of African countries have positive fiscal space (UNECA 2019).¹⁷
- III. **In years prior to the pandemic, contractionary fiscal policy to reduce debt balances was being implemented in over a dozen African countries that were receiving IMF external financing support.**¹⁸ This means austerity measures were in place despite their negative impact on the long-term growth potential of countries (Sibeko 2019).
- IV. **On the revenue side, tax revenue has been highly cyclical and increasingly regressive.** This has forced a number of significant reforms to the tax system during the post-2008 downturn. As shown in figure 8 below, resource tax intake remains low, while revenue from direct taxation (predominately income taxes) have fallen the most, driven by a fall in corporate income taxes as a share of GDP, which fell from 3 per cent in 2010 to 2.8 per cent in 2018 (OECD/AUC/ATAF 2020). This places a greater burden on generally more regressive, indirect taxes (predominately sales taxes or value-added taxes).

¹⁷ Defined as the difference between a country's debt limit and current debt level.

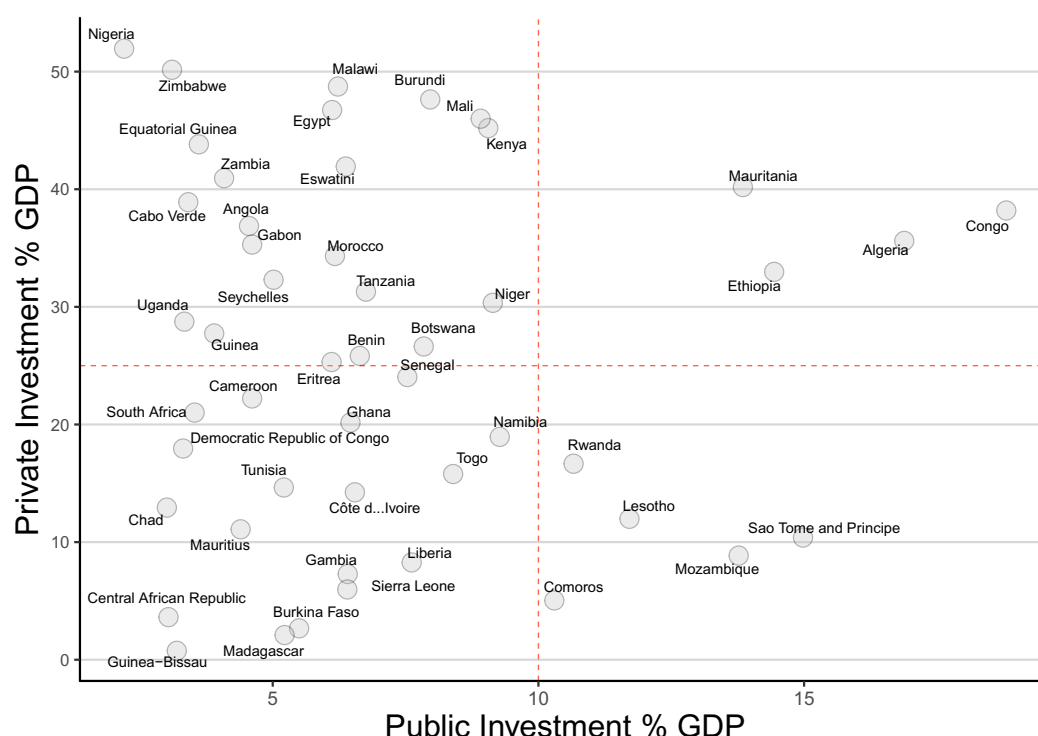
¹⁸ The IMF currently has extended arrangements (EFF) with Angola, Cote d'Ivoire, Equatorial Guinea, Ethiopia, Gabon and Tunisia; Morocco has a Precautionary and Liquidity Line (PLL); while Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Congo (Democratic Republic of), Cote d'Ivoire, Ethiopia, Guinea, Liberia, Madagascar, Malawi, Mali, Mauritania, Niger, Sao Tome and Principe, Sierra Leone and Togo have an Extended Credit Facility (ECF) with the IMF.

► **Figure 8:** Revenue intake for African governments over time by type

Source: UNECA (2019).

V. **The balance between public-led and private-led investment strategies varies across the continent.** As seen in figure 9, there exists a diversity of fiscal policy regimes in Africa. Ethiopia, in the top right quadrant, has a state-led macroeconomic investment framework, whereby public investment has successfully been used to crowd in foreign private investment and financing. Kenya, in the top left quadrant, is more reliant on private investment, with public investment used to directly support private investment and to maintain a generally enabling environment for export competitiveness and domestic capital formation. Uganda, also top left, has had an almost exclusively private-sector-led approach with moderate levels of public capital formation and a greater utilization of public and market-led incentives to foster overall capital formation. A few countries in the bottom right quadrant, such as Mozambique, have had significant government investment but without commensurate private sector investment, in this instance probably due to governance challenges, which deter investment, and the agrarian structure of the economy. Those in the bottom left quadrant suffer low levels of public and private investment, often mutually reinforcing. Although commodity-dependent exporters exhibit a variety of investment structures, they tend to reside in (or near) the top left-hand quadrant (including Nigeria, Angola, Gabon, Guinea and Botswana). This highlights the difficulty in leveraging private mineral investments to advance wider economic linkages, including through recurrent tax and expenditure mechanisms. The status of the country as a major exporter of hard commodities and petroleum plays some role in determining where the country lies.

► **Figure 9: Different approaches to investment spending in Africa**



Note: Public and private investment can be compliments but are currently used differently across Africa. Bottom right quadrant is public-led investment regime. Top left quadrant is private-led. Top right and bottom left quadrants involve various mixes of the two. Public investment helps drive private investment in Ethiopia, Rwanda, Côte d'Ivoire and Namibia. Botswana, Morocco and Kenya are more private-sector led. Mauritius, Ghana and Tunisia adopt more mixed approaches. Country size and commodity dependence will mediate this relationship, making it more complex.

Source: Authors based on data from Commission et al. (2018).

- VI. **Fiscal policy tends to be regressive in Africa and this has eroded further over time** in 29 of the 47 countries for which data is available, showing a decline in the distributional effectiveness of their fiscal policy (Bhorat et al. 2017). Most African economies have regressive taxation (Bhorat et al. 2017)¹⁹ even though, in specific countries, tax intake has been increasing since 2010 (AfDB 2019b), as governments try to deal with the fallout from weakening state finances as global demand and commodity prices decline.
- VII. **Across the continent, African governments have adjusted fiscal policy in the face of COVID-19.** Forty-five African governments have announced some form of fiscal stimulus in response to the pandemic. For the most part, these have been smaller than stimulus deployed in advanced economies. The median stimulus package for the region was only 1.5 per cent of GDP. Only three African countries – Seychelles, Sierra Leone and South Africa – have had stimulus packages of over 5 per cent of GDP. At the same time, budget deficits and debt levels have increased significantly.

¹⁹ Although subsidies and transfers are mostly equalising, inequality-induced tax regressivity is a common phenomenon, where most countries with a revenue-to-GDP ratio of 20 per cent and above have Gini coefficients of 0.5 or more.

2.3 Existing monetary policy regimes in Africa

The choice of monetary policy regime shapes the relative importance and impact of other macroeconomic policy instruments. For example, fiscal policy and monetary policy have very different impacts under fixed versus flexible exchange rates (Krugman et al. 2018) and reserve accumulation and management is a much bigger issue under fixed exchange rates (see glossary), for example. With a fixed exchange rate, external shocks cannot be absorbed through exchange rate adjustments. As a result, the transmission channels from the various tools in our macroeconomic policy framework on employment are also very different.

According to the IMF *de facto* exchange rate classifications (Kokenyne, Veyrune, Habermeier and Anderson 2009) of 53 African countries in 2018, only 9 or 17 per cent had floating arrangements,²⁰ while around 72 per cent of countries (38 countries) had various forms of fixed, or non-market determined, exchange rates²¹. Most African countries peg their exchange rate, partly due to the CFA franc zone. Among countries with pegs, the euro is the most popular anchor currency, followed by the US dollar.

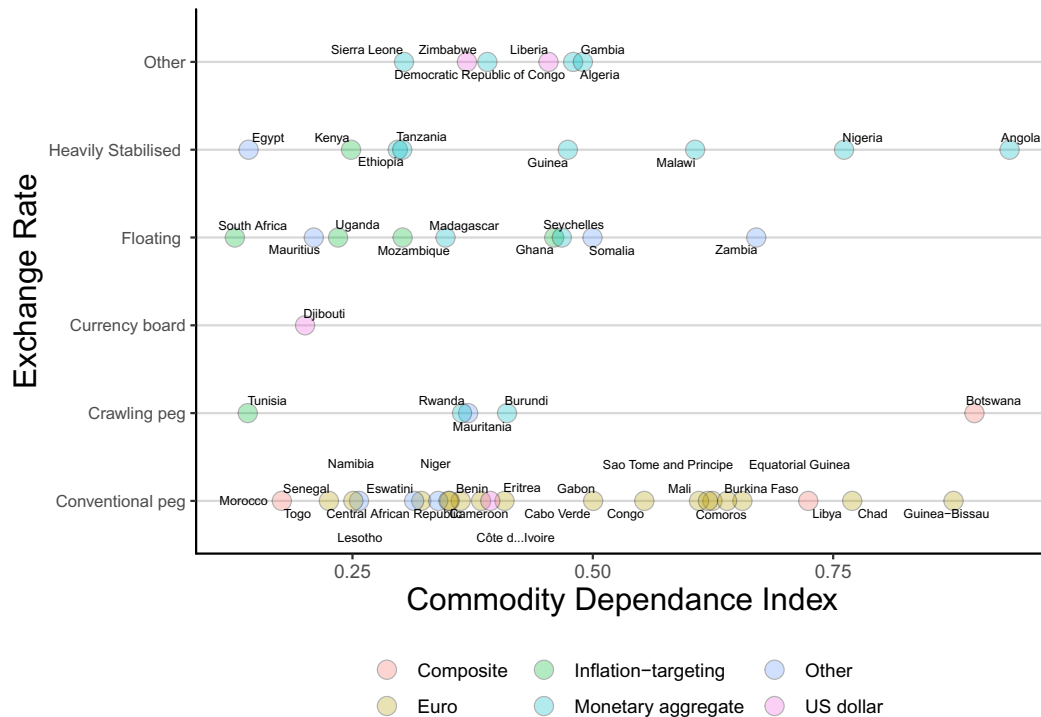
As visible in figure 10, pegged regimes have been highly resilient in Africa (IMF 2016), limiting monetary policy flexibility and thereby making countries more reliant on other policy mechanisms. Following the so-called “trilemma” (figure 11), countries can only choose two from among: (1) monetary policy independence; (2) exchange rate stability; and (3) external financial integration. An exchange rate peg entails selecting the second and third of these and thereby sacrificing monetary policy independence, thus placing greater reliance on other policy tools. For example, reserve accumulation management becomes a much bigger concern for central banks under fixed exchange rates, while interest rates and the domestic money supply are adjusted to maintain the value of the exchange rate peg.

For externally-integrated developing countries, flexible exchange rates do not always allow for monetary policy independence (namely the ability to set interest rates to target inflation or employment). Because they occupy subordinate positions in global currency hierarchies, in reality countries may be forced to move their interest rates in line with the global credit cycle and US interest rate movements (Edwards 2015). Under these conditions, independent monetary policies are possible only if the capital account is also managed, according to Rey (2015). This implies that achieving monetary policy independence under globalisation requires, in practice, the concurrent and active use of several policy tools.

²⁰ The criterion for a float is that the exchange rate is largely market-determined.

²¹ This includes countries with softer pegs such that, in practice, the exchange rate is “not largely market determined”. Six countries were considered to be “other” by the IMF either because not enough information was available on them or because they use multiple indicators when setting monetary policy. We do not distinguish between Crawl and Crawl-like. And we call a stabilized regime a “heavily stabilized” regime. Our categorization follows definitions by Kokenyne et al. (2009).

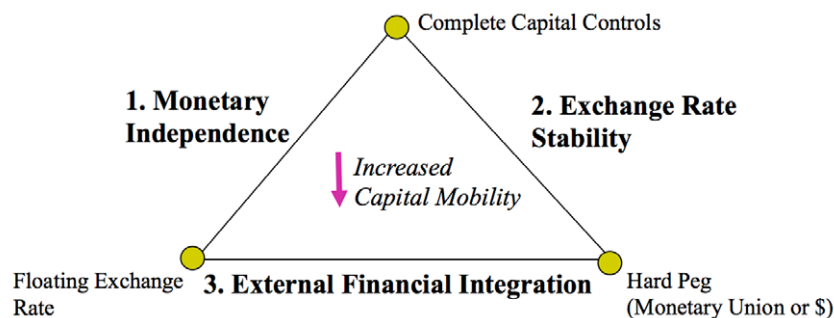
► **Figure 10:** Exchange rate and monetary regimes in Africa by degree of commodity dependence



Note: The colour of the bubbles corresponds to different monetary regimes: “Composite” is a mixed currency peg; “Monetary aggregate” means the monetary authority targets a growth rate for a monetary aggregate, which becomes the nominal anchor or target of monetary policy. Pegs tend to be more common among more commodity-dependent economies subject to strong cyclicity in financial flows. Floating tends to be used by more diversified producers. Tunisia, Kenya and Mozambique are listed here as “inflation-targeting” even though they have only made some steps in this direction. Commodity dependence is based on the UNCTAD (2019a) export concentration index.

Source: Authors based on classifications and data from World Bank (2019c) and International Monetary Fund (2019).

► **Figure 11:** The macroeconomic trilemma facing African economies



Note: African countries tend to favour reduced monetary policy independence (1), in exchange for access to foreign capital inflows in particular (3), and, in turn, exchange rate stability (2). This “trilemma” follows from the Mundell–Fleming model, which looks at the implications of fixed versus floating exchange rates for monetary policy and fiscal policy effectiveness (Mundell 2001).

More developed economies in Africa are more likely to adopt flexible exchange rates (South African Reserve Bank 2016; Van der Merwe 2004). An inflation-targeting regime is one example of a flexible exchange rate regime. Countries with flexible exchange rates have outperformed others in terms of GDP growth since 2000 (some speculation as to why is provided in IMF (2016)) but with higher levels of inflation. No one regime is associated with a preferred method of expanding employment opportunities and advancing structural transformation. This may be because some currency regimes are more appropriate than others given the level of development of the economy and its currency markets, as well as its production structure. For example, high commodity prices tend to be associated with strong capital inflows, leading to nominal appreciation of the exchange rates. This helps explain the various exchange rate regimes designed to “lean against” or entirely mitigate the resulting nominal currency appreciation. Furthermore, no central bank in Africa has an explicit dual price stability and full employment mandate as can sometimes be found in other parts of the world. For example, the dual price stability and maximum employment mandate of the United States Federal Reserve and the price stability and maximum sustainable employment mandate of the Reserve Bank of New Zealand. What is clear, as seen further below, is that the choice of regime and mandates strongly influences the role of other policies in advancing employment growth.

2.4 Employment growth and the balance of payments constraint

The balance of payments is also given particular prominence in our framework below (see figure 12). This is because in an open economy the two goals of current account balance (“external balance”) and full employment (“internal balance”) are inseparable. If attempting to achieve one comes at the cost of the other (which it often does), then the economy lands up failing in both as one disrupts the other (Caves et al. 2007). This is particularly important in many African economies. The fulfilment of domestic aggregate demand, an important determinant of employment, is, by definition, constrained by the supply of domestic goods available. Insufficient domestic production in the face of increased demand will lead to increased imports and a growing current account deficit.²² Therefore, employment growth using macroeconomic policies in an open economy requires that a balanced current account be targeted concurrently; and furthermore, under a fixed exchange rate, this may require the use of multiple instruments.

African economies find themselves suffering from problems with both internal and external balances –underemployment and excessive current account deficits. This occurs for a variety of reasons which policy needs to address:

- ▶ A lack of aggregate demand, due to insufficient spending. Constrained by policy choices, funding, external donors or policy requirements of loans.

²² See “balanced of payments” constrained growth models of Thirlwall (1979, 1997), Thirlwall and Hussain (1982) and the Cambridge Economic Policy Group of the 1970s and earlier (McGregor and Swales 1985).

- ▶ A high propensity to import owing to sectoral imbalances in production favouring a narrow focus on commodities for export rather than production, which can also be demanded domestically.
- ▶ Perceived high inflation rates limit the employment target considered desirable or attainable by authorities.
- ▶ A lack of aggregate supply which provides inputs and the right sort of inputs to ensure demand can be met domestically.
- ▶ Insufficiently targeted labour market policies supporting formal labour markets and human capabilities development by advancing inclusion and decent working conditions.

In other words, the challenge of mobilizing domestic resources to ensure sufficient aggregate demand to drive up resource utilization and employment is just one side of the challenge. The other side is ensuring this can be sustained through maintaining a balanced current account while the former is undertaken. The problem is that, if the government works to actively expand employment opportunities through expansionary fiscal policy, this could cause a country's current (trade) account balance to go into deficit, all else being equal. If instead the current account is to be kept in balance while fiscal policy remains expansionary, then it must be accompanied by a higher (namely a devalued) exchange rate so that the trade balance can be kept out of deficit.

This challenge is compounded in the context of fixed exchange rates, which (as shown above) is widespread in Africa. Fixed exchange rates provide little room for exchange rate adjustments to achieve external balance – that is, a current account deficit cannot be ameliorated through currency devaluation. This has made policymakers cautious of expansionary policies that attempt to increase employment domestically, as there is a risk that these lead to, or worsen, a current account deficit. However, a number of non-exchange rate methods can be used in conjunction with expansionary fiscal policy to ensure that employment growth is possible. We discuss these later.²³

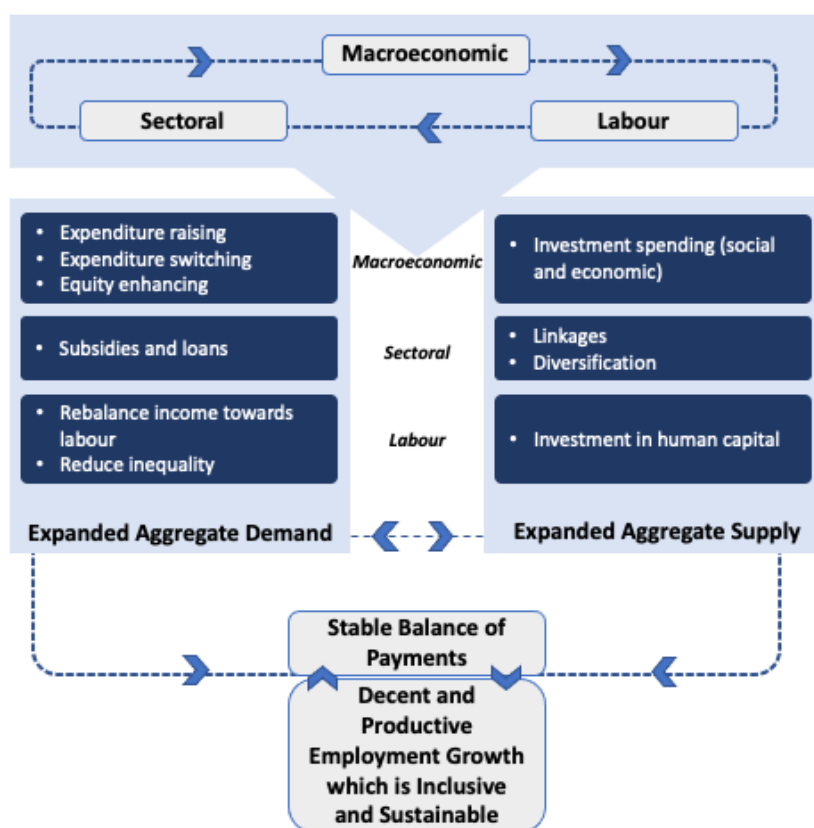
We should reiterate that, in the long-run, a sustainable current account can only be achieved through structural transformation that diversifies and expands domestic production in a manner that allows domestic supply to expand to absorb domestic demand, thereby reducing imports and supporting greater exports, and achieving a more positive terms of trade. This, once again, speaks to the crucial intersection of macroeconomic, sectoral and labour market policies.

²³ An additional complication is that the policy prescriptions differ depending where in Zone 3 the economy lies. If the economy is in the bottom left-hand side of the triangle, then the currency should be devalued and expenditure by government increased. But if the economy is in the bottom right-hand side of the triangle then expenditure by government should be cut and the currency still devalued. (In practice, the level of inflation is often used by government to help decide where the economy is. But, if an economy has an excessively low inflation tolerance, then even if the economy needs additional government spending to increase employment this may not be possible.)

3. An alternative framework

The policy framework for advancing productive employment in Africa proposed here is a simplified version of a more complex macroeconomic reality. Yet it encompasses the key linkages, constraints, instruments and targets necessary for a well-rounded macrosectoral policy employment programme for Africa. Proper employment generation in Africa requires all three sets of the following policies: (i) **macroeconomic policies**; (ii) **sectoral policies**; and (iii) **labour market policies**. As outlined in section 2, each has its own impact on employment conditions, operating through different causal chains and linkages. This is summarized in figure 12.

► **Figure 12:** Transformative macroeconomic framework for employment generation and structural transformation



Note: Showing the combined impact and channels of macroeconomic policies, sectoral policies and labour market policies. Each set of policies contributes to the aggregate employment outcome in different mutually reinforcing ways. In combination, they advance a transformative macroeconomic policy framework necessary for sustaining aggregate demand while transforming long-run supply capabilities of the economy. The latter is required to unlock the balance of payments constraint, without which domestic employment objectives will remain prematurely thwarted through inflationary pressures, debt and reserve balance pressures, and current account deficits.

3.1 Macroeconomic policies

Macroeconomic policies, primarily fiscal and monetary policies, work to target aggregate demand and aggregate supply. These seek to maximize the potentially positive relationships between economic growth and employment (“Okun’s Law”).

- ▶ **Aggregate demand** increases the level of employment through changing the level and composition of expenditures.
- ▶ Policies to increase aggregate demand for full employment (internal balance above) are called **expenditure-raising policies**; they target the level of expenditure, which in turn drives aggregate demand. Expenditure-raising policies might include:
 - Government spending (level).
 - Revenue mobilization.
 - Composition of government spending (consumption versus investment).
 - Spending which impacts the distribution of income.
 - Monetary policy measures to stimulate spending decisions.
 - Income policies, such as tax breaks or government transfers.
- ▶ Policies to improve the trade balance (external balance) are called **expenditure switching policies**; they target the type of expenditure by changing relative costs. This in turn drives the relative demand for exports over imports. Expenditure switching policies might include:
 - Exchange rate management.
 - Multiple and dual exchange rates.
 - Import and export taxes and quotas to discourage imports and encourage exports. These can be fairly targeted (focusing on particular products or sectors).
 - Capital controls and interest rate mechanisms to attract or repel capital flows (thereby impacting pressures on the exchange rate).²⁴
- ▶ **Aggregate supply measures** target employment growth through increasing the availability and quality of production and the factors used to engage in production. For example, by spending on health or education, human capabilities can be raised. Similarly, spending on physical infrastructure can create jobs directly but also increase productivity, which in turn can increase employment through economic expansion.
- ▶ **If done correctly, these demand- and supply-side policies positively reinforce each other.** For example, employing more healthcare professionals through increasing

²⁴ Capital controls and interest rates might be thought of as two additional tools, to exchange rate depreciation, which can be used to offset current account deficits through encouraging net capital inflows through the financial account. In general, the greater the degree of capital mobility that is permitted, the more capital inflows from abroad can be drawn on to offset current account deficits. However, excessive capital openness can also lead to a sudden stop then outflow of capital from the domestic economy, which can severely impair the ability of a country to run a sustainable balance of payments. The use of interest rates to achieve net financial inflows to fund any current account deficit is possible in theory: higher interest rates relative to the global risk adjusted return required by investors will lead to a net capital inflow. The problem with this is that the interest rate will in turn impact the domestic economy in other ways, which may be undesirable. Moreover, under fixed exchange rates, monetary policy instruments – and the interest rate – must be devoted to maintaining the nominal value of the exchange rate against the currency or basket of currencies to which it is pegged.

the expenditure level could improve aggregate supply through a healthier workforce. Similarly, infrastructure investment is critical to a growing economy. An expansion of supply (production) in the economy can in turn raise revenue and create greater fiscal space. This again indicates why targeting structural transformation – transforming the productive structure of the economy (supply) – should be an important goal of macroeconomic policy.

- ▶ **Macroeconomic policies target employment growth** in that they ensure employment growth can be sustained through ensuring proper macroeconomic management of imbalances that can arise as aggregate demand increases. These goals in an open economy are traditionally framed as the need to achieve both internal balance (such that production is at its capacity to achieve full employment and minimal inflation) and external balance (a balanced current account). If imbalances in these variables persist, or policies which aim to increase employment through increases in spending lead to these negative macroeconomic outcomes, over a sustained period, then employment growth cannot be sustained.
- ▶ **Macroeconomic policies are able to spur sustainable and inclusive employment growth** through ensuring that policies raise the level of government spending, support expenditure switching, expand supply capacity and target sectors of the economy that spur structural transformation and include marginalized groups.
- ▶ **Macroeconomic policies should be coherent with sectoral and labour market policies.** For example, if sectoral policies are aiming to extend credit to particular sectors or types of businesses, it would be counterproductive for monetary policy to be managed in a manner that contracted credit in the economy. Similarly, indiscriminate and undue austerity measures can undermine critical investment in human and physical capital.
- ▶ **Macroeconomic policies here target:**
 - Primary direct policy targets: level of aggregate demand, level of aggregate supply, composition of aggregate supply and composition of aggregate demand.
 - Employment outcome variables: The level of employment, the volatility of employment, the productivity of employment, rural-urban employment, labour participation rates and the type of employment.

3.2 Sectoral policies

Sectoral policies aim to achieve changes in the size and composition of different sectors in the economy. Understood progressively, they aim directly for a compositional shift in employment and output towards higher productivity sectors of the economy. They, therefore, both expand employment and diversify production into sectors which are more skilled and more productive, with higher domestic value added, as well as support demand in these sectors. They should include measures to improve the quality of jobs.

- ▶ **These policies create sustained employment growth** through policies which advance structural transformation in a targeted manner. They allow for employment to be sustained over time, even when commodity prices are low, by diversifying and upgrading production. These are not limited to “industrial” policies, narrowly defined, since they include all attempts to diversify production of goods and services across agriculture and the minerals sector, manufacturing, and services into higher productivity, higher value-added production.
- ▶ **Sectoral policies are needed to achieve sustained employment growth not reliant on commodity prices and the export of a few key commodities.** This can help reduce inequality and the capital- and resource-intensive nature of growth in Africa if done properly. Present market prices by themselves incentivize further domestic and foreign investment into Africa’s commodity sector. As a result, non-market forces are required to incentivize production into other branches of production with long-term benefits and positive economy-wide externalities that prices might not fully take into account. The absence of developed market forces in most African economies makes it even more important for the state to create markets, rather than simply support them.
- ▶ **Advancing domestic linkages and domestic inputs can be prioritized in all sectors, rather than just “industry” as traditionally considered.** This is especially important given the predominance of the agricultural sector for formal and informal employment in Africa and the potential for services to diversify sources of foreign exchange generation. Other important policy measures include the attraction and utilization of overseas skills, financing, productive capital, the geographic set-up of production, investment and R&D enhancing policies, and training and infrastructure policies which transform supply.
- ▶ **Sectoral policies aim to affect relative prices,** in order to reorient capital into branches of production where on the basis of present market prices the return on capital may be insufficient to warrant private investment. For example, it might not be most profitable to invest in a particular sector at the outset, but sustained and coordinated investment in that sector may nevertheless enable profitability and lead to significant long-term benefits.
- ▶ **Sectoral policies are equally crucial to promote environmental sustainability and a just transition towards carbon neutral economies.** Carbon footprints and environmental impacts of production are highly varied between different sectors. Hence, while macro rules to curb emissions and drive sustainable production and consumption patterns are crucial, sectoral policies are also central to any effort towards the promotion of green jobs and a just transition.
- ▶ **Sectoral policies are able to support inclusive and decent employment growth** through sectoral targeting and because higher productivity jobs are more skilled and better paying, often with better employment conditions.
- ▶ **Sectoral policies can also help to support a balanced macroeconomic environment.** For example, Africa’s low inflation tolerance, in response to internal and external shocks, is largely due to its insufficiently diversified and productive supply capacity. Similarly,

Africa's tendency to drift towards a current account deficit when commodity prices fall is the result of similar forces. Sectoral policies aimed at structural transformation help to lift these constraints, which act as suffocating breaks on employment generation in Africa whenever aggregate demand gets going.

► **Sectoral policies here target:**

- Primary direct policy targets: Composition, depth and linkages of aggregate supply. Composition refers to which industries exist ("horizontal linkages"); depth refers to the degree of domestic value added; and linkages refer to backward linkages into machinery inputs and forward linkages into consumer-facing production.
- Employment outcome variables: Productivity of labour, decent employment opportunities, formal sector employment, sustainable employment opportunities (namely those not reliant on high external commodity prices) and volatility of employment.

3.3 Labour market policies

Labour market policies are direct interventions to benefit workers and businesses or structure labour markets differently. They consist of both passive and active policies to replace income or promote better integration into the labour market. Passive labour market policies consist mainly of unemployment benefits, often combined with other cash transfers and enterprise support measures. Active labour market policies exist both on the demand side, for example, to preserve or support employment during the crisis and recovery or to provide incentives to create new jobs, and on the supply side, for example, to enhance workforce adaptability and provide incentives to seek and keep employment. Labour market intermediation measures help bridge the gap between supply and demand in the labour market by promoting more efficient and better-quality matching of jobseekers and vacancies (ILO 2020c).

- **These ensure that employment growth produces equitable access to employment opportunities.** Inclusive employment is when youth, women, rural populations and all those who want jobs or who have the least access to employment opportunities are provided with these. They directly target the labour market distribution, competitive dynamics and the technology of production. Labour market policies also seek to advance greater representation of workers, both in the informal and formal sectors. In this way, they work to enhance the policymaking process. This, along with their impact on technology and competition, works to impact the long-term trajectory of the economy.
- **Improve the economic and labour-related environment for informal economy workers while incentivising the formalization of informal economic activities and actors.**
- **Labour market policies – in combination with appropriate macroeconomic and sectoral policies – can contribute towards recalibrating otherwise dysfunctional growth paths.** Growth in Africa, and its fruits, only weakly impact domestic employment due to the structure of domestic labour markets. This relates to the sectoral composition

of output and exports especially but is not limited to it. It is also related more generally to the ability of the economy to absorb labour and advance a position where labour is able to benefit from and be integrated into the wider economy. Formal sector employment remains highly capital-intensive (particularly given the bias towards commodity sectors), youth and women are often excluded from key labour markets, aggregate demand is highly unevenly distributed, and domestic labour markets tend to be unable to capture some of the gains from domestic and foreign production.²⁵

- ▶ **Similarly, labour market policies can also play a support role in achieving a balanced macroeconomic environment.** These can provide a measure of robustness to the economic cycle by helping to create a deeper pool of domestic consumption and improved human capabilities and human capital. This helps insulate the economy from commodity price shocks, drops in exports and loss of wage competitiveness from currency appreciation or low-wage competition from abroad. They therefore have secondary macroeconomic effects on the level of aggregate demand and supply by potentially changing the level and composition of incomes, costs, expenditures, and the techniques and technologies used in production. As a result, they are important to any macroeconomic framework which looks to achieve specific employment targets and structural transformation.
- ▶ Such policies could include active labour market programmes, minimum wages, inequality-reducing fiscal measures, targeting employment-intensive sectors, promoting spending with employment-intensive and labour-intensive multipliers, and expanding government investments in infrastructure and human capital.
- ▶ **Labour market policies here target:**
 - Primary direct policy targets: direct labour market interventions that place quantity or price restrictions and measures which advance employment outcomes in all other policy areas.
 - Employment outcome variables: Decent employment, inclusive employment, the level of employment and sustainable employment.

3.4 An integrated employment policy framework: The intersections between macroeconomic, sectoral and labour market policies

Macroeconomic, sectoral and labour market policies should be mutually reinforcing as highlighted by the ILO's integrated employment policy framework. The policies proposed here lie at the intersection between two or more of these different instruments, with macroeconomic policies traditionally operating through aggregate demand but also changing the level and composition of aggregate supply; sectoral policies aiming at transforming the composition of aggregate supply through diversification, linkages and local capacity development; and labour market policies focused on transforming the labour market directly and ensuring employment objectives are paramount when other instruments

²⁵ The Prebisch–Singer hypothesis of commodity terms of trade famously also operates through the different bargaining power of labour in developed compared to developing economies.

are used. Integration of these objectives is also helped through certain institutional policies and changes which we discuss.

This requires integration between short-term and long-term strategies. For example, achieving greater employment today requires greater spending. But expanding the size of Africa's integrated labour markets, and its capacity to produce items domestically instead of importing them from abroad, requires a focus on aggregate supply and sectoral policies.

In the African context, open-economy objectives must be integrated across policy spheres. For example, the exchange rate is a country's key relative price in an open economy. As a relative price it impacts both the level of expenditure and the direction of expenditure (between local and foreign goods and services). In doing so, it can play a key role in determining the sustainability of a country's balance of payments. If managed in conjunction with appropriate sectoral policies, it can help relax the constraint. As a relative price, it reflects the underlying productive potential of the local economy compared to the foreign economy, and it impacts the relative balance of exports and imports. As such, it lies at the intersection between macroeconomic management of the balance of payments and industrial policy, which aims ultimately to relax the balance of payments constraint.

Successful management of the macroeconomy is key. This is especially difficult given that objectives might work against one another, instruments might work against one another and the fact that multiple objectives are desired. Given the multiple prices and constraints in a macroeconomy, using multiple tools becomes essential. This means that coordination across economic policymaking is indispensable.

Together these three sets of policies are required for creating a "transformative" macroeconomic policy framework. Such a framework must utilize a sufficient range of policies to achieve a variety of important employment targets, external macroeconomic balance (namely current account sustainability), moderate domestic inflation and financial stability, and structural transformation of the economy towards higher productivity, higher value added and domestic production. Macroeconomic policies which advance growth or price stability are helpful but by themselves insufficient to achieve this broad range of macroeconomic outcomes. As noted before, the transmission channels to achieving decent and productive employment growth which is inclusive and sustainable is not simply through more economic growth. Multiple policy tools, each operating through different (though potentially overlapping) transmission channels, are required.

4. Policy approaches

We focus on seven spheres of policy intervention to establish the transformative macroeconomic framework we have discussed. This paper cannot provide an exhaustive list of such policy options. Instead, those offered are illustrative of the most important policies, policies with a proven track record of success, with the most direct channels of transmission, or are those most illustrative of how policy can be constructed and implemented. They are also policies which highlight the integration of sectoral and labour market policies within macroeconomic policies, institutions and processes. They are:

1. Government expenditure to increase aggregate demand while advancing supply capacity.
2. Expenditure switching methods: rebalancing expenditure.
3. Diverse inflation policy and raising Africa's inflation tolerance.
4. Revenue mobilisation through taxation.
5. Production linkages.
6. Minimum wage policies to support and advance sectoral and macroeconomic policies.
7. Employment-intensive public investment programmes.

Following this, in section 5, we discuss facets of policymaking processes and institutions.

4.1 Government expenditure to increase aggregate demand while advancing supply capacity

When speaking about expenditure-raising policies, it is important that we view these in an integrated manner. First, we should appreciate the complementarities between public consumption and investment expenditure, the former generally understood as referring to spending on government goods and services, via either salary costs (teachers, nurses, civil servants and so on) or the purchase of goods (medicine supplies, textbooks and so on). Second, we should acknowledge the integration between raising demand in the short term and transforming supply capacity in the long term (achieving structural transformation). Third, we should appreciate that public sector spending most often “crowds in” private sector spending. Some important policy approaches include:

- I. **Investment expenditure supports decent and productive employment growth which is inclusive and sustainable.** Investment spending – for example, on roads, broadband and electricity – is unique, since it concurrently advances demand and supply (both the type and capacity). It is able to stimulate demand for domestic inputs (provided they exist) and to expand the capacity of the economy to produce in the future. Such spending should include projects that are inclusive and allow for the economy to absorb and enhance labour's productive capabilities; projects which facilitate diversification of supply and linkage development across sectors and markets (including rural and urban labour markets); and policies which raise supply capacity.

- II. **Governments should target a certain level of private and public investment expenditure, relative to GDP and government revenue.** This is commonly done in development planning in Asia and Latin America. A baseline target tends to be devoting around 10 per cent of GDP to productive public investment spending which works to achieve sectoral, macroeconomic and labour targets. Currently the Africa-wide average is estimated at 7 per cent by the IMF and 11 per cent by the AfDB (see figure 6 above). Specific projects have been targeted with accompanying funding mobilisation from a combination of banks, pension funds and private investment funds, and international investors. For Rwanda, the Government's strategic investment plan aimed to alleviate critical infrastructure constraints, consistent with the objectives of the Government's Economic Development and Poverty Reduction Strategy. It did so despite the considerable dependence on foreign aid, while domestic revenues stood at only 12.5 per cent of GDP (Akitoby et al. 2019).
- III. **Particular attention is needed to raise African countries' capital stock and improve the efficiency of public investment spending.** Although African public investment spending (as a percentage of GDP) is in line with emerging and developing Asia and Latin America and the Caribbean, public capital stock per capita is well below them (reflecting a historical deficit) and the efficiency of public investment spending is poor (Barhoumi et al. 2018). Certain forms of public investment, particularly in infrastructure, also tend to be skewed towards supporting commodity production.

Textbox 2: Investment regimes

Ethiopia is often seen as a public-led investment model. This has helped to crowd in the private sector (Cheru, Cramer and Oqubay 2019). In Ethiopia, public investment rates are in excess of 10 per cent of GDP and private investment in excess of 30 per cent of GDP. It is one of the few countries in Africa to have used public investment to diversify production and crowd in private investment. Public investment increased from 5 per cent of GDP to as high as 19 per cent of GDP between 1991 and 2018. Mauritania, Algeria and Congo have seen high rates of public investment leading to higher rates of private investment, but this has not diversified sectoral capabilities and has instead reinforced existing patterns. Countries such as Rwanda, Comoros and Lesotho have not yet seen public investment galvanize private investment. Ethiopia's success has been aided through drawing explicitly on foreign capital, especially Chinese, to help fund and rapidly advance infrastructure projects (Hauge 2019). Relying solely on domestic resource mobilization would not have allowed it to achieve its targets. This also allowed Ethiopia to keep fiscal deficits low. Moreover, its policies have directed the investment into priority sectors in accordance with longer-term national planning goals and targets (Chang, Hauge and Irfan 2016). A lot of the infrastructure investment has been linked directly or indirectly to diverse export-oriented private production, increasing profitability and productivity-enhancing affects.

- IV. **Target investments in the care economy sectors.** The care economy sectors – education, health and social work – are particularly important social sectors. These serve to advance human capital development which has long-term benefits on both the supply and demand sides of the economy. They also have significant direct employment potential.²⁶ Employment in these social sectors is also more inclusive with a larger percentage of women workers, higher wages and greater equity (De Henau et al. 2017). Expanding service provision in these sectors has significant long-term benefits to human capital development. Investment in the care economy is a strategic policy intervention to enhance women’s economic empowerment through employment generation in care sectors and beyond them (generated in other sectors through backward linkages of sectoral spending, resulting in total employment creation) (ILO 2018b).

Textbox 3: Social spending in African countries

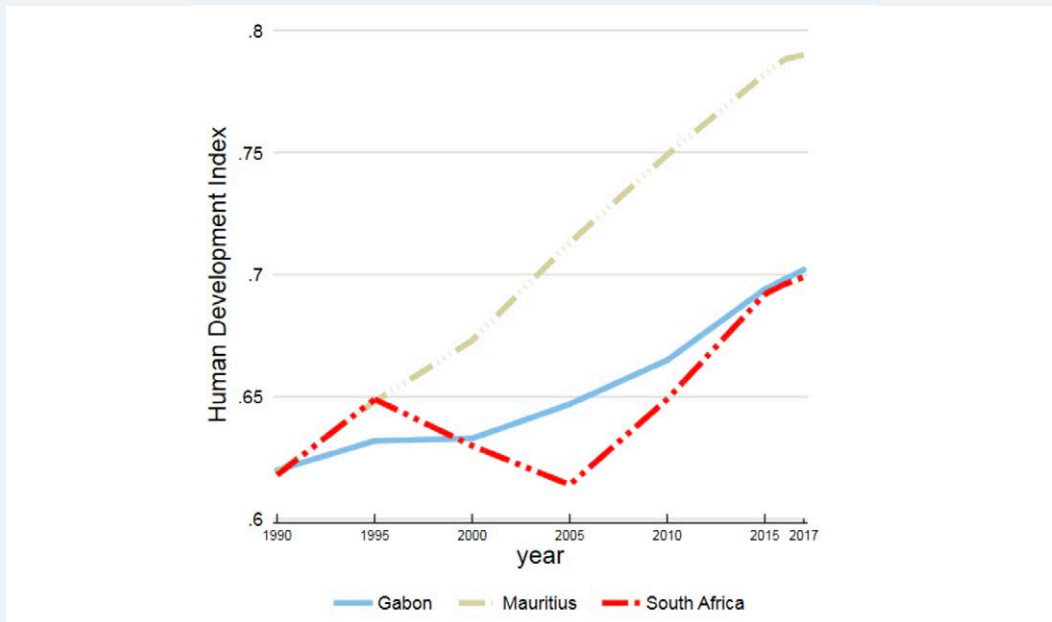
Government expenditure in Africa has shifted significantly into social sectors (health, education, housing, social welfare and so on) since the debt forgiveness programmes of the 2000s. For the 36 countries receiving this debt relief – 30 of which were African – debt service payments declined by about 1.8 percentage points of GDP between 2001 and 2014. According to the IMF, before the HIPC Initiative, eligible countries were, on average, spending slightly more on debt service than on health and education combined. Such social spending is now about five times more than debt service payments.

As a result, life expectancy has increased across Africa from 20 per cent to 45 per cent between 2000 and 2017. A recent World Bank analysis of Ethiopia found that Ethiopia’s investment in health, education and social protection has contributed to overall economic growth and poverty reduction (World Bank 2016). Mauritius is notable for making strong gains in living standards. This coincides with Mauritius being a more diversified producer with a stronger services sector, tourism and some manufacturing. The Mauritius government provides free universal health care, free education up to tertiary level and free public transport for students, senior citizens and the disabled. All this works to raise Mauritius’ level of productivity and in turn its ability to sustain GDP growth, which have averaged more than 5 per cent annually for almost 30 years. Its current growth rates are around 4 per cent. Poverty is still a notable feature of Mauritius though.



²⁶ Investment in the health and care sectors has been shown to have as good, if not better, employment multipliers to investing in construction. In a study of seven emerging markets (Brazil, Costa Rica, China (People’s Republic), India, Indonesia and South Africa) it was found that a 2 per cent of GDP investment in the health and care sector would generate increases in overall employment ranging from 1.2 per cent to 3.2 per cent, depending on the country. This compared favourably to the construction sector, with a similar level of investment resulting in overall employment gains of between 1.3 per cent and 2.6 per cent depending on country variables (De Henau et al. 2017).

► **Figure 13:** HDI in three African economies 1990–2017



Note: Gabon and Mauritius are two of the richest countries in Africa in per capita terms, while South Africa has the largest economy in Africa.

Source: UNDP (2019).

- V. **Investments will maximize employment and economic gains through sectoral prioritisation.**
 - **Prioritising employment-intensive sectors that enhance productivity gains** is important, and can have high employment multipliers as well as long-term economic gains. Investment decisions should also consider the impact on technology, human capital accumulation, infrastructure and capacity building (Armah & Baek, 2019).
 - **Prioritising sectors with a high share of domestic inputs or which earn export revenue** will be beneficial to lift balance of payments constraints.
- VI. **Although it should not eclipse long-term investment spending, consumption expenditure also has an important role to play in ensuring balanced and inclusive employment growth.**
 - **Public sector employment stimulates aggregate demand, is more secure employment and often includes a high number of women workers.** Such employment should prioritize front-line service delivery. Public procurement can also play an important role.
 - **Social security transfers have the potential to stimulate and stabilize aggregate demand and support human capital development.**
- VII. **Automatic stabilizers can maintain macroeconomic balances in order to support employment growth.** Automatic fiscal stabilizers are expenditure or tax policies that

kick in at a certain (recessionary) point in the business cycle (Lee and Sheiner 2019) or when a condition is met (such as a person receiving unemployment insurance). This recessionary point could be after the economy undergoes two quarters of negative (real) GDP growth or when the employment-to-working-age-population ratio declines by a certain proportion. Recent research shows the importance of automatic stabilizers, such as unemployment insurance, in advanced economies (McKay and Reis 2016a). More work is required to better understand their use in the developing economy context, although some examples exist (see Debrun and Kapoor 2010; Fatás and Mihov 2001). In the advanced economy context, automatic fiscal stabilizers have shown to be very effective in limiting the depth of recessions when monetary policy is restricted by the lower bound on interest rates (McKay and Reis 2016b). These studies also conclude that welfare payments are more successful than tax adjustments in stabilizing demand by boosting the disposable income of the poorest households. This could be beneficial in the African context where the tax system is less developed, and where monetary policy is limited by either global monetary conditions or by the need to maintain a (fixed) exchange rate anchor for monetary policy. Automatic stabilizers are helpful in avoiding irrational fiscal rules imposed externally or internally. The IMF and domestic policymakers often avoid raising budget deficits during a recession to stabilize demand, even when this can be funded at low costs through debt issuances, if the country's public debt to GDP is regarded as high (C. D. Romer and Romer 2018; 2019).

Examples of potential fiscal stabilizers:

- During a recession, social income payments could be made automatically to low-income households or existing income transfers increased. This has been suggested for advanced economies by several prominent economists in a recent book (Boushey, Nunn and Shambaugh 2019).
- Public employment schemes.
- When inflation reaches above a certain level, fiscal policy could engage in revenue switching through tariff and quota policies or engage in a one-off tax or limit capital inflows, depending on the cause of the inflation boom.
- Unemployment insurance (UI) can serve as an automatic stabilizer to mitigate the economy's sensitivity to shocks (Maggio and Kermani 2016). Unemployment insurance and wage support, albeit not automatic, have been widely used in response to the COVID-19 pandemic together with cash transfers to households and vulnerable groups.

Expenditure choices should also consider their distributional impact. Increasingly it is recognized that issues of growth and distribution (inequality) should not be separated when approaching the macroeconomy. Research led by the IMF (Dabla-Norris et al. 2015) finds a strong link between growth and distribution, drawing on a growing body of evidence on why inequality might be harmful for an economy (Aghion et al. 1999; Galor and Moav 2004; Bourguignon and Dessus 2009; Acemoglu 2011; Ostry and Berg 2011; Ostry et al. 2014). Expenditure should therefore also be targeted in a manner that is inequality reducing.

This will be context specific but reinforces the approach taken here – that labour-intensive sectors, which can absorb more marginalized groups and are able to lead to progressively increasing wages, should be targeted.

4.2 Expenditure switching methods: Rebalancing expenditure

Expenditure switching policies advance employment growth through supporting domestic production over imports. Expenditure switching works to support a healthy current account balance. In so doing, it creates room for policies to increase employment through other policy measures. Expenditure switching methods can impact the composition of employment if they impact the composition of aggregate supply or increase domestic demand. In doing this, labour may shift to the tradable sector. This can help facilitate better paying, more productive employment.

Expenditure switching is the reallocation of expenditure from imported items to domestic through the changing of relative costs. The key mechanism is adjustments in the exchange rate, which reflects the relative cost (and ultimately productivity) differential between imported and domestic goods and services. This is a key macroeconomic policy tool, though it has considerable overlap with the so-called “industrial policy” tools. This is because industrial policy is partially concerned with relieving the constraint imposed by the current account on countries’ ability to use government policies to stimulate demand (and supply).

The primary means through which expenditure switching occurs in upper-middle-income countries and above is through exchange rate management: a currency devaluation switches expenditure to domestic production and exports as imports become relatively more expensive. This helps balance the current account, which reflects the balance of trade (along with investment income from portfolio and direct investment). A currency appreciation does the opposite, making imports cheaper relative to domestic production.

Expenditure switching via exchange rates is difficult to achieve in Africa since exchange rates are fixed in the majority of countries, making regular active exchange rate management difficult to compensate for any unsustainable current account deficit; this makes the use of other expenditure switching tools even more important in the African context, including direct sectoral policies.²⁷ These “non-traditional mechanisms” redirect expenditure through price adjustments or quantity adjustments (examples below).

²⁷ Moreover, African’s exchange rates are subject to strong volatility owing to the volatility and procyclicality of commodity prices and the resulting financial flows. This results in Dutch disease type effects whereby nominal exchange rate appreciation occurs for countries with floating regimes, as capital flows are sucked into the economy (frequently into the enclave commodity sector) further switching expenditure to imports and making non-commodity exports less competitive. If this aggravates domestic inflation (relative to the foreign country) then this will still appreciate the domestic currency for a fixed (pegged) exchange rate value against the foreign economy. This also highlights the important and irreparable links between macroeconomic management (expenditure switching and inflation) and sectoral policies which change the character of domestic supply away from dependence on commodity exports and the importation of finished manufactured consumer and machine goods.

These only make sense to the extent that substitute goods can be attained domestically or regionally. If not, then such non-traditional mechanisms risk simply pushing up the price level, bloating the import bill and reducing real incomes. As such, expenditure switching policies ideally need to fit within a wider, long-term orientated policy regime.

As price adjustments:

- I. **Two-tier exchange rates.** Two-tier exchange rates have been used but are difficult to administer because it requires elaborate controls and opens up the possibility for large arbitrage opportunities at a substantial cost to government (Caves et al. 2007).
- II. **Multiple exchange rates.** Multiple exchange rates are another option. For example, the government could charge a higher price for foreign exchange when it is used to purchase luxury consumer goods which suck in imports, compared with when it is used to purchase essentials or capital goods imports, such as fuel and spare parts.
- III. **Taxes/tariffs on imports and exports.** These can work to pool limited foreign exchange and help redirect this to reinvestment in capital goods. This was undertaken historically by South Africa. Modern global production methods make the need for judicious and limited tariff policies important since imports are required to facilitate exports and reduce the costs facing firms.
- IV. **Export-facing incentives, including targeting specific sectors.** The above policies can be combined with export-facing incentives which increase the relative price (return) to exports. Enhanced export-facing infrastructure is one way to do so.

And as quantity restrictions:

- V. **Targeted import quotas.** Quotas are a common mechanism restricting the quantity of an item from entering an economy. Import quotas work to limit imports and can help switch expenditures to domestic supply. But this requires effort to concurrently support domestic supply capacity. Quotas and import restrictions generally have the effect of increasing prices for producers and consumers and so should be used judiciously.
- VI. **Capital controls.** By impacting the relative demand for domestic currency, capital controls can be used to arrest exchange rate appreciation. These include:
 - Straightforward taxes or withholding taxes on transactions, foreign borrowing and foreign investment in local bonds (for example, Brazil in 2009 to 2012 and Thailand in 2010).
 - Residency requirements that require that capital remain in the country for a stipulated period.
 - Unremunerated reserve requirements (URR) on investments or a minimum holding period and higher reserve requirements for foreign currency liabilities (for example, Chile in 1991 to 1998 and Peru recently). These would take the form of a compulsory non-interest-bearing deposit in foreign currency to be lodged with the central bank for a set period (such as one year) in an amount proportional to the size of the inflow.

Capital controls are primarily used for short-term interventions to stabilize exchange rates. They work best in the medium to long term if they are used as an opportunity to tackle underlying macroeconomic imbalances, for example, by directing credit towards productive investment. Historically, capital control measures were more effective for developing economies when imposed as a tax (on in or outflows) rather than as a restriction (on the volume or type of flow). Moreover, tax revenues raised can be helpful in offsetting some of the costs. Capital controls should be used in a targeted manner since they can raise the cost of borrowing for governments and firms (Andreasen, Schindler and Valenzuela 2019).

Textbox 4: Capital controls and exchange rates in Brazil

Between 2009 and 2012, Brazil implemented a number of capital controls including a tax on portfolio equity and fixed income flows, unremunerated reserve requirements, taxes on external debt and taxes on derivatives. These were successful at changing the composition of flows (for example, less carry trade and more direct foreign investment) although with more mixed results on the volume of total capital inflows. This meant they were successful in avoiding excessive debt and asset price bubbles (Garcia 2013), but it did not translate into significant changes in the exchange rate. However, the exchange rate strongly depreciated after a tax on the notional amount of derivatives was adopted in mid-2011. That strong response may have been driven by complementarities with the previous measures (Charmon and Garcia 2014) and indicates the importance of tailoring the forms of capital controls to the local context.

VII. Maintaining a competitive fixed exchange rate. A common issue with fixed exchange rate regimes is appreciation as domestic inflation exceeds inflation of the target currency or basket (IMF 2016). Botswana is an instructive study (textbox 5) on how to avoid appreciation through adjusting its currency. It is of particular interest given that inflation in Botswana has remained relatively contained since 1998 (at less than 10 per cent) despite being heavily commodity dependent on diamond exports. Currency revaluation may be needed due to terms of trade shocks too – for example, see Gabon historically (Zafar 2004). Expenditure switching policies (discussed above) tend to need to be used in conjunction with real crawling devaluations in order to limit any increase in pass-through inflation which may follow (see textbox 6). Textbox 6 also discusses the role of sterilization in maintaining a competitive exchange rate.

Textbox 5: Botswana's crawling peg

In Botswana's case, the manner in which the exchange rate "crawls" is determined using a forward-looking approach and is revised on a regular basis. In this forward-looking scheme, the authorities periodically determine the rate of crawl for the subsequent period, such as the next six or twelve months. A crawling band exchange rate mechanism was introduced in Botswana at the time of its second devaluation in May 2005 with the objective of enabling an automatic nominal adjustment of the Pula exchange rate, with a view to maintaining real effective exchange rate stability and avoiding the need for sizeable discrete adjustments as had been the case in the past. Once a crawling peg/band system is in place, discrete devaluations and revaluations should be avoided as they undermine the credibility of the crawling peg/band mechanism and are also a reflection of policy failures in other areas. Maintaining a credible crawling peg/band mechanism imposes certain constraints on other economic policies, such as monetary and fiscal policies, where these policies have to complement the exchange rate policy, failing which it would be difficult to sustain the crawling peg/band mechanism regime and might, therefore, call for the reintroduction of discrete adjustments.

The crawling band exchange rate regime is implemented through the Botswana Central Bank's continuous adjustment of the trade-weighted NEER of the Pula at a rate of crawl based on the differential between the Bank's inflation objective and the forecast inflation of trading partner countries. The rate of crawl is, therefore, determined using a forward-looking approach and is revised on a regular basis. In this forward-looking scheme, the authorities periodically determine the rate of crawl for the subsequent period, such as the next six or twelve months. Since the introduction of the crawl, Botswana's inflation objective has generally been higher than the average inflation of its trading partners and this has necessitated a downward crawl. However, if inflation differentials were to be reversed such that the domestic inflation objective fell below expected inflation in trading partner countries, then an upward crawl could be introduced.

Source: Bank of Botswana (2019).

Textbox 6: Sterilization policies

Sterilizations are another important tool needed to maintain a competitive exchange rate.²⁸ A central bank can intervene in the foreign exchange markets to prevent currency appreciation by selling its own currency for foreign currency-denominated assets. This also leads to a build-up of its foreign reserves. However, because the central bank is creating, or at least releasing, more of its currency into circulation, this will expand the money supply – money spent buying foreign assets initially goes to other countries but then soon finds its way back into the domestic economy as payment for exports. The expansion of the money supply can cause inflation, which can erode export competitiveness just as much as the initial currency appreciation.²⁹

The open market operation of selling bonds is usually used to sterilize (in this case “soak up” the extra cash) the inflationary effect of the extra money flowing into the domestic base. A variety of other measures can also be used.³⁰

A central bank normally makes a loss from its overall sterilization operations though, as the interest it earns from buying foreign assets to prevent appreciation is usually less than what it pays on domestic bonds issued to absorb the excess liquidity.³¹ Losses on such interventions have increased post the global financial crisis. This has led leading countries to use other measures, such as raising of reserve requirements for large banks.³² But for African economies with thin bond markets, authorities may instead need to rely on non-market instruments. These include:

- ▶ Transferring the deposits of government and public financial institutions from the commercial banking system to the central bank or selling foreign exchange reserves to the government (perhaps to allow it to reduce external sovereign debt) (Aizenman 2009).
- ▶ Forced bond sales at fixed (low) interest rates, mandatory lending by commercial banks to the central bank and raising reserve requirement ratios. This last method is now widely used in emerging markets (Lavigne 2008).



²⁸ For evidence on practice in Asia and Latin America see Aizenman and Glick (2009).

²⁹ In contrast to interventions against currency depreciation, there is no inherent limit on interventions aimed at preventing appreciation. If a central bank runs out of domestic currency to buy foreign reserves, it can always print more.

³⁰ Central banks may offset the effects of reserve accumulation on the monetary base in a number of ways, including selling market instruments, such as government bonds or central bank bills, or by using swaps or repurchase operations. With foreign exchange swaps, the central bank typically agrees to buy foreign exchange forward, while with repurchase operations (“repos”) the central bank sells securities with an agreement to buy them back in the future.

³¹ See, Online: <https://www.ft.com/content/19f52ea0-ca7b-11df-a860-00144feab49a>.

³² See, Online: http://www.chinadaily.com.cn/china/2011-04/18/content_12340753.htm.

Classical sterilization policies may not be possible for many smaller countries with undeveloped bond markets. Less conventional measures vary from wider-band exchange rate policies and forward exchange market intervention to capital controls, such as variable deposit requirements and interest equalisation taxes on foreign borrowings. Often, countries have turned to a so-called “belt and braces” strategy, which combines the indirect instruments of monetary policy with some capital controls (Lee 1997).

The composition of the balance of payments flows may be relevant to sterilization policy. FDI flows tend to be sterilized less in emerging markets than current account surpluses (Aizenman and Glick 2009). Sterilizing capital inflows remains vital to ensuring African economies can benefit from overseas financing without having to depress domestic demand and employment through simply raising interest rates or cutting government spending.

Sterilization policy has limits though, particularly if the undermining cause of the imbalance requiring sterilization is not resolved. As a result, it is a short-term policy which requires dealing with the underlying balance in trade, currency levels or financial flows through combinations of targeted import quotas, wider currency bands or lower targets, and capital controls. Moreover, in practice, policy is often limited by an inadequate supply of marketable instruments or by thin and segmented local market conditions.³³

4.3 Diverse inflation policies and raising Africa’s inflation tolerance

Diverse inflation policies help better achieve macroeconomic balance that sustains employment growth. Inflation frequently interferes with sustainable macroeconomic balances in Africa. Given a lack of deep and diversified supply capacity, increases in spending – say through more supportive and expansionary fiscal policy measures – could lead to increasing rates of inflation. This could place a limit on the ability of the economy to sustain higher levels of economic growth and in turn high rates of employment growth.

Rather than adopting a uniform response to all instances of inflation, inflation policies must address the source of the inflation and target this as best as possible. The source of inflation may be: (i) External or internal; (ii) Demand or supply; and (iii) Transitory, cyclical or permanent. It makes little sense to use a single instrument (such as the interest rate or the tax rate) to target all these different inflationary sources. The first step in monetary policy formation to combat inflation, therefore, requires a diagnosis of the primary sources of inflation, usually some combination of (i), (iii) and (iii).

³³ See, Online: <https://www.imf.org/external/pubs/ft/issues7/index.htm>.

Appropriate inflation policies also involve using more than a single instrument to target inflation. If this is not done, say through simply doubling the benchmark interest rate to try to tackle inflation, then inflation may be reduced but at the cost of impacting other parts of the economy, such as production, employment and income growth. As noted earlier, the dual mandates of some central banks encompassing price stability and employment allows monetary policy to manage trade-offs between the two, prioritizing one element over the other depending on economic circumstances. Similarly, if monetary policymakers, concerned about an appreciation of their currency, respond with lower interest rates they risk an unwanted housing boom.

If the source of inflation is external:

- I. **Capital controls.** Judicious capital controls are vital for developing economies to control inflation if the source of inflation is the influx of foreign capital. The underlying cause of the influx might be higher commodity prices, high interest rates, a lack of regulation in the real estate or another booming sector, or global liquidity conditions (such as quantitative easing). Capital controls, while most often used in a limited and targeted manner, have the benefit of not reducing domestic expenditures and employment as other inflation-reducing measures might (Cordero and Montecino 2010). The same types of capital controls listed above regarding exchange rate management can be used, including taxes, residency requirements and unremunerated reserve requirements.
- II. **Macroprudential measures.** Macroprudential measures can also limit inflation caused by capital inflows (external demand). Prudential domestic financial regulations refer to policies that shape the ability and terms under which domestic financial institutions can provide capital to certain types of projects. These change the allocation of credit in the economy. Theoretical models show that when authorities are constrained by an exchange rate peg, macroprudential policy should be used “aggressively” as part of an optimal policy framework (Devereux and Yu 2018). For example, changing the maximum loan-to-value (LTV) ratio has a similar impact to a 25 basis point increase in the policy rate on output and substantial effects on credit and house price growth (ECB 2018; Kohn 2018; Richter et al, 2018). A 2019 study by the Bank of International Settlements argues that macroprudential policies are complementary to other policies for tackling inflation (Agénor and Silva 2019). These measures include:
 - Caps on loans (via loan-to-value ratios, loan loss provisions and debt-to-income ratios).
 - Restrictions on lending for real estate or speculative purposes.
 - Restricting foreign access to the domestic currency.

If the source of the inflation is internal:

- III. **Taxes and charges.** Internal pressures due to high aggregate demand can be met by higher taxes and one-off charges. This demand can then be reallocated by the state to expenditures which are not inflation enhancing but ultimately inflation reducing by expanding and diversifying supply capacity.

IV. **Price controls and food management.** Food price shocks are a common cause of inflationary pressures. Food price management must be taken into account in most monetary frameworks in Africa given the large weight it accounts for in the CPI. This also means that stripping out food prices from core inflation measures may be a bad idea. Better management of domestic and imported food production through transport and storage upgrades, lower tariffs, and greater regional integration and regional management of grain storage, are all important measures to advance; direct provision of basic foodstuffs has been used in Asia and Latin America. Land use policies play a role in this too, such that a balance is sought between production for domestic supply and production for exports.

Transitory inflation shocks, for example a one-off release of pent-up demand due to COVID-19 lockdowns, should not be responded to as they are unlikely to permanently impact price levels and inflation expectations.

Reducing the likelihood of inflation is also vital in order to provide governments with more room to utilize macroeconomic policy tools to stimulate growth and employment.

This is primarily achieved through diversifying supply. If the source of inflation is high domestic demand with insufficient domestic supply, then measures to diversify sourcing locations of inputs are critical. Increasing the inflation tolerance of the economy therefore has clear overlaps with sectoral policy which looks to upgrade and diversify supply capacity.

Inflation targeting, achieved predominately via the manipulation of short-term interest rates, is not an advisable policy approach. This is because inflation targeting regimes often adopt overly narrow approaches to containing inflation using instruments that have a contractionary impact, while often setting arbitrarily low inflation targets.³⁴

For countries with flexible exchange rates and inflation targeting regimes dual mandates to target both employment and inflation are sensible, and ultimately require use of multiple tools if both objectives are to be achieved.

³⁴ Research shows inflation targeting has had at best been a mixed success in developing economies (Samarina, Terpstra and De Haan 2014). The IMF (2016) found that: “Consistent with the monetary discipline and policy credibility that pegs provide, sub-Saharan African countries with pegged regimes have had lower inflation than their peers with floats or intermediate regimes. The lower-inflation benefit associated with exchange rate pegs has been greatest for the countries where the central bank *de jure* commits to and *de facto* maintains parity against an anchor currency.” In the case of South Africa, inflation targeting has led to a potentially unnecessary cost of domestic employment growth with no proven inflation reduction benefits (Kantor and Kavli 2011; Pollin, Epstein, Heintz and Ndikumana 2009). In the case of Uganda, even worse outcomes seem apparent, partially due to the inability of monetary policy transmission channels to operate as effectively there, given the constrained level of financial development (Waeyenberge, Bargawi et al. 2018). For opposing developing country econometric evidence see Gonçalves and Salles (2008). And for a recent detailed developing economy assessment released through the Bank for International Settlements see Agénor and da Silva (2019).

4.4 Revenue mobilisation through taxation

Appropriate revenue mobilization has the ability to promote decent and productive employment that is inclusive and sustainable.

Taxes are needed to raise revenue as a major limitation on government policies in Africa is funding. Diversifying away from a reliance on external financing through the financial account or government debt issuance is important. This was most evident post-financial crisis when, as commodity prices and financial inflows fell, government finances became strained across African economies.

Tax policy also more directly impacts employment outcomes. Higher taxes work to increase revenue while changing the distribution of income. As a price mechanism they also impact supply-side factors.

- I. **Progressivity of tax.** Progressive taxation can reduce inequality and ensure decent employment growth as the cost of social services falls more squarely on those with higher incomes. Progressive taxes have been put forward as a core component for Domestic Resource Mobilisation (DRM), which is part of Sustainable Development Goal (SDG) 17.1.³⁵ However, many tax systems in Africa are regressive (Bhorat et al. 2017) and recent studies have revealed the reliance on indirect taxes as the major tool for domestic revenue mobilization in Africa. Indirect taxes, and in particular VAT, have been found to be regressive with a gender bias (TJNA 2018).
- II. **Removal of exemptions and investment incentives which are ineffective or excessive.** Tax exemptions and incentives are used widely across Africa but often fail to spur the most valuable forms of investment and deplete public funds. As a consequence, some countries are undertaking tax expenditure analysis to assess the effectiveness of tax incentives. Padilla et al. (2020) argue that tax incentives are justified only when they deliver intended short- and long-term results (namely attracting the right investments and generating social benefits) and when the associated costs are economically and socially acceptable. Countries should review these periodically against very specific employment-centric criteria. In fact, tax incentives can be designed with explicit quantitative and qualitative employment requirements.
- III. **Improved taxation of mineral rents and resources.** The low tax intake of GDP for many commodity-dependent economies (figure 54 in appendix) implies the potential for greater revenue mobilization from commodity producers. Taxes can occur on excavation, land, income, windfall profits and resource rent taxes. And this can be applied through royalty, licensing, leases, joint ventures and a variety of other instruments. Notwithstanding the potential danger of an oil boom for growth and governance, recent commodity booms do offer an important opportunity for mineral-abundant countries to generate significant tax revenues and increase their policy space. The potential

³⁵ SDG 17.1: Strengthen domestic resource mobilization, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection.

revenue capture from such booms far outweighs aid flows. However, recent experience suggests that, in sub-Saharan Africa at least, this potential is not being realized. Two examples of less and more successful attempts are given in textbox 7.

Textbox 7: Resource taxation in Africa

In the case of Zambia, mineral taxation policy has been constantly changing, swinging from almost zero effective taxation to taxing everything (Hill and Mitimangi 2018). The Government's response in the late 1990s to slowing production was to privatize the copper industry and lower mineral royalties in order to attract foreign investment. For copper, corporate taxes were reduced from 35 per cent to 25 per cent, exemptions from customs duties introduced, mineral royalty rates reduced from 2 per cent to 0.6 per cent, the period for which losses could be carried was increased from 10 to 20 years, and exemptions from the withholding tax on interest, dividends, royalties and management fees was given (Fraser and Lungu 2007). As a result, mining companies paid almost zero income taxes between 2000 and 2006.

This limited Zambia's ability to use resource revenues to finance fiscal policies to expand non-mining production and infrastructure. As a result, Zambia's reliance on commodities has grown over time. This in turn has limited its ability to drive employment growth and poverty reduction. MIT Observatory of Economic Complexity data shows that 79 per cent of exports in 2017 were in the metals category consisting largely of raw and refined copper, up substantially from 62 per cent in 2000.

To try and reverse previous excessively generous (and ultimately costly) tax policies, the Government introduced a range of taxes, and especially since 2018 increased mineral rents that were initially put in place in 2005 (Chibuye and Siwale 2019; Manley 2013).

Botswana offers an important example of effective resource taxation amid considerable commodity dependence. As Botswana recognized that the booming diamond sector could not create employment directly, it decided that employment generation had to come from government through the creation of parastatals and through private sector development programmes. Unlike most countries that spent the revenue from a booming commodity sector, Botswana's government chose to sterilize the surplus by putting the income into a Revenue Stabilisation Fund that is managed by the Bank of Botswana. The policy followed by the Government of saving the extra diamond revenue for most years achieved several outcomes: it helped Botswana partially avoid the "Dutch disease", provided sustainability to spending and more moderate inflation, and avoided rapid unproductive overinvestment (Limi 2007; Khama 2016). The country remains fairly resource dependent though (Stephens 2016). As a result, unemployment is high despite a stable economy and the building of infrastructure through a diamond and public-sector-led development model (IMF 2018b).

Textbox 8: Successfully mobilizing and using resource rents in Norway

Norway is unique among its OECD counterparts in its ability to exploit oil production to fund its government. The 11th largest oil exporter in 2012, Norway supports the oil industry by incentivising exploration and development of new resources while also heavily taxing any profits. On top of its 27 per cent corporate income tax, Norway levies an additional 51 per cent resource extraction tax on the exploration, development and production of petroleum, a 78 per cent total tax rate. Despite this high tax rate, resource investment in Norway has not experienced an outflow and Norway managed to insulate itself from recessions.

Some argue that the private sector is still interested in the Norwegian energy sector because of its stability and transparency. There is policy certainty and all the investors know far in advance what they would have to pay and how much they earn. Everything is open, documented and transparent, and the entire system is considered not to be corrupt.

Norway recognizes that temporary revenues can create short-lived booms that are followed by difficult adjustment periods when revenues decline. Since 1990, the Norwegian Government has placed a large share of the oil revenue into its government run investment fund, Government Pension Fund Global, to prepare for a post-oil future. The bulging sovereign wealth fund, managed by the Norwegian Government, is set to top \$1 trillion within this decade. At the end of 2013, its value stood at 5.2 trillion kroner or \$903.4 billion. This sovereign wealth fund contributes to intergenerational equity, by allowing both current and future generations to benefit from the petroleum revenues.

Pending climate breakdown limits the ability of other oil-rich countries to follow the same model in the long term. However, the approaches adopted are instructive for all commodity-rich countries.

- IV. **Implementation of measures to curb tax evasion and tax avoidance.** Strengthening audits and human resource management capacities is crucial to tackling evasion and avoidance. This includes improved monitoring of multinational enterprise transfer pricing mechanisms with external assistance (through treaties and other mechanisms). The digitalization of taxation systems reduces costs and improves compliance and tax yields (ATAF 2018).
- V. **Capacity building.** Revenue collection efficiency and effectiveness needs to improve (Brumbu 2016). Administrative structures need to be evaluated and resources released to adequately train tax personnel. Also, coordination between the central and local authorities is crucial in administering tax policies.

Textbox 9: Successful tax reforms in Africa

For Burkina Faso, a low-income economy, a substantial increase in tax revenue by 5 percentage points of GDP occurred between 2008 and 2013 through tax policy reforms including the simplification of the tax system and the broadening of the tax base (Akitoby, Honda, Miyamoto, Primus and Sy 2019). It is instructive that it used the crisis as a way to increase its tax intake rather than expand debt. Financial support from Switzerland helped with the reforms, highlighting the importance of cross-country learning and collaboration for successful economic policymaking and interventions. Throughout the tax reform period, Burkina Faso continued efforts to enhance revenue collection and built fiscal space for critical infrastructure investment and social spending. Although a lower corporate income tax (CIT) at a rate of 25 per cent was introduced – the lowest that can be charged in the WAEMU area, a number of exemptions were removed, including limiting the deductibility of investment spending from profit taxes; introducing a special tax on transactions related to mining stocks; and applying VAT on imports of operational mining companies and companies that signed contracts with the Government. In Gambia, tax reforms were necessary post-crisis given unsustainable debts. Part of the reform package was a detailed compliance improvement plan for large taxpayers. As a result, about 86 per cent of large taxpayers filed their income tax returns in 2012, up from 79 per cent in 2011 (Akitoby et al. 2019).

A broadly similar crisis in Mauritania caused by the ending of the commodity price “super-cycle” saw it enact a number of successful tax reforms, including in 2012 removing the CIT exemption of the main gold company, contributing to the increase in CIT by 1.3 percentage points of GDP. Furthermore, the Government implemented a withholding tax of 15 per cent on payments to non-residents to protect its tax base against aggressive tax planning by multinational companies.³⁶ *The tax reforms were also used to encourage domestication*; VAT was extended to cover the mining sector, and mining companies receive reimbursement only if they can prove that their purchases have been acquired from formal domestic suppliers. Akitoby et al. (2019, 16) find that: “This provided an incentive for local suppliers to register and become formal. The tax identification numbers increased from 1,789 in 2011 to 5,860 in 2013 and allowed to broaden the tax base.” To offset the regressive effects of the removal of a fuel subsidy, a cash transfer programme for targeted households was introduced in 2012 with the aid of the World Food Programme. In the case of Senegal, its approach to tax reforms post-crisis was inclusive, with tax reform measures prepared in consultation with employers and labour unions. These social partners had the opportunity to provide inputs and comments on the draft version of the new tax code. This inclusive approach created a greater acceptance of the reforms.



³⁶ The Mauritanian authorities also eliminated the global income tax in 2012 and switched to a dual tax system, adapted and transformed for the country context.

Lastly, in Uganda's case, domestic tax reform allowed it to reduce its reliance on external donor funding, thereby increasing its macroeconomic policy independence. Uganda increased tax rates, including VAT, and removed exemptions. The top marginal bracket for personal income tax (PIT) was increased by 10 percentage points, from 30 to 40 per cent. In all the above cases, the tax reforms were incredibly successful, despite how different they were. This highlights the importance of undertaking reforms within the local country context.

4.5 Production linkages and transforming supply capacity

A vast literature on industrial policy (a subsection of what here is defined as sectoral policies) explores how multiple policy instruments can be used to promote structural transformation and transform supply capacity within the economy (Andreoni et al. 2018). Recently, industrial policy has been re-recognized as essential to achieving development (IMF 2019e). Given space constraints in this paper, instead of undertaking a superficial take on dozens of policy tools, we focus on the issue of linkages. This is because the development of linkages is critical in its own right and highlights the importance of the integrated approach taken here (Kaplinsky et al. 2011).

The development of linkages is able to drive employment growth through simultaneously promoting sectoral expansion and structural transformation. At the same time, this can bring balance in the macroeconomy – for example, easing inflation or balance of payments constraints. Developing appropriate linkages can also prioritize growth in sectors that provide decent and productive employment, and which advance the objectives of inclusion and sustainability.

In the African context, commodity sectors have strong potential linkages with the rest of the economy and these are insufficiently capitalized on. Albert Hirschman (1969) proposed that three possible linkages exist between the commodity sector and the industrial sector:

- ▶ **Fiscal linkages:** Resource rents appropriated by the government and used to promote industrial development in unrelated sectors or general macroeconomic policy management (see above).
- ▶ **Consumption linkages:** Incomes earned in the production of commodities generate the demand for locally produced industrial goods. We argue that minimum wages can be viewed as a mechanism to help enhance consumption linkages (see below).
- ▶ **Production linkages:** These are backward in the supply of inputs, forward in the processing of commodities and horizontal into other sectors and industries (discussed here).

While the dominance of primary sectors – both agriculture and mining – is a danger to African countries, how best to leverage these sectors for the benefit of the rest of the

economy is an important consideration. Linkages ensure that macroeconomic measures which work to stimulate the level of aggregate demand or aggregate supply can have a ripple effect on the domestic economy, by stimulating domestic production and domestic income. If minimal linkages do not exist (so called “enclave” economies characteristic of developing countries) then production will remain undiversified: increases in aggregate demand will raise imports causing balance of payments problems rather than stimulating domestic employment (Prebisch 1950; Singer 1950).

Sectoral policies, designed and monitored in consultation with the social partners, are needed to advance employment which is sustainable even in the face of low commodity prices.

- I. **Direct employment policies.** A number of countries have direct employment requirements in place in mining sectors. Some examples include (policy measures drawn from the International Institute for Sustainable Development, 2018):
 - a. **A requirement to employ a percentage of local staff.** In the petroleum sector in Angola 70 per cent of the workforce must be Angolan nationals.
 - b. **Certain types of jobs reserved for nationals.** In the Nigerian petroleum sector only Nigerians may be employed in junior and intermediate positions.
 - c. **Quotas on the numbers of expatriates per job categories.** In Ghana, firms must apply for an immigration quota for expatriates, with the ability to adjust the quota in certain circumstances. The share of expatriate staff should not exceed 10 per cent of total senior staff within the first three years and 6 per cent after three years.
 - d. **Training of staff.** In South Africa, mining companies must invest a percentage of annual payroll in essential skills development activities for historically disadvantaged South Africans.
- II. **Forward linkages.** These occur primarily in the form of mineral or commodity beneficiation (for example, into food or metal processing). Using macroeconomic and sectoral policies to expand these sectors results in more productive, higher-skilled, better paying and more formalized employment opportunities; expanded domestic supply capacity and hence an easing of the balance of payments; and the generation of foreign exchange and revenue from exports. Examples of such policy measures include (drawn from the International Institute for Sustainable Development, 2018):
 - a. **Domestic sales requirements,** achieved through: domestic market obligations, where mining firms are requested or forced to sell a percentage of their proceeds to local manufacturers; and captive mining, where governments award mining rights only on the condition that the mineral will be used in domestic production for a pre-defined sector.
 - b. **Export restrictions** to safeguard domestic supply of raw materials for local industries through: export taxes, quotas, bans or licensing; dual price mechanisms (to ensure cheaper prices to the local market); a reduction in or the elimination of VAT rebates on exports; restrictions in customs clearing points to control exports of certain products; and limits on the right to export certain goods to specific firms.

- c. **(Non-automatic) licencing requirements** to control ownership structures, the number of firms involved in extraction activities, the type of minerals being extracted and in what forms minerals should be exported.
- d. **Trade-balancing measures**, whereby imports should represent a limited proportion of locally produced exports, in terms of either volume or value.
- e. **Domestic and international market reserve policies**: Some markets may be reserved for local production or managed intentionally through: government procurement contracts; state owned enterprises; production controls; and offset agreements, whereby a government may enter into a contract with a firm and in return request investment in the economy.
- f. **Import duties** on finished products to protect and promote local production.
- g. **Subsidies** to support local industries, notably by: transferring funds directly to beneficiaries; assuming part of industries' risks; selectively reducing or increasing the taxes they would otherwise have to pay; and/or imposing mandates and barriers to trade. Other "indirect" subsidies may include access to selected capital imports; concessionary loans; transport access/infrastructure; and others. Ethiopia, for example, has made good use of such subsidies.

Textbox 10: South Africa's mineral linkages

Chile is often referenced as a country which took a less "interventionist" approach to mining-related development compared to other mineral-rich economies. However, the role of the state-owned company Codelco should not be underestimated. Codelco had its own local content policy and systematically supported smaller mining-related companies in developing their human capital, in particular their local engineering competencies. When it partnered with international firms, it ensured that smaller local firms benefited from the exposure to gain experience and markets. As a result, the share of engineering service providers sharply increased from barely 10 per cent in the 1970s to 90 per cent in the 1990s.

Chile's success is attributed to its clear vision regarding the desire to upgrade the participation of its local suppliers in the global value chain. Accordingly, it systematically encouraged the development of world-class supply chains by providing a number of incentives and support mechanisms, while ensuring that activities were coordinated across stakeholders. But the programme is largely attributed to effective partnerships with the mining company BHP Billiton and national industries and research institutions. This programme was distinctive on several fronts. The company identified and presented an operational challenge to suppliers instead of simply requesting existing, standardized solutions. This created a demand for innovation, which built a better alignment with market needs and improved the use of resources, and therefore created a secured and tailor-made market for suppliers.



Ghana enacted a local content policy for its mining industry in 2012. The regulation specified the use of local content, applicable to: (a) holders of reconnaissance and prospective licence holders (namely exploration companies); (b) holders of mineral licences (namely mining companies involved in extraction activities); and (c) mine support service providers. It focused on four specific aspects, namely:

- (i) Employment, through the promotion of local workforce and training requirements. The regulation set numerical targets for the number of expatriates allowed, restrictions for certain categories of job reserved for local staff and timeframes for implementation.
- (ii) Procurement of locally produced goods and services. This is guided by a list of specific product categories published by the Minerals Commission. A first list, consisting of eight products, was published in 2014. In 2016, 11 new product categories were added to the initial list, bringing the number of products required to be sourced locally to 19 in total. Mining firms must provide a procurement plan stating how much they will buy from local firms.
- (iii) Compulsory reporting requirements.
- (iv) Strict penalties for non-compliance.

Compliance with the local content requirements is assessed annually. With regards to local employment, it would appear that most companies have been able to meet the quotas set in the legislation for all professional categories listed. With respect to local sourcing of goods and services, the latest assessment suggests that local manufacturers have managed to supply on average about half of the products listed, with wide variations across product categories. This pointed to a number of challenges, mostly related to product quality, difficulties finding enough suppliers who had sufficient manufacturing capacity, and internal policy inconsistencies that made local manufacturers less competitive than importers. It is interesting to note that mining companies took the lead to support local suppliers in addressing some of those challenges. For instance, two items, electrical cables and grinding media, were particularly problematic, due to supply-side constraints. Mining companies provided technical and financial support to find practical solutions and improve quality and standards. In the case of electrical cable, this led to a substantial increase in locally manufactured items, from 36.1 to 73.4 per cent between 2015 and 2016. Similarly, for grinding media, procurement doubled from 28.7 per cent to 42.2 per cent in the same period.

Source: International Institute for Sustainable Development (2018).

- III. **Backward linkages.** Although the focus on resource-based industrialization (such as beneficiation) is through forward linkages, a key often overlooked opportunity is to develop backward linkage from mining and agricultural production. This also has the benefit of being high value-added, high-productivity production, with higher profit margins and the associated employment opportunities. This is ideally done at

the regional or continental level through enforcing joint ventures and domestication requirements as a condition to investment.

- Backward linkages are commonly advanced through domestic sourcing requirements of inputs. For example, that car assembly done in a country has to, over a ten-year period, transition to using domestically produced tyres or exhausts. Measures include: local sourcing requirements, domestic employment requirements, local presence or ownership requirements, and technology transfers. See the discussion of South Africa's mineral linkages in the textbox below.
- Such requirements can also be put in place for labour, training and management, such that more domestic workers benefit; these could include compulsory training and skills transfers. Skills and technology transfers are vital for industrial upgrading and generating higher productivity activities, in all sectors including for mineral linkages and manufacturing (Morris, Kaplinsky and Kaplan 2012) and agriculture (Woldemichael, Salami, Mukasa, Simpasa and Shimeles 2017). Among other benefits, this has the capacity to upgrade human capital and ensure more inclusive and decent employment growth.

The example of South Africa is illustrative (textbox 11).

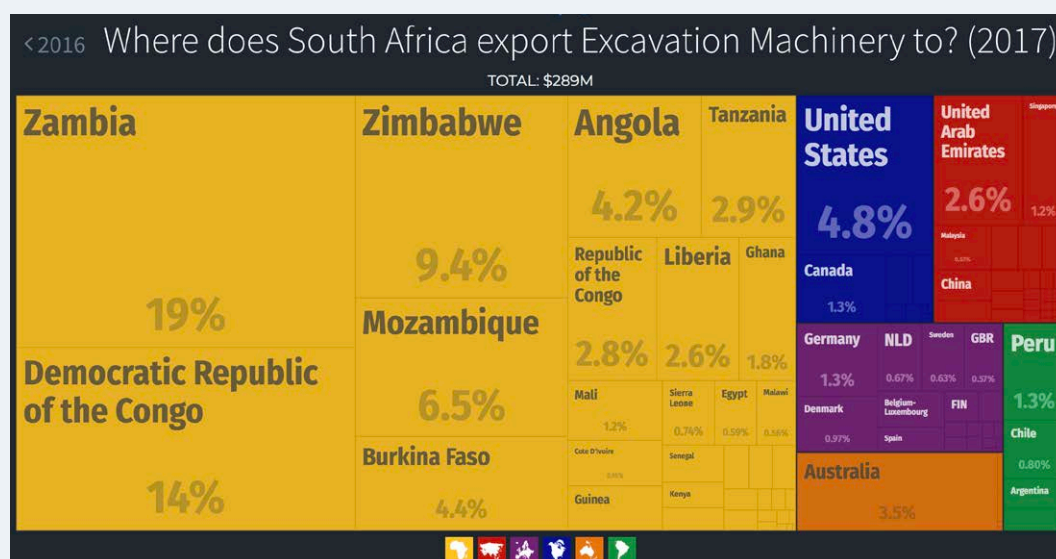
Textbox 11: South Africa's mineral linkages

South Africa has developed backward linkages from its mineral industry into mining equipment and related services, which is “the only significant area of industrial activity where South Africa is located at the global technological frontier” (Morris et al. 2012, 101). South Africa's outward FDI helps maintain this advantage such that its products are exported to its mineral extraction sites across Africa even though South Africa is a large net importer of capital goods overall. Africa accounts for the majority of South Africa's machinery exports – though exports to Germany plays a very important role too, and the USA to a much lesser extent. The exports are also concentrated in the countries in which South Africa has established its own mineral production plants and facilities, namely Zambia, Angola, Congo (Democratic Republic of), Zimbabwe and Mozambique, among others.

This highlights the importance of outward FDI as a compliment to exports and in maintaining and extending competitive advantages. Machine production is a significant employer in South Africa, accounting for 20.9 per cent of manufacturing employment in the country. Other projects in these countries, including those established by non-South African direct investors, also import South African mining machinery.



► **Figure 14 South African exports of mining machinery**



Note: South Africa sustains its advantage in the mineral sector through its backward linkages into machinery production, even as its supply and production of key minerals has declined. Other countries may want to establish joint ventures to help spread this knowledge across the continent.

Source: MIT Observatory of Economic Complexity (n.d.).

- IV. **Ownership and skills transfer.** The South African case also highlights the need for countries to impose requirements on South African and other commodity investors on the continent to ensure that over time some ownership or skills in commodity machinery production is transferred to African joint ventures. These would ideally be regional or continental champions given the scale necessary to compete and develop expertise, in the same way that Airbus is a pan-European champion competing against Boeing. Nigeria, for example, enforces joint ventures with foreign petrol companies as a condition of investment. Oil companies, including Royal Dutch Shell, Chevron and ExxonMobil, operate in Nigeria through joint ventures with the state-owned NNPC.

4.6 Integrating labour market policy: The example of minimum wage policies

The integration of macroeconomic, sectoral and labour market policies has been stressed as necessary to achieve decent and productive employment which is inclusive and sustainable. Multiple labour market policies have sought to contribute towards this. Often labour market policies have been left to do the “heavy lifting” of achieving decent work on their own. The policy discussions above have shown how macroeconomic and sectoral policies are essential complements. Similarly, labour market policies can further the macroeconomic and sectoral goals discussed.

Here we utilize the example of minimum wages to highlight the interdependence between macroeconomic, sectoral and labour market policies in achieving decent and

productive employment which is inclusive and sustainable. We do this because this is a labour market policy relevant to most economies across differing income levels that will help to enhance sectoral and macroeconomic policies (and so integrate well with them) and it has a proven track record, historically and across economies, in achieving decent and inclusive employment outcomes. Minimum wage policies, depending on how they are enforced and structured, directly impact employment conditions of hourly, daily or monthly wage compensation. Minimum wage policies can only be fully effective, including in dealing with challenges of inequality, if combined with strong collective bargaining.

Minimum wages are commonly seen as impacting only the labour market. But their aggregate impact is macroeconomic in nature, impacting both aggregate demand and aggregate supply. Minimum wages inform macroeconomic policy and macroeconomic policy benefits from labour policy. Historically, minimum wages have proven to be one of the most effective policies in achieving a range of macroeconomic goals and employment goals (ILO 2016b). As a result, we recommend national (as well as regional) minimum wage policies as an essential part of any macroeconomic framework.

- ▶ **Minimum wages advance employment growth through diversifying and balancing sources of aggregate demand within the macroeconomy.** They do so by balancing the mix of profit income and wage income in the distribution of income. This can be helpful if additional profits are not being reinvested in production by firms. Higher minimum wages allow for consumer growth to be sustained without asset or credit bubbles, promoting what Albert Hirschman called “consumption linkages” (see above), whereby incomes earned in the production of commodities generate the demand for locally-produced industrial goods. They do this by helping to rebalance the gains from production away from profits and rents, and towards wages. This is helpful if the financial sector and credit is weak. Minimum wages also help create resilience against external shocks by helping balance demand away from an exclusive reliance on commodity prices and FDI flows into the commodity sector. Importantly, minimum wages help balance out the sole reliance on external demand by increasing sources of internal aggregate demand. This works to provide greater insulation against external shocks by ensuring that domestic sources of demand exist. Most recently, over the last decade China has mandated high growth in wages across key provinces in order to rebalance demand away from investment and towards consumption.
- ▶ **Minimum wages also advance employment growth through compressing income distribution** – high levels of inequality have been shown to reduce economic growth (ILO 2013; Ostry et al. 2014; Picketty 2014) and minimum wages have a proven track record in rebalancing both the functional and personal distributions of income – income between capital and labour, and across different workers – towards greater equality.
- ▶ **Minimum wages also advance sustained employment growth.** They promote a change in the long-term growth trajectory of the economy by changing the techniques and technologies used in production, and the competitive dynamics in an economy. Minimum wages can potentially make different branches of production more or less

viable, tilting the growth path towards more productive and higher value-added sectors. The productivity-enhancing effects are well documented in the minimum wage literature (Bassanini and Venn 2007; Dickens et al. 1994; Dube et al. 2014; Nickell and Layard 1999, Mayneris et al. 2014; Rizov et al. 2016). This should be coordinated with other investments in an economy's infrastructure, skills and long-term industrial goals.

- ▶ Such success at advancing productivity upgrading is seen historically in Asian economies, as firms were forced to compete through upgrading human and physical capabilities (Vogel 1991), rather than through low-wage competition, which does not require investments in skills, machinery or products. For example, minimum wages were central in Singapore upgrading to higher value-added production (Vogel 1991). Similarly, national minimum labour standards were a vital part of the package which helped restore growth to America after the Great Depression (Schlesinger 2003). They achieved this in part by changing the competitive dynamics of the free market to incentivize competition which upgraded productivity. This is a dynamic advantage which can sustain an economy's employment and export markets. In contrast, low-wage competition offers economies no sustained advantages, making it considerably vulnerable to lower-wage competition from abroad. In this regard, the barriers to entry are low and can act as an external shock.
- ▶ **Minimum wages also advance inclusive and decent employment growth.** They do so by: raising labour standards and ensuring wages meet basic needs; levelling wages across sectors with more vulnerable workers; and encouraging employers and the state to invest in training and human capital development. They also lift wages in the informal economy and have the potential to contribute towards the shift in employment from the informal to the formal sector (Belser and Rani 2015; Boeri et al. 2010; Saget 2001; World Bank 2015).
- ▶ **Minimum wages will not fully achieve these objectives alone.** In addition to their potential in their own right, they help to highlight the broad potential of labour market policies within a transformative macroeconomic framework.
- ▶ **Optimal minimum wage systems, and especially their implementation and enforcement, will vary across countries. However, the following should be considered:**
 - **While they may be structured at the sectoral, industry, regional or national level, or all of the above, more uniform policies – national minimum wages or regional minimum wages in federal systems – are considered most effective (combined with a system of collective bargaining).** Compared with a sectorally-differentiated system, a national minimum wage covers all workers, is easier to enforce and does not set lower minima for sectors with high proportions of vulnerable workers (as has been shown to occur under differentiated systems). Further, a national minimum wage can be set to take account of broad policy objectives such as reducing inequality and economy-wide economic impacts rather than only narrow sectoral considerations (Isaacs 2016).
 - **Regional minimum wage systems should also be considered.** To prevent a “race to the bottom” and competition primarily through low-wage sectors (as discussed above) regionally agreed and enforced minimum wages, differentiated at the national level

tied to the national median wage, should be considered as part of regional economic communities' industrial policy handbook.

- **Minimum wage should be set to take into account the needs of workers and their families.** Benchmarks for setting and adjusting the level of the national minimum wage include: cost of basic needs indicators such as the poverty threshold for the working poor; labour market indicators such as the average wage; and collective bargaining indicators (ILO 2020; Koponelko 2016).
- **Minimum wages should be set based on the "basic wage"** (includes income tax and social insurance contributions but excludes wage supplements such as productivity pay and in-kind benefits). Additional income such as tips, bonuses and other premium payments should be considered over and above the minimum wage (Castel-Branco 2015 and 2016a).
- **Minimum wages should ensure a basic level of income even for part-time workers.** This might take the form of a higher minimum wage level for part-time workers or the setting of hourly/daily and weekly/monthly minimum wages (Castel-Branco 2016b).
- **Minimum wage levels should be increased annually at a faster pace than average or upper-end wages.** This is necessary in order to ensure that minimum wages reduce inequality.
- **Measures to enforce compliance are essential.** These include a strong and well-staffed labour inspectorate, streamlined procedures, and appropriate penalties and sanctions for violators. It also could include incentives for compliant employers (Castel-Branco 2016b and 2016c; Murahwa 2016; Rani et al. 2013).
- **All social partners should be engaged in setting, overseeing and adjusting the minimum wage in line with the ILO Minimum Wage Fixing Convention, 1970 (No. 131)** (Castel-Branco 2016b and 2016c).

4.7 Employment-intensive investment programmes

Employment-promoting public investments work at the intersection of labour policy, sectoral policy and macroeconomic policy within our transformative macroeconomic framework. Traditionally, increasing the employment-intensive investment programmes creates a focus on job creation and poverty reduction. In this regard, it is more seen as a countercyclical fiscal measure. In the jargon of macroeconomists, this means leaning more heavily on targeted fiscal policy and less on untargeted monetary policy to maintain nationally appropriate levels of aggregate demand (Bivens 2018). However, appropriate employment-promoting investment also has crucial long-run outcomes. Depending on the emphasis of the investments, the policies can be slanted in different directions.

- **Employment-intensive public investment programmes can promote employment growth.** If the primary aim is to increase the level of employment, then this works to stimulate short-term macroeconomic aggregate demand as a macroeconomic policy. If this is to be sustained without unbalancing the macroeconomy, then such investments must be in productive sectors such that they help transform the supply capacity of the

economy. As a result, it is vital for employment-intensive public investments to help promote local enterprises and long-term structural transformation of supply. A number of useful ILO briefs detailing African and Asian country case studies can be found and are useful for governments to look through further (ILO 2019e; 2020b; 2021). Such investment overlaps with sectoral policy which looks to advance new branches of production, and macroeconomic policies which look to increase the productivity of inputs.

- ▶ **Employment-intensive public investment programmes can promote inclusive and decent employment growth.** They do so by: targeting particular population groups for employment; ensuring employment conditions advance the rights of workers; and working to increase domestic skills and capabilities.
- ▶ **A number of important policy considerations exist:**
 - **Such programmes should prioritize investments and sectors with the greatest direct and indirect employment multipliers.**
 - **Training and skills development should be integrated into these programmes.** For example, Kenya has successfully combined a number of employment-intensive investment programmes with skills training programmes, with the benefit of outside collaboration. See textbox 12.

Textbox 12: Skills development in Kenya's public employment programmes

In 2012, the Government of Japan and the ILO jointly initiated the Youth Employment for Sustainable Development Project (YESD) with the aim of empowering the young women and men of Kenya by developing their skills and increasing their participation in the rehabilitation and maintenance of roads using employment-intensive techniques, in particular “Cobblestone paving” and “Do-nou technology”.

In a period of nine months, the project managed to build national capacity for the planning and implementation of Cobblestone paving and Do-nou technology. The project provided technical skills training to 830 young men and women; 150 of them received business training. As a result, 20 small and medium enterprises owned by youth were established to work on road maintenance using Do-nou technology. Another group of 330 youth registered businesses using the cobblestone road paving technology. Among the 830 youth trained, 260 (31 per cent) were women.

In addition, three centres of excellence for cobblestone training were developed in three technical and vocational training institutions under the Ministry of Roads and Ministry of Youth. A cobblestone training curriculum was also developed and a total of 13 trainers (five women) and four small contractors were trained as part of building the capacity of the above-mentioned institutions. Advocacy and awareness creation activities targeting senior managers and policymakers in government were undertaken through public meetings, workshops and study tours to project sites.

Sources: Authors based on ILO (2019d).

- **An appropriate sectoral focus is key.** This could take the form of helping invest in specific types of infrastructure, such as road construction and other market-relevant infrastructure, social infrastructure such as care facilities, as well as environmental infrastructure, which are particularly amenable to skills training and domestic-input requirements, or the investment in specific areas which themselves serve as industrial policy tools (such as special economic zones). Moreover, such investments can be undertaken through joint ventures with foreign governments or companies, in areas such as telecoms, railway, water and electricity, as a way to maximize long-term supply impacts, provided that sufficient sectoral policies are in place to ensure domestication of skills and supply from the foreign firm.
- **Domestic inputs requirements and incentives should be used.** Employment-intensive government spending that integrates the concurrent development of aggregate demand, aggregate supply and sectoral transformation should also consider local-content requirements in government spending and government contract work. Legislation should prescribe the use of domestic inputs where possible for key inputs in government infrastructure spending. Economies such as the US now use this regularly. This can take a number of forms, including (see textbox 13 for a discussion on the South African case):
 - Minimum thresholds on the amount of locally-sourced materials to produce goods. This is usually expressed as a percentage of volume, length, or number.
 - Minimum thresholds on the amount of locally-sourced expenditure or man-hours for the consumption of services, such as engineering and transport, financial services and insurance.
 - Explicit or implicit requirements that companies take local content development into account in their projects and strategic planning, or when undertaking feasibility studies.
 - Requirements for companies, operators or investors to establish facilities, factories, production units or other operations locally to carry out any production, manufacturing or service provision being imported.

Other considerations include:

- Given limited domestic supply capacity in many African economies, it is recommended that these policies are very targeted and undertaken through appropriate protocols at the level of the regional economic community (REC), such that production sharing takes place within the region.
- These local-content requirements and the distribution of investment spending might have a specific geographical content. This can be done narrowly in order to build special economic zones with decent labour standards; to integrate rural and urban markets; or to spread aggregate demand across regions and communities. This includes strategic deployment of public investments like infrastructure, energy efficiency, and early child care and education. These investments are crucially important to undertake even if they result in no net new jobs at all. But their

deployment can be prioritized in part based on their potential for creating jobs in communities that need them.

- **Shorter-term countercyclical employment programmes can be used to deal with temporary disruptions to domestic labour markets.** It is important though that such policies also work to advance equity regionally and among the various population demographics. Moreover, they should not come at the cost of investment programmes, which can provide the same level of employment while also building a productive asset with lasting value.
- **The approach to recruitment for these programmes also matters for inclusivity.** This includes how and who they hire, how they are advertised and the geographic scope.

Textbox 13: Domestic-content requirements in South Africa

The South African Government has (in effect) attempted to raise fiscal multipliers through a raft of public procurement legislation beginning in 1999 (ICLG 2019). Though partially successful in boosting domestic demand, local content policies in South Africa have perhaps suffered from not being sufficiently targeted, or implemented, such that all state procurement has tried to advance local-content requirements. As a result, despite the relative development of supply capacity in South Africa, local-content policies have not resulted in the desired levels of local procurement as producers have failed to deliver on project requirements, including timing, quality, price and overall guidelines (Nyakabawo 2017).³⁷ A lack of data collected by government also made evaluation of the impact of the programme very difficult. This highlights the benefits of rolling out government policies first through targeted experiments before generalising them more widely (as China has frequently done since 1976, beginning with the experiments with capitalism through the special economic zones in Guangdong).

³⁷ See the recent TIPS project, Online: <https://www.tips.org.za/policy-briefs/item/3332-south-africa-s-local-content-policies-challenges-and-lessons-to-consider>.

5. Policymaking and implementation process

Our transformative macroeconomic framework cannot be advanced without a supportive policymaking process. Policy design often takes a top-down approach, which undermines implementation and lacks stakeholder participation (Dialoke et al. 2017). This can lead to policy silos and a lack of coordination within, and between, various government units and departments. In this paper, we focus on three elements of the policy process which are complementary to the approach adopted thus far.

Our emphasis here is on a participatory policymaking process, where independent and representative organizations of workers and employers and other relevant stakeholders play a core role. Such an inclusive approach requires participatory policymaking processes which are responsive to all populations. Economic policymaking's legitimacy rests not only on its results but also on its ability to be the result of a collective process with wide representation (Briault, Haldane and King 1997). Growing scepticism over "experts" reflects an unhelpful technocratic turn to experts, and in response the Bank of England and now the Federal Reserve are trying to undo this through greater public communication and information campaigns. Such unidirectional communication efforts – from the Banks to the public – is just an initial step but inclusivity should go further than this. In addition, the power that International Finance Institutions have wielded in macroeconomic policies in Africa since the 1980s must be reconsidered as this potentially disempowers local actors.

5.1 Social partners in the macroeconomic policy framework

In order for macroeconomic and sectoral policies to effectively integrate employment objectives, the first step must be to provide representation to formal and informal sector workers in the policymaking process. This draws on the ILO Tripartite Consultation (International Labour Standards) Convention, 1976 (No. 144). This should be streamlined in macroeconomic policy deliberations (ILO 2019c). Sectoral policies are more effective when this is done, as ultimately labour must be willing and able to embrace policies which look to structurally transform the economy, including compensation for shifts in the focus of production, training programmes and geographical projects which advance special zones for key foreign investments through improved transport and logistics infrastructure. When this is not done, then industrial unrest can ensue. Such consultation can occur through various institutional frameworks, forums and forms. Two examples are given here.

The use of tripartite forums for discussing and negotiating macroeconomic, sectoral and labour policy can be strengthened. In South Africa, for example, the National Economic Development and Labour Council (NEDLAC) recently negotiated the implementation of

a national minimum wage (2015 to 2017), policies to be adopted at the Presidential Jobs Summit (2018 to 2019) and jobs-enhancing macroeconomic policy measures (ongoing from 2019). In Benin, a National Council for Social Dialogue was established in 2016; the Governments of Senegal and Togo increased the budgets for their national institutions for tripartite social dialogue in 2016; and institutions in Côte d'Ivoire (2015) and Guinea (2016) were strengthened. The ILO (2019c) also notes a number of recent successes:

“In 2017, Chad’s National Commission for Social Dialogue brokered an agreement between the government and public sector unions that helped to end a three-month strike in public services and to mitigate the impact of the oil-price crisis. The tasks of the High Council for Labour Relations in Senegal and the High Council for Social Dialogue in Burkina Faso, the national institutions for tripartite social dialogue, were strengthened in 2014 and 2017, respectively, to include preventing and settling major labour disputes and enhancing peace and stability. The tripartite partners in Benin signed pacts for economic and social development.”

These are important steps but their use in practice remains mixed. In addition, often macroeconomic policy is not covered within such institutional frameworks. This must be incorporated.

In advanced economies, monetary policy is being made more representative in response to questions over its legitimacy and usefulness. In response, the Federal Reserve now conducts meetings with communities from across the income and demographic spectrum and uses this information in the formulation of monetary policy (Greeley 2020). This complements the Federal Reserve’s dual mandate and the priority it gives to employment outcomes. This has allowed the Federal Reserve to better understand divergent inflation and employment trends across communities and, in turn, the limitations of using a single mean indicator when using the interest rate to target these variables. In particular, the fact that the national inflation rate used by monetary policymakers does not reflect that of consumers is of increasing concern.

Practically, tripartite representation on monetary policy setting committees is important given that monetary policy is a key policy tool. If monetary policy, both in terms of how its goals are formulated and how it is implemented, is to be legitimate and effective, it requires representation not only from technocrats but also from the population at large. This can also help steer the policy mandate and help ensure policy is communicated better to the public. The inclusion of social partner representatives on monetary policy committees would be a step in the right direction. Concerns about expertise can always be met by providing mandatory training for all members of the monetary policy committee, with expenses for research assistance for the committee as a whole, as well as for individuals.

5.2 Economic planning commissions: Integration of macroeconomic, sectoral and labour market policies

Economic planning commissions are another potential way to ensure coherence across macroeconomic, sectoral and labour market policies. Balancing macroeconomic and sectoral objectives in the short and long run can be particularly challenging (Vogel 2013) and planning commissions can often take a longer-term view than other policymaking processes. Planning commissions can serve as an effective way to coordinate, share information and devise policy by existing “above” other departments, while ensuring policy coherence. They can provide for the long-term planning necessary to bring coherence, ensure that scarce resources are prioritized and allocated accordingly, and ensure that a macroeconomic framework can be coherently constructed and implemented.

Transitioning towards a more managed integration into the global economy requires a degree of planning. This has been the experience of China since it began its managed integration and as it began to allocate scarce resources to the special economic zones (SEZs), beginning in 1978 (see textbox 14 below).

In Ethiopia’s case, similar challenges existed as it moved towards being a more open economy, with less state ownership, and the ending of war. It took inspiration in national planning from Asia. As noted by Oqubay (2018):

► “Industrial policy dialogue supported by the Japanese government and scholars has been in place since July 2008. Later developments include the institutionalization of the Japanese Kaizen approach, the transformation of technical and vocational education training (TVET) and university system along German lines, the establishment of sectoral institutes, and science and technology universities in line with the South Korean model, and learning from China’s policymaking and industrialization”.

In Ethiopia’s case a number of separate regulatory and coordination mechanisms existed between 2005 and 2015, with separate responsibilities for investment coordination and export coordination. The Ethiopian Investment Board, however, had a large say in directing industrial and investment policy. Textbox 14 gives examples of planning commissioning, with the South African case being a cautionary tale of what can go wrong.

Key characteristics of successful planning commissions are:

- **Centralized control and allocation of resources**, while utilising and incorporating information which is closest to the source, including from peripheral government localities.
- **Realistic plans with clear targets which can be met.** This includes financing mechanisms and policy tools which will need to be used, as well as regional dimensions to any problem. Having unclear or unrealistic targets greatly hobbles the seriousness with which policy is taken. This does not undermine the need for policies which are bold and visionary.

- ▶ **Planning commissions need clearly defined roles.** Financing, research, implementation, monitoring and evaluation, and long-term planning are five very different roles, different combinations of which commissions tend to take on.
- ▶ **Clearly defined organizational and informational flows and responsibilities between departments.** Policy formulation tends to remain the responsibility of each individual ministry, while it is only edited and adjusted through the commission at the end. The constant back and forth in each ministry's policy formulations is helped by the commission first having a good idea of key targets, industries and budgetary allocations available.
- ▶ **Representation.** It is important for labour and civil society to have permanent seats on any planning board.
- ▶ **Use of internal and external experts.** Planning requires government administration being a place which attracts and draws on excellence. The Japanese Ministry of Economy, Trade and Industry (METI)³⁸ and supporting government departments attracted the top university graduates.

Textbox 14: Planning commissions past and present

The Ethiopian Government established a National Planning Commission in 2013. Ethiopia has five-year development plans but the Planning and Development Commission is preparing the nation's first ever ten-year Perspective Development Plan to assess the country's economic and social development in order to help medium-level plans be better realized. The ten-year plan will focus on eight pillars including macroeconomic, agriculture transformation, expansion of manufacturing, transport infrastructure, urban housing, hydro economics and human resource development. The process is currently concluding.

The National Development and Reform Commission of the People's Republic of China (NDRC) is known as a "mini-state council". In the Chinese context, planning consists of tangible targets (such as rural health coverage, GDP per capita growth and investment rates), prioritisation of resources, and selection of key industries and goals with localization content targets. The Commission studies and formulates policies for economic and social development, maintaining the balance of economic development and guiding the restructuring of the economic system. The NDRC has twenty-six functional departments/bureaus/offices with an authorized staff size of 890 civil servants. The size of the council is partly due to the fact that state-owned entities and state financing continue to play a major role in the economy.



³⁸ Ministry of International Trade and Industry (MITI) was reorganized as the Ministry of Economy, Trade and Industry (METI) in 2001.

China is thus the extreme case whereby five-year plans are decided and strictly determine the general outlines of macroeconomic, industrial and labour policy goals, even if the actual implementation can change as circumstances change.

In 2010 South Africa established the National Planning Commission (NPC), which developed the National Development Plan (NDP), published in 2012. The NPC's mandate is to develop a long-term vision and plan for South Africa and is constituted of 25 part-time commissioners appointed by the President. Unfortunately, disputes arose between social partners after the publication of the NDP, particularly in regard to the economics chapter, reflecting a failure in the process to generate either agreement or buy-in. This has limited the role of the NDP in guiding policy in practice.

5.3 Interdepartmental coordination within government

Government coordination mechanisms are fundamental to resolve divergences between priorities and policies and promote mutually supporting actions across government departments and institutions. Historically, an imbalance has been present in African countries with ministries of finance playing a dominant role in economic policy. As Thandika Mkandawire (1999) writes:

- ▶ "... economic policy has given overwhelming priority to financial policy instruments and objectives (exchange rates, interest rates) relative to concerns for the 'real' side variables and goals that directly affect employment and growth. Such shifts are not only reflective of the exigencies of adjustment to the economic crises that have ravaged Africa since the mid-1970s, but also of the increased presence of international financial institutions (IFIs) in African policymaking."

It is important that this imbalance in influence is addressed. This is because all institutions are likely to prioritize their core mandate. Even when departments of finance adopt a transformative approach to macroeconomic policy, they will tend to focus on certain objects and particular policy instruments. Ensuring the ministries of trade, industry, development and labour have equal influence will ensure more balanced economic policymaking and better employment outcomes. It is also important to ensure coordination across spheres of government – local/municipal, provincial/state and national.

Effective coordination includes coordination in: policy and budget design, implementation and monitoring. Regarding the latter, the OECD (2015) shows how the benefits of particular policies may appear in areas monitored by departments other than those that are implementing the policy. Table 1 shows some potential policy approaches.

Table 1: Policy coordination structures

Alignment tool	Strengths/weaknesses
Creation of “super ministers” with responsibility for more than one department or portfolios that span departments	Success depends on the status of an individual and might not lead to effective integration at the policy level. Internal silos often remain; merging two departments might not solve problems where policy has multiple dimensions.
Policy “tsars”	Success depends on the status/personality of an individual.
Inter-ministerial committees	Permanent (standing) or ad hoc committees are the most typical mechanism for “routine” coordination, but are less suited for ambitious, game-changing initiatives.
Independent policy units	May face challenges in establishing legitimacy across departments.
Inter-ministerial policy teams	Can work if departmental priorities and approaches are aligned; more difficult if inherent trade-offs are involved.

Source: OECD (2015).

Central government nodes, for example, or units in the office of the head of state may be advantageous sites to locate such coordination. This is because these (OECD 2015):

- ▶ Are, in principle, policy neutral, unlike departments, which tend to be interested parties.
- ▶ Combine strategic vision, policy coordination, and monitoring functions and capacity.
- ▶ Have convening power borrowed from the head of government and can bring significant pressure on departments to align policies. It does not need to rely on achieving consensus through compromise and lowest-common-denominator negotiations.
- ▶ Have a more strategic relationship with the ministry of finance than line ministries tend to have.
- ▶ Have coordination expertise tied to political sensitivity. Line ministries might have little experience in driving cross-disciplinary policies.
- ▶ Can house high-profile leadership for strategic priority actions – such as secretaries of state and policy tsars – without them becoming associated with a specific sectoral interest.

Among the many tools that such units can manage effectively – and potentially more effectively than can be done at the department level – are (OECD 2015):

- ▶ Holding funding pools and designing accountability frameworks for allocation across departments.

- ▶ Building centrally located policy units drawing on expertise and staff from relevant line ministries.
- ▶ Managing the presentation of evidence and briefing to the cabinet and the head of government in order to ensure high-level support and buy-in.

Textbox 15 demonstrates ways in which interdepartmental coordination has been instituted in various countries.

Textbox 15: Working across departments

The Korean Economic Planning Board (ECB) has been lauded internationally for its contribution to the country's economic progress. Between 1961 and 1994, the ECB drove macroeconomic and sectoral goals through its five-year economic development plans. The ECB mandate extended to managing the Government's budget allocations, resource mobilization (particularly by securing foreign loans) and extensive monitoring of exports. While the President made the major decisions, the ECB was composed of the following stakeholders: the Ministry of Finance, the Ministry of Trade and Industry, other government ministries and the Federation of the Korean Trade Unions. These four core groups represented the interests of state-owned banks, industry/business associations and industrial unions.

The Ministry of Economy, Trade and Industry (METI) in Japan was founded in 2001. The Economic Planning Agency was merged with agencies from other ministries related to economic activities. The METI leads the economic policies of Japan and supports businesses. METI engages extensively with businesses through joint committees and groups that monitor the performance of, and set targets for, various strategic sectors. The METI's mandate extends to ensuring efficient supply of energy and mineral resources. The Ministry is in charge of the long-term planning for Japan and reports directly to the Prime Minister. The METI's mission is to facilitate the shift of resources into high-tech industries by developing plans with assistance from corporations, banks, trade unions and universities.

The Ministry of Finance and Economic Development (MoFED) of Ethiopia is the main institution behind strategic economic and financial planning for the Ethiopian economy. MoFED is responsible for developing, executing and evaluating the Growth and Transformation Plan (GTP), which is an ambitious five-year growth plan. The GTP puts forward a macroeconomic framework as well as an economic sectors plan. MoFED is now implementing GTP II with a national vision of becoming a lower-middle-income country by 2025.

6. Conclusion

This paper has provided a novel approach to developing a transformative macroeconomic policy framework. It has shown how macroeconomic, sectoral and labour market policies should be mutually reinforcing to achieve economy-wide objectives. The achievement of decent and productive employment growth which is inclusive and sustainable will be impossible within the African context if macroeconomic policy remains narrowly focused on price stability and specific debt-to-GDP ratios while being divorced from its relationship with sectoral and labour market policies. Rather, the role of macroeconomic policy in transforming the structure of the economy must be appreciated. This will allow the growth of formal, higher-productivity and better-paying employment opportunities. If this was true before the COVID-19 crisis, it is even more so now as countries grapple with how to “Build Back Better”.

In the African context it has been shown that macroeconomic imbalances will retard employment growth. At the same time, these imbalances cannot be adequately addressed through macroeconomic policies that focus only on a limited range of macroeconomic aggregate indicators, such as price stability. Rather, achieving structural transformation through demand management and diversifying the supply side of the economy is essential – this requires appropriate macroeconomic and sectoral policies. This will generate greater fiscal space (through increased tax revenue and higher GDP) and accommodate increased aggregate demand without worsening the balance of payments or leading to undue inflation. At the same time, sectoral and labour market policies can boost demand in the economy. Labour market policies can also help to boost aggregate demand through distributing income towards workers, who have a higher propensity to spend, and expand aggregate supply through ensuring human capabilities are upgraded.

In all these ways, a coherent transformative framework that combines employment-centred macroeconomic, sectoral and labour market policies is the principal way to ensure decent and productive employment growth which is inclusive and sustainable on the African continent.

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8. Appendix

8.1 Low productive capacity is a major macroeconomic challenge in Africa

Africa's primary challenge is not only that it is, first and foremost, *demand-constrained*. Yet this is the primary macroeconomic framework used by progressive-minded economists trying to boost and sustain employment growth in advanced economies through expansionary fiscal and wage policies (Bivens 2019a, 2019b). In this framework, the problem is low inflation and low demand (rather than high inflation, volatile demand and low supply – as for most African economies). In advanced economies, sufficient labour productivity exists for macroeconomic policy to target higher wages and more spending, since domestic *supply capacity* is diverse and highly developed. This is less true of lower income, less diversified economies, such as those in Africa.

Stimulus spending alone is unlikely to sustain domestic formal-sector employment in Africa because spending goes mainly into imports (relative to exports).³⁹ The problem then is that domestic *supply capacity* is underdeveloped and commodity dependent, such that fiscal spending to reach “internal balance” (full domestic employment) tends to come at the cost of “external balance” (balance of payments sustainability).⁴⁰

Therefore, increases in domestic demand – while important – raise imports, which requires high commodity prices and external demand to sustain. As a result, since 2009 sub-Saharan Africa has run a persistent current account deficit as global demand, and eventually commodity prices, fell (IMF 2019c). Similarly, its financial account (reflecting the balance between inflows and outflows of financial flows) turned negative from 2007 and has stayed there (IMF 2019c).⁴¹ This has led to growing indebtedness among African governments, especially among oil exporters (Coulibaly et al. 2019).⁴² Inflation in Africa is also, in the final analysis, a result of a lack of domestic diversification in productive capacity. As such, changes in import prices or increases in domestic demand have a large impact on domestic prices (Nguyen et al. 2017; Razafimahefa 2012).

³⁹ In a Mundell–Fleming model fiscal policy is ineffective if exchange rates are flexible, assuming perfect capital mobility. Once exchange rate expectations are introduced, these results no longer hold (Dornbusch 1976).

⁴⁰ By definition, the current account balance (*CAB*) is necessarily equal (with sign reversed) to the net capital and financial account balance (*NKA*) plus reserve asset (*RT*) transactions (International Monetary Fund 1993, 160): $CAB = NKA + RT$. Such that by definition, a current account deficit must be reflected in a decrease in net claims on the rest of world, either through a drawing down of reserves assets (*RT*) or through *NKA* becoming negative (increase in liabilities to non-residents).

⁴¹ In 2016 every single country in Africa on which there is data available ran a trade deficit except for Madagascar, Seychelles, Botswana, Lesotho, Eswatini, Burundi, South Sudan, Nigeria, Liberia, Sierra Leone, Guinea-Bissau and Gambia. This was largely unchanged from 2015, with the exception of Nigeria and South Sudan becoming negative and Côte d'Ivoire becoming a positive net exporter (IMF 2019a). While in 2016, for countries in Africa on which data exists, only South Africa, Botswana, Eswatini, Lesotho, Mauritius, Côte d'Ivoire and Algeria have a positive net international investment position, reflecting the fact that the accumulated value of African-owned financial assets in other countries is less than African liabilities to residents of other countries. The difference between assets and liabilities is the African country's “net international investment position” (IMF 2019b).

⁴² However, as African and global financial markets have evolved this is now a mix of domestic and foreign debt.

Africa is instead *constrained in its productive capacity*, defined as a lack of domestic productive capacity in industrial and consumer goods sectors, coupled with an undue reliance on the commodity, export-oriented sector for formal-sector employment, government revenue, foreign exchange revenue and maintaining macroeconomic balance in the exchange rate. 22.9 per cent of Africa's exports in 2016 was petroleum (Commission et al. 2018). More generally, raw materials accounted for 44 per cent of sub-Saharan Africa's exports in 2017, while approximately 63 per cent of imports was accounted for by consumer goods (37 per cent) and capital goods (26 per cent) combined (World Bank 2019b).⁴³ This led to sub-Saharan Africa running a trade deficit of 1.8 per cent of GDP in 2017.⁴⁴

Unfortunately, Keynesian macroeconomic theory was written for countries who *are* demand-constrained (such that more government spending could, in a closed economy, act as a fix); or for where inflation was driven by employment being at full capacity – rather than due to supply bottle necks. Neither of these two approaches apply to most of Africa's economies.⁴⁵

Macroeconomic policy in Africa, therefore, is faced with the challenge of trying to reduce the constraint imposed on its balance of payments and internal domestic employment from commodity dependence. African countries which have made progress towards greater export diversification over the last two decades have managed to best overcome these two constraints, and in turn deliver stronger domestic formal-sector employment growth (Commission et al. 2018).

Achieving this ultimately requires macroeconomic policy in Africa to be more *long-term* orientated than in Europe and the United States, where short-run government spending on consumption is potentially sufficient to stimulate pre-existing domestic, technology-intensive sectors and quickly move the economy back to its full employment status. In contrast, one third of African countries saw government fiscal stimulus post-2008 stimulate almost exclusively domestic consumption and not domestic investment (Coulibaly et al. 2019). In particular, IMF models have tended to focus on improving current account balances in Africa by reducing domestic expenditures (increasing savings) relative to income, rather than adopting a long-run approach which increases national income relative to spending.⁴⁶

⁴³ For example, in 2016 diamonds alone accounted for 21.4 per cent of export revenue for landlocked developing African economies; petroleum accounted for 34.6 per cent for Africa's landlocked developing economies and 24.9 per cent for Africa's lower-middle-income economies; gold accounted for 15.1 per cent of export revenue for Africa's upper-middle-income economies and 22.9 per cent for low-income African economies (Commission et al. 2018).

⁴⁴ Outside of Central and West Africa though, export diversification appears to have improved dramatically. See number of export products it takes to make 75 per cent of export revenue in Commission et al. (2018).

⁴⁵ The diversity of Africa's economies makes a single macroeconomic approach, regardless of its content, not entirely desirable.

⁴⁶ From a static perspective, government deficits can increase current account deficits but over time the opposite can be the case if government deficits are used to fund additional public and private investment expenditures, which improve the long-run supply capacity of the economy. The static perspective follows from the current account balance reflecting the difference between domestic savings and domestic investment, each of which can be broken down into public (*g*) and private sectors (*p*): $S I = S p + S g I p I g$; "In particular, a sustained current account deficit may reflect persistent government spending in excess of receipts, and such excess spending suggests that fiscal tightening is the appropriate policy action" (IMF 1993, 1).

8.2 Understanding employment outcomes

Understanding current employment outcomes is a vital backdrop to this paper.

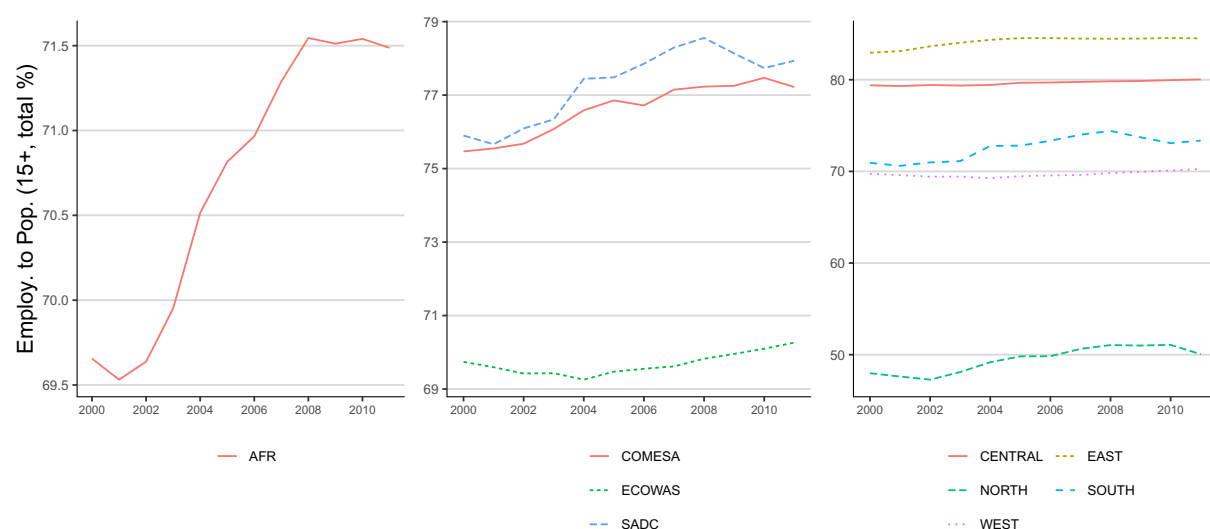
As visible in table 2, in theory Africa compares favourably to the rest of the world in terms of the percentages of the population which is in employment. However, this is misleading and occurs because of the manner in which informal and agricultural employment is included within this data. Figure 15 shows that Central and East Africa have the highest rates of employment (employment to population), whereas this is considerably lower in North Africa. Figure 16 shows the increasing rates of urbanisation across Africa. This will drive people out of agriculture and into the labour market.

Table 2: Employment rates in Africa

	Employment as % of population 25+, 2017	Employment as % of population 25+ (Males), 2017	Employment as % of population 25+ (Females), 2017	Percentage of workers in vulnerable employment, most recent observation (2008-17)
<i>Southern Africa</i>	69,3	79,4	59,7	49,8
<i>Central Africa</i>	79,2	88,5	69,8	64,1
<i>East Africa</i>	50,7	61,7	40,1	72,6
<i>North Africa</i>	53,0	69,9	36,0	28,4
<i>West Africa</i>	76,8	85,8	67,3	78,9
Africa	64,6	75,7	53,6	63,3
Rest of world	62,5	76,2	49,2	41,0

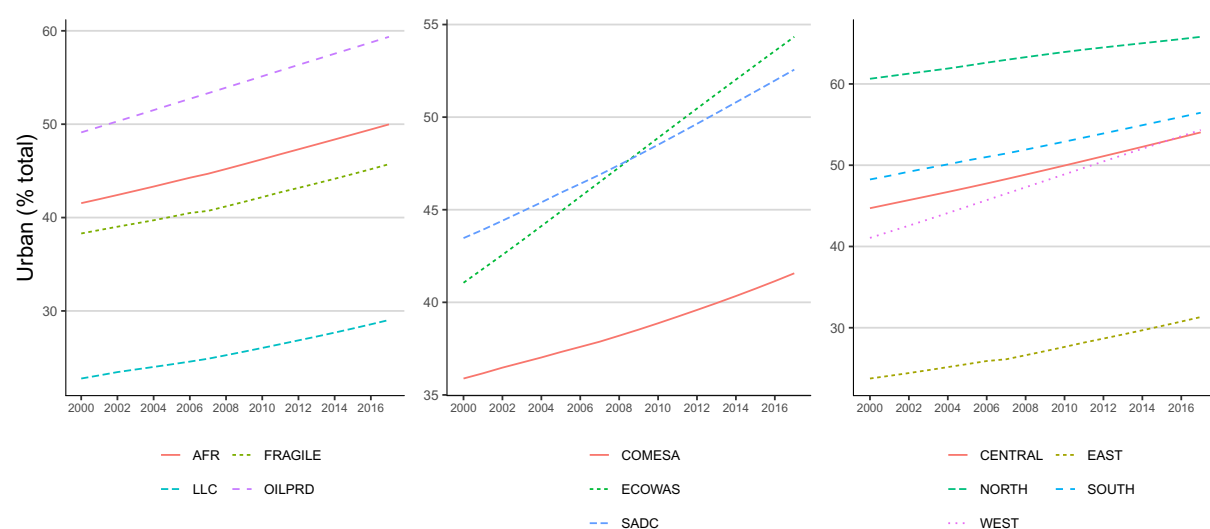
Source: Commission et al. (2018).

► **Figure 15:** Employment to population ratio



Data Source: African Development Bank (2019a).

► **Figure 16:** Urban population as percentage of total population



Data Source: African Development Bank (2019a).

8.2.1 Unemployment in Africa

As a consequence of the above, looking at “unemployment in Africa” as a key metric is not our primary measure of the labour market. However, it is worth considering the dynamics of youth unemployment and the gendered nature of unemployment, particularly because of Africa’s “youth bulge” and our concern for inclusivity and equity.

Youth unemployment:⁴⁷

- ▶ Africa's youth population is rapidly growing and expected to double to over 830 million by 2050.
- ▶ Of Africa's nearly 420 million youth aged 15 to 35, one third are unemployed and discouraged, another third are vulnerably employed, and only one in six is in wage employment. Youth face roughly double the unemployment rate of adults, with significant variation by country.
- ▶ 263 million young people will lack an economic stake in the system by 2025.
- ▶ 90% of Africa's youth live in low- and lower-middle-income countries and the biggest challenge they face is the lack of formal jobs. In these countries, 10 to 15 per cent of youth labour force participants find wage employment, while 30 to 50 per cent are vulnerably employed. In contrast, upper-middle-income countries such as Algeria and South Africa have higher wage employment and lower vulnerable employment but high overall unemployment rates, with almost one in every five youth unemployed.

Gendered unemployment (ILO 2016):

- ▶ Some of the highest gender unemployment gaps are found in Northern Africa.
- ▶ In sub-Saharan Africa, 60 per cent of all working women remain in agriculture, often concentrated in time- and labour-intensive activities, which are unpaid or poorly remunerated.
- ▶ In sub-Saharan Africa, a high proportion of women work as contributing family workers (34.9 per cent) or as own-account workers (42.5 per cent).
- ▶ Informal employment is a greater source of non-agricultural employment for women than for men.
- ▶ Gender gaps in informal employment can reach up to 13 per cent, as is the case in sub-Saharan Africa.
- ▶ In countries in Africa, the prevalence of underemployment for both women and men is high, with gender gaps of 7.5 per cent.

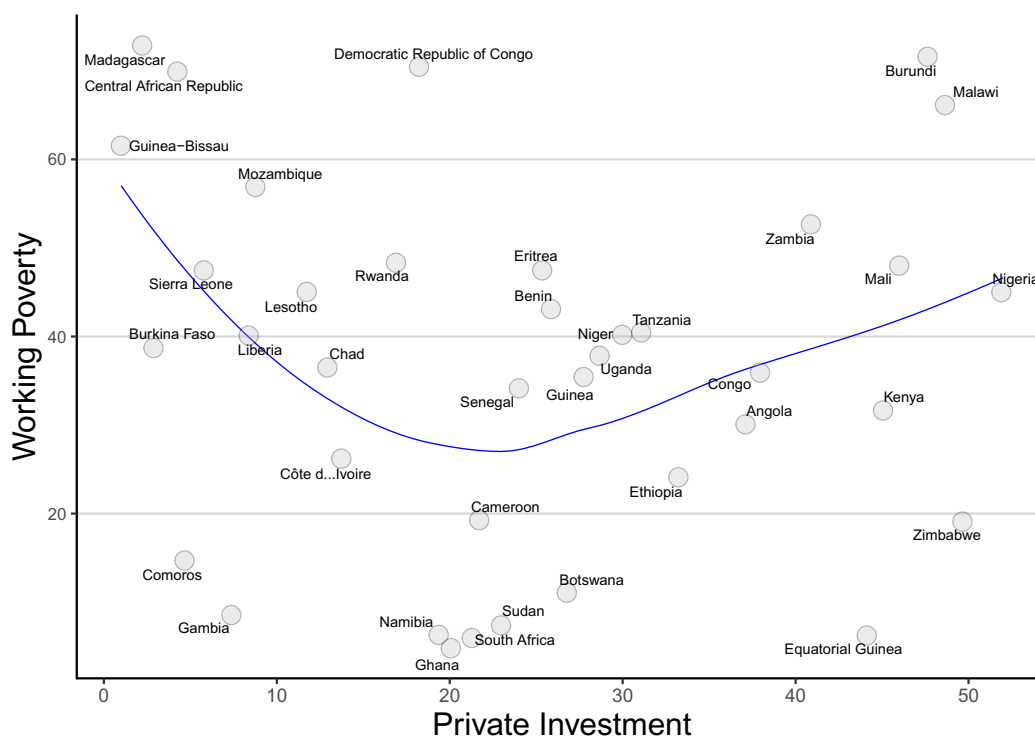
8.2.2 Economic correlates of working poverty in Africa

Given "high" rates of employment, we are better off looking at the quality of that employment. Working poverty is a particularly important measure. As we saw in figure 1, working poverty has fallen in Africa, although less so for women and young people. The figures below explore the macroeconomic correlates of working poverty to try and unpack what might be influencing the prevalence of working poverty across Africa. What we see below:

- ▶ Working poverty is highest in countries with low levels of private investment (figure 17).
- ▶ Working poverty and public investment are not strongly correlated (figure 18).
- ▶ Working poverty is high in commodity-dependent countries (figure 19).
- ▶ Working poverty falls as levels of taxation rise (figure 20) and health (figure 21) and education (figure 22) spending rises.

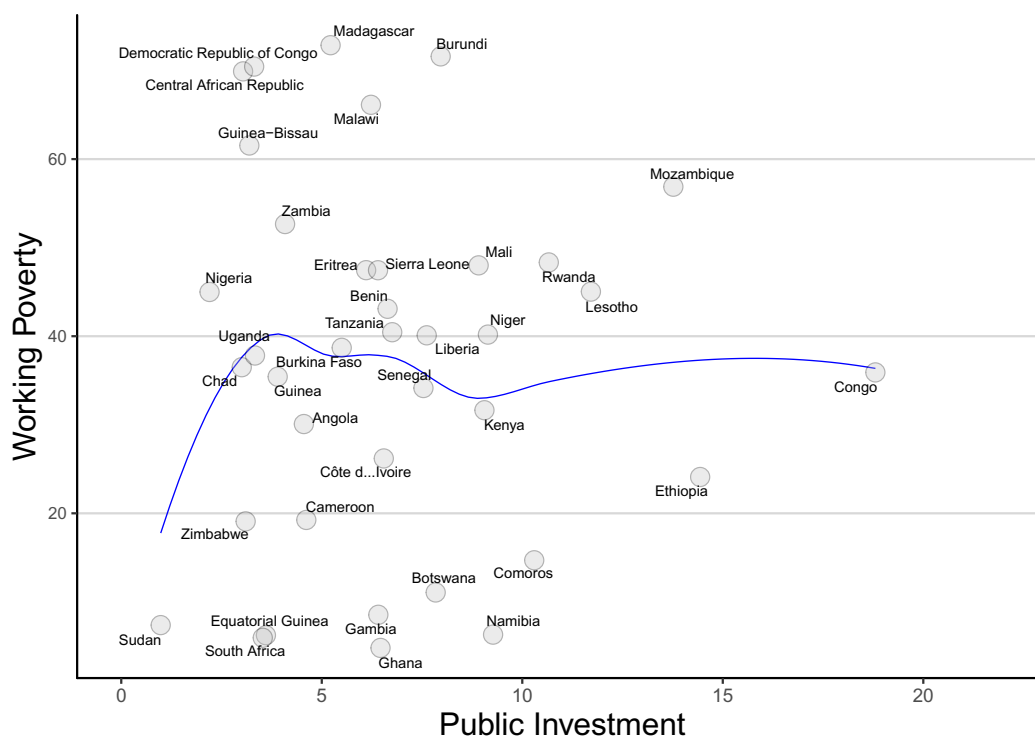
⁴⁷ See, Online: https://www.afdb.org/fileadmin/uploads/afdb/Images/high_5s/job_youth_Africa_job_youth_Africa.pdf.

► **Figure 17:** Working poverty and private investment

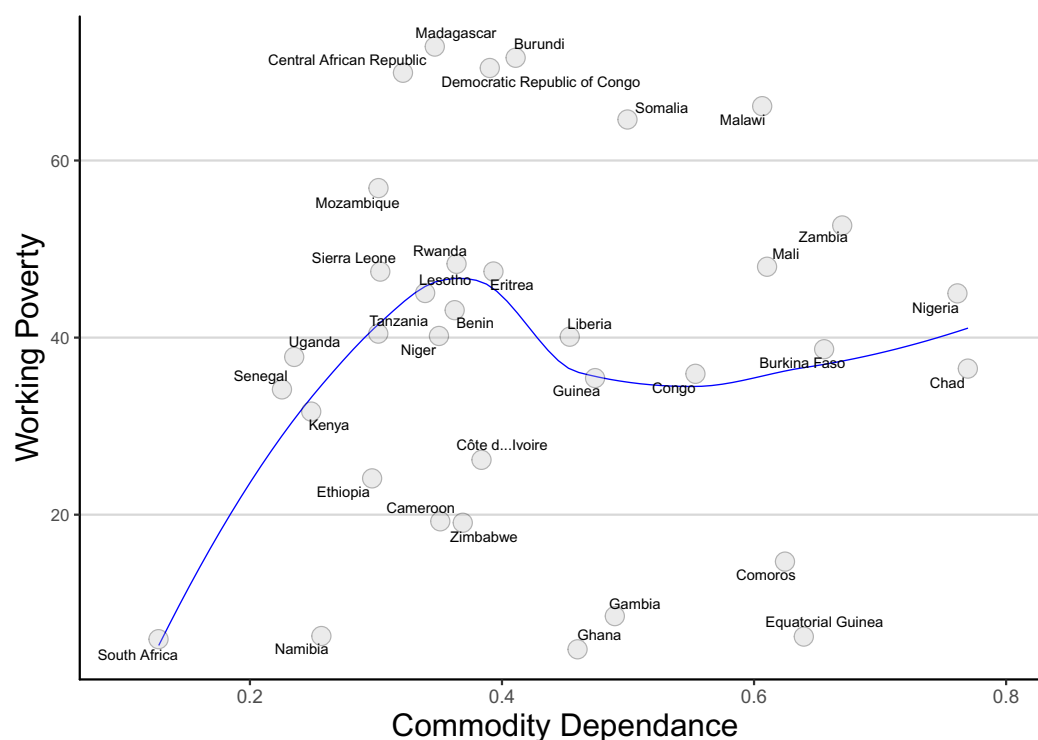


Data Source: World Bank (2019c) and ILO (2019a) for 2016.

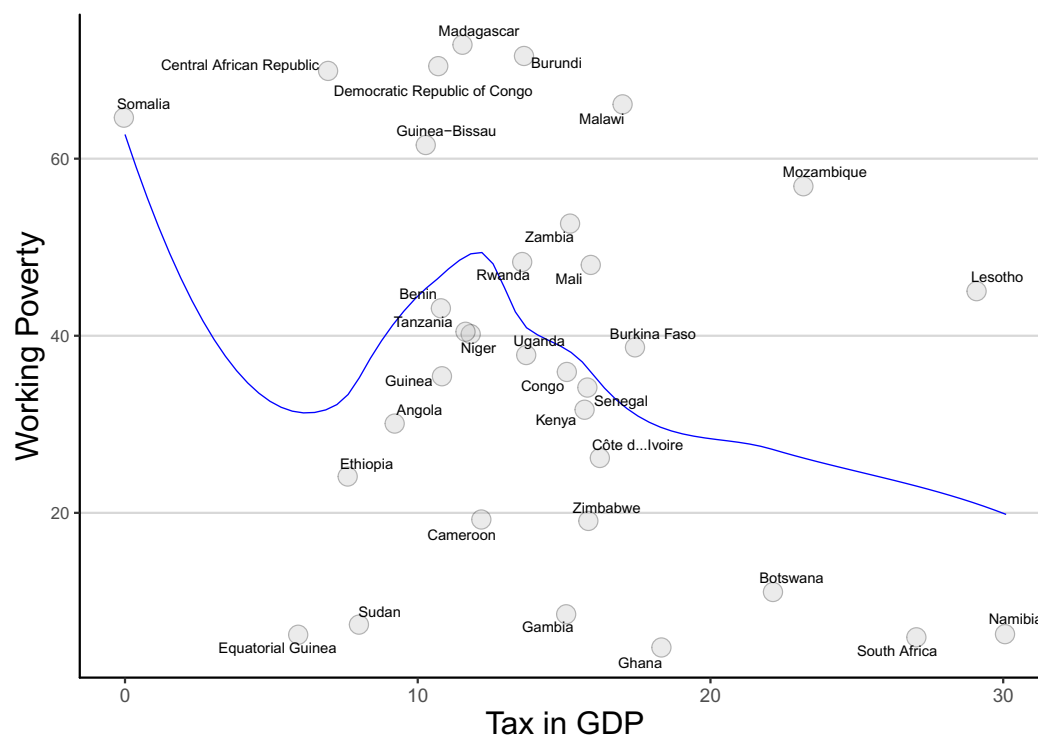
► **Figure 18:** Working poverty and public investment as a percentage of GDP



Data Source: World Bank (2019c) and ILO (2019a) for 2016.

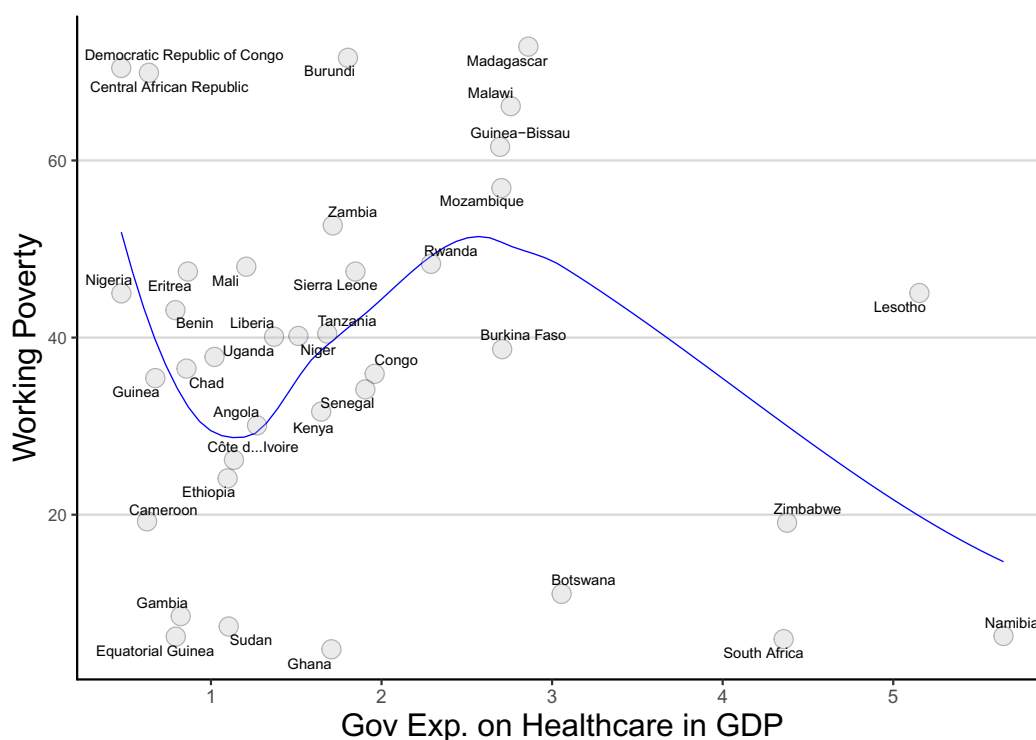
► **Figure 19: Working poverty and commodity dependence**

Data Source: UNCTAD (2019a) and ILO (2019a) for 2016.

► **Figure 20: Working poverty and tax share in GDP**

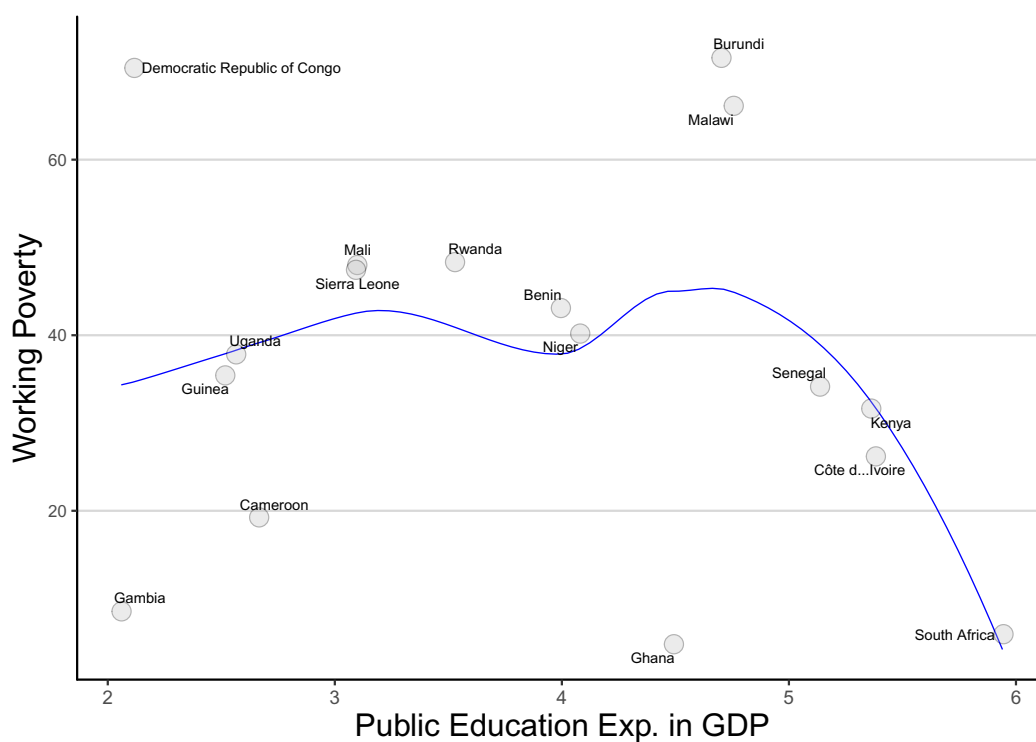
Data Source: World Bank (2019c) and ILO (2019a) for 2016.

► **Figure 21:** Working poverty and government health expenditure as a percentage of GDP



Data Source: World Bank (2019c) and ILO (2019a) for 2016.

► **Figure 22:** Working poverty and public spending on education as a percentage of GDP



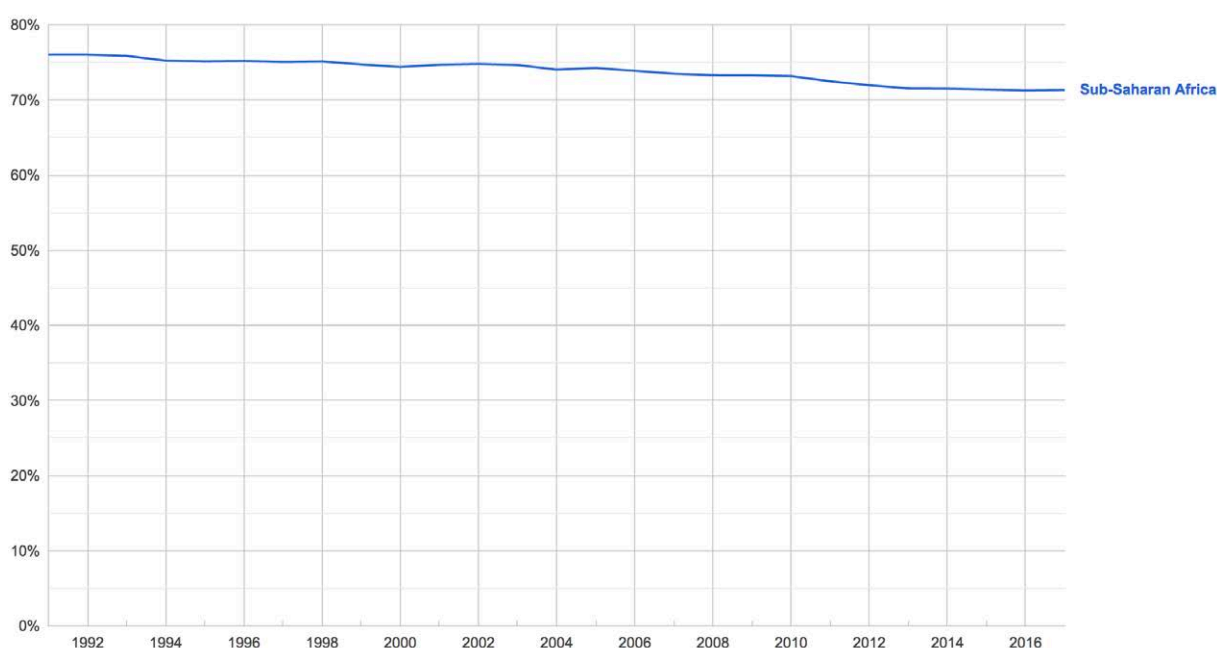
Data Source: World Bank (2019c) and ILO (2019a) for 2016.

8.3 Economic correlates of vulnerable employment in Africa

Although the term “vulnerable employment” is no longer being prioritized in policy analysis, the historical data on the correlates of vulnerable employment is very revealing. Vulnerable employment is unpaid family workers and own-account workers as a percentage of total employment. The proportion of unpaid family workers and own-account workers in total employment is derived from information on status in employment.

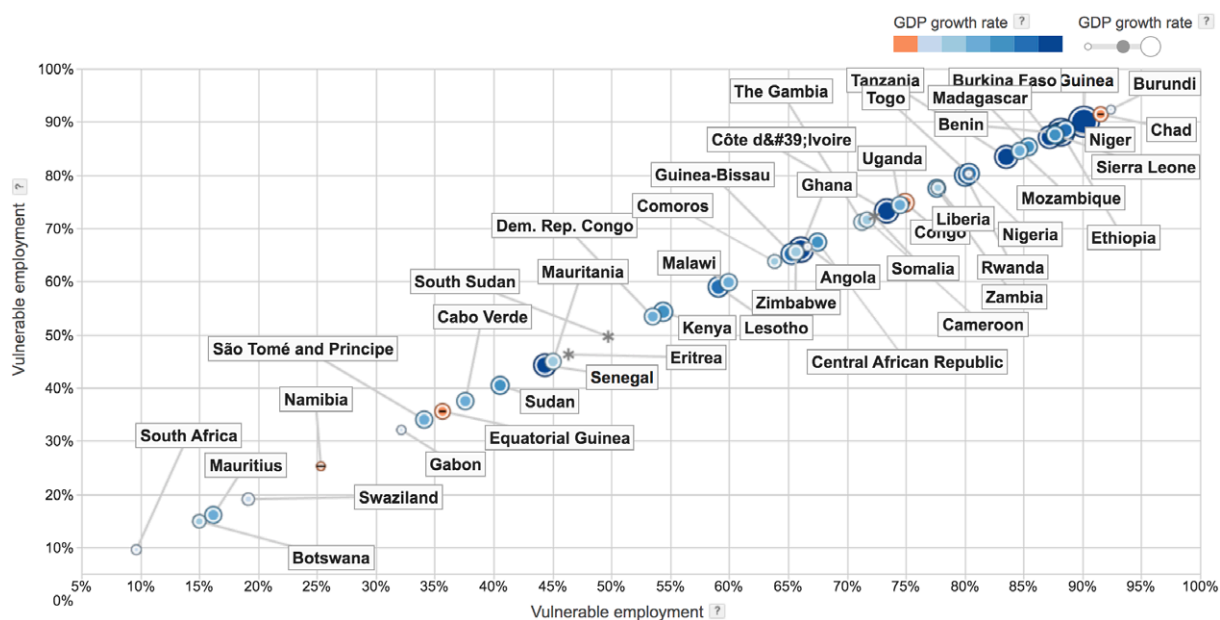
- ▶ Figure 23 shows that vulnerable employment has not fallen much in the last three decades across Africa.
- ▶ Figure 24 shows vulnerable employment by country for 2017. The dot size is proportional to GDP growth. There is no obvious relationship between vulnerable employment and GDP growth in Africa.
- ▶ Figure 25 shows that African countries with higher levels of vulnerable employment are more likely to have to rely on multilateral borrowing and the macroeconomic constraints this involves. As such, those countries with the most levels of vulnerable employment tend to have the most restricted macroeconomic policy space.
- ▶ Figure 26 shows that countries with higher manufacturing exports have much lower vulnerable employment; this indicates the importance of diversification and structural transformation in achieving desired employment outcomes.
- ▶ Figure 27 shows higher interest rates are associated with higher levels of vulnerable unemployment, reflecting greater country level risk/inflation.

▶ **Figure 23:** Trends in vulnerable employment in sub-Saharan Africa



Data Source: World Bank (2019c).

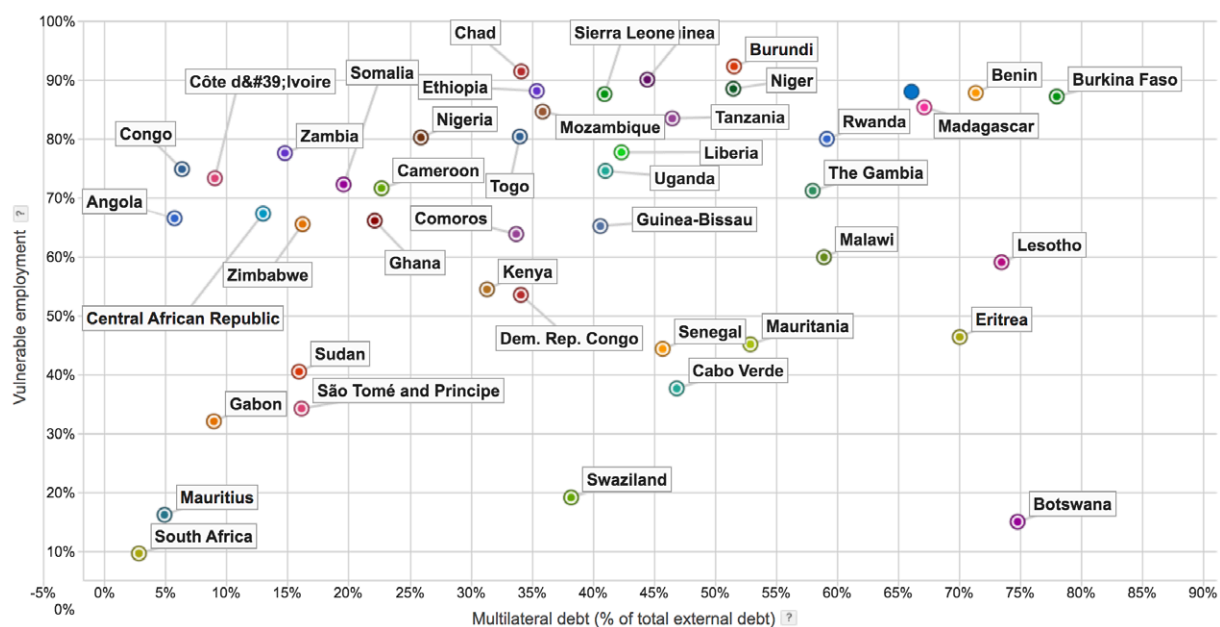
► **Figure 24:** Vulnerable employment in sub-Saharan Africa by country and GDP growth (bubble size)



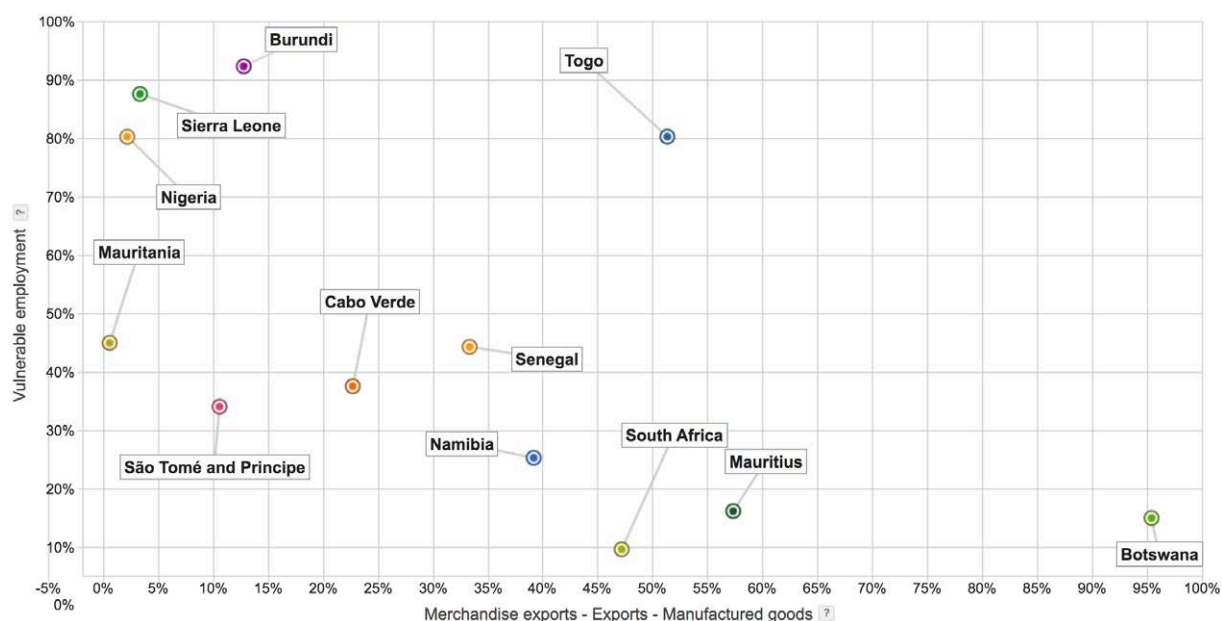
Note: Dot size is proportional to GDP growth.

Data Source: ILO Estimates.

► **Figure 25:** Vulnerable employment and multilateral debt are strongly associated in Africa

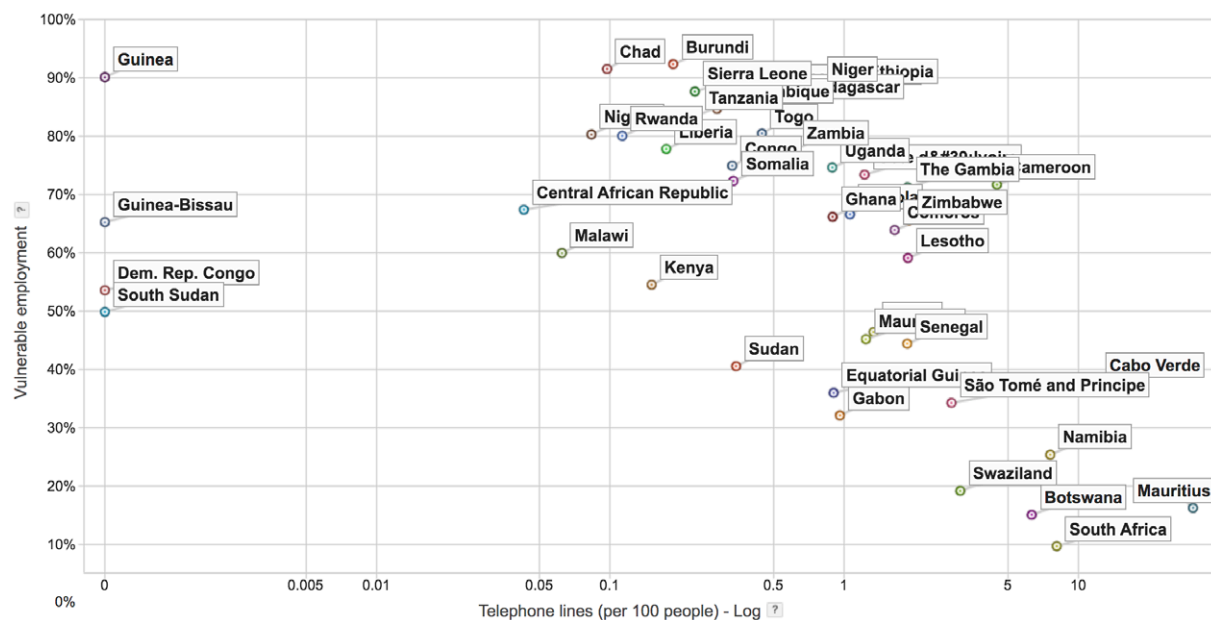


Data Source: Various accessed via Google Data Explorer.

► **Figure 26:** Manufacturing exports and vulnerable employment are inversely related

Note: Showing data for which countries are available.

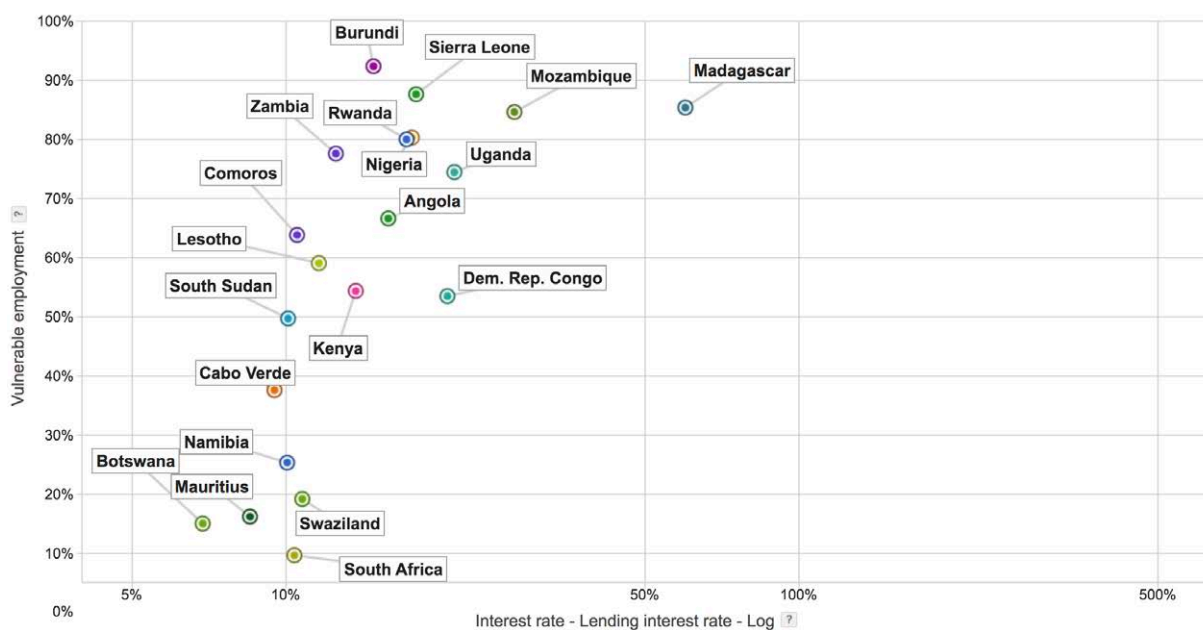
Data Source: Various accessed via Google Data Explorer.

► **Figure 27:** More public infrastructure is related to less vulnerable employment in Africa

Note: Infrastructure development is central to reducing vulnerable employment. This requires fiscal policy to focus limited resources on investment relative to consumption.

Data Source: Various accessed via Google Data Explorer.

► **Figure 28:** Higher interest rates are a feature of countries with more vulnerable employment



Data Source: Various accessed via Google Data Explorer.

8.4 Production structure

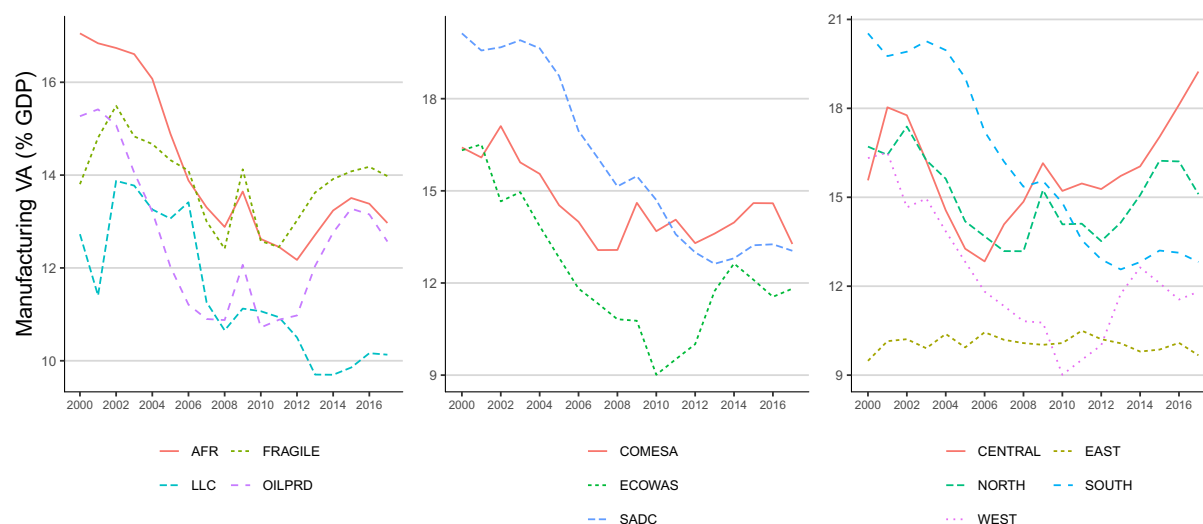
Throughout this paper we have stressed the limitations imposed by the current structure of African economies and the need for structural transformation. The tables and figures below further demonstrate some of those limitations.

- Table 3 shows how commodities continue to play a much more pronounced role in African economies than elsewhere in the world. Resource rents in Africa stand at 7.8 per cent of GDP in comparison to a global 2.8 per cent, agriculture as a share of value added is almost triple the global norm (15.8 per cent versus 5.7 per cent), and manufacturing value added in Africa is below the global norm (14 per cent versus 17.3 per cent); in East and West Africa it is as low as 7 per cent and 9.4 per cent respectively, with Southern Africa sitting at 10.7 per cent.
- Figure 29 reinforces the above and shows that not only is manufacturing as a share of value added low, but it has actually fallen significantly from around 17 per cent of GDP to 13 per cent (the slight difference between the table and the figure is based on data sources and methods of calculations).
- Table 4, figure 30 and figure 31 confirm the above but with reference to exports. We see in table 4 a higher Herfindahl–Hirschman concentration index for Africa and figure 30 confirms that commodities back up the majority of exports.
- Figure 31 shows the poor performance of merchandise exports relative to agriculture, in particular in the latter years shown.
- Figure 32 shows imports and highlights the flipside of exports – what while commodities are being exported, capital and consumer goods are being imported (together with necessary inputs to mining).

Table 3: Sectoral composition of GDP

	Oil rents (% of GDP), 2016	Mineral rents (% of GDP), 2016	Total natural resources rents (% of GDP), 2016	Agriculture, forestry, and fishing, value added (% of GDP), 2016	Industry (including construction), value added (% of GDP), 2016	Manufacturing, value added (% of GDP), 2016	Services, value added (% of GDP), 2016	Employment in agriculture as % of total, 2016	Employment in industry as % of total, 2016	Employment in manufacturing as % of total, 2016	Employment in services as % of total, 2016
<i>Southern Africa</i>	2,1	2,3	7,2	5,1	29,1	10,7	57,5	43,8	13,5	5,9	29,0
<i>Central Africa</i>	6,5	3,1	17,6	16,1	35,3	14,3	42,5	77,2	10,3	8,8	8,9
<i>East Africa</i>	0,1	1,3	7,9	29,4	17,1	7,0	43,5	63,6	10,5	6,4	17,7
<i>North Africa</i>	4,8	0,6	6,6	11,9	31,7	21,1	52,2	25,2	29,6	12,8	23,7
<i>West Africa</i>	2,7	1,7	7,9	22,2	19,8	9,3	55,0	43,6	12,6	8,3	33,1
<i>Africa</i>	3,1	1,4	7,8	15,8	26,3	14,0	52,3	50,4	14,5	8,2	23,7
<i>Rest of world</i>	1,7	0,4	2,8	5,7	28,6	17,3	60,3	24,0	23,7	13,7	30,3

Source: Commission et al. (2018).

► **Figure 29: Manufacturing value added as a percentage of GDP**

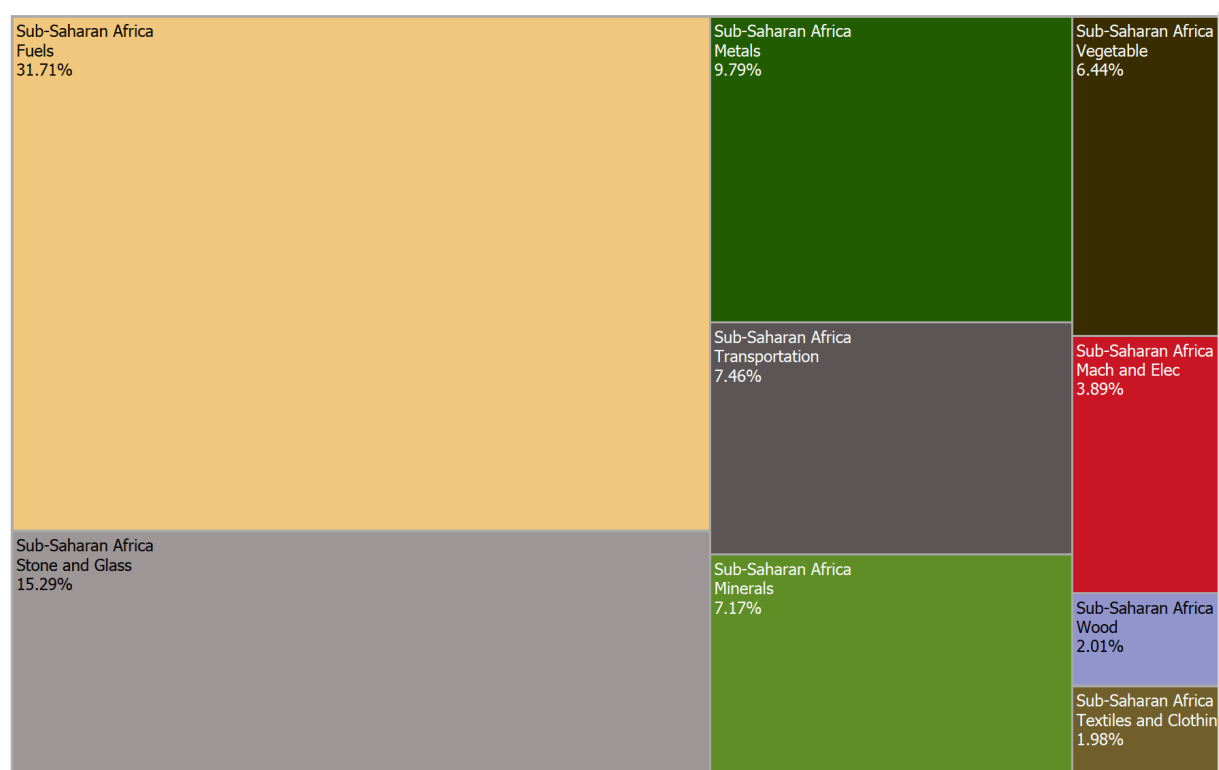
Data Source: African Development Bank (2019a).

Table 4: Export concentration

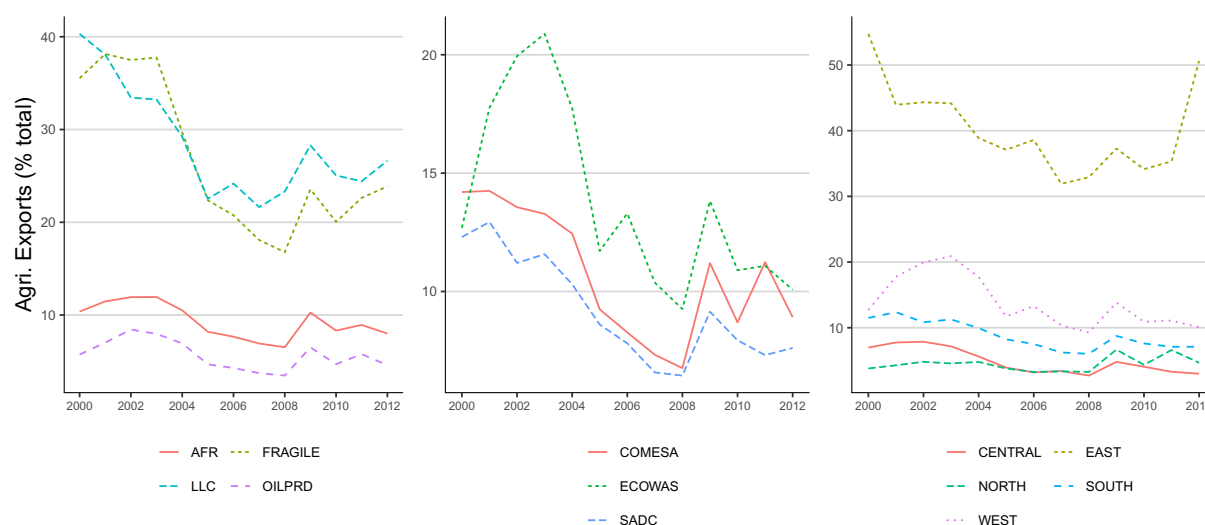
	Number of products amounting to 75% of total exports, 2016	Number of products amounting to 90% of total exports, 2016	Value of total exports of goods and services as % of GDP, 2016	Herfindahl Concentration Index of exports, 2016	Normalized Herfindahl Concentration Index of exports, 2016
<i>Southern Africa</i>	22	110	31,2	0,141	0,136
<i>Central Africa</i>	5	12	29,3	0,351	0,343
<i>East Africa</i>	32	91	16,0	0,227	0,221
<i>North Africa</i>	36	122	18,2	0,150	0,146
<i>West Africa</i>	6	21	15,3	0,264	0,260
<i>Africa</i>	41	145	20,2	0,241	0,236
<i>Rest of world</i>	23	29	27,1	0,143	0,139

Source: Commission et al. (2018).

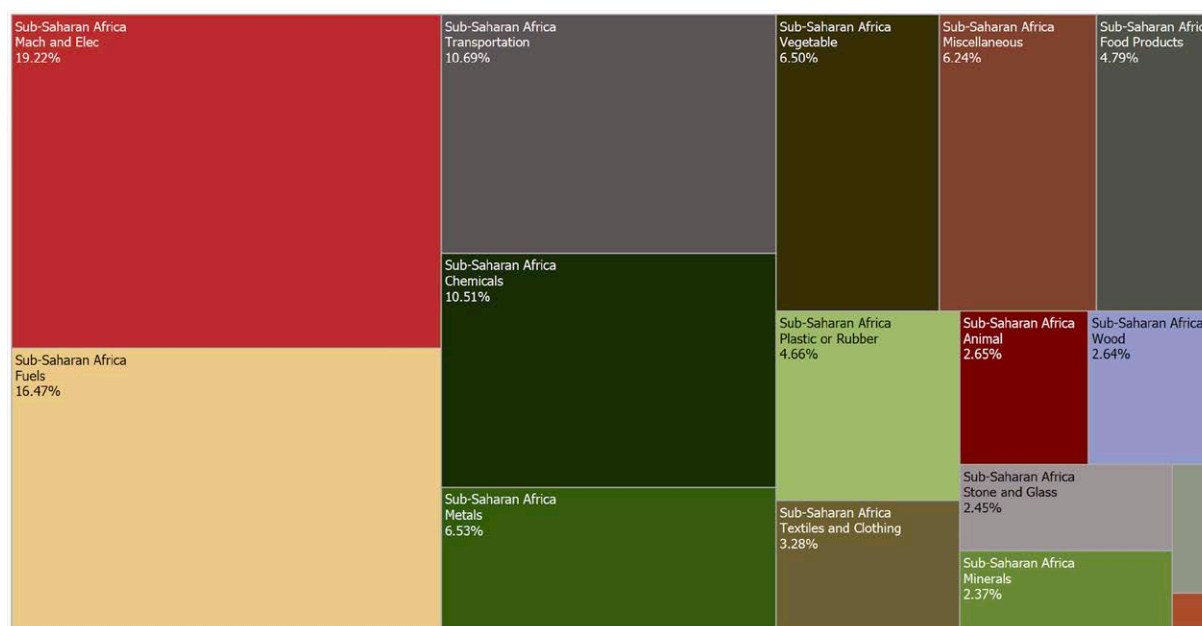
► **Figure 30:** Sub-Saharan African export composition



Data Source: World Bank (2019a).

► **Figure 31:** Agricultural exports (percentage of merchandise exports)

Data Source: African Development Bank (2019a).

► **Figure 32:** Sub-Saharan African import composition

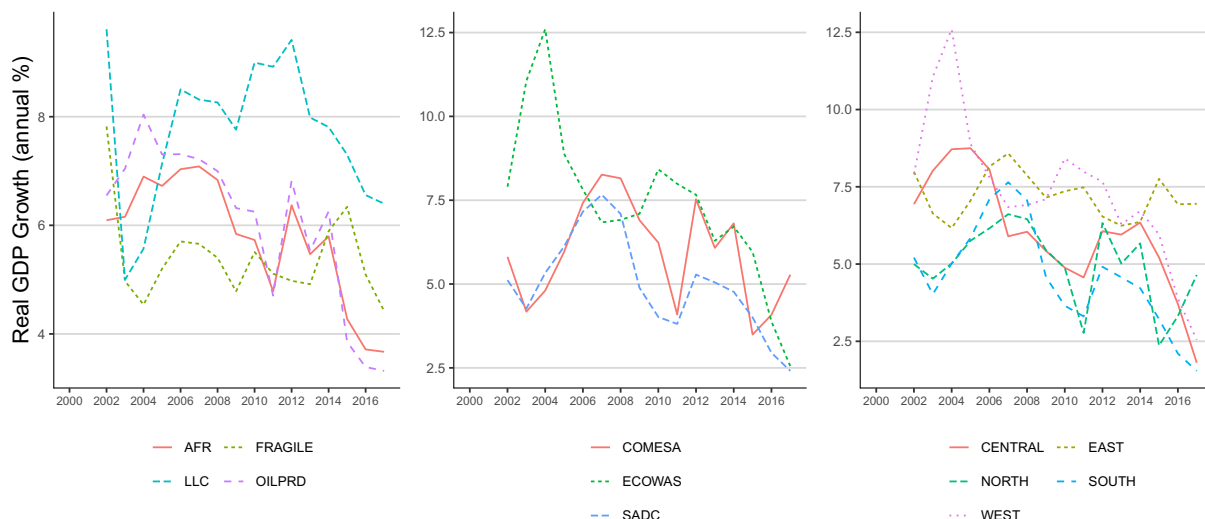
Data Source: World Bank (2019a).

8.5 Macroeconomic context in Africa

In section 2 we describe the current macroeconomic context in Africa. This is supported by data collected and this data is given in this part of the appendix.

For further information on data and country group definitions please visit African Development Bank (2019a). All figures based on annual data. Data is for 2000 to 2017.

► **Figure 33:** Real GDP growth (3-period simple moving average, 2000–2017, constant local currency)



LLC = Land Locked Countries. Countries are: Botswana, Burkina Faso, Burundi, Central African Republic, Chad, Ethiopia, Lesotho, Malawi, Mali, Niger, Rwanda, Eswatini, Uganda, Zambia and Zimbabwe.

FRAGILE = Fragile States. Countries are: Burundi, Central African Republic, Comoros, Congo (Democratic Republic of), Côte d'Ivoire, Guinea Bissau, Sierra Leone, Sudan and Togo.

OILPRD = Oil Producers. Countries are: Algeria, Angola, Cameroon, Chad, Congo, Côte d'Ivoire, Congo (Democratic Republic of), Egypt, Equatorial Guinea, Gabon, Ghana, Libya, Mauritania, Nigeria, Sudan and Tunisia.

8.5.1 Performance indicators

- Figure 34 shows that Africa experienced above normal growth in GDP per capita during the commodity boom. However, it has recently fallen across country groups and regions. This growth did not translate into rapid changes in the nature of employment in Africa because production did not shift sufficiently into higher productivity outlets.
- Table 5 shows middling growth projections for all except a handful of countries. It also shows that this is currently accompanied by current account deficits.

Note: Moving average is used to help smooth the data (remove volatility).

Data Source: African Development Bank (2019a).

► **Figure 34:** Impressive gains in GDP per capita for sub-Saharan Africa are in reverse

Data Source: World Bank (2019c).

Table 5: Sub-Saharan African economies: Key metrics

	Real GDP			Consumer Prices ¹			Current Account Balance ²			Unemployment ³		
	2018	Projections 2019 2020		2018	Projections 2019 2020		2018	Projections 2019 2020		2018	Projections 2019 2020	
Sub-Saharan Africa	3.2	3.2 3.6		8.5	8.4 8.0		-2.7	-3.6 -3.8		...	...	...
Oil Exporters⁴	1.3	2.0 2.4		13.0	11.4 11.4		1.9	-0.1 -0.3		...	...	...
Nigeria	1.9	2.3 2.5		12.1	11.3 11.7		1.3	-0.2 -0.1		22.6	...	...
Angola	-1.2	-0.3 1.2		19.6	17.2 15.0		6.1	0.9 -0.7		...	...	...
Gabon	0.8	2.9 3.4		4.8	3.0 3.0		-2.4	0.1 0.9		...	...	...
Republic of Congo	1.6	4.0 2.8		1.2	1.5 1.8		6.7	6.8 5.3		...	...	...
Chad	2.4	2.3 5.4		4.0	3.0 3.0		-3.4	-6.4 -6.1		...	...	...
Middle-Income Countries⁵	2.8	2.8 2.9		4.6	4.6 5.2		-3.6	-3.6 -3.9		...	...	...
South Africa	0.8	0.7 1.1		4.6	4.4 5.2		-3.5	-3.1 -3.6		27.1	27.9	28.4
Ghana	6.3	7.5 5.6		9.8	9.3 9.2		-3.1	-3.6 -3.8		...	...	...
Côte d'Ivoire	7.4	7.5 7.3		0.4	1.0 2.0		-4.7	-3.8 -3.8		...	...	...
Cameroon	4.1	4.0 4.2		1.1	2.1 2.2		-3.7	-3.7 -3.5		...	...	...
Zambia	3.7	2.0 1.7		7.0	9.9 10.0		-2.6	-3.6 -3.4		...	...	...
Senegal	6.7	6.0 6.8		0.5	1.0 1.5		-8.8	-8.5 -11.1		...	...	...
Low-Income Countries⁶	6.2	5.3 5.9		7.6	9.2 7.4		-7.0	-7.9 -8.0		...	...	...
Ethiopia	7.7	7.4 7.2		13.8	14.6 12.7		-6.5	-6.0 -5.3		...	...	...
Kenya	6.3	5.6 6.0		4.7	5.6 5.3		-5.0	-4.7 -4.6		...	...	...
Tanzania	7.0	5.2 5.7		3.5	3.6 4.2		-3.7	-4.1 -3.6		...	...	...
Uganda	6.1	6.2 6.2		2.6	3.2 3.8		-8.9	-11.5 -10.5		...	...	...
Democratic Republic of the Congo	5.8	4.3 3.9		29.3	5.5 5.0		-4.6	-3.4 -4.2		...	...	...
Mali	4.7	5.0 5.0		1.7	0.2 1.3		-3.8	-5.5 -5.5		...	...	...
Madagascar	5.2	5.2 5.3		7.3	6.7 6.3		0.8	-1.6 -2.7		...	...	...
<i>Memorandum</i>												
Sub-Saharan Africa Excluding South Sudan	3.2	3.2 3.6		8.2	8.3 8.0		-2.7	-3.6 -3.8		...	...	...

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a list of economies with exceptional reporting periods.

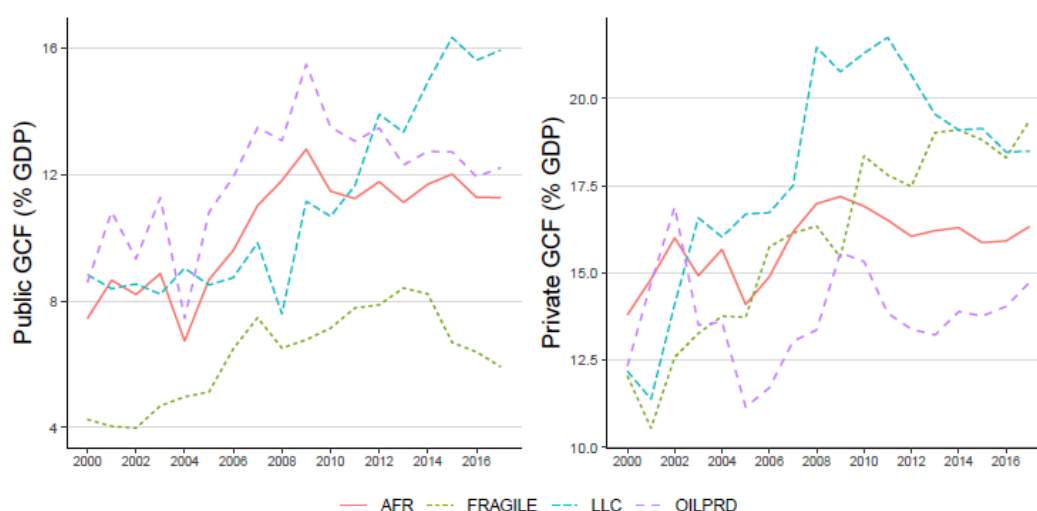
¹Movements in consumer prices are shown as annual averages. Year-end to year-end changes can be found in Table A7 in the Statistical Appendix.²Percent of GDP.³Percent. National definitions of unemployment may differ.⁴Includes Equatorial Guinea and South Sudan.⁵Includes Botswana, Cabo Verde, Eswatini, Lesotho, Mauritius, Namibia, and Seychelles.⁶Includes Benin, Burkina Faso, Burundi, the Central African Republic, Comoros, Eritrea, The Gambia, Guinea, Guinea-Bissau, Liberia, Malawi, Mali, Mozambique, Niger, Rwanda, São Tomé and Príncipe, Sierra Leone, Togo, and Zimbabwe.**Note:** Real GDP, Consumer Prices, Current Account Balance and Unemployment (annual percentage change, unless noted otherwise).

Data Source: IMF (2019d).

8.5.2 Investment indicators

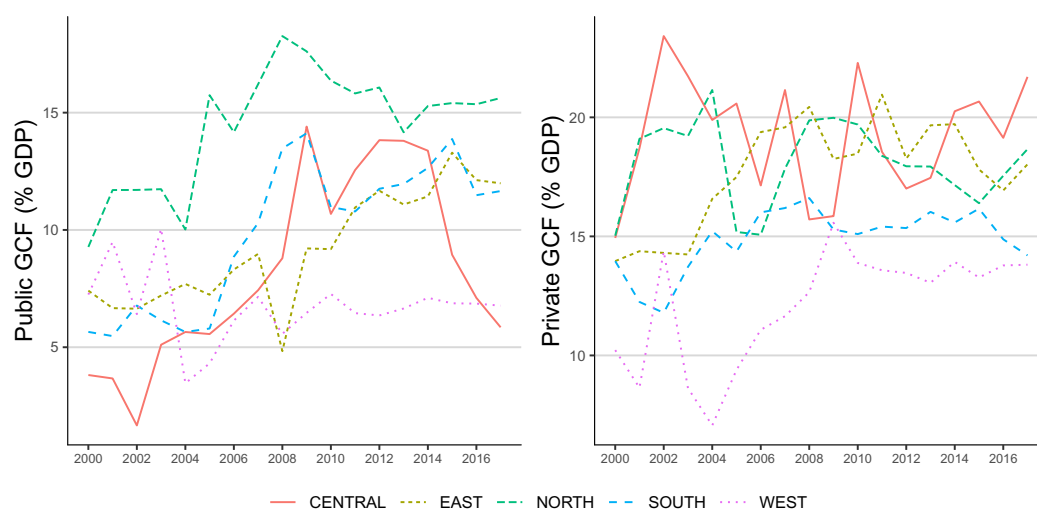
As discussed in the paper, investment is considered key for long-term growth. Figure 35, figure 36 and figure 37 show public and private investment trends across groupings and regions. We see that since the end of the commodity boom (circa 2008) both public and private sector investment rates have levelled off after a period of increase. The main groupings to have sustained public investment increases are oil producers and East Africa. The hardest hit have been fragile states and Central and North African economies. For private investment, investment in oil-producing economies was sustained until 2010 but has tapered off subsequently. In recent years, Southern African has seen falling private sector investment, probably due to reduced investment in South Africa.

► **Figure 35:** Public and private investment rates (gross capital formation as percentage of GDP) by groupings



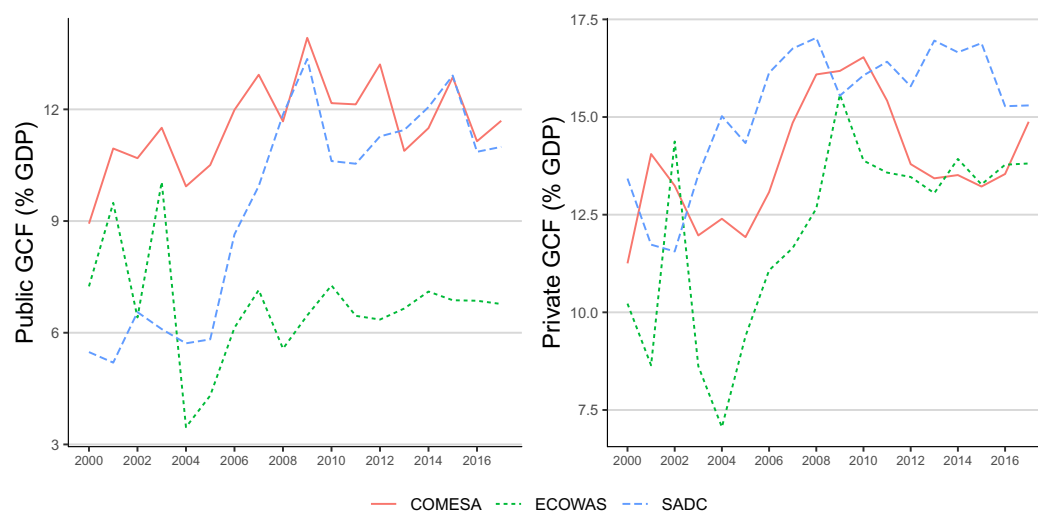
Data Source: African Development Bank (2019a).

► **Figure 36:** Public and private investment rates (gross capital formation as a percentage of GDP) by region



Data Source: African Development Bank (2019a).

► **Figure 37:** Public and private investment rates (gross capital formation as a percentage of GDP) by regional economic community (REC)



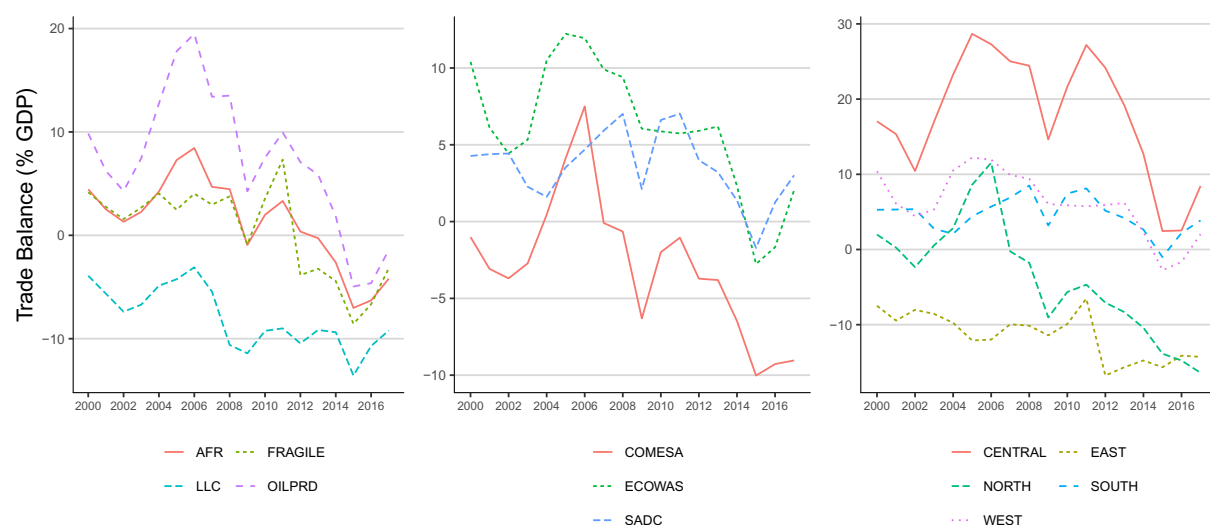
Data Source: African Development Bank (2019a).

8.5.3 Balance of payments

The balance of payments has received particular attention and figures below give further statistical evidence.

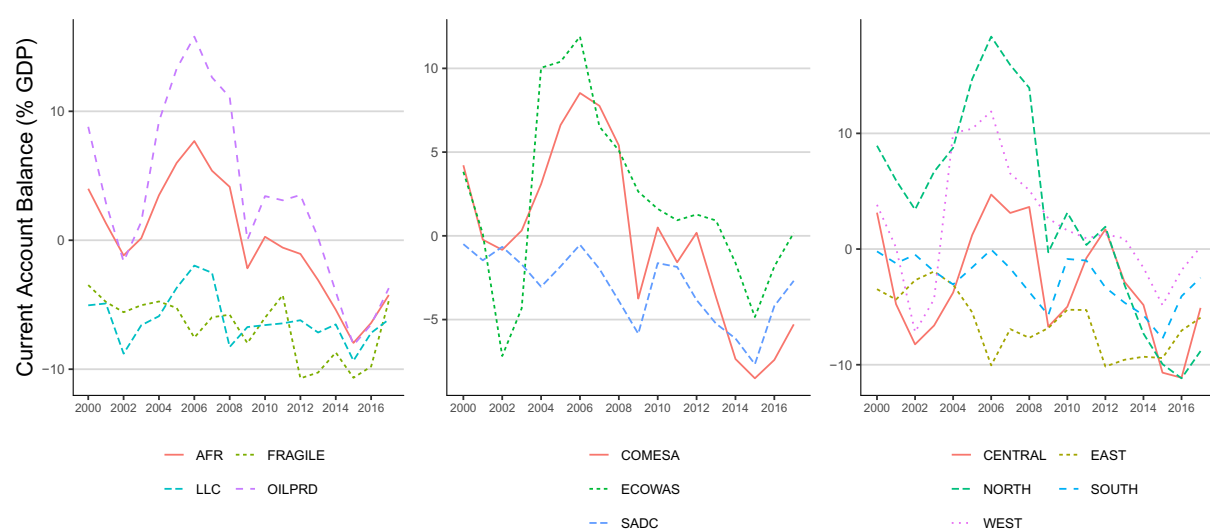
- Figure 38 shows a deteriorating trade balance in line with the end of the commodity boom; this is particularly pronounced in Central and North Africa. Africa's trade balance is therefore shown to be reliant on high commodity prices and is cyclical in nature. It limits the ability of Africa to fund policies which advance employment.
- This results in worsening current account balances as shown in figure 39.
- Figure 40 shows how the financial account inflows have helped to sustain Africa's trade deficit. This means they are cyclical in nature, such that they help the economy overheat but are not supportive of the trade deficit for most African economies when commodity prices are low.
- FDI has also been cyclical in nature, as visible in figure 41, with a fall occurring towards the end of the commodities boom; this is particularly pronounced for Southern Africa. Table 7 shows that portfolio flows are below the rest of the world and negative in Central Africa, East Africa and North Africa. Official development assistance is higher for Africa, and FDI and remittances are above the rest of the world.

► **Figure 38:** Trade account balance as a percentage of GDP



Data Source: African Development Bank (2019a).

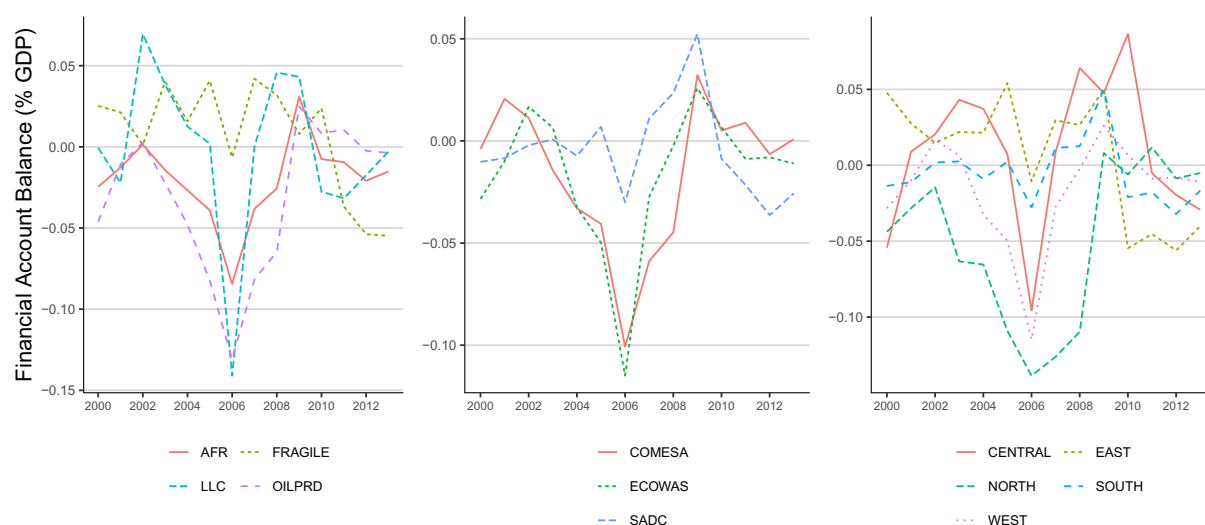
► **Figure 39:** Current account balance as a percentage of GDP



Note: The current account is roughly equal to the sum of the trade balance and the balance on investment income (foreign direct and portfolio).

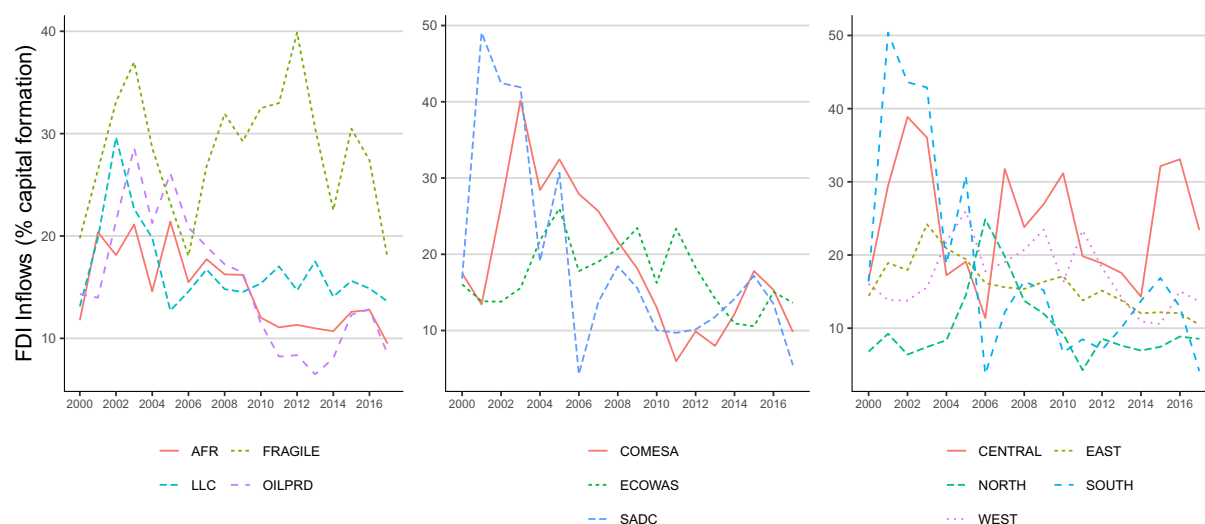
Data Source: African Development Bank (2019a).

► **Figure 40:** Financial account balance as a percentage of GDP



Data Source: Authors constructed from African Development Bank (2019a) GDP and Financial Account current US\$ data series.

► **Figure 41:** Foreign direct investment (percentage of gross capital formation)



Data Source: African Development Bank (2019a).

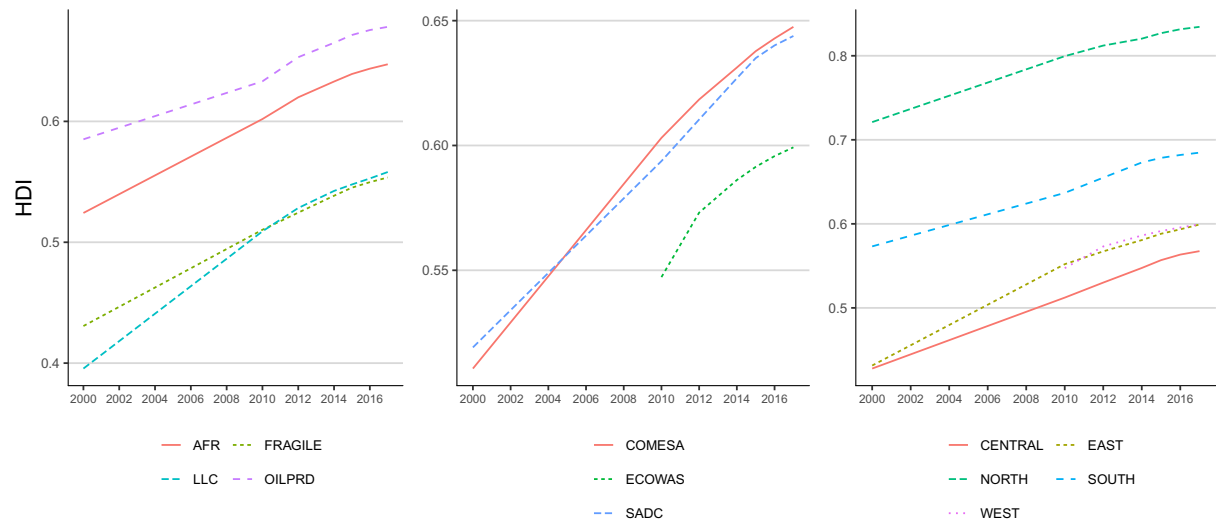
Table 6: Global financial integration and capital flows

	Portfolio investment inflows as % of GDP, 2016	Net Official Development Assistance (ODA) inflows as % of GDP, 2016	Foreign Direct Investment (FDI) inflows as % of GDP, 2016	Remittances inflows as % of GDP, 2016	Total financial inflows as a % of GDP, 2016
<i>Southern Africa</i>	2,1	1,6	2,5	0,6	6,8
<i>Central Africa</i>	-0,4	3,7	7,4	0,5	11,1
<i>East Africa</i>	-1,7	5,8	2,9	1,6	8,6
<i>North Africa</i>	-0,2	0,8	2,0	4,5	7,0
<i>West Africa</i>	0,8	2,0	2,2	4,9	9,8
Africa	0,3	2,1	2,5	3,3	8,2
Rest of world	0,9	0,2	2,2	1,1	4,4

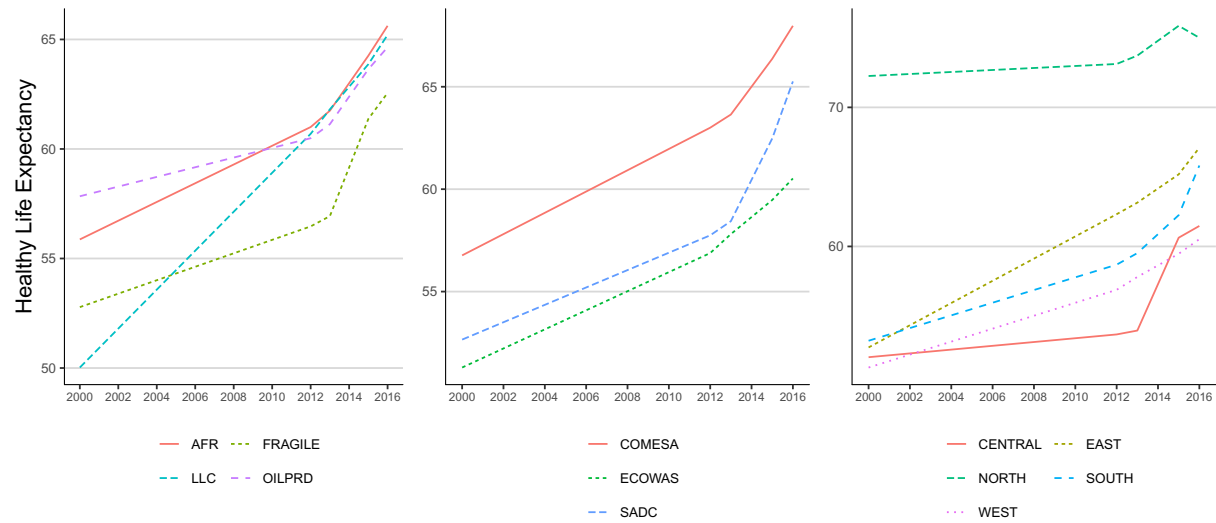
Source: Commission et al. (2018).

8.5.4 Development indicators

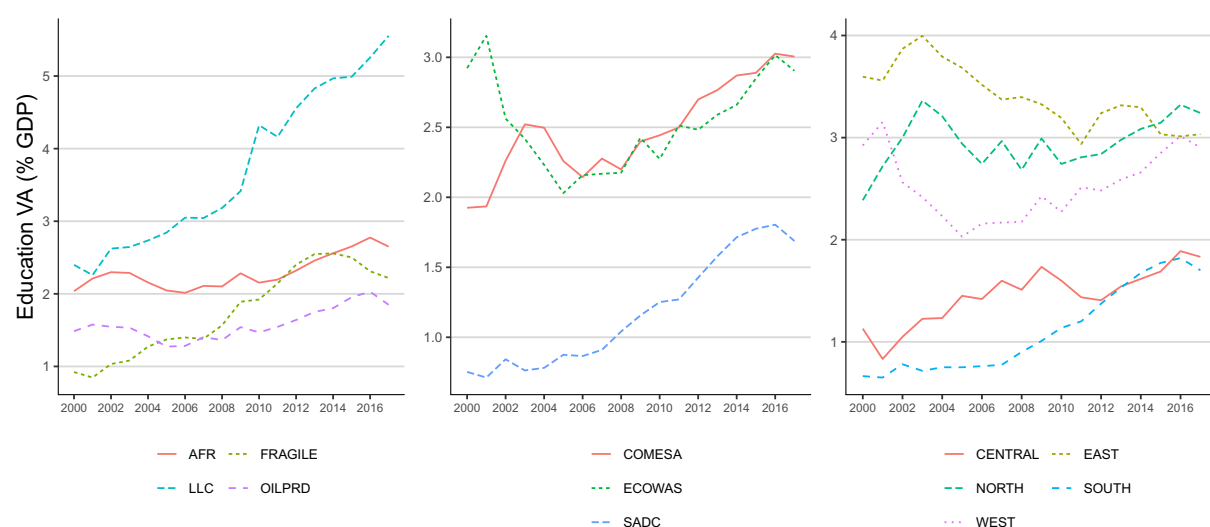
African countries have seen an improvement in development indicators across different indicators and groupings. This is captured in the improved Human Development Index shown in figure 42, and increased life expectancy in figure 43; an increase in educational investment has probably had some positive benefit as seen in figure 44. Improvements are also visible with regards to increased access to water and sanitation as seen in figure 45 and figure 46 respectively. However, this is unevenly distributed – figure 47, for example, shows that gains in sanitation are muted for the urban population, reflecting large population growth and growing urbanisation rates as the labour force moves out of informal agricultural production.

► **Figure 42: Human Development Index (HDI)**

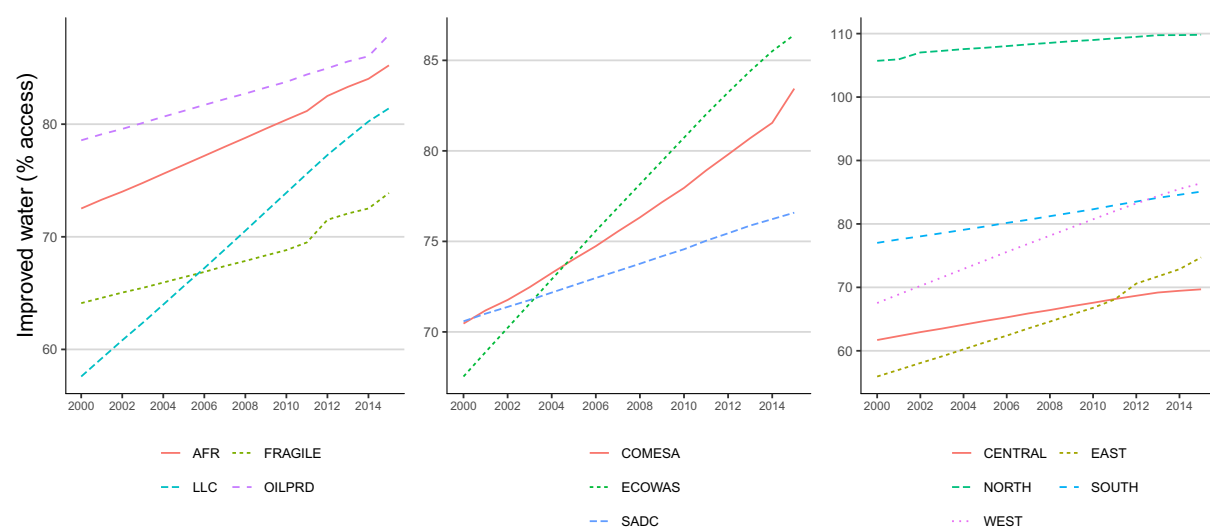
Data Source: African Development Bank (2019a).

► **Figure 43: Healthy life expectancy (for babies born in 1990)**

Data Source: African Development Bank (2019a).

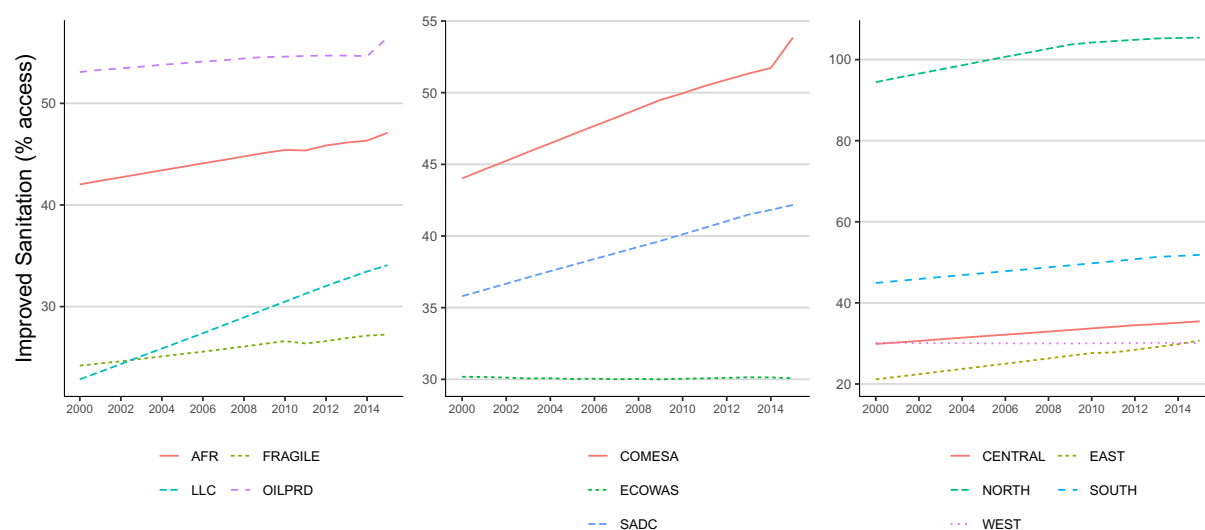
► **Figure 44:** Education value added (as a percentage of GDP)

Data Source: African Development Bank (2019a).

► **Figure 45:** Access to improved water (percentage of total population)

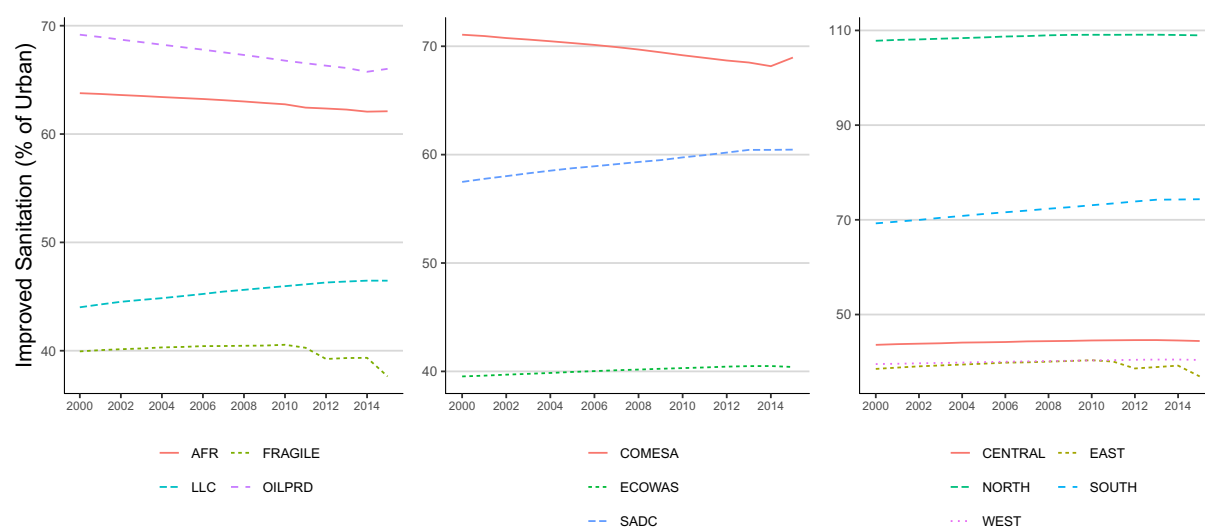
Data Source: African Development Bank (2019a).

► **Figure 46:** Access to improved sanitation (percentage of total population)



Data Source: African Development Bank (2019a).

► **Figure 47:** Access to improved sanitation (percentage of urban population)



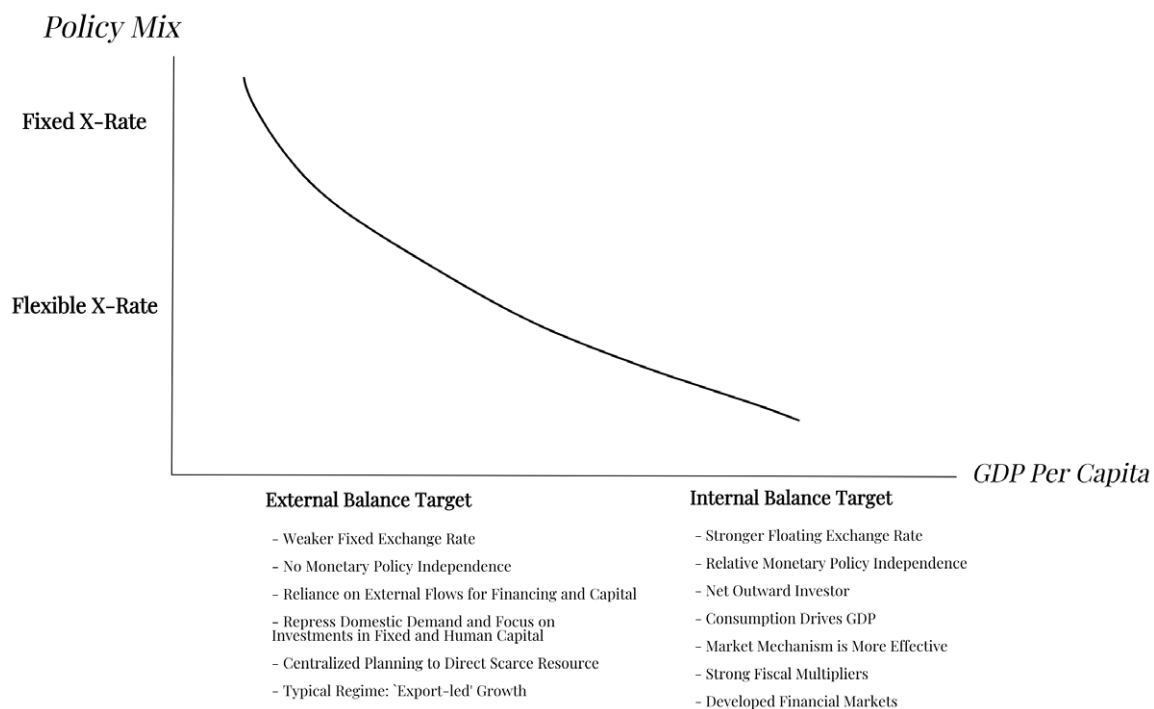
Data Source: African Development Bank (2019a).

8.6 Macroeconomic policy regimes in Africa

8.6.1 Further discussion of the Swan Approach

The historical development trajectory of countries is shown in figure 48. Human-centred and productive investments is what has allowed and facilitated the transition from external balance to internal balance.

► **Figure 48:** Stylized macroeconomic policy mix historically



Note: At lower levels of GDP per capita, economies have tended to focus on developing supply through the allocation of resources towards investment and away from consumption. This is done through greater use of fixed prices including exchange rates. As a country becomes richer, internal balance is prioritized and is now more congruent with external balance as domestic supply capacity is more fully articulated. Exchange rates are flexible and monetary policy becomes more independent.

Complications to the Swan Approach exist. A one-time exchange rate depreciation has never been – and still is not – an easy “solution”, given mass currency speculation which can follow, potential inflationary pressure, and higher foreign denominated debt costs (Frankel 2005; Rajan and Shen 2006). As a result, a currency depreciation usually must be used in conjunction with strong capital controls (which can become “too” effective); or instead undertaken via floating the exchange rate in conjunction with market-friendly fiscal contraction to ensure no massive outflows occur; or instead done via repression of domestic prices through productivity increases and deflation.⁴⁸ It will also require accumulated foreign reserves to withstand any possible immediate increase in import costs as exports can be slower to respond to the exchange rate depreciation.

Perhaps more fundamentally, only sectoral diversification and upgrading, which expands and diversifies supply conditions within the country, can provide the economy with greater “breathing room” and a greater number of policy options in addressing these challenges. This can be seen by noting that the exchange rate can only serve its role as an expenditure switching device if domestic production is diversified and globally competitive (Davidson 2015), such that a depreciation allows domestic firms to replace imports and increase exports. Moreover, without diversified domestic production, the income elasticity of demand for imports will be high, such that fiscal stimulus could

⁴⁸ See discussion by Paul Krugman, 1998, “Latin America’s Swan Song”, online: <http://web.mit.edu/krugman/www/swansong.html>.

shift the entire external balance line (Davidson 2015). This is not at all a call for “self-reliance”, since foreign finance, capital and value chain integration are necessary parts of any solution.

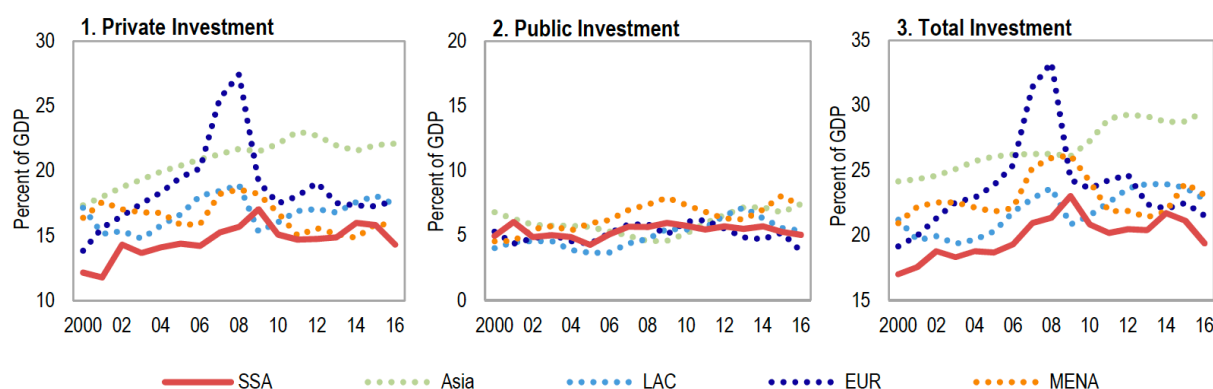
8.6.2 Fiscal policy indicators

The paper contains a discussion of current macroeconomic policy approaches. The figures here give further information.

- Figure 49 shows how sub-Saharan Africa has made impressive gains in investment which need to be sustained and advanced. Private investment is still far lower in sub-Saharan Africa than in other regions. However, its growth trend since 2001 has been far above any other region, including Asia. This has gone hand-in-hand with robust public sector investment rates, challenging the levels seen in Europe (EUR) and Latin America and Caribbean (LAC). Total investment remains low despite the gains. Asia’s rate is roughly double that of sub-Saharan Africa.
- In general, as shown in figure 50, government spending and debt supports investment spending in Africa. The relationship is non-linear for government debt though, such that more debt can be associated with less government investment spending in GDP; country size and development will mediate this relationship considerably.

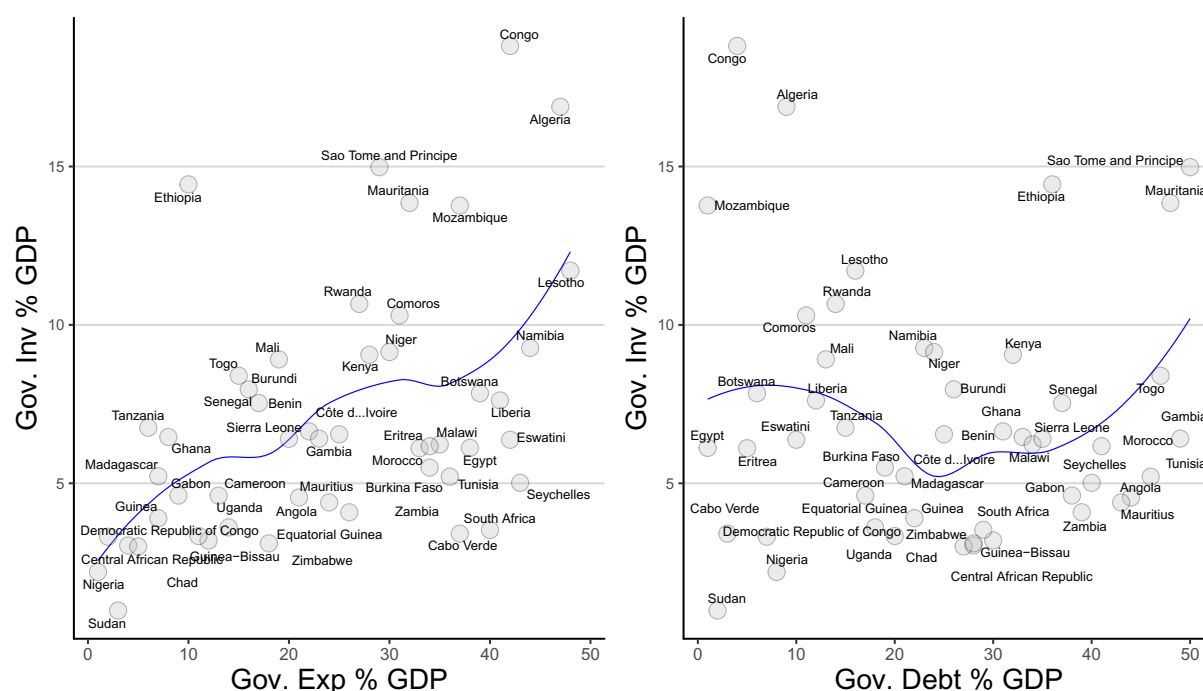
Figure 51 shows an increase in debt service costs since the end of the commodities boom and global financial crisis. This is linked to falling tax revenue (figure 8) and rising deficits (figure 52). This is exacerbated by the fact that commodity-dependent and lower-income economies tend to have a lower tax intake (relative to GDP) than more developed economies (figure 53). Government revenue in Africa is unfortunately considerably lower than global averages. Table 7 shows that revenue as a percentage of GDP is only 21.8 per cent in Africa compared to 33.3 per cent in the rest of the world, and that this is driven by lower tax intake (only 27.1 per cent of GDP compared to 35.3 per cent), while levels of debt remain comparable.

► **Figure 49:** Comparative levels of investment



Source: IMF (2018).

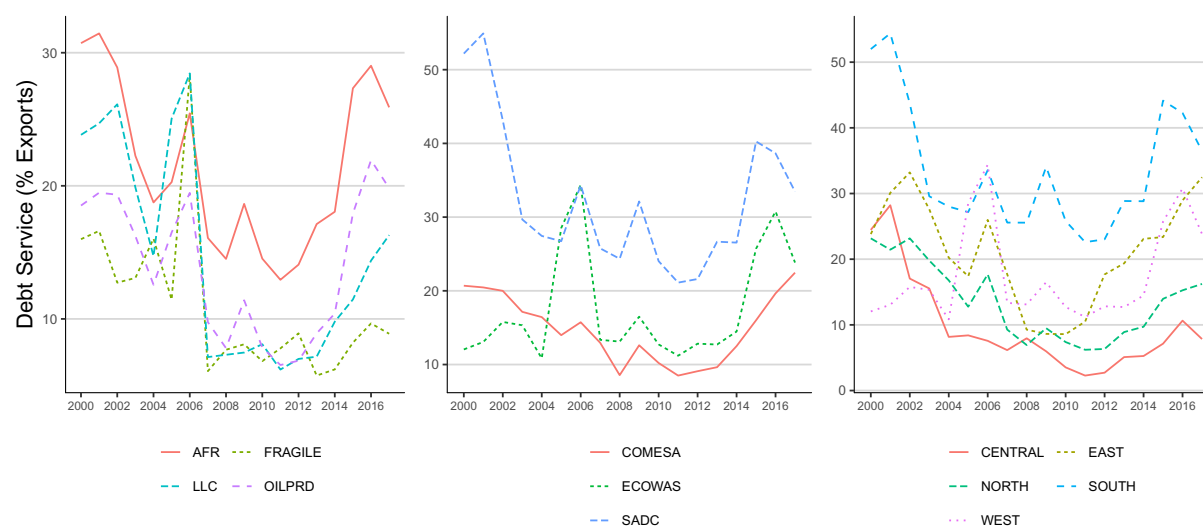
► **Figure 50:** Fiscal policy in Africa is fairly supportive of investment



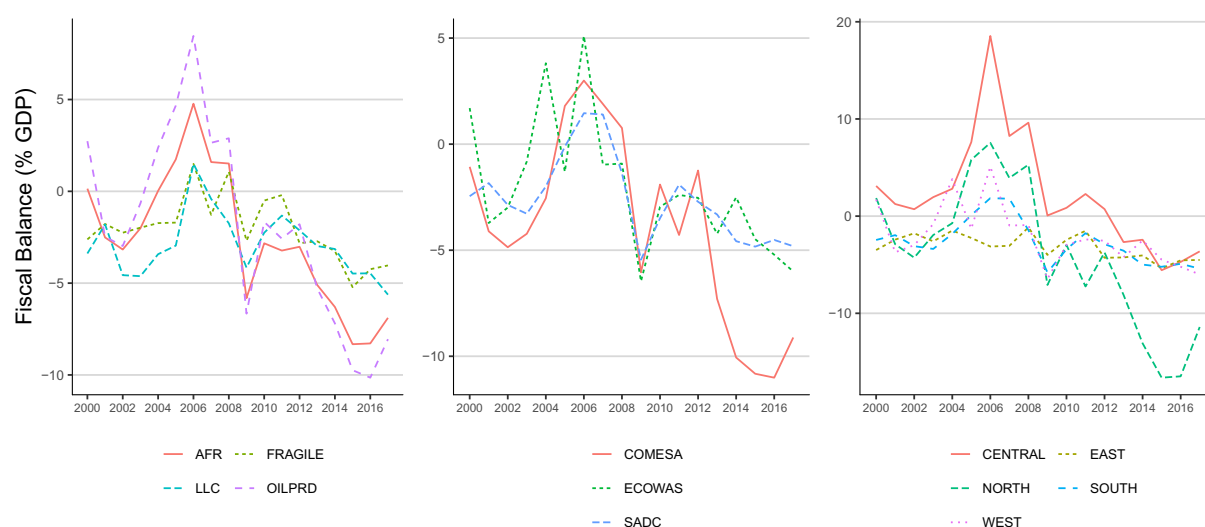
Note: Showing both variables as a percentage of GDP. Showing fitted local polynomial regression ("LOESS") in blue.

Source: Authors based on data from Commission et al. (2018).

► **Figure 51:** Debt service: Principle, interest and amortization paid as a percentage of total exports

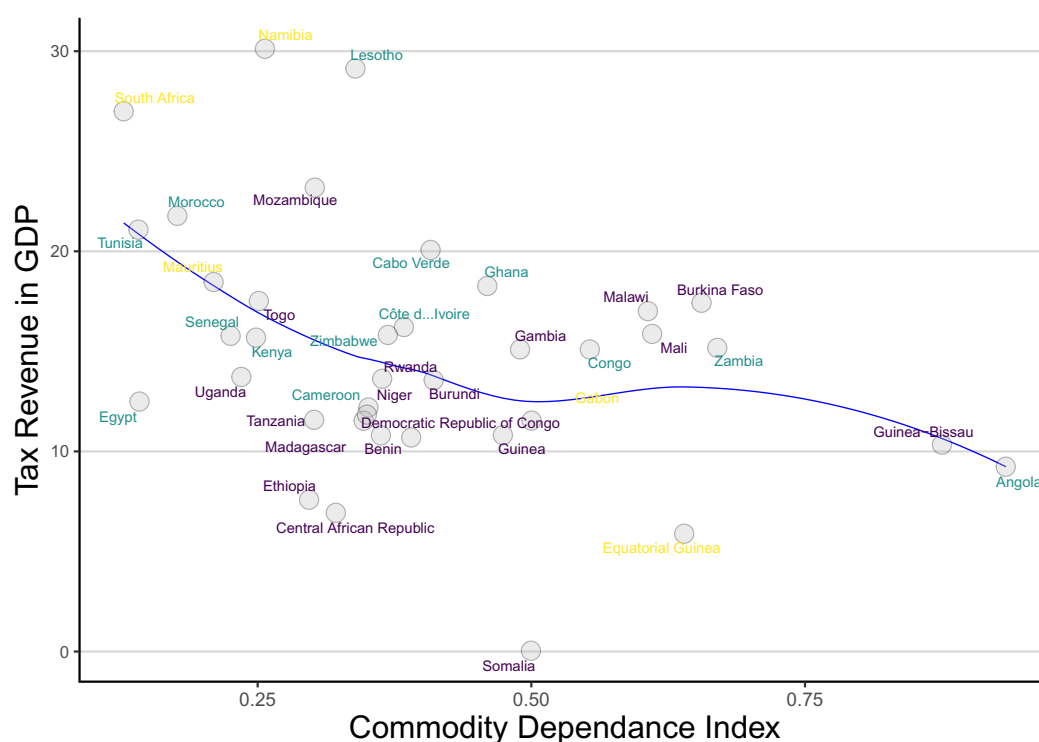


Data Source: African Development Bank (2019a).

► **Figure 52:** Central government fiscal balance (as a percentage of GDP)

Note: Fiscal balance is defined as total government revenue plus grants less government spending and net lending.

Data Source: African Development Bank (2019a).

► **Figure 53:** Mineral dependent countries have lower tax intakes

Note: Showing fitted local polynomial regression ("LOESS") in blue. Colour of country name is by income level. Seychelles and Botswana are removed since they are outliers (high tax revenue, high income, high commodity concentration economies).

Source: Authors, data from World Bank (2019c).

Table 7: Domestic finance

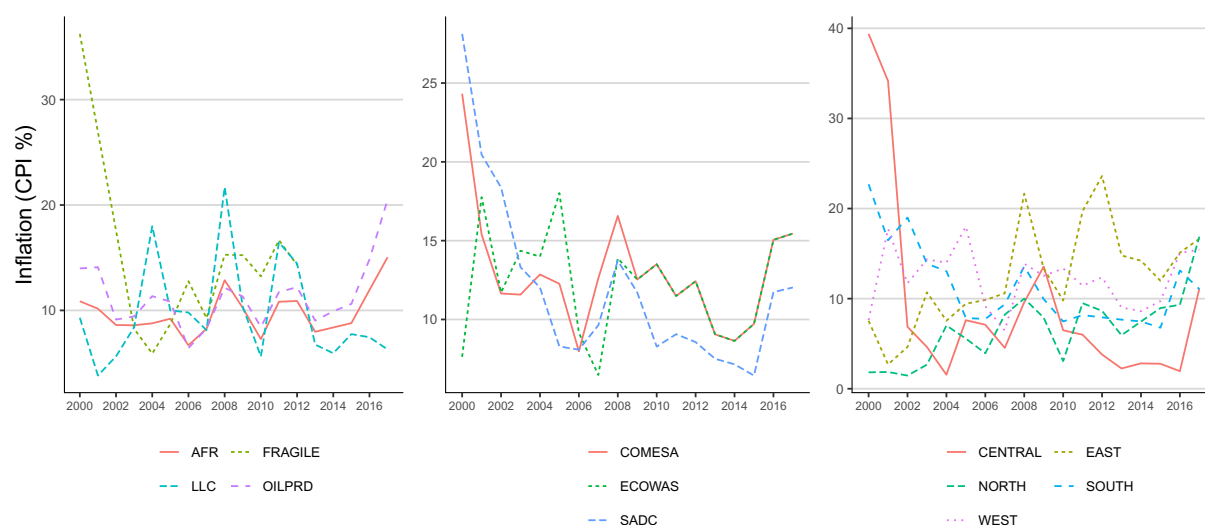
	General government revenue as % of GDP, 2017	General government taxes as % of GDP, 2017	General government expenditure as % of GDP, 2017	General government gross debt as % of GDP, 2017
<i>Southern Africa</i>	26,5	22,3	31,7	52,0
<i>Central Africa</i>	17,0	11,0	20,3	58,5
<i>East Africa</i>	20,6	13,2	25,5	62,7
<i>North Africa</i>	30,9	20,2	42,4	68,6
<i>West Africa</i>	19,1	13,3	23,5	56,3
<i>Africa</i>	21,8	15,2	27,1	58,7
<i>Rest of world</i>	33,3	19,0	35,3	56,4

Source: Commission et al. (2018).

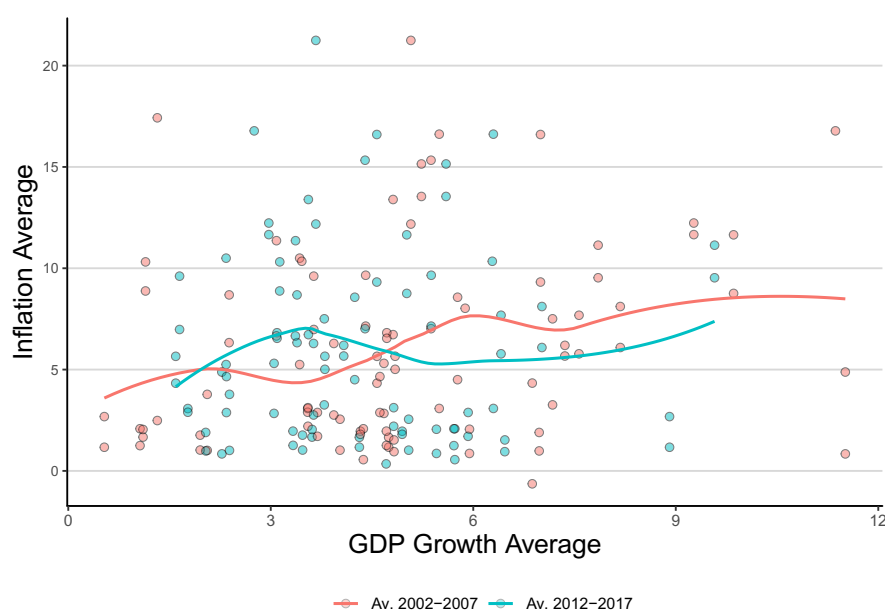
8.6.3 Monetary indicators

Existing monetary policy regimes are also described in the paper. The further data is given here.

- ▶ Figure 54 shows relatively moderate levels of inflation across African (except for East Africa) but that this has risen significantly in recent years. When exploring why this might be, we see in figure 55 and figure 56 that inflation... Figure 57 shows that inflation in Africa is not associated with a lack of monetary discipline and has no obvious relationship to broad money relative to GDP. This indicates that internal monetary discipline is not the driver of domestic inflation in Africa.
- ▶ Figure 58 shows that higher interest rates in Africa are associated with much weaker exchange rate levels, reflecting a greater country risk premium (inflation) and the need to maintain capital flows given this.
- ▶ Figure 59 shows the level of reserve accumulation has levelled off, with North Africa pulling the average up considerably. For the other regions, countries hold approximately five months' worth of imports in reserve. A deteriorating trade balance would place strain on this.

► **Figure 54:** Inflation rate (CPI, annual percentage)

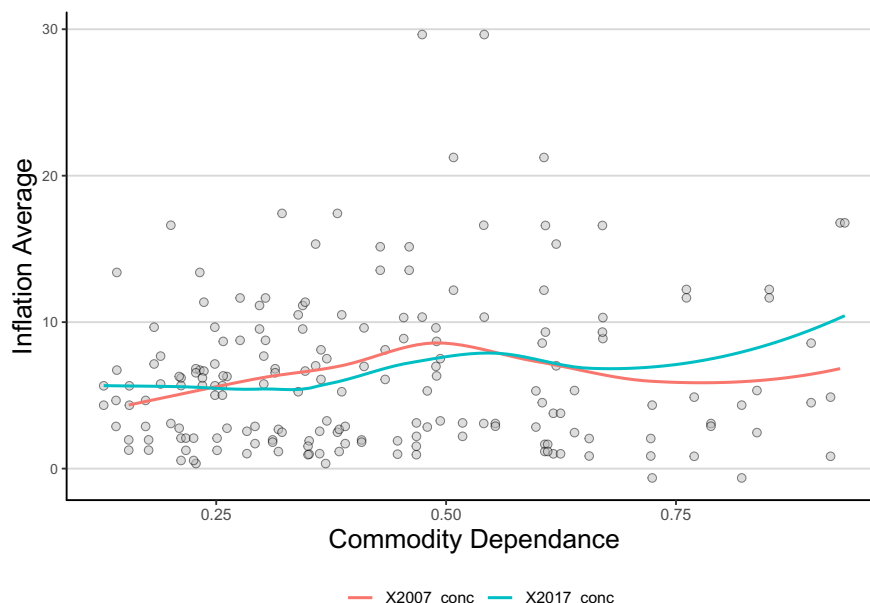
Data Source: African Development Bank (2019a).

► **Figure 55:** Relationship between growth and inflation in Africa

Note: Relationship between average growth and average inflation by country by time period. Showing fitted local polynomial regression ("LOESS") by year period.

Source: Authors, data from World Bank (2019c) and United Nations Economic Commission for Africa (2016).

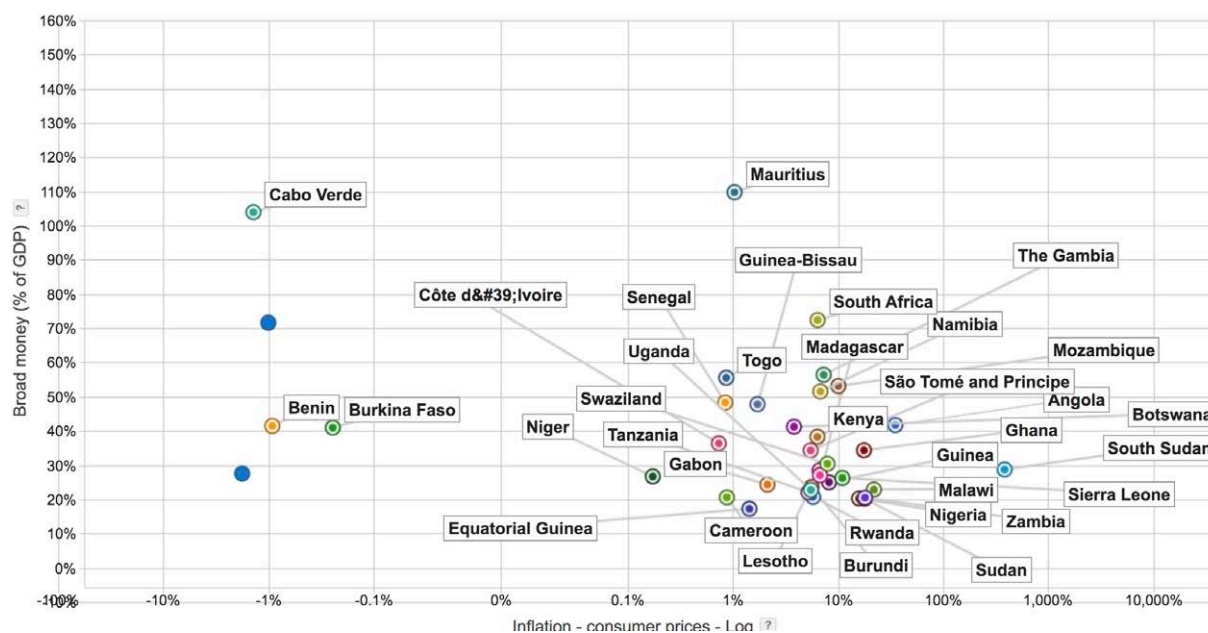
► **Figure 56:** Inflation and production structure



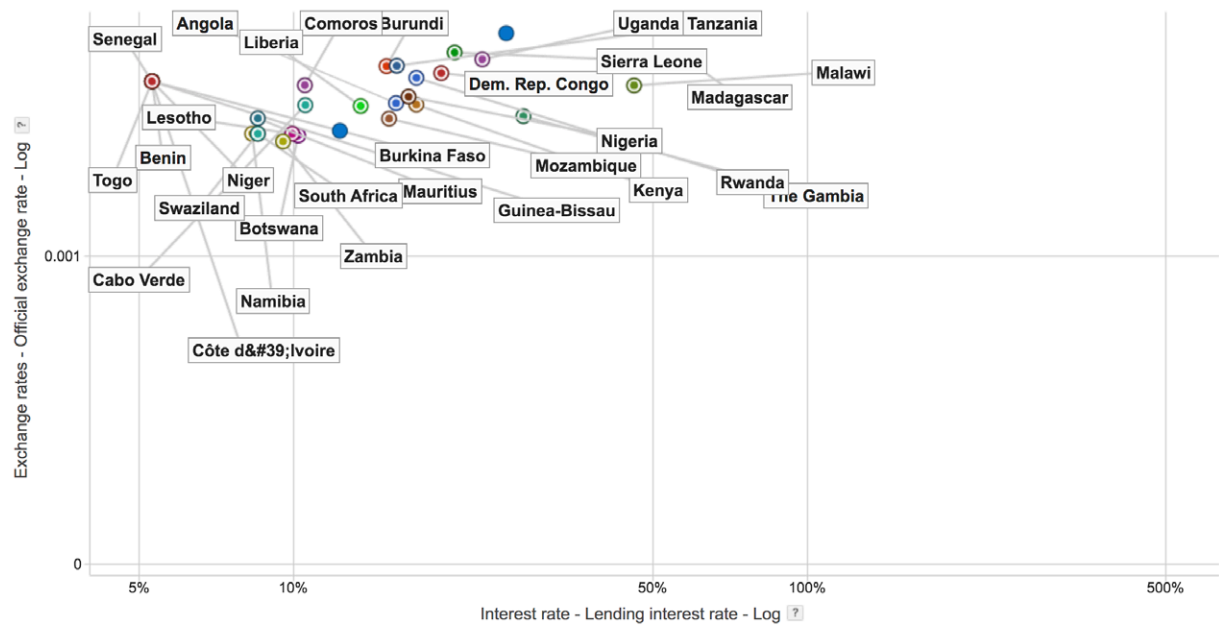
Note: Showing fitted local polynomial regression ("LOESS") by degree of commodity concentration in 2007 and 2017. Removing Guinea-Bissau and Gabon who are outliers.

Source: Authors, data from UNCTAD (2019a) and United Nations Economic Commission for Africa (2016).

► **Figure 57:** Inflation in Africa is not associated with a lack of monetary discipline

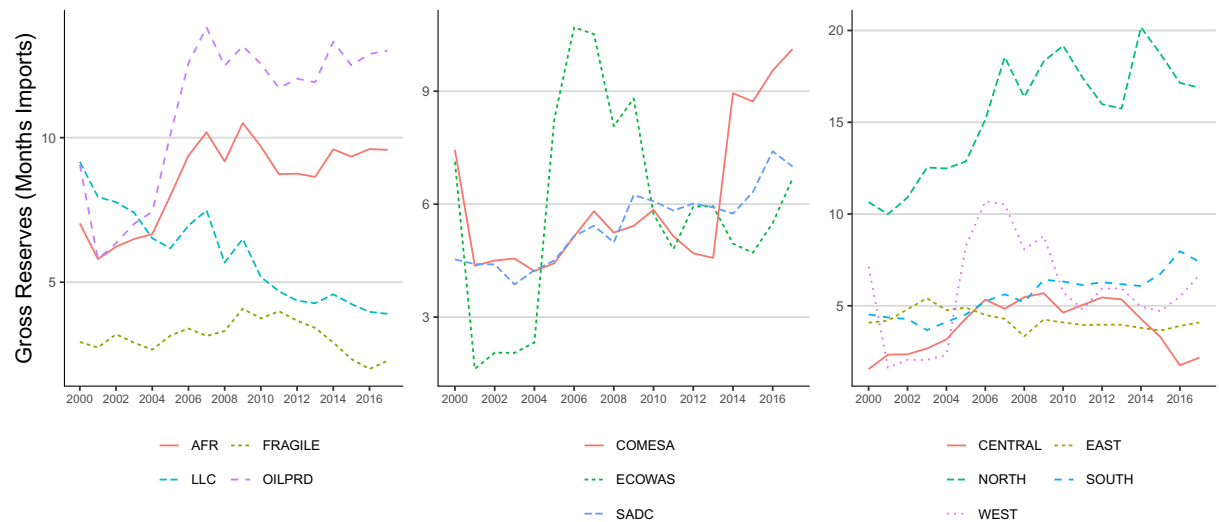


Data Source: Various accessed via Google Data Explorer.

► **Figure 58:** Exchange rate and interest rate levels are positively correlated

Note: 2013 data.

Data Source: Various accessed via Google Data Explorer.

► **Figure 59:** Foreign international reserves (percentage of imports number of months)

Note: Should cover at least six months of reserves as a heuristic.

Data Source: African Development Bank (2019a).

