*Chapter 2*

# Structural transformation in a changing development context

Chapter 2 deals with the topic of structural transformation in a new macro environment. The previous 15 years were favourable toward developing and emerging economies, partly because of strong growth in China and a commodity price boom. It is uncertain whether these conditions will prevail over the next 15 years and development strategies based on agriculture and extractive industries may no longer be sustainable. Alan Hirsch writes about the growth take-off in Africa during the 1990s and 2000s and that although there are many obstacles to African development, there are reasons to be hopeful. Donald Mmari draws on the experience of Tanzania to offer policy advice on diversification for sub-Saharan Africa. Neuma Grobbelaar outlines five "game changers" that have the potential to accelerate African development if harnessed correctly. Vugar Bayramov and Ahmad Alili put forward a vision for a prosperous Azerbaijan not dependent on oil and gas reserves.

The period of shifting wealth may be coming to an end. As identified in the preceding overview, the global economy is exhibiting sluggish output growth, below target inflation and low interest rates. This is caused partly by the slowdown in some large emerging economies, particularly the People's Republic of China (hereafter, China). As the world's largest importer of raw materials, China's slowdown greatly reduces the demand for raw materials – the resulting end of the commodity super cycle has significant implications for developing countries heavily reliant on natural resources' rents. The worsening economic climate is also contributing to an increasingly volatile global financial system, which many developing countries are finding difficult to access. Furthermore, digitalisation and automation have the potential to accelerate the trend of premature deindustrialisation: manufacturing as a share of total employment has stagnated or fallen in all developing regions except South Asia since 1990. In this new context, previously successful development strategies based on commodity exports or industrialisation may no longer be sustainable.

The authors of the sections in this Chapter explore some of these risks and challenges in the contexts of sub-Saharan Africa and Azerbaijan. One risk examined by several of the authors is the over-reliance on certain sectors within the economy. Donald Mmari uses the case of Tanzania to illustrate a problem common to many sub-Saharan African countries: the majority of Tanzanians derive their livelihoods from agriculture, which is based on low-productivity smallholder farms.

Alan Hirsch recognises the key role played by the commodity super cycle and China's large-scale infrastructure investments in Africa's growth take-off during the mid-1990s and 2000s. Because of rising commodity prices and China's investment drive, many sub-Saharan African countries became more dependent on extractive industries during this period. In a similar vein, Vugar Bayramov and Ahmad Alili highlight Azerbaijan's reliance on large oil and gas reserves and rising commodity prices during the past 15 years.

The challenge of diversification thus emerges from all these sections. Diversification will be difficult, however, because Tanzania and other sub-Saharan African countries do not possess the requisite levels of technological readiness, skilled workers and infrastructure to move to higher-productivity activities, including manufacturing. Whilst more advanced along these indices, Azerbaijan faces similar problems. Moreover, the twin "economic policy risks" – as Hirsch calls them – of high levels of inequality and large capital account and fiscal deficits could severely impede development in sub-Saharan Africa if mismanaged.

Positive trends exist. Neuma Grobbelaar identifies five "game changers" that have the potential to invigorate Africa's growth and development, including mobilising domestic resources to address the infrastructure gap, accelerating land reform and using migration as a positive driver of development. Hirsch is similarly optimistic about the growth of SMEs in many parts of Africa, the recent surge in infrastructure investment, and regional success stories, such as East Africa, which is exhibiting improved trade integration, freer movement of people and enhanced cross-border banking. Bayramov and Alili also contend that further integration with regional trading blocs, such as the EU Eastern Partnership programme and international institutions, such as the WTO, will place Azerbaijan on a positive development trajectory.

Taken together, the contributors to this Chapter underscore some of the key risks and challenges of structural transformation facing emerging economies and provide some policy measures for overcoming them. The contributions to this Chapter neither represent the positions of the Development Centre nor the OECD, but are solely the authors' own views.

## Section 1. Risks and challenges to sustainable growth and development in Africa

Alan Hirsch[1]

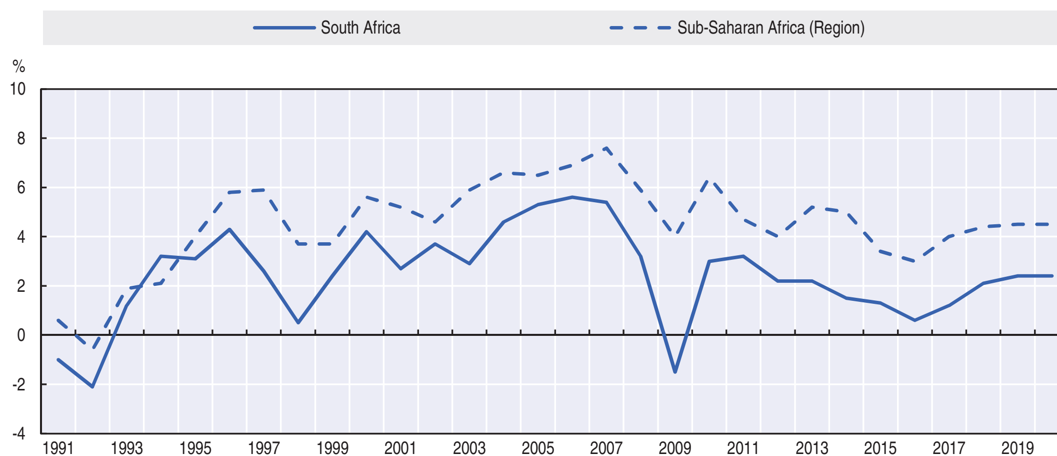
As we know, growth accelerations are pretty commonplace among developing countries. There were 83 growth accelerations of eight consecutive years at 2% higher than the five-yearly average between the mid-1950s and early 2000s (Hausmann, Pritchett and Rodrik, 2005). But most growth accelerations, and especially those in Africa, were short-lived and did not form the foundation of a long-term step-change to a more diversified growth path. Drawing on the language of W.W. Rostow, most growth accelerations do not amount to a "take-off".

The risk following the recently ended booms is that due to insufficient planning and excessive optimism the windfalls of the most recent round of growth accelerations were wasted.

Have the growth accelerations completely fizzled out or has the slowdown in recent years left developmental legacies that can be built upon? Or, have some African countries used the opportunities in recent decades to implement effective longer term growth and development strategies?

Since the early 1990s many African countries have been on a trajectory of higher growth. The global financial crisis in 2007-9, to the surprise of many observers, did not spell the end of Africa's growth surge, though the rate of growth moderated somewhat (Figure 2.1). More recently African growth has slowed further and, at around 4% in GDP terms, it is considerably lower than the 6% plus for emerging Asia. Yet growth remains stronger than in the "lost decades" between the mid-1970s and mid-1990s. In some countries, particularly but not only those less dependent on a narrow range of commodity exports, a higher rate of growth has been maintained.

Figure 2.1. **Growth in sub-Saharan Africa moderated somewhat after the global financial crisis**




*Note*: All data after 2016 is projected.
*Source*: Author's calculations based on IMF (2016), Datamapper.

Africa's developmental performance has improved considerably since the early 1990s. It is evident that African poverty and infant mortality, while still lagging, has improved significantly in recent decades (see Figures 1.2 and 1.3 of the overview chapter). Data would show similar improvements in education access and in access to infrastructural services such as roads and electricity. The higher rate of growth has been a valuable asset,

though it is by no means the only factor which has allowed developmental improvements. While these developmental improvements have themselves contributed to growth, the current relatively low growth rate inhibits the pace of the improvement in the lives of Africans.

As Amadou Sy (2016) points out, the current expected pace of per capita growth, in an environment of rapidly growing populations, would lead to a very slow rate of improvement in per capital income and the capacity of African countries to improve the lives of citizens, compared with the pace of growth in the first decade of the 21st century. "If the region was able to regain its 2004-2014 growth rate" argues Sy, "GDP per capita could be doubled in 20.5 years, by 2036. In contrast, at a [per capita] growth rate of 1.4% as currently predicted, this achievement would only be realised in 50 years, by the year 2065."

### Growth factors

To get a real sense of why growth has slowed (reducing the capacity for rapid development), we first need to ask why the period since the mid-1990s was so much better than the previous two decades.

The commodity super cycle, centred on China's huge public and private investments, was the standout economic factor in recent decades for Africa through the demand for African products (see Figure 1.5). Later, China's capital surplus due to its export-based growth allowed it to offer huge credits for infrastructure investments in Africa as Chinese infrastructure growth began to wind down.

But indicators show that growth and development improvements began in Africa before the super cycle. While the commodity supercycle underwrote many of Africa's accelerations, other factors were at play.

Clearly important was the completion of Africa's liberation—the democratic transitions in Southern Africa. South Africa's post-democratic growth has had a significant impact on the rest of sub-Saharan Africa mostly through outward investment by South Africa's multinationals, but also through rising trade (Arora and Vamvakidis, 2005).

The South Africa factor is a subset of the positive impact of the end of the Cold War which contributed by allowing greater domestic accountability and improved governance in many African countries, not only South Africa and Namibia.

The improvements in governance, encouraged in part by debt relief initiatives (the Heavily Indebted Poor Countries initiative and the Multilateral Debt Relief Initiative) and the Millennium Development Goals programme, in turn created of an environment that frequently encouraged direct and indirect investment.

### Reasons for slowdown

African growth slowed after the global crisis, but the slowdown was not as rapid as initially feared, partly because of global mitigation measures (e.g. for trade credits liquidity) and partly because African growth was also driven by rising domestic consumption (including government services) and investment (including infrastructural investment). Growth has slowed down more in recent years in most African countries under the shadow of several economic policy risks.

By economic policy risks, I mean risks which can be lessened or deepened, depending on the quality of economic policy.

### Economic policy risks

Even after the global economic crisis, several African countries were able to embark on sovereign bond issues for the first time.

"Before 2006, only South Africa had issued a sovereign bond in sub-Saharan Africa. Since 2009, 14 other countries have issued a total of USD 17 billion in sovereign bonds. These include Angola, the Democratic Republic of the Congo, Côte d'Ivoire, Gabon, Ghana, Kenya, Namibia, Nigeria, Rwanda, Seychelles, Senegal and Tanzania. Excluding South Africa, sub-Saharan sovereigns issued USD 6.3 billion of foreign-currency denominated bonds in 2014 alone." (Nalishebo and Halwampa, 2015).

The bonds were generally issued in foreign currencies (except in South Africa) on expectations of receipts from the continued export of commodities. In several of these countries, faced with lower than expected tax revenues as commodity prices fell, bond finance was used for current expenditure rather than capital investments. Infrastructure spending continued, sometimes funded by concessional loans from China. It is arguable that by 2014 investors should have been wary of high-yield sovereign bond sales. Two years later the IMF is much busier than it has been in Africa since the height of the HIPC programme, and has called for a "policy reset" in Africa.

The impact of twin deficits – fiscal and the capital account of the balance of payments – is potentially greater than simply a sharp and temporary slowdown. Since the early 1990s, democratic governments in Africa have derived some of their legitimacy from slowly but steadily improving living conditions. Cut-backs potentially threaten the legitimacy of open democracies. The Zambian government delayed entering into negotiations for relief from the IMF until after recent elections. If the inevitable debt restructurings are not carefully designed there are potential risks to political stability.

The second major economic policy risk is that growth is tempered with high levels of inequality. High inequality reduces the impact of growth on poverty, and growing inequality is slow to reverse (Bhorat 2016). Africa has the highest Gini co-efficient among continents and in the richer countries of Central and Southern Africa the Gini coefficient is over 0.55. If these inequality levels cannot be reduced, the sustainability of growth in the region will be compromised.

Finally, is it feasible that Africa will meet, let alone beat, target 9.23 of the Sustainable Development Goals, doubling the share of employment and output attributable to the industrial sector? Much of the increase in employment and value added in recent decades has come from the services sector – now over 50% of value added (Page, 2016).

In a study of 72 developing countries spanning 1996 to 2012, the UNU-Wider project on extractives found that 66 (or 88%) had become more dependent on extractives during the commodity super cycle (Roe and Dodd, 2016).

Developing a manufacturing sector requires managerial competence, sufficiently skilled workers, and a good or improving infrastructural environment. It also needs consistent policies and a state that understands and supports industrialisation in order to replicate what Page (2016) calls Asia's export push policies.

Not many African countries meet these criteria currently—the countries seriously striving for recognition as the exceptions are Mauritius (already there) and Ethiopia (Narreinen, 2013; Oqubay, 2015).

### Positive trends

But there are significant positive trends in the rest of Africa too, to counteract the growing pessimism about the fate of Africa's recent growth accelerations. These trends could underpin a long term growth and development trajectory.

- Agricultural productivity is rising, not rapidly, but significantly and consistently, including the smallholder sector in many countries.
- Small businesses are proliferating and thriving in many parts of Africa.
- Several African countries, beyond Ethiopia and Mauritius, are committed to industrial or sectoral strategies, and some are being encouraged by development agencies.
- The recent surge of investment in infrastructure, from rural roads to airports, if well managed, offers advantages for producers and traders.
- East Africa is in many ways showing the way forward with better government-business relations (far from perfect), better trade integration, advances in the freedom of movement of people, and in the development of a regional payments system allowing of easier cross-border banking, for example.
- Improvements in health and education access have impacted, and will impact further when quality improves further.
- Finally, African countries have responded to emerging fiscal squeezes with less resistance and denialism, and more resolve, than in the 1980s.

The risks have grown in recent years, but the developmental improvements of the past two decades may well have generated a sufficient legacy to enable many African countries to move to a stronger footing.

## Section 2. Transforming sub-Saharan Africa towards modern, industrial-led economies: Challenges and options

## Donald Mmari[2]

As the OECD Development Centre correctly observes, the prospects for development in emerging and developing economies are vast, yet confronted by formidable challenges. The past fifteen years have witnessed rapid economic growth and social progress in Asia, led by China and India. Other countries such as Malaysia and Viet Nam have recorded dramatic growth and economic transformation, coupled with increased productivity, visible structural change, and significant poverty reductions. In sub-Saharan Africa, a few countries have also sustained high growth momentum, albeit with different outcomes in social development. Botswana, for example, has achieved upper-middle income status, although its limited economic diversification makes it vulnerable to commodity price shocks. Ethiopia, Tanzania and Rwanda are heralded as among the fastest growing countries in sub-Saharan Africa. Despite such success stories, many challenges remain unresolved. These challenges include slow structural transformation, coupled with increased informality and "premature" deindustrialisation; changing demographics without corresponding investments in key enablers such as skills development, technology and innovation; and an infrastructure gap. Unless addressed in the near future, these shortfalls will reverse the gains from economic growth and frustrate the achievements of development visions in developing countries, resulting in sustained concentration of wealth in developed countries and widened inequality.

Understanding that developing countries are not homogenous, many of those in sub-Saharan Africa share certain traits, on which this article seeks to focus, drawing more from

the experience of Tanzania. First, a large majority of their population lives in rural areas and is dependent on agriculture and related livelihoods. Second, industrial development has been slow, if not reversed in terms of the share of manufacturing value added and manufacturing employment. Third, they are dominated by the growing informal sectors, mostly in low productivity trade and services.

### Agriculture and rural transformation

A major concern is that the majority of the people of Tanzania derive their livelihood from agriculture, including crops, livestock and fisheries. The latest labour force survey estimates that 67% of the labour force is engaged in agriculture (Tanzania National Bureau of Statistics, 2014). However, past economic growth has not benefited agricultural producers due to generalised low productivity, market-related constraints, limited and high cost finance, and poor skills that undermine innovation and the uptake of new technologies.

Actions are needed to transform agriculture through a holistic approach to agribusiness development and transforming the rural economy into high productivity economic activities. For the great potential that Tanzania has in agriculture, including arable land and a young population, investments must be made to, first, improve farm level productivity. This requires the following interventions:

- Scale up the adoption of improved farming practices, technology and innovation through agricultural research and extension services, these to be complemented by strategic vocational and adult education
- Invest in rural infrastructure, especially roads (and railway linkages), electricity and small scale and community level irrigation
- Promote access to rural finance, particularly in the form of long-term and low cost agriculture development finance

Second, strengthen agricultural markets, making them efficient and accessible to smallholders who constitute the majority of rural producers in most of sub-Saharan Africa. The following interventions are proposed:

- Where large scale commercial farms exists or are being developed, promote linkages between them and small farms in integrated agricultural production systems that include backward linkages to production and supply of inputs and forward linkages to agro-processing, packaging and marketing
- Foster market linkages and invest in affordable storage and processing facilities to minimise post-harvest losses
- Promote effective producer and market organisations to maximise the benefits of both vertical and horizontal co-ordination, including economies of scale, knowledge spillovers, and bargaining power

Third, create opportunities for diversification of the rural economy. While raising productivity and transforming agriculture, governments should create opportunities for the rural population to improve their livelihoods in non-farm activities in rural areas. This entails diversification of the rural economy by promoting value addition and commercial activities, treating agriculture as an important driver in the diversification process. Enterprise development must be supported to facilitate diversification and moving up the value chains through agro-industry services and trade services. This requires the following interventions:

- Public and private investments in agro-processing facilities
- Providing business and technical training to the rural based youth

- Integrating special financing and incentives for rural based enterprises
- Scaling up job-creating public works in rural infrastructure development.

### Industrialisation drive in the error of "premature" deindustrialisation

Structural transformation and economic diversification have proved to be necessary for any economy to promote its growth and to build resilience to shocks. At the core of this transformation, as theory suggests, is a movement from low productivity primary production to the more productive and modern manufacturing sector, and later towards service oriented activities. Underlying this transformation is science, technology and innovation that lead to increased productivity in agriculture, which supplies cheap raw materials and surplus labour to industry. The levels of technology and application of science for production and innovation in developing countries is still generally low. According to the *Global Competitiveness Report 2015-16* (WEF, 2015), Tanzania and other sub-Saharan African countries ranked very low in technological readiness and innovation indices, in contrast to the Southeast Asian tigers. This means that the structural change and decline in agriculture in GDP is not necessarily driven by a notable increase in productivity. Other factors, such as diversification towards informal non-farm activities; migration of young people to cities and peri-urban areas; and growth of basic manufacturing, construction, and related service industries explains the change.

For effective and sustainable structural transformation, industrialisation as a fundamental pillar for adding value to primary products, creating the knowledge base for further transformation into knowledge intensive sectors and for creating jobs cannot be avoided. Thus, the following policy initiatives are proposed to promote rapid industrialisation. First, promote resource-based industrialisation, and second support technology and innovation. In this respect, some form of industrial policy will be required to facilitate the transformation of comparative advantages in natural resource-based industries into competitive advantages.

The proposed strategic interventions are:

- Put high priorities in terms of budgets and policy incentives to agro-industry and value addition to primary production and natural resources. Areas with good natural comparative advantages can easily create significant competitive advantages when processed and converted into industrial goods:
    - Agricultural related value addition
        - Sugar cane: ideal soil and climate.
        - Livestock: the sector can form the basis of a leather industry with multiple export opportunities and export of cut and processed meat.
        - Horticulture: land availability, good climatic conditions, regional and international links to export of packed vegetables and fruits.
        - Fruit and nut processing: untapped potential, with less than 10% produce currently processed.
- Mineral and metal-based industries
    - Tanzania has large quantities of iron ore with an estimated reserve base of two billion tonnes and an extractive capacity of 1.25 million tonnes of steel. This can be used to set up a local steel industry with the potential to support Tanzanian industrialisation in the medium to long term. Regional markets in Eastern and Southern Africa provide further impetus to warrant such investments.
    - Natural gas based industries: in addition to its uses as a source of energy and fuel, natural gas can potentially be used as a productive input in a number of

industries i.e. petro-chemicals and fertiliser industries. These are important industries for building the technology base and fostering linkages with other sectors such as agriculture, construction and transport.

- Accumulate and concentrate industrial firms through cluster development, supported by Special Economic Zones (SEZ)
- Adopt trade policy management which is supportive to industrialisation, permitting industry to progressively mature into competitive industry (selective and strategic protection, while ensuring that import cartels are not allowed to threaten the survival of the nascent manufacturing sector)
- Public investment to close the infrastructure gap
- Public investment to promote the education and skills that is relevant for providing the critical mass of semi-skilled and skilled workforce in strategic industries.

### Transforming the informal economy

The labour force in most African economies has continued to grow, but structural transformation has not paved the way for the formal sector to create employment for the growing labour force. A recent UNECA-AUC report has shown that the effects of global financial and economic crisis retarded African economic growth and also raised the numbers of the unemployed and poverty rates (UNECA-AUC, 2010). This situation has led to the increasing importance of informal economic activities as a source for employment opportunities and earnings. Data from a number of sub-Saharan African countries show that growth in employment opportunities has been concentrated in the non-wage sector, with the most important source of growth being in the non-farm self-employment sector. Over two thirds of the labour force is employed in the low-productivity informal economy in vulnerable employment (Ibid).

Thus, to reduce the levels of poverty and vulnerability, interventions to increase productivity and earnings in the informal enterprises are essential for accelerating productivity. The proposed interventions are:

- Design and implement policies and supportive measures to raise the level of productivity in informal enterprises by enhancing their access to resources and markets, and legal identity and rights. These include:
  - Enhance the business environment to remove biases of existing policies against informal enterprises, including: macro policies that create demand for the goods and services produced by informal enterprises and workers. For example, requirements for the government Procurement Act set a threshold on the types of goods and services that can only be supplied by micro and small enterprises.
  - Legal recognition of the informal enterprises with a view to realising the empowerment of the owners to access government contracts and supplies, access to services, and access enforcement of property rights
- Design and implement measures to reduce risk, cost of doing business and eliminating institutional biases that work against informal enterprises. These are meant to drive the transition towards formalisation of the informal economy by supporting to organisational development and reform of the legal and regulatory framework that facilitates and simplifies registration and taxation. These include:
  - Promoting access to information and skills development - small informal enterprises need information on markets, technology and business skills, which can be provided more efficiently by public institutions, or market based institutions supported by state

- Strengthening voice and organisation of informal enterprises - most activities in the informal sector are family business and sometimes seen as means for supplementing income or a survival strategy for the urban dwellers who cannot find jobs in the formal sector. Labour contracts are often implicit with no legal standing, and collective bargaining is also hard to implement. Thus there is need to create institutions that can reach this sector effectively and organise them to be more productive and responsive to the technology-induced transformation and growth.
- Appropriate and responsive political governance and development management. Relevant public institutions must reach out to these informal businesses, to better understand their diversity and challenges (including land, finance, knowhow, etc.) and provide solutions to enable them to participate more effectively in the growth and development process.

## Section 3. Five game changers for Africa
## Neuma Grobbelaar[3]

The overview chapter "Development prospects in a new global context" makes a number of important observations regarding the new paradigm facing development actors. The constraints facing developing countries that seek to pursue the traditional development path, i.e. related to export-orientated industrialisation and the more difficult external environment for especially commodity-dependent economies are well-considered. However, some of the assertions regarding the end of the commodity super cycle, shifting wealth and premature de-industrialisation seem overstated – particularly in a developing world context. More importantly, the anticipated demographic transition that is sketched in the context of Africa and other developing countries seems too linear, not taking into account how urbanisation and growing middle class affluence influence fertility rates. Migration, while currently a major political topic because of the flood of Syrian migrants into Europe as an outcome of war and conflict, is a prominent feature of a globalised world with mobility directly linked to scarce skills sets and economic opportunity. There is no doubt that developing countries face a more challenging global context, but this also presents an opportunity for innovation, rethinking of traditional solutions and experimentation. It is also important to note that a focus on getting the basics right is critical in creating an enabling environment for development, i.e. pursuing policies that create regulatory certainty and consistency, that enable the private sector to flourish within proper checks and balances, that respect planetary boundaries and global commitments to combating climate change and that do not neglect the most vulnerable.

### Where should Africa direct its policy thinking and solutions?

In considering its policy options in pursuing a sustainable development path it is important for Africa to build on its comparative advantages, i.e. abundant labour, a growing middle class, pristine ecological biospheres and abundant natural resources, minerals and vast tracts of arable land. There are at least eight game changers that Africa has to master – or perhaps more realistically, manage – to ensure that it will not remain in perpetuity a continent on the margins of the global economy with growing internal inequality and only brief flowerings of prosperity.

These include combating climate change, accelerating land reform, tackling the digital divide, addressing Africa's enduring infrastructure deficit, pursuing adaptive human resource development and employment creation in the age of greater automation, political and governance reform including managing migration, urbanisation and domestic resource mobilisation. In all eight areas both the private sector and governments

have powerful roles to play and the need to creatively engage a variety of new actors in the development space is paramount. As the SDGs illustrate, sustainable development requires a 360 degree approach and indeed all eight game changers listed above are interlinked. I will unpack five of the key game changers below.

### Managing the impact of climate change and moving away from a carbon intensive growth path

The move away from fossil fuels will be a major disrupter for many African but also many other oil-producing economies. This is no longer a moot point. For all the speculation about a long tail end to the phasing out of oil and coal as the bedrock of most power generation capacity globally, the adverse impacts of climate change are upon us and Africa is poorly prepared to deal with the negative impacts of inclement weather, searing droughts and disease. However, this is also a unique opportunity for Africa to reframe its energy policy and related infrastructure.

There are at least some positive steps in this direction as seen through the successful roll-out of the independent power producers' programme of the South African government to support a greater uptake of renewable energy in its mainly coal-driven power grid (Department of Energy, 2016). There is the potential to roll-out this initiative across Africa tailoring renewable energy projects for both off-grid and on-grid solutions. The emergence of the Ethiopian government as a major regional champion of hydropower is a second example of what is possible with determined leadership. In both cases, it is clear that given the right policy frameworks, it is possible to unleash the power of the private sector to complement the desire of governments to break the mould. The Ethiopian case also offers useful examples around domestic resource mobilisation, the need to break down complex projects into manageable chunks and the importance of exploring complementary partnerships, such as with China in the infrastructure space.

### Addressing the infrastructure gap and the role of domestic resource mobilisation

There is no doubt that economic activity is impossible without sufficient power and an enabling infrastructure, namely roads, rail, airports, harbours, adequate water and sanitation. As noted by the Africa CEO Forum (2014) 'inadequate infrastructure deprives Africa of 2 points of GDP growth annually.' In addition the report noted that private firms would see an improvement in productivity gains of 40% with the appropriate, enabling infrastructure in place.

African countries and infrastructure companies need to approach the massive infrastructure gap in Africa as a major opportunity rather than a constant drag on economic development. The infrastructure sector is able to absorb fairly low-skilled labour in large numbers. It is important that African countries become more equal partners in infrastructure development on the continent. This is entirely possible if there is a greater emphasis on domestic resource mobilisation efforts, skills transfer with the eye on ongoing maintenance and greater local participation in infrastructure projects.

While the emergence of new development finance institutions like the BRICS New Development Bank financing infrastructure is to be welcomed, there should be greater emphasis in African countries on the development of local development finance institutions and infrastructure and other financing instruments (OECD, 2015). The work by institutions like the Collaborative Africa Budget Reform Initiative (CABRI) to improve budget sector reform and tax collection is instrumental in supporting fiscal accountability and transparency (CABRI, 2016). But it is also important that regulatory reforms improve the financial maturity and depth of markets, increases access to banking services and

finance (i.e. not only commercial lending) and supports the development of new financial instruments that are appropriate to the African context.

### Tackling the digital divide

Technological innovation is able to act as a spring board to leapfrog development, spur economic activity and enhance public participation and accountability. The World Development Report (World Bank 2016a) on technological innovation in the digital age is illustrative of the potential of technological innovation and digital access to spur economic development. This is an area that African governments need to prioritise given its power to shrink in real time geographical distances between societies, firms and people. Digital access could be a game changer for African societies if managed well, enabling the development of local entrepreneurs and start-ups, the improvement of firm performance and consumer choice and the roll-out of education and training and e-health services at a fraction of the traditional costs linked to these services. Digital access also enables faster adaptive learning, which will be essential in the new job market where life-long learning will be a critical determinant of job security.

### Accelerating land reform

Another important area that African countries ignore at their peril is the nascent ability of Africa to become the breadbasket of the world. Agriculture and agribusiness have been put forward by various studies as one of the most important ways that African countries can move up the value chain. Highly labour intensive, with some automation possibilities upstream, this sector has the potential to position many African economies on a more sustainable growth path. It is important that land tenure is adequately addressed along with proper agriculture support programmes appropriate to emerging farmers. In addition, countries should focus on preserving their bio-diversity. There is a trade-off to manage in covering vast parts of Africa with the latest strains of drought resistance crops versus responsible guardianship of some of the most diverse biospheres on the planet. Sustainable use of wildlife is a term that is particularly emphasised by Africa's policy makers, but it is important not to neglect the income generating potential of the tourism sector, another major labour absorptive sector for Africa. Lastly, while a relatively slow growing China of 6% of GDP is not in any way comparable with the 14% average experienced over the last decade, this represents healthy demand for African resources and a sound base on which to exploit Africa's mineral resources with greater regard for the environment.

Thus the capacity to exploit labour absorbing sectors in Africa, that are not necessarily only linked to extractives, raises the question of whether premature de-industrialisation need be such a major factor. Instead, there seems to be a strong argument emerging that a growing middle class in Africa would stimulate the development of the domestic services sector. This is an important opportunity for both African and developed economies and raises questions around the rather pessimistic view that migration is primarily driven by conflict.

### Migration as a positive driver of development

We accept that South-North migration is a fait accompli for a variety of reasons, no less because of the incidence of conflict. However, as the recent global financial crisis also showed, skilled labour is incredibly mobile. We have seen this with Portuguese and Spanish migration to Africa and South America following the impact of the 2008 financial crisis. While some European countries are discussing the introduction of a basic income grant and the reduction of working hours, others are increasing the retirement age. Yet on

the other side of the world there is a huge demand for education and health services, in addition to other professional services such as engineering, actuary, legal, financial etc. The broader question therefore is whether over the next 15 years and in fact until 2050 the current trend will not strengthen further, i.e. a proliferation of South-South, North-South and South-North migration. With rising income levels in Africa, but also because of its significant skills deficit, it is incumbent on African governments to introduce smart labour legislation that enables the sourcing and retention of skilled labour.

The big question is what will the societal implications be? Are we ready for closer forms of integration, a smaller world, but at the same time less formalised to counter the fragmentary forces emerging in the European project? It remains an open question what the trend in Africa will be compared to other regions in supporting functional co-operation. It is in this respect that governance norms become crucial, both economically and politically, as well as support of regional norms and partnerships to support collaboration across great divides.

A sober assessment of the development path that Africa will need to charter over the next 15 years underscores the importance of determined leadership, political will, pragmatism, resilience and resourcefulness.

## Section 4. Azerbaijan: an economy trapped in the Caucasus. The next 15 years between the Russian Federation, Turkey and Iran

**Vugar Bayramov[4] and Ahmad Alili[5]**

Azerbaijan has a similar background to other Commonwealth of Independent States (CIS) countries in the South Caucasus and Central Asia, such as the Russian Federation, Kazakhstan and Turkmenistan. During the period of 2000-15, it experienced a similar path of economic growth, fostered by high oil and gas prices; and stagnation over the past two years, under declining oil prices.

The oil income has strikingly affected Azerbaijan's path of economic development for the past 15 years. Now, following the slump in oil prices, the country is experiencing a completely different set of conditions. This is the perfect time to forecast the economic trends for Azerbaijan for the next 15 years. Since Azerbaijan is trapped in a sensitive geopolitical region – the Caucasus – the importance of forecasting and the ability to adapt to the quickly changing international environment is vital.

This article analyses the economic and policy agenda of Azerbaijan for the next 15 years. First, it presents a brief preview of the current economic trends, and explains the challenges. In the following section, the article presents recommendations.

Before proceeding with the forecasting, two points should be made clear. First, the growth model, which worked for the country for the previous 15-year period, is no longer effective. Forecasting based on previous trends is impossible, simply because the trends have been reversed. During 2000-15, Azerbaijan experienced rapid economic development. It was mainly attributed to the exploitation of oil and gas basins in the Caspian Sea. During this period, oil revenues constituted nearly half of the country's GDP. Thanks to the oil revenues, in 2006-07, the country experienced the highest increase in economic growth in its history – averaging 29.8% (Asian Development Bank, 2014).

In terms of economic growth, 2015 was not a favourable year for Azerbaijan. Slumping oil prices significantly affected the macroeconomic indicators of the country. The first sign was the devaluation of the national currency – the manat – followed by the decrease in the Central Bank reserves by USD 8.74 billion, equivalent to the five-year accumulation. Considerable declines in GDP and income of the population, negative shifts in the labour

market, and the substantial effect of the devaluation of the national currency on the banking sector indicate serious problems in the national economy (Center for Economic and Social Development, 2016). 2015 was a trend-changing year, pushing the government to instigate reforms.

Second, the economic agenda in Azerbaijan heavily depends on the geopolitical agenda of the country. Studies on the political determinants of economic reforms in former Soviet Union countries indicate a "strong correlation between the progress in political and economic reforms" (Dabrowski and Radzislawa, 2002). Also, studies indicate the greater role of the Russian Federation in forming the political and reform agenda in "non-Baltic Post-Soviet states", while the EU played a prominent role in prompting some of the Eastern European Countries to undergo liberal economic reforms (Cameron and Orenstein, 2013).

Located in the Caucasus, between the Russian Federation, Turkey and the Islamic Republic of Iran (hereafter, Iran), the political and hence reform agenda in Azerbaijan is heavily influenced by these actors. Left with little oil revenues in the upcoming years, the surrounding nations, and the political-economic agenda in these countries, will strongly influence economic trends in Azerbaijan over the next 15 years.

The prognosis on the Russian Federation's future for the following 15 years is usually accompanied with pessimistic notes (Stratfor, 2015). Unlike the Russian Federation, Iran – having reached a deal over its nuclear programme – is expected to attract more foreign investment and economic growth. Immigrants from Azerbaijan would usually choose Russia as the main immigration destination. Following the change of economic fortunes, Iran might become a new destination for Azerbaijani job migration, and hence source of remittances. It might ultimately affect the political landscape of the country also (Alili, 2015). The World Bank's Doing Business indicators also show challenges for the economy in Azerbaijan. Getting credit, dealing with construction permits, getting electricity and trading across borders are among the areas to be improved for attracting investment (World Bank, 2016b).

Nevertheless, the next 15 years will provide new opportunities for Azerbaijan. The World Economic Forum's recent Global Competitiveness Report (WEF, 2016) gives Azerbaijan the best ranking among CIS countries. This should create additional opportunities over the coming 15 years.

So, for the post-oil period, policy makers should anticipate dramatic changes. Due to declining oil prices, politically important actors in the region may increase their leverage over the political and economic life of the country. It creates a completely new set of challenges for the country, which should be tackled.

Azerbaijan needs economic reforms. Future prospects depend on how nimbly the government will liberalise the economy, and thereby allowing foreign direct investment to flow in.

To resolve these problems, the following recommendations are suggested:

1. Diversifying the set of economic partners and lessening dependency on Turkey, Iran and the Russian Federation, by liberalising the economy. Strengthening economic ties with the EU can play a crucial role in diversifying Azerbaijan's set of partners. Signing a new Co-operation Agreement with the EU should be the top policy agenda for the government.
2. Improving good governance and human rights. It is crucial to enhance citizens' well-being, the functioning of institutions and in turn spur greater interest for investment into Azerbaijan and greater linkages with the OECD countries.

3. Accelerating WTO accession. This will lead to increased predictability of economic development in Azerbaijan, enhanced transparency and reduced corruption. WTO accession will create new opportunities for the business sector and also open foreign markets to the local goods. It will lead to more competition in domestic markets and access to innovative technology.
4. Committing to structural reforms and improving the business environment is necessary to increase competitiveness in the country. Advancing reforms in customs and the public finance system is very important for attracting foreign investment.
5. Liberalising the public financial sector and creating measures to counter the volatility of the national currency will play an important role for local business development.

### *Notes*

1. Alan Hirsch is Professor of Development Policy and Practice and has directed the Graduate School of Development Policy and Practice at University of Cape Town since 2013.
2. Donald Mmari (Ph.D) is the Executive Director of REPOA in Tanzania.
3. Neuma Grobbelaar is the Research Director of the South African Institute of International Affairs (SAIIA), a leading African Foreign policy think tank based at the University of the Witwatersrand.
4. Vugar Bayramov (Ph.D) is the Chairman of Centre for Economic and Social Development (CESD) in Azerbaijan.
5. Ahmad Alili is a Senior Researcher at the Centre for Economic and Social Development (CESD).

## *References*

Africa CEO Forum (2014), "The private sector, driving force of Africa's growth", organised by Groupe Jeune Afrique in partnership with the African Development Bank (ABD) and Rainbow Unlimited, Geneva, 19 March 2014, https://www2.deloitte.com/content/dam/Deloitte/fpc/Documents/nous-connaitre/deloitte-afrique-francophone/deloitte_africa-ceo-forum-the-private-sector-driving-force.pdf.

Alili, A. (2015), "Azerbaijan and Iran after the Sanctions: The Pathways of Advanced Engagement and Confrontation", *Russkii Vopros*, http://cesd.az/new/wp-content/uploads/2016/01/Azerbaijan-and-Iran-after-the-Sanctions.pdf.

Arora, V. and V. Athanasios (2005), "The Implications of South African Economic Growth for the Rest of Africa", *IMF Working Paper*, African and European Departments https://www.imf.org/external/pubs/ft/wp/2005/wp0558.pdf.

Asian Development Bank (2014), *Azerbaijan: Country Partnership Strategy (2014-2018)*, https://www.adb.org/sites/default/files/institutional-document/81989/cps-aze-2014-2018-0.pdf.

Bhorat, H. (2016), "Inequality in Africa: Implications for Sustainable Development Goals", *Brookings Brief*.

Cameron, D.R., and Orenstein, M.A. (May 2013), "Post-Soviet Authoritarianism: The Influence of Russia in Its "Near Abroad", *Post-Soviet Affairs*, Vol. 28, No. 1, pp.1-44, DOI: 10.2747/1060-586X.28.1.1

Center for Economic and Social Development. (2016), *The Economy of Azerbaijan in 2015: Independent View,* CESD Press, Baku, Azerbaijan, http://cesd.az/new/wp-content/uploads/2016/01/CESD_Research_Paper_Azerbaijan_Economy_2015.pdf.

Collaborative Africa Budget Reform Initiative (2016), http://www.cabri-sbo.org/, accessed 17 September 2016.

Dabrowski, M. and G. Radzislawa (2002), "Political Determinants of Economic Reforms in Former Communist Countries", *CASE Network Studies and Analyses*, No. 242. http://ssrn.com/abstract=1440725.

Department of Energy, Republic of South Africa (2016), *Renewable Energy Independent Power Producer Procurement Programme*, http://www.ipprenewables.co.za/.

Hausmann, R., L. Pritchard and D. Rodrik (2005), "Growth Accelerations", *Journal of Economic Growth*, Vol. 10, pp. 303-29, DOI: 10.1007/s10887-005-4712-0.

IMF (2016), *Regional Policy Outlook Sub-Saharan Africa April 2016: Time for a Policy Reset* https://www.imf.org/external/pubs/ft/reo/2016/afr/eng/sreo0416.htm.

Nalishebo, S. and A. Halwampa (2015), "A Cautionary Tale of Zambia's International Sovereign Bond Issuances", *Zambia Institute of Policy Analysis and Research (ZIPAR) Working Paper* No.22, March, http://www.zipar.org.zm/index.php?option=com_docman&view=download&alias=44-a-cautionary-tale-of-zambia-s-international-sovereign-bond-issuances&category_slug=working-papers&Itemid=120.

Narreinen, S.P. (2013), "Industrialisation: The Mauritian Model" in J.E Stiglitz, J. Yu Lin and E. Patel (eds.), *The Industrial Policy Revolution II: Africa in the 21st Century*, Palgrave Macmillan, London.

OECD (2015), *Infrastructure Financing Instruments and Incentives*, OECD Publishing, Paris. http://www.oecd.org/daf/fin/private-pensions/Infrastructure-Financing-Instruments-and-Incentives.pdf.

Oqubay, A. (2015), *Made in Africa: Industrial Policy in Ethiopia*, Oxford University Press, Oxford.

Page, J. (2016), "Sustaining Domestic Growth: Structural transformation depends on Jobs, Industry and SMEs", *Foresight Africa: Top Priorities for the Continent in 2016,* Brookings Institution, https://www.brookings.edu/wp-content/uploads/2016/01/foresightafrica2016_fullreport.pdf.

Roe, A.R. and S. Dodd (2016), "Like it or not, poor countries are increasingly dependent on mining and oil & gas, *United Nations University*, June 2016, https://www.wider.unu.edu/publication/it-or-not-poor-countries-are-increasingly-dependent-mining-and-oil-gas.

Stratfor (2015), *Decade Forecast:* 2015-2025, https://www.stratfor.com/forecast/decade-forecast-2015-2025.

Sy, A. (2016), “Managing Economic Shocks: African Prospects in the Evolving Global Environment”, *Foresight Africa: Top Priorities for the Continent in 2016*, Brookings Institution, https://www.brookings.edu/wp-content/uploads/2016/01/foresightafrica2016_fullreport.pdf.

Tanzania National Bureau of Statistics (2014), *The 2014 Integrated Labour Force Survey (ILFS) – Analytical Report*, TNBS, Dar es Salaam, http://www.nbs.go.tz/nbstz/index.php/english/statistics-by-subject/labour-statistics/614-the-2014-integrated-labour-force-survey-ilfs.

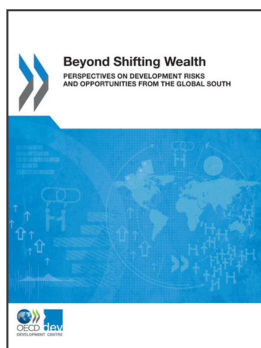
United Nations Economic Commission for Africa (2010), *Economic Report on Africa 2010. Promoting high-level sustainable growth to reduce unemployment in Africa*, UN Economic Commission for Africa, Addis Ababa, http://www.un.org/en/africa/osaa/pdf/pubs/2010era-uneca.pdf.

World Bank (2016a), *Digital Dividends*, World Development Report, World Bank Group, Washington, DC., http://documents.worldbank.org/curated/en/896971468194972881/pdf/102725-PUB-Replacement-PUBLIC.pdf.

World Bank (2016b), *Doing Business 2016. Measuring Regulatory Quality and Efficiency*, World Bank, Washington, DC, DOI: 10.1596/978-1-4648-0667-4.

World Economic Forum (2016), *Global Competitiveness Report (2016-17)*, http://www3.weforum.org/docs/GCR2016-2017/05FullReport/TheGlobalCompetitivenessReport2016-2017_FINAL.pdf.

World Economic Forum (2015), *The Global Competitiveness Report 2015-2016*, World Economic Forum, Geneva, http://www3.weforum.org/docs/gcr/2015-2016/Global_Competitiveness_Report_2015-2016.pdf.



**From:**
# Beyond Shifting Wealth
Perspectives on Development Risks and Opportunities from the Global South

**Access the complete publication at:**
https://doi.org/10.1787/9789264273153-en

**Please cite this chapter as:**

OECD (2017), "Structural transformation in a changing development context", in *Beyond Shifting Wealth: Perspectives on Development Risks and Opportunities from the Global South*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/9789264273153-5-en

This work is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of OECD member countries.

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

You can copy, download or print OECD content for your own use, and you can include excerpts from OECD publications, databases and multimedia products in your own documents, presentations, blogs, websites and teaching materials, provided that suitable acknowledgment of OECD as source and copyright owner is given. All requests for public or commercial use and translation rights should be submitted to rights@oecd.org. Requests for permission to photocopy portions of this material for public or commercial use shall be addressed directly to the Copyright Clearance Center (CCC) at info@copyright.com or the Centre français d'exploitation du droit de copie (CFC) at contact@cfcopies.com.

OECD