



The “African growth support” initiative, multi-stakeholder study group
Second meeting minute

Date: 24th April, 2008 (18:40 – 20:50)

Place: GRIPS Room 4B

Participants: 12 people with background in government, aid implementation agencies, research institutes, and 7 people from the GDF secretariat participated.

I. Opening

The secretariat introduced the second growth support initiative study meeting with a brief summary of the first study meeting’s proceedings and introduced the day’s agenda. Two presentations were made before discussions were opened. The first presentation from the secretariat highlighted the significance of the “growth diagnostics” (the framework pioneered by Harvard University professors Hausmann, Rodrik and Valesco, hereinafter HRV) to understand its implication for development assistance, and conditions for a more effective participation by Japan; and the second presentation from one of the participants focused on private sector development tools in Africa, with reference to the experiences of other donors.

II. Discussions

1. Growth diagnostics

- Participants agreed that the HRV approach provides substance in that it helps confront binding constraints to growth in a systematic way and recognized that, unlike the Washington consensus, it is more contingent with the recipient country’s economic environment and represents a key element in the efforts to search for new approaches to growth strategy as it comes with a decision tree to identify binding constraints to growth and prioritizes reform in the desired sequence.
- Nevertheless, despite the theoretical claim that the framework not be amenable to simple formulas as it requires the judicious use of evidence to look for clues (contingent to country environment) that will identify the most binding constraints, in practice though, it is feared the degree of convergence with which the method is applied (just checking a series of boxes) will end up identifying constraints that are not feasible to remove. It is yet to be known to what extent donors are prepared to work on customized prescription, based on realistic assessment of the institutional capacity of respective countries
- Participants further noted that many of the growth diagnostics lack prescription which leaves the important task of planning, designing, and implementing reform policies to remove identified binding constraints to developing countries to deal with on their own, despite their weak capacity. This raised questions of the true purpose of the HRV approach. Is it (i) a tool for donors to obtain analytical

insights for formulating their country assistance strategies or (ii) a tool for the recipient countries to avail for prioritizing reforms to support growth? The uncertainty creates a gap between the diagnosis on the one hand and the remedy (prescription) on the other.

- The language of "growth diagnostics" has become commonplace in multilateral agencies and donor organizations, and the approach has already been pilot-tested by the World Bank and the DFID in a number of countries. Under such circumstances, participants concurred that the need to fill this gap presented a good entry point for Japan to effectively participate in the growth diagnostics framework by working closely with recipient governments, through policy dialogue to help clarify the options available for them to respond to the identified binding constraints and to design growth strategies together. Japan has the experience and track record in development assistance (especially in East Asia) that she could bring to bear.
- Another weakness of the HRV model is that it assumes that economic activity is usually constrained by at least one of two factors: either (A) the private return to investment is too low, or (B) the cost of finance is too high. While many, if not most countries in Africa fall in category (A), their economies are characterized by constraints listed not only in (A) but also in (B). With such a laundry list of needed reforms in (A) and (B), developing countries either tried to fix all of them at once or started with reforms that were not crucial to their country's growth potential. The often generalized nature of the CEM report prepared by the World Bank (for example Morocco) exemplifies such dilemma.

The case of El Salvador

- Five to six years ago, El Salvador's private think-tank, FUSADES (Fundacion Salvadorena para el Desarrollo Economico y Social) - which has close link with the government - invited Hausmann and Valesco to carry out a study to identify binding constraints to economic growth. This study, thought of as the precursor to the 2005 HRV methodology - indeed El Salvador is included as one of the case studies in the 2005 HRV paper - was prompted by the failure to achieve growth despite implementation of drastic economic reforms following advice and recommendations from the Chicago (neo-classical) school. Therefore, this time, the government sought advice, from a "market failures" perspective. Participants noted however that ever since the study by the Harvard researchers concluded that "self-discovery" was to single most binding constraint to economic growth in El Salvador, there has not been any mention of Hausmann and Valesco in the country.
- Participants concurred that while the requirement for the "self discovery" process may be essential, more analysis for the best method to carry that farther would be needed. In principle, close collaboration with partner countries to assess areas of comparative advantage would enable division of labour accordingly, especially with regard to sector-specific tasks.

Meaningful Japanese participation

- Participants noted that despite the difference of approach between Japan and western donors – Japan’s practical, hands-on approach and western theoretical, framework approach – there is complementarity between them. Nevertheless, participants agreed for there being a need for Japan to aggressively publicize her approach. Even though the World Bank and the DFID are already implementing the HRV approach, efforts to make growth diagnostics a practical and more effective growth enhancing tool should be continued. Far from challenging or defying the current growth diagnostics, Japan would build on her long exposure with growth in East Asia to deepen the approach, and lead to what participants called “second generation” growth diagnostics. Whereas Hausmann and Valesco are more familiar with Latin America, Japan has significant local knowledge advantage in Asia.
- To leave Japan’s footprint on the “second generation” growth diagnostics, the following elements would have to be incorporated; (1) cooperation with recipient countries stakeholders for policy dialogue, (2) hands-on planning process, and (3) focus on the “positive list” of things to start with instead of focusing solely on the negative binding constraints, which in the case of Africa will be pretty negative. Here, participants recognized the importance of motivating the recipient country by focusing on the areas of their greatest potential for breakthrough. This approach was used with good effect in Asia where specific industry sectors and regions with the greatest potential were carefully targeted with short-term “doable” objectives and ring-fenced from the forces reinforcing the low level traps of corruption, poor governance, and others, to create growth poles.
- Even when Japan could only piggyback on the on-going growth diagnostics framework, the important thing would be to showcase that Japan’s commitment and support were critical in ensuring success. This would require Japan to focus her assistance on a few carefully selected countries. One possibility would be to work with countries where Japan provides wide ranging support from budget support to policy dialogue, to dispatch of industrial policy advisers (for example, Tanzania).

2. Private sector development tools

- This presentation described how the economic environment in developing countries is not adequate for the development of small and medium-sized enterprises (SMEs). In the current environment, (i) lack of suitable policies and institutional frameworks, (ii) lack of access to finance, (iii) lack of access to business support, (iv) poor value chain management, and (v) poor infrastructure, remain considerable bottlenecks. Tapping into innovative, donor-funded, aid instruments as a means to help SMEs acquire the finances and skills they need for private sector development was discussed. Concrete examples such as the IFC’s microfinance loan guarantee program (in collaboration with City group), and the USAID portable guarantee (both in Uganda) were described.

III. Closing

- There is consensus among participants on the need to deepen our understanding of the growth diagnostics, as well as the need for Japan's engagement in developing the 2nd generation growth diagnostics and for promoting her intellectual contribution to the process.
- Within this context, the next meeting (to be held in May) shall discuss concrete steps Japan can take to support infrastructure development for growth promotion.
- Discussions on private sector development tools shall be continued in the next meeting, as well.