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How Can Europe Better Contribute to Africa's Economic Transformation in a Post-Corona Era?

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Dear Readers,

Economic explanations are urgently required in a rapidly changing world. Aside from the challenges posed by global digital competition, an environmental movement and a welfare chauvinism, the Covid-19 pandemic has led to a severe economic crisis worldwide. Events such as Brexit and the US-China trade war also force us to rethink the mismatch between theoretical explanations and actual policy decision-making in a real world. At the same time, these changes will create new policy rules and institutions, making some established ones superfluous. In this context, a broad range of in-depth economic analyses is more urgently required than ever before, offering integrated perspectives of theoretical and institutional aspects combined with real economic policy-making.

Here at ifo and CESifo we closely follow these developments and are constantly striving to further improve our services to meet our readers' needs, preferences, and topical focus. In this context we have decided to compile the best elements from two English-language publications in our portfolio: the ifo DICE Report and the CESifo Forum. Starting July 2020, there will be a redesigned publication under the CESifo Forum brand, equipped with a more compact presentation of information. It will reflect the scope of ifo's and CESifo's activities, from academic research to up-to-date business data, and feature articles about the current international economic policy debate with a particular focus on institutional economics. It will be issued bi-monthly.

This issue focuses on the partnership between Africa and Europe, which has changed considerably in recent years. However, tangible improvements in the areas of economic and political development, prosperity, health and education have only been recorded in a few African countries. The Covid-19 crisis now poses an additional threat to the achievements of the past. The following pages outline the current relationship between Arica and Europe and the main drivers of Africa's economic transformation, and look at the role of foreign aid and foreign direct investment. In addition, special attention is given to the future paths of political and economic cooperation between the two continents in the post-Corona era.

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FOCUS

How Can Europe Better Contribute to Africa's Economic Transformation in a Post-Corona Era?

RESEARCH REPORT

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How Can Europe Better Contribute to Africa's Economic Transformation in a Post-Corona Era?

The Afro-European partnership has changed considerably in recent years, yet tangible improvements in terms of economic and political development, prosperity, health, and education are limited to only a few countries in Africa. The Covid-19 crisis poses now an additional threat to the achievements of the past. The focus section of this CESifo Forum issue examines and discusses the current relations between Africa and Europe, and outlines the main drivers of Africa's economic transformation. Due to the importance of capital flows for development, this section also addresses the use and effectiveness of foreign aid and FDI. The following contributions devote special attention to the future paths of political and economic cooperation between the two continents in a post-corona era.

Arkebe Oqubay

Africa's Economic Transformation and the Future of EU-Africa Cooperation*

Europe is Africa's principal trading partner and primary investor and the EU remains Africa's largest donor.[1] Cultural exchanges and tourism have been an important and growing arena for cooperation and business opportunities. However, despite the long history of economic relations between Africa and Europe and their geographical proximity, economic and diplomatic ties have not reached their full potential. Current Europe-Africa economic ties are inadequate and, arguably, asymmetric. A timely review of current ties is needed so that a new para-digm can be established based on a growth agenda rather than the traditional "donor-recipient" view-point.

For the last six decades, EU-Africa ties have been framed by the EU-ACP (Africa Caribbean Pacific) agreements, which were established by the Lomé Conventions I–IV (1975–2000), and after 2000 by the Cotonou Agreement expiring in 2020. The Cotonou Agreement lays down such principles as the equality of the partners, that ACP countries have the right to determine their own development paths, and that cooperation is multidimensional and all-encompassing. African and European leaders have also approved the Joint Africa-EU Strategy (JAES), which outlined how cooperation between Africa and Europe can develop into a new strategic level. This strategic partnership agreement was adopted at the second EU-Africa summit in Lisbon in 2007.[2]

TOWARDS A NEW BEGINNING

The evolving multi-dimensional crisis associated with the Covid-19 pandemic has exposed the weakness of international collaboration, including between Europe and Africa. It is worth exploring how this crisis could be used as an opportunity to kick-start a new trajectory. After all, an extraordinary crisis of this nature brings with it not only chalenges but also opportunities for learning and starting afresh.

This paper argues that thriving Africa-Europe economic ties must be developed within the framework of Africa's economic transformation, and that such cooperation must be accompanied by a paradigm shift that emphasizes mutual benefits and recognizes Africa as a true economic power and a partner among equals.

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* The author is grateful to Dr Taffere Tesfachew for his constructive comments.

[1] In 2017, Europe imported more than EUR 240 billion of Africa's goods accounting for 36 percent of Africa total exports.

[2] Although the paper's focus is on the European Union, it alternately and flexibly uses "Europe" and "European Union".

The paper draws on continental and specifically Ethiopian cases and is structured as follows. It first reviews the key drivers of Africa's economic transformation and considers how the existing economic ties between Africa and Europe could be changed. The second and third sections review African economic transformation and African economic integration, the two pillars that could serve as the foundations for building productive economic ties. The fourth section examines the Covid-19 crisis and its implications for Africa-Europe ties. The fifth and final section explores pathways towards a future productive Africa-Europe partnership.

AFRICAN ECONOMIC TRANSFORMATION

Understanding the African Context

The Europe-Africa relationship is influenced by a number of prevailing standard perspectives. The first is the dominant misperception of Africa and its growth trajectory, based on the standard "Afro-pessimism" and "African dummy" perspectives. Afro-pessimism is an ideologically driven bias that misrepresents Africa as a tragically doomed continent (Cramer, Sender and Oqubay 2020). The overly simplistic African dummy research approach treats the continent as a homogeneous entity and offers uniform diagnoses, despite the huge diversity between and within its 54 countries.[3] This viewpoint denies not only the diversity of Africa but also its capacity for dynamic learning.

Second, past development experience shows that diversity in development paths is the rule rather than the exception. There is no uniformly applied magic wand, and even late latecomers traveling their own paths have the opportunity to catch up. Instead of searching for a "one-size-fits-all" model, African countries should discover and pursue their own economic development paths based on their own specific conditions and contexts, and recent experience confirms these lessons (Amoako 2020). For instance, Ethiopia's growth was achieved through the pursuit of policy independence and an unorthodox economic development model (Oqubay 2015).

Third, African countries can benefit from both policy learning by government and technological learning by firms (Oqubay and Tesfachew 2019). A development-oriented state (government) and a dynamic private sector are vital for successful economic transformation and catch-up (Oqubay and Ohno 2019). The economic liberalization advocated by international financial institutions and their shareholders, and the policy prescriptions of the Washington Consensus, dismantled state apparatus and seriously damaged development paths. The experience of successful latecomers, however, suggests that openness may work well alongside rapid industrialization and transformation when complemented by strategic pathways and effective industrial policy. The state's role as leader, catalyst, and supporter of economic development is critical for successful catch-up – although it plays different roles in different sectors, countries, and development stages. African countries will not be able to achieve their ambitions to industrialize and climb the development ladder without sustained state support to enhance technological capability and learning.

Ethiopia: A Bright Spot

High Growth and Economic Transformation

Africa's economic performance since 2000 has significantly improved, following the sluggish growth of the 1980s and 1990s, a period associated with Washington Consensus prescriptions for economic liberalization. Africa's average annual GDP growth rate for the last 20 years has been 4.6 percent, but lower than that of Asia. Growth has also been uneven across African regions and countries. Furthermore, faster economic growth has not translated into deeper economic transformation. This is evident in the low level of diversification of national economies, weak and low-value exports, and the slow growth of manufacturing and other high-productivity sectors. Nor have Africa's new investments been able to generate sufficient jobs, despite the 20 million new entrants into the labour market every year.

Nevertheless, some of the world's fastest-growing economies are in Africa, and Ethiopia is one of the continent's bright spots. Ethiopia's remarkable record of economic growth and its home-grown development path have inspired the entire continent. As the last decade drew to a close, Ethiopia, with its population of 112 million, was one of the very few countries to top the list for high-level economic growth. The country's gross domestic product has jumped by 146.7 percent since 2009, and its per-capita purchasing power parity has risen by 149 percent.[4] According to the World Development Indicators, Ethiopia's economic growth has averaged 10.5 percent since 2004, twice the African average, while life expectancy in the country rose from 44 to 67 years between 1990 and 2017, also twice the average for the continent (see Figure 1).

Unlike other countries, Ethiopia's development path has been home driven, despite its lack of endowment in natural resources such as oil and minerals. The country continues to generate jobs and economic growth by focusing on attracting productive investment, industrialization, and education. Productive capacity has been developed by building physical infrastructure, developing human capital, especially in

[3] This approach applies to most writings based on the neoclassical growth theory, which ascribes similar policies to all African countries. The recommendation of Structural Adjustment Programs to all indebted African countries by the IMF falls into this category. For a discussion on Africa's post-colonial economic performance and the notion of the African dummy, see Jerven (2011).

[4] See, *Financial Times* "Ethiopia seizes crown as fastest-growing country in the 2010s".

vocational education, and transforming the university system (Oqubay 2015; 2019).

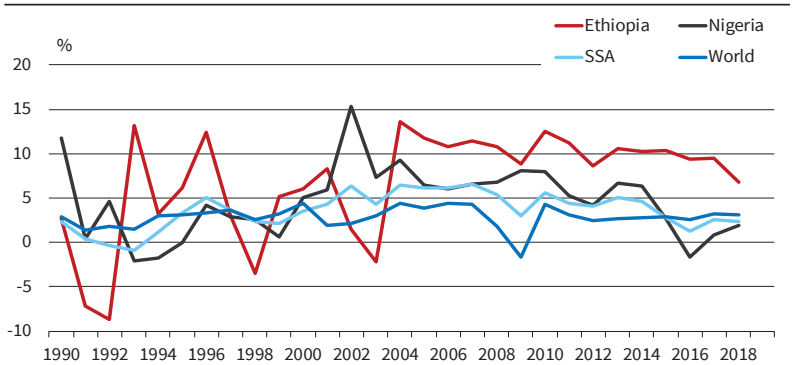
Ethiopia has built world-class industrial parks to attract investment, facilitate skill and know-how transfer, and promote linkages and environmental sustainability (UNCTAD 2019). This enabled it to increase FDI four-fold between 2012 and 2017. The country's share of East Africa's FDI inflows rose from 10 percent to about 50 percent, and inflows into the rest of the continent from 1 percent to 10 percent. For many foreign investors, the main reason for investing in landlocked Ethiopia has been the government's commitment to support investors and engage in dialogue.

In 2010, the government turned its attention to attracting foreign direct investment (FDI) into the productive sector, particularly manufacturing, promoting targeted sectors and firms, and working closely with investors. Four-fifths of FDI inflow into Ethiopia in the last few years has been destined for manufacturing (see Figure 2 and 3).

Manufacturing FDI also needs to be channeled towards expanding the export sector to tackle the balance-of-payments constraint. A major challenge for policy makers is how to sustain double-digit growth while at the same time generating enough decent jobs; expanding the export sector; resolving the balance-of-payments constraint; building a solid manufacturing base; and transforming the agriculture sector. Attracting targeted and productive FDI is essential for creating jobs, broadening the skills base of the local industrial workforce, motivating domestic firms, and sharing management know-how.

Figure 1

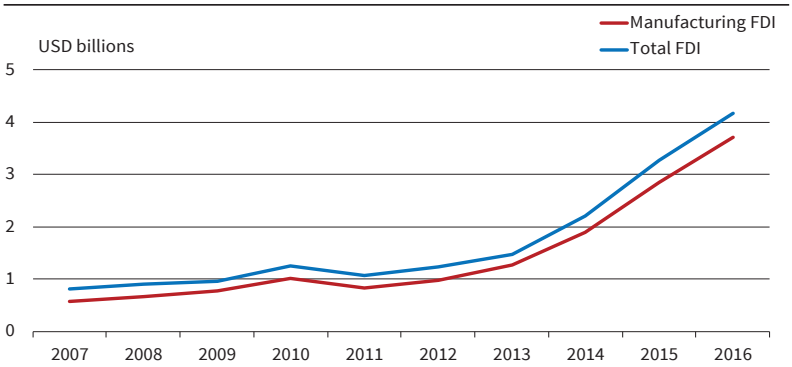
Economic Growth



Source: World Bank Development Indicators (2020). © ifo Institute

Figure 2

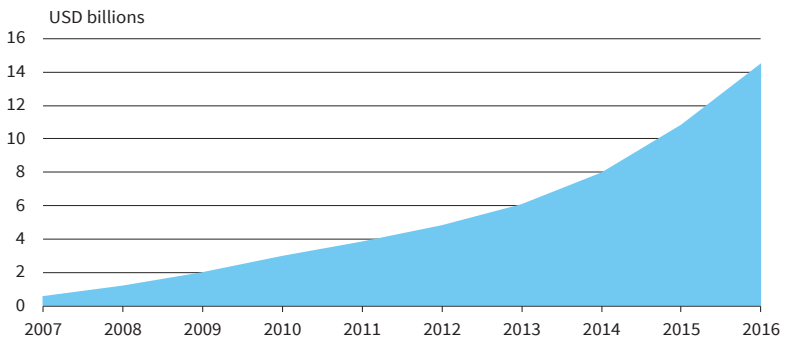
Total and Manufacturing FDI Inflow to Ethiopia



Source: National Bank of Ethiopia and Ethiopian Investment Commission (2020). © ifo Institute

Figure 3

Manufacturing FDI Stock



Source: National Bank of Ethiopia and Ethiopian Investment Commission (2020). © ifo Institute

Targeting and Attracting Productive FDI

Ethiopia's rapid and inspirational growth symbolizes the continent's bright future. At a time of slow global economic growth, African policy-makers should be single-mindedly focusing on building the continent's production capacity and attracting productive FDI in three ways. First, African government should focus on creating the necessary conditions for productive investment. Improving the business climate is an essential, but not a sufficient condition: productive investment requires educated personnel, energy infrastructure, and investment in efficient connectivity (Lopes and Kararch 2020).

Second, African governments must avoid focusing solely on generic foreign investors. The evidence shows that the growth outcomes of FDI for host countries are mixed, with some of it simply acting as "phantom" rather than real capital and bricks-and-mortar investment. African governments should identify their priority sectors and the most promising sources of higher-quality FDI, and should also target firms. An institution fit for purpose should be developed to act as a single investment channel, providing better coordination mechanisms, and building the diverse expertise required to attract, facilitate, and retain targeted FDI. Without these essential reforms, there can be no improvement in investment promotion outcomes.

Third, new industrial parks need to be built and existing ones expanded. Policy-makers often fail to understand that industrial parks require a strategic approach linked to creating a wider productive industrial ecosystem that contains pockets of excellence. Ethiopia's approach to building an industrial ecosystem has been driven by learning from others and finding unique solutions to challenges and binding constraints (Oqubay and Kefale 2020).

AFRICAN ECONOMIC INTEGRATION

A Pan-African Renaissance

Another foundation conducive to Africa-Europe economic ties is Africa's economic integration journey. Creating and promoting a union that will increasingly play an essential role in political, diplomatic, and economic arenas has been guided by the spirit of pan-Africanism and a stronger belief that rapid growth and economic transformation is the pathway to achieving a prosperous Africa. A major milestone was reached on May 25, 1963 when 32 signatory governments established the Organization for African Unity (OAU). The OAU was pivotal in the fight against colonialism and apartheid, and in progress towards a stronger political union through the founding of the African Union Commission (AUC). Stronger economic ambition and initiatives to revitalize the African Union have led to the launch of the New Economic Partnership for African Development (NEPAD), in which peer review mechanism (PRMs) focus on experience sharing among African countries (Amoako 2020).[5]

African countries committed to implement the Millennium Development Goals (MDGs) between 2000 and 2015, which would contribute to improved social welfare systems. Governments recognized, however, that Africa must aim beyond the MDGs to long-term sustainable development and economic transformation leading to the evolution and commitment of Agenda 2063, which is aligned to the United Nations' Sustainable Development Goals (SGDs).[6] The development of a stronger European Union has influenced African leaders and policy makers to work towards sustainable political union and economic integration.

Economic Integration

African governments, the African Union, and the United Nations Economic Commission for Africa (UNECA) have made concerted efforts to foster Africa's economic integration, in which the African Continental Free Trade Agreement (AfCFTA) represents a fundamental milestone made possible by the emergence of regional economic communities such as COMESA, EAC, ECOWAS, and SADC which gained experience and confidence through experimentation (UNECA 2020).[7]

The AfCFTA was ratified on March 21, 2018 by leaders of 28 African countries. Intra-Africa trade currently represents a mere 15 percent of Africa's total trade, showing that the continent's intra-regional value chain is very weak compared with that of Asia, where it stands at 80 percent. Africa's trade volume is also constrained by the relatively slow economic growth in the continent – averaging 4.6 percent since 2000 in contrast to Asia's 7.4 percent – and by the weak development of productive capacity, especially manufacturing.

However, there is a worrying lack of understanding among policy makers and scholars of the implications and requirements of AfCFTA. Instead, there is a sense of overblown euphoria about what it will achieve. The benefits of economic transformation may only be partial if not combined with additional policy measures targeting binding constraints to ensure a larger share of intra-Africa trade and to build regional value chains based on bigger value addition.

The outcome of the AfCFTA will depend on whether African countries embrace industrialization and focus on increasing their productive capabilities in a highly competitive global landscape. At least three interventions are required if AfCFTA is to succeed as a development opportunity. First, the development of manufacturing is essential if African countries are to increase their production of value-added products, expand exports of such products, and reduce their trade imbalances. This approach improves economic diversification, which accelerates structural transformation (Cramer, Sender and Oqubay 2020). Developing productive capacity in an intensely competitive environment requires massive new investment, a supportive industrial ecosystem, and skill acquisition. The decreasing trend in labour productivity (currently 50 percent that of Asia) must be reversed, as the competitiveness of African economies will be shaped by their productivity gains.

Second, while increasing intra-Africa regional value chains is necessary, African countries also need to increase their marginal share in global exports, currently slightly less than 3 percent. Increasing African exports will contribute to economies of scale, create decent jobs, and serve as a source of international learning to improve productivity.

Third, AfCFTA is constrained by infrastructure deficits and the fragmentation of supply chains. Currently, African countries are not investing sufficiently in connectivity and infrastructure, significantly to the detriment of regional trade. The harmonization of regulations related to different sectors (such as pharmaceutical products) and sub-regional blocks is needed to create a conducive business climate that will foster trade.

A Focus on Productive Capacity and Industrialization

Although there is no universal recipe for industrialization, a pragmatic approach to evidence-based policymaking undoubtedly improves outcomes. African countries need to design their own economic development strategy and an industrial policy that fits their unique circumstances (Oqubay 2020c; UNECA

[5] See African Union (2020a).
[6] See African Union (2020b).
[7] For instance, East African Community (EAC), Common Market for Eastern and Southern Africa (COMESA), Economic Community of West African States (ECOWAS), and Southern Africa Coordination Conference (SADCC) founded in 1967, 1994, 1975, and 1981 respectively.

2016). Policy learning by governments, policy dialogue among African countries, and technological learning by firms making use of the latecomer advantage, are especially important.

For instance, lessons can be drawn from Ethiopia's new approach to building special economic zones and industrial hubs. The establishment of these state-of-the-art industrial parks was itself based on learning from others (Oqubay and Kefale 2020). African countries could also leverage the economic ties they already have with traditional partners and form new South-South avenues for cooperation. China-Africa economic ties have helped to catalyze economic transformation in some African countries, including Ethiopia (Brautigam 2019).

Industrialization and economic transformation must guide the current AfCFTA narrative. It is important to emphasize that Africa's future will be determined by a focus on industrialization, and by the transformation of agriculture and the economy (ACET 2018). Policy makers need to single-mindedly focus on industrialization, as the hard truth is that there is no shortcut to economic transformation.

THE EVOLVING COVID-19 CRISIS

Covid-19 and Africa

As the new decade opens with some optimism in Africa, a multi-dimensional global crisis has brought the world economy to its knees. In less than four months, Covid-19 has evolved from what was initially understood to be a flu-like illness into the greatest threat the world has faced since the Second World War. The level of globalization and the interconnectedness of the world render it particularly destructive although is not the deadliest infectious disease recorded. The depth of the global economic crisis is exceptional; not only is it worse than the 2008 global financial crisis, but it is also happening at a time when there is weakened global collaboration and increasing political posturing over trade and technology among major global trading partners. The crisis revealed the limitations of scientific advances in health care and medicine, the vulnerability of weak national healthcare systems, the weakness of misdirected technological advances, the damage done by populist and political posturing, and the general instability of the global economy and the globalization trajectory.

As European countries see the curve flattening, the next epicenter – and the most vulnerable – will be African and other developing countries. The impact on these countries is expected to be more damaging because of their weak healthcare systems and generally low levels of economic resilience, innovation ability, knowledge base, resource diversity, and social fabric. Support for developing economies must be part of an international cooperative movement. Millions of Africans may become infected with Covid-19, and researchers at Imperial College London recently estimated that, even under the most optimistic scenario, the virus would kill 300,000 people in Sub-Saharan Africa – not to mention the immense economic costs of lost export revenues, severed supply chains, and plummeting demand.[8]

The response by most African countries to Covid-19 has been swift and bold in the face of a world short of progressive global leadership and a unified global response. The lessons learned from the 2014–16 response to Ebola in West Africa, which exposed the vulnerability of national health emergency systems and wider socio-economic impacts, has led to improvements in some African countries and to the establishment of CDC-Africa.[9] A comprehensive Covid-19 response must also take account of the pandemic's economic consequences. Already, oil prices have plummeted – bad news for Africa's producers, although beneficial for oil importers.[10] Supply-chain disruptions augur declining exports. The damage to the travel and tourism sectors is just beginning to show.

Managing the post-Covid-19 economic recovery will also be critical. Limiting the damage to the most dynamic sectors as much and as early as possible is essential, because more productive activities have bigger spillover effects and are crucial for recovery and large-scale employment. The biggest mistake would be to place all economic activities on an equal footing and try to make everyone happy. Instead, policy makers should focus on export industries, which are vital to ensure foreign-exchange liquidity, ease balance-of-payments constraints, and generate employment. Encouraging services exports and high-value service activities is also critical, as is ensuring affordable food supplies.

African and international leaders must act boldly, decisively, and immediately to prevent a catastrophe. African governments, in cooperation with communities and international actors, can take steps now to limit the damage – and lay the foundations for a healthier, more resilient future. If managed well, the Covid-19 response will result in stronger healthcare systems that are far better equipped to keep populations healthy in normal times – and to respond to inevitable future crises (Oqubay 2020b). But, to be successful, African governments will need external support.

International Collaboration and Support for Africa

At a time when the world is looking for direction, advanced economies, including European countries, ab-

[8] See, https://www.imperial.ac.uk/media/imperial-college/medicine/sph/ide/gida-fellowships/Imperial-College-COVID19-Global-Impact-26-03-2020v2.pdf and https://www.mckinsey.com/featured-insights/middle-east-and-africa/tackling-covid-19-in-africa.

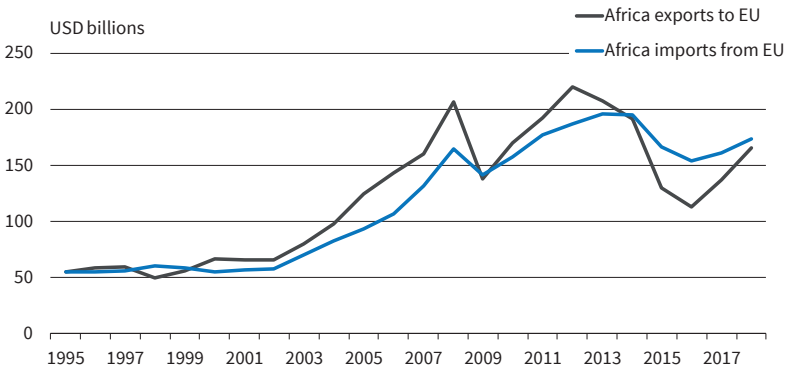
[9] The hardest-hit countries in the 201416 Ebola pandemic were Guinea, Liberia, and Sierra, and since 2018 the Democratic Republic of the Congo.

[10] See AfDB's (2020) forecasts; 3.9 and 4.1 percent for 2020 and 2021 respectively is no more valid.

dicated their global leadership roles, falling prey to international posturing. We live in an era of hyper-globalization when such crises can no longer be contained within national boundaries. A holistic approach implies that emergency health measures and economic interventions are not mutually exclusive. It also means that maximum unified global collaboration and cooperation by governments, and especially coordination with WHO, is no longer a choice but a necessity. The 2020 G20 summit failed to recognize Covid-19 as an unprecedented global threat and ended without any significant decisions on the global economic crisis and health emergency.

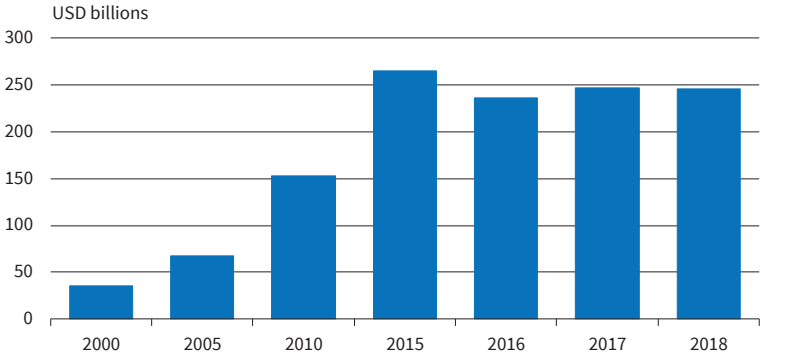
International action must be guided by several key principles. Any support needs to focus on emergency health measures to help African countries control the pandemic. International cooperation must include development assistance to help countries manage both economic crisis and humanitarian needs. It should also include support for foreign-exchange liquidity to limit insolvency and protect essential economic activities. The most generous debt relief, preferably through cancellation, and new funding should be applied to those African countries (typically non-resource rich and less politically strategic) that are least able to borrow in commercial markets and least able to spend on building health care systems.

Figure 4
Patterns of EU-Africa Trade



Source: UNCTAD's merchandise trade data (2020). © ifo Institute

Figure 5
Patterns of EU's FDI Stock in Africa



Source: UNCTAD database (2020). © ifo Institute

THE FUTURE OF AFRICA-EUROPE TIES

Strengthening Africa–Europe Ties through Productive Collaboration

Africa-Europe economic ties suffer from multiple weakness and constraints. Lack of internal cohesion within the European Union is a major impediment. Europe's sluggish economic growth and weaker economy following the 2008 global recession has limited the scope of collaboration with African countries. The sluggish economic recovery in Europe and the austerity measures pursued have created a fertile environment for discontent and the rise of nationalism and populism, weakening European common interest and partnership with other regions. Historical bonds between European and African countries, though important, have not proved strong enough to build a mutually beneficial partnership. Europe has been shown to lack coherent policy and strategy towards Africa or a strong commitment to the relationship (Medinilla and Teevan 2020). New partnership initiatives begun by some European leaders were short-lived and often linked to the election cycle, further evidence of the absence of a strong commitment to the Africa-Europe relationship.

Many European countries have encouraged their firms to invest in Africa, but the impacts have been limited. The investment inflow has focused on the extractive sector, with less attention paid to productive sectors such as manufacturing. In addition, investment from Europe is distributed unevenly across African countries.[11] While it is evident that foreign investment goes to sectors where profits are high and its accountability is often to shareholders, there are incentive measures that home governments can take to encourage their multinational companies to invest in productive sectors abroad. A new paradigm for the Europe-Africa partnership could benefit from such measures. The objective is to encourage multinational companies from Europe to invest in Africa's productive sectors, particularly manufacturing, and contribute towards the continent's growth and economic transformation agenda.

Thus, the conventional paradigm of the donor-recipient relationship must evolve towards a "new growth generation" approach to Africa's partnership with Europe. The latter will not only deepen the relationship but will also positively contribute towards Africa's economic transformation. The focus must be on expanding trade, productive investment, infrastructure, and collaboration to build human capital (see Figures 4 and 5).[12] The European Union and its member nations must note that the current support is inadequate."

[11] For instance, the bulk of UK investment is concentrated in Nigeria, Kenya, Ghana, and South Africa.
[12] It is important to fix visa processes for promoting trade, investment, and develop human capital. See, Oqubay (2020a) on existing visa flaws.

To sustain Africa's economic transformation and high growth, the focus must be on promoting productive investment to create jobs in Africa, developing domestic linkages and skills, and enhancing export capability. In addition to promoting FDI in productive sectors, both sides must work on expanding trade volume, on the diversification of African exports and on addressing the trade imbalances, which can be achieved through the expansion of productive capacity. It will be essential to focus on infrastructure development, with a particular emphasis on the expansion of energy and connectivity. However, none of this will suffice if not supported by technological and know-how transfer.

A Sustained Partnership on Global Threats

Three principles must guide the future of Africa-Europe economic ties: first, the focus must be on activities that impact economic transformation and high growth in Africa; second, it must be based on complementarity and a relationship among equals that addresses the current asymmetric relationship; and third, it must focus on fundamental global threats. Environmental sustainability is vital for Africa, Europe, and the global community. In an increasingly globalized world, global pandemics are likely to undermine all countries. Global partnerships must aim at improving international governance rules, with a particular focus on resolving the constraints that affect developing countries.

Another critical issue is that while Africa should continue to engage with its traditional partners ("the West" and "the North"), it also needs new partners from the east and the south. The economic ties between Africa and China are a good example of win-win benefits, especially when it comes to attracting productive investment and trade, financing infrastructure, and human capital (Oqubay and Lin 2019). This should induce other countries to develop ties with Africa's interests at their heart, not governed by "pre-conditionality" but based on values of mutual respect and non-interference in others' internal affairs.

Such collaboration can be realized only if there is strong political commitment by both sides, supported by strategic and institutional frameworks. Lessons from the recent expansion of China-Africa economic ties over the last two decades may provide insights on what improvements to make. A Eurocentric view that questions the legitimate rights of African countries to develop economic ties with West and East is dangerous and must be rejected. For instance, portraying China-Africa ties as "new colonialism" reflects a paternalistic view of the relationship that regards African countries as backward and lacking the capacity to rationally comprehend their national interests. Stronger China-Africa ties would create more jobs for Africans, promote and diversify exports, and expand infrastructure, all of which are useful for facilitating investments and operations of firms from the West. Developing a strong regional value chain will also assist European firms to diversify their global value chains.

CONCLUDING REMARKS

It is often said that a major global crisis, particularly of the type that we are facing at the moment, presents not only challenges but also opportunities for learning, rethinking policy direction and adjusting strategy. As African and European countries begin to formulate their policy responses for the post-Covid-19 recovery phase, it is important that a new approach to the Africa-Europe economic relationship is prioritized. The relationship between Africa and Europe has a long history extending beyond geographical proximity. Unfortunately, however, the ties that have emerged in the last five decades have been less beneficial, especially for Africa's growth and economic transformation agenda, than the recent economic ties that Africa has created with countries in other regions.

The post-Covid-19 recovery period provides an opportunity for a paradigm shift in the Africa-Europe relationship from the conventional "donor-recipient" approach to one that is based on mutual respect and aligned with Africa's sustainable economic transformation agenda. There is no doubt that Europe wishes to see a growing, dynamic, and prosperous Africa. As noted above, Europe is the major donor to African countries. The point is that Africa's prosperity and economic transformation will not be achieved through aid alone. It requires investment in productive sectors and infrastructure, the creation of a strong domestic knowledge base generating well-paying jobs, and technological learning through linkages. Above all, it is achieved by building the domestic productive capacity that is critical for producing a wide range of products that African countries need both for consumption and to sell competitively in international markets. What Africa expects from its ties with Europe is a partnership that enables it to acquire these capabilities. The new decade may finally offer a new opportunity for a paradigm shift.

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Horst Köhler

Crisis and Credibility – Towards New Honesty in EU-Africa Relations

Crises tend to nail our minds to the present. The current pandemic is no different. As we struggle to adapt to manifold ways in which this virus digs into all our lives and only begin to understand the economic and social havoc it will leave behind, we tend to turn inwards and focus on the nearest and most immediate challenges ahead of us. This tendency – however comprehensible and necessary it may be – is dangerous. For the steps we take or fail to take in the midst of this crisis will set the course for the era thereafter. And to allow the crisis to narrow our field of vision would come at great cost.

This applies particularly to relations between the European Union and Africa. The corona crisis has hit both continents in a year that was planned to bring pivotal change to their partnership. Only in March, the European Commission published its new Strategy with Africa. Broad dialogues should follow and lead to an ambitious declaration on the future of cooperation at the EU-Africa Summit in October. It is easy to imagine how the everyday undertow of crisis management could set a blatant hold to these aspirations. This would be fatal.

THE FATES OF EUROPE AND AFRICA ARE DEEPLY INTERTWINED

The virus has proven, once more, how much the well-being of each and every one of us today depends on the well-being of people across the globe. For Europe, this applies more than anywhere to the well-being of people in Africa. A quick survey of the main facts: Africa is separated from Europe only by a narrow sea strait. Its 55 countries are home to roughly 1.3 billion people. By 2050 this number will probably double. In the middle of this century, about 20 percent of the world's population will be African and only 5 percent European. This huge pool of hopeful, creative, and forward-looking young people is not only Africa's biggest resource. It also has the potential to offer vast markets to European companies on a continent that still has a huge thirst for real investment into businesses, roads, hospitals, homes, transport, energy, and manufacturing. And African youth may sooner than we think come to be a welcome source of fresh minds and labor for our continent.

At the same time, this population growth entails enormous challenges. Today, almost half of the long-term unemployed in sub-Saharan Africa are below the age of 25. The International Monetary Fund (IMF) estimates that Africa will need to create the immense number of 20 million additional jobs every year – an historically unprecedented challenge. And to offer a real perspective, a substantial proportion of these jobs will have to be created in the kind of future-oriented and high-value-added sectors that in many African economies are still only nascent. The current crisis exacerbates this challenge. The economic fallout from plummeting demand in China and the EU for commodities and raw materials is already being felt throughout the continent. Tourism has collapsed. This leaves African governments with even fewer resources available to adopt similar policies to European governments who are stepping in to prop up their domestic businesses affected by the containment measures. Without bold responses, this crisis will further diminish the prospect of job creation and industrialization in Africa. This would be ruinous. It would fuel political conflict, ravage our neighbor continent, and, of course, also harbor serious risks for European security. The fates of Europe and Africa are deeply intertwined. We have to understand that there is no future in which Europe prospers while Africa suffers.

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It would thus be a great mistake for Europe and its nations to turn inwards. While physical isolation is the order of the day, political isolation surely is not. If anything, the virus and the connectedness it underscores give new urgency for Europe to become a credible partner in Africa's economic transformation. However, this requires a serious restart of our relation both in attitudes and in politics.

THE CHANGING NATURE OF EU-AFRICA RELATIONS

Let us start with the attitudes. First of all, we must resist the temptation to let this crisis reinforce trite clichés. These days, much of our thinking about Africa focuses on the possible damage the coronavirus could do on the continent. Often, we do this with the best of intentions. Indeed, if large outbreaks occur, many African countries will need support to avoid a collapse of their public health care systems and, like many other countries in the world, many African states will need globally concerted

efforts to overcome the economic crisis the virus inflicts.

However, we must also be aware that part of these concerns stems from our old habit of imagining Africa as a continent of death and disease, a worry to the world, in need of foreign assistance. We often overlook the fact that many African countries have experience in dealing with infectious diseases and have reacted much quicker to the coronavirus than many of the Western countries. Too often, we still conduct our relations with Africa with an air of superiority and through the prism of dependency and aid, treating our neighbor as an object of European influence, not as a subject of its own political and economic fate. Overcoming this habit is not just a matter of political correctness. It is a fundamental precondition for a credible partnership. And the relationship between the two continents is changing, whether Europe wishes it or not.

First, we must realize that the Western "brand" has lost much of its splendor. Even before the coronavirus, Africans carefully noted Europe's inability to provide tangible solutions for its own most pressing issues. How is it that a decade after the Eurozone crisis, the structural problems of monetary union remain unaddressed? What real solutions for climate change does Europe have to offer? And is the Western economic model really something to strive for if it cannot put a halt to the inequalities and the continuing overexploitation of natural resources within its own societies? The past decade has hardly made a good case for Europe to be a role model for Africa's development. The new images of overcrowded hospitals and overwhelmed public services will further diminish any delusions about Western grandeur. The simple truth is: Europe can no longer afford the hubris it has exuded in its relations with Africa.

Second, Europe today is by no means the only partner available to Africa. China's growing presence in the region has often been maligned, and Europe watches Chinese billions pouring into new investments in Africa's infrastructure and natural resources with growing concern. Similarly, India is increasingly keen on deepening economic relations, and last year Russia joined the bid for influence on the continent with the first-ever Africa summit hosted in Moscow. Of course, this new scramble for Africa is probably no less exploitative and no more devoid of geopolitical interests than European approaches have been in the past. However, what these new partners do have to offer are new political and economic options for African politicians. And this means that Europe can no longer claim the prerogative of interpreting what direction Africa's development should take.

Third, the relationship is also changing due to the growing self-confidence with which many Africans are now claiming their place on the global stage. We can see this self-confidence in the way in which African leaders are enacting bold economic visions such as the African Continental Free Trade Agreement (ACFTA), which aims to remove 90 percent of tariffs on intra-African trade. Once fully established, the agreement will turn into the world's largest free trade area and one of the best chances Africa has to boost growth, investment, and job creation.

We can also find growing self-confidence in the ongoing process of cultural and scientific self-assertion. Many African writers, designers, filmmakers, researchers, and academics are reaffirming the diversity of their roots and identities and changing the narratives about their continent. For our part, we should – first – be a lot more curious about these debates. We should – second – be ready to question our own narratives and allow those of others. And – third – we should be ready to massively engage in the process of mutual cooperation, which, by the way, also means removing obstacles like denying entry visas for academics. I am happy to see new academic clusters like the "Africa Centre for Transregional Research" at the University of Freiburg, which intends to conduct its research not only *on* Africa, but *with* Africa. I strongly recommend listening to African voices and taking note of African research, for example through Afrobarometer surveys or through the work of the Mo Ibrahim Foundation on good governance. And I think we must answer the call for respectful intercultural dialogue that was recently voiced in an open letter from African intellectuals to Germany's Chancellor Merkel and President Steinmeier. Their conclusion reso[1]nates with me: "The reconciliation of humanity with itself and with all living beings is the only way to face the great dangers of the century. (...) Its foundations must be truth and justice, without distinction of race, religion or nationality".[1] A process that, by the way, also includes the righteous claim for Europe to return the artistic heritage it has robbed from the continent over the past centuries. A call that Europe, I believe, finally must answer. And, last but not least, we can witness this self-confidence in the vibrant creativity and entrepreneurial power with which the young generation in particular is expediting the technological transformation of their home. A power that good old Europe may well be able to learn a thing or two from: for example, how Kenya has become the world leader in mobile money, or why 4G connectivity in Côte d'Ivoire is better than in Germany. I am always amazed by the refreshing matter-of-factness with which this young generation simply takes it for granted that the 21st century is theirs to shape. And they are absolutely right to do so.

All of this shows us that the not-so-subtle hierarchies that still rule much of European thinking about Africa are not just offensive and outdated. They are

[1] See, https://secure.avaaz.org/fr/community_petitions/angela_merkel_chanceliere_allemande__soutien_des_intellectuels_africains_a_achille_mbembeafrican_intellectual_support_

also increasingly ridiculous. The EU should vigorously embrace this change, for it forces Europeans to set aside our own preconceived notions of our relation to Africa and reset our politics in ways that allow for a more credible, reliable, and productive partnership for both sides.

THE NEED FOR A NEW CREDIBILITY IN EUROPE'S PARTNERSHIP WITH AFRICA

Now, the idea of such a partnership is not a new one. In fact, Europe has used the language of equal partnership at least since the EU-Africa Summit in Lisbon, in other words for almost 15 years. The term has been used so frequently that it runs the serious risk of being reduced to dusty rhetoric, a mindless tool to gloss over the lack of substantial movement on the part of the EU. However, this does not make the concept any less important. I am convinced that in order to truly turn the page on its cooperation with Africa, Europe needs exactly this kind of partnership. However, this requires our politics to become more honest with Africa and, even more so, more honest with ourselves.

Let us begin with a basic fact: The relationship between the EU and Africa is a political one. This sounds self-evident, but too often the EU still approaches Africa in the technocratic spirit of solutionism. Take the current debate on "fighting the causes of migration". This discussion often implies that Europe just needs to find the right buttons to push, the most efficient way to spend money, the best-tested development tools – and the phenomenon of young Africans seeking better economic fortunes in Europe will simply go away. Of course, the causes of migration need to be addressed in the interest of both Europe and Africa. But it will not be a matter of technical fixes and it will not be solved somewhere in Africa. The increase in migration tells us that the current levels of economic inequality across countries cannot be sustained in a globalized world. Addressing this cause of migration is not an exercise in effective philanthropy. It is a political challenge for all humankind. And, like all politics, it is a question of who gets what and how, and it will mean us Europeans giving up some of our privileges.

Another fact Europe needs to be honest with itself about: Some European policies are still part of the structural barriers that hamper Africa's economic transformation. Agriculture today accounts for 32 percent of African GDP and it is one of the sectors that offers the greatest potential for poverty reduction and job creation. According to the World Economic Forum, growth generated by agriculture in Africa is about 11 times more effective in reducing poverty than growth in other sectors. However, among factors impeding this development are subsidized European agricultural exports that outcompete local producers and EU trade barriers on processed food that make it difficult for African producers to increase value addition. African governments have pointed to this for years, and their arguments sound very similar to the justified concerns Europeans are now raising about unfair trade practices on the part of China. Nonetheless, too little has changed. Let us be honest: Effecting change will be costly. Some European producers stand to lose from reforms to the current system of trade and subsidies. However, it is these kinds of trade-offs that Europe has to take seriously if it wants to be a credible partner.

A credible partnership also requires us to apply the same kind of standards on both sides of the table. The protection of infant industries has been a main point of contention between Africa and the EU for a long time. While African governments have often insisted on industrial policy measures to safeguard nascent sectors, especially in manufacturing, the European side tended to portray such measures as protectionism in disguise. Now industrial policies are making a striking comeback in European politics as the EU is seeking to adapt its own economic rulebook in order to foster growth in its nascent digital industries. All of this is undertaken on the premise that we need to enable our vulnerable industries to compete with rising competition from China and the US. The implication of double standards might be unfair but the impression that Europe is more open-minded to pragmatic approaches within its own borders than in Africa does weigh heavily on the Union's credibility.

Finally, building a credible partnership also requires taking an honest look at why some aspects of cooperation are not yet producing the desired results. For example, we know that foreign direct investment is key to economic development and that Africa could benefit immensely from European firms bringing new capital, technologies, and know-how into local markets. However, so far, too little European investment is taking place and existing commitments often do not provide enough spillovers in local markets. Too much of Europe's investment still focuses on natural resources and the infrastructure linked to their extraction and has therefore contributed to the lack of diversification that is now making Africa especially vulnerable in the current crisis. For Europe, this means a need to think about new approaches to encourage outward investment in different sectors and make sure that European companies create the kind of forward and backward linkages that domestic economies need to benefit from foreign capital.

Realizing that the relationship between the EU and Africa is political and shaped by both interdependencies and differences of interest does not mean falling back into the trap of zero-sum thinking. On the contrary, I am convinced that having no illusions about the asymmetries in our partnership will allow us to use them more constructively.

Why not let the insight that the EU's current agriculture system is a roadblock for African development

guide us to seek new synergies between the economic transformation of Africa and the ecological transformation of Europe? I believe there are plenty of ways in which we can build a greener and healthier agriculture system in Europe and give African producers a fair chance to compete. Why not turn the creativity that the EU now puts into developing new industrial strategies in Europe into a more open-minded approach to the promotion of infant industries in Africa?

The economic recovery programs in the current crisis will give new impetus to the need to diversify African economies and build more sustainable and resilient local value chains. Being open about the fact that European investment, so far, has often failed to produce the desired effects may serve as a starting point to reflect on the kinds of investment Europe wants to bring to Africa. Maybe sometimes smaller is bigger, and African businesses may benefit if large-scale projects are complemented with the engagement of small and medium-sized firms with a stronger tendency to entrench into local economies.

FIRST SIGNS OF A NEW PARTNERSHIP

For all the historical baggage and missteps of the past, I am cautiously optimistic that relations between Africa and the EU are moving in the right direction. Africa should be a focal point of the new "geopolitical" Commission, and for that the African Union should be a central partner. I was happy to see that last year, the new President of the European Commission, Ursula von der Leyen, chose Addis Ababa as the destination for her first official trip and that she revisited this year together with a delegation of 20 European Commissioners to meet with their counterparts in the African Union.

The coming weeks and months will show whether these visits will remain symbolic or whether the EU is finally giving its neighboring continent the political priority it deserves. The role that Europe plays in working with Africa to set the agenda for recovery from the current pandemic will be a litmus test. The most recent joint statement of 18 African and European leaders outlining a collective strategy to fight Covid-19 and its widespread economic, social, and humanitarian damage gives some hope. It urges in strong words for an economic stimulus package of at least USD 100 billion, an immediate moratorium on all bilateral and multilateral debt payments, both public and private, and asks the IMF to decide on the allocation of special drawing rights to provide additional liquidity for the procurement of basic commodities and essential medical supplies. German Chancellor Angela Merkel was amongst the signatories. I think the implementation of this statement should be an issue for Germany's Presidency of the Council of the European Union in fall 2020.

There must also be stronger efforts to coordinate the various Africa policies of European countries. To date, in some African countries, European governments and organizations are competing rather than working with each other. A more coherent approach, embedded in our Common Foreign and Security Policy, would make the EU a much stronger, more credible, and more reliable partner. I see some promise in the Commission's new Africa strategy published at the beginning of March. Much of the detail will have to be discussed in the coming months. But I think it is encouraging that cooperation in the areas of the green and digital transformation has been put front and center. Not just because I believe there is a lot to be gained from closer collaboration, for example, on green energy investments or the digitalization of schools and education in Africa. But also because the Commission – by highlighting the flagship initiatives of its own tenure in the strategy – is showing that it is starting to structure its thinking about relations with Africa not along the lines of dependence and support but in the spirit of addressing common challenges and a mutual transformation. I very much hope that the two initiatives the German government has put forward in recent years – the "G20 Compact with Africa" and the "Marshall Plan with Africa" – will also work in this direction. There is plenty of room to work on stable roots for a new, credible partnership.

ENVISIONING NEW FUTURES

Let me end with three ideas that would allow Europe and Africa to transform their existing asymmetries in productive and mutually beneficial cooperation and so set a new long-term course for our common future. First, let us find ways to build stronger financial bridges between the rich and ageing societies of Europe and the young, poor, investment-hungry countries of Africa. Here, the piles of idle savings in the North could contribute to real investment with both an economic and a societal dividend. Again, this requires reforms on both sides. African countries will have to find ways to provide more secure investment environments, including more rigorous efforts to fight corruption. And Europe will have to think about financial regulation that enables institutional investors to engage, for example, in infrastructure financing in Africa. The benefits on both sides could be immense.

Second, let us build stronger legal migration pathways into Europe and let us make circular migration an expression of normality in the 21st century. Not because we feel bad for Africa or because we are afraid of Africa, but because we ourselves could benefit greatly from plugging the gap arising in our ageing labor force. The remittances that African migrants send home already exceed the sum of foreign aid. And because whenever I talk to African youth, I hear the same wish – let us come to your country, to study, to learn, to grow, and then we are better equipped when we return and build our communities. Europe should be generous towards that wish. Our answer to the

rise of migration should not be to build walls, but to offer more internships and scholarships and exchange programs on all levels, so that more of Africa's youth can become global citizens who contribute with their creativity and their skills to the whole of humanity.

And third, let us not leave all initiatives for deeper economic cooperation to governments. My impression is that European businesses – and not least German ones – have made themselves a bit too comfortable in waiting for governments and international organizations to provide them with ideal investment conditions in Africa. Many companies need to acknowledge that they themselves have a vital interest in realizing Africa's growth potential. In fact, events in recent weeks have again underscored this by highlighting the risks that the current over-reliance on Asian markets can pose to the functioning of supply chains and production. European companies should, therefore, be creative and take a much more proactive stance in promoting African markets. For example, European business associations could use their vast expertise on the development of regional economic hubs to work proactively with African governments and regional institutions and develop concepts for special reform zones. Such zones could combine a favorable local business climate with the promise that European businesses will not only embark actively on industrial cluster building, but also invest in the training of local employees and branch out to African suppliers. The room for experimentation and learning is large, and I believe that projects along these lines could turn into nuclei of structural transformation in Africa and, at the same time, into long-term engines of real growth for European firms.

Crises are turning points. The steps we now take or fail to take will have a major impact on the Europe-Africa partnership. If the African Union and the European Union are able to forge a relationship that gives the right answers to this crisis – answers about partnership, common goals above diverging interests, and new honesty above old slogans – the two continents could send a sign of hope to the world that multilateralism is not obsolete. On the contrary, that two continents are putting hope and confidence into achieving an economically, socially, and ecologically more prosperous future for them both through cooperation. In that case, this year really would be a year of pivotal change.

Inge Kaul

Want to Take the Africa-EU-Partnership to the Next Level? Press the Reset Button[1]

On March 9, 2020, the European Commission (EC) and High Representative of the Union for Foreign Affairs and Security Policy (HR/VP) presented a joint communication to the European Parliament and Council entitled "Toward a Comprehensive Strategy with Africa."[2] According to EC President Ursula von der Leyen, this strategy is the roadmap to bring the partnership between the African Union (AU) and European Union (EU) "to the next level."[3] However, the EC President specified neither how she characterizes the current partnership level nor how the envisioned next level differs from the present one. Would it be in terms of goals and objectives, partnering modalities, implementation strategies, or all of that?

A NEW AFRICA-EU PARTNERSHIP?

The aim of this paper is to search for clues about what might be new and different about AU-EU partnering at the next level. However, should one bother probing this issue now when the world confronts unprecedented challenges from Covid-19 requiring everyone's urgent and fullest attention? I argue "yes."

The reason is that the Covid-19 pandemic has heightened policymakers' and the general public's realization that challenges to the global public good such as Covid-19 could potentially affect anyone of us, wherever we live, north or south. Often, they also require all of us to take corrective action. As a result, the willingness to engage in international cooperation is spiking. Major humanitarian assistance efforts have already been launched, debt relief has been granted and other short and longer-term response measures are underway, with further ones being considered and likely to follow soon. However, to achieve their intended effects, these measures must fit local and national circumstances. This, in turn, calls for close consultation and cooperation between the recipient country or region and its external partners.

African policymakers clearly hope for a cooperative approach to exploring and devising international response initiatives, even now – or especially now – during these times of crisis when their countries are highly dependent on external support and policy effectiveness is of utmost importance. In a virtual meeting convened by the International Monetary Fund and the World Bank, the Chairperson of the African Union Commission (AUC) Moussa Faki Mahamat recently stressed that Africa asks "for equity based on solidarity, not as a concept of gestures of sympathy, but collective global action."[4]

Therefore, it is timely to ask whether the partnership relation envisioned in the proposed new EC/VP strategy document corresponds to the AUC Chairperson's notion of international cooperation. The ensuing discussion shows, it does not. It leaves uncorrected the weaknesses that have thus far characterized AU-EU partnering, namely asymmetry between partners and elusive results.

Accordingly, I recommend that, at their next summit, AU and EU leaders may want to consider the following course of action: (i) to initiate a partnership reset and, to this end, ask the AUC and EC to prepare, based on extensive consultations within and between the two unions, a jointly drafted document on AU-EU partnering in the post-Covid-19 world to be submitted for leaders' consideration and decision-making at an extraordinary summit, perhaps to be convened in 2022; and (ii) to identify an interim partnership program focused on matters needing urgent attention in order to minimize the crisis effects on Africa, Europe, and the world economy.

In developing this argument, I begin by presenting an overview of the nature of AU-EU partnering to date. Next, I examine the strategy document released on March 9, 2020. In light of the findings that emerge, I then make the case for a partnership reset and outline the key features of a true next-level partnering – "cooperation on equal footing."[5]

THE FUNCTIONING OF AU-EU PARTNERSHIPS TO DATE

Africa and the EU are major partners in trade, investment, and international cooperation.[6] The focus in this paper is on international cooperation activities

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[1] The author thanks Maximilian Jarrett for his comments and observations on this paper.

[2] https://ec.europa.eu/international-partnerships/priorities/eu-africa.

[3] https://ec.europa.eu/commission/presscorner/detail/en/IP_20_373/.

[4] https://au.int/en/pressreleases/20200417/chairpersons-remarks-imf-wb-mobilising-africa teleconference-17-april-2020.

[5] At the outset, it should be noted that this paper deals only with the new AU-EU partnership, leaving aside the negotiations between the Africa, Caribbean, and Pacific (ACP) Group and the EU on a successor to the Cotonou Agreement being conducted in parallel. See https://www.euractiv.de/section/eu-aussenpolitik/news/cotonou-nachfolgeabkommen-eu-uneins-bei-migration/.

[6] For more information, see https://www.consilium.europa.eu/en/policies/eu-africa/.

undertaken within the context of the AU-EU partnership framework. These activities, past and current, are being assessed in terms of their compliance with the principles, goals, and other stipulations set forth in official partnership documents. For empirical evidence I draw on the literature on AU-EU partnering, including scholarly studies, official AU and EU documents and reports, as well as other materials.

Interestingly, while the various literature contributions cover a wide range of issues, there are two recurrent themes of direct relevance to the discussion in this section: asymmetry between partners and elusive partnership results.

Asymmetry between Partners

Since the first AU-EU summit in Cairo in 2000, summit declarations and related documents, such as the roadmaps for summit follow-up, routinely included (re)commitments to the principles of a relationship of equals and shared ownership. However, analysts (in Africa and Europe) continue to note that these words have yet to be translated into matching changes in partner relations and in real joint agency for agenda-setting, strategizing, and decision-making on other partnership aspects. This, although, African partners have repeatedly conveyed their willingness and readiness to exercise stronger agency. The AU's *Agenda 2063* is a clear case in point.[7]

No doubt, several factors have contributed to the persistence of asymmetric partner relationships, including institutional lock-in and path dependency that, as institutional economists have shown, frequently impede organizational change. Among the more context-specific factors is the strong emphasis placed on the rollout of values and norms in EU activities. Another variable is the difference between the unions' institutional capacities. In comparison to the AUC, the EC is more established, better resourced, and thus in a stronger position to act proactively and, importantly, put its money to where its interests are. Seemingly, it may also unilaterally decide to change allocations, as happened, for example, in the field of migration governance, where funding priorities were shifted from development to restricting migration flows and border control, and recently when existing allocations were moved to augment the funds available for activities related to Covid-19.[8] Neither the need nor the desirability of these reallocations is necessarily being questioned here, but the pattern of decision-making.

Adding to the impression of EU dominance is also that the majority of partnership activities happen in Africa and partnership documents rarely, if at all, refer to initiatives that concern change in EU policy that currently has negative spillover effects on Africa; for example, its support for European agriculture that acts as a barrier to African development (Mitchell and Baker 2019), or its policies for the control of illicit financial flows from Africa into the EU, which still allow large capital outflows from Africa posing central challenges to the continent's development financing (Signé et al. 2020).

Hence, it is not too surprising that the EU's behavior is sometimes perceived as resembling that of a principal in a principal-agent relation rather than that of a peer in a joint-agency relationship and, as analysts note, gives rise to African partners' perceptions of asymmetry.

However, Africa has achieved significant progress in human and institutional capacity building and has developed its own ideas about Africa's future and the development path to reach it (Lopes and Kararach 2020). Moreover, a growing number of external public and private actors are vying to access Africa's expanding markets and natural resources, widening the circle and choice of external partners to cooperate with.

Assuming that the aim is to strengthen future AU-EU partnering and to make it work efficiently and effectively, the lack of enthusiasm on the African side analysts felt they could sometimes observe (Pharatihatihe and Vanheukelom 2019, EC-Eval 2017) should perhaps be interpreted as signaling that the closing of the gap between the rhetoric of equal partnering and the still asymmetric practice of partnering cannot be delayed for much longer. The Covid-19 pandemic is unlikely to revert the global trend toward multipolarity – notably that toward multipolarity in human capabilities and exercise of policymaking agency.

Elusive Results

The AU-EU summit declarations and their accompanying roadmaps usually indicate four to five broad topics around which the partners intend to cooperate. These so-called "strategic priorities" have not changed much over time. Understandably so, because they concern long-term challenges, in other words, "moving targets" likely to remain on national and international policy agendas for years, even decades, possibly with some new accents and readjustment when policy realities or accents change. For instance, the 5th Summit Declaration (AU-EU 2017) mentions as priority areas: investing in people, education, science, technology, and skills development; strengthening resilience, peace, security, and governance; migration and mobility; mobilizing investments in Africa's structural transformation, including job creation. In fact, these "priorities" are just descriptions of economic sectors and policy functions, listed in a relatively arbitrary way. Put differently, for quite some time, AU-EU partnering

[7] See https://au.int/en/agenda2063/overview/.

[8] For spending on migration, see Valero (2018), and for corona-related reallocation of funds, see https://ec.europa.eu/commission/presscorner/detail/en/ip_20_604 and Chadwick (2020).

has been functioning without a systematic overall framework.

Thus, it is not surprising to find that assessments of partnership outcomes frequently use terms like "marginal," "fractured," or "lacking in coherence." These qualifications do not imply that partnership initiatives failed to deliver altogether. In fact, they delivered inputs (e.g., money and experts) and produced outputs (e.g., students trained, policy dialogues held, or budget support provided). What is unclear is to what tangible results all this adds up to. What effects and impact result from the numerous policy dialogues and training activities that were conducted for purposes of value and/or rollout in quite several quite diverse policy fields? What is the result of the partnership activities aimed at institutional capacity-building undertaken in a range of different policy areas?

Necessity of Stronger Cooperative Links and Strategic Framework

Considering the existence of *Agenda 2063* and its detailed First Ten-Year Implementation Framework,[9] one would expect to see strong cooperative links between the EC and the AUC as the continental focal point for agenda implementation. In fact, such commission-to-commission links exist. For example, the EU provides budget support for the AUC and funding for some *Agenda 2063* projects, including the African Peace and Security Architecture (APSA). However, although of critical importance to institution-building, the tool of budget support is known generally to be associated with difficult-to-trace effects. Thus, the European Court of Auditors (ECA 2018, 2) also found that "the EU's support for the APSA has had a poor effect." Of course, this could in addition be due to the complexity and intractability of the peace and security challenge itself.

In fact, EU assistance has been extended to a number of African institutions with a continent-wide mandate, ranging from earth observation in the case of AfriGEOSS to capacity-building for disease control as in the case of the Africa Centres for Disease Control and Prevention, an achievement of major importance now for the fight against Covid-19.[10]

This brings us back to the missing strategic framework of AU-EU partnering, which not only makes the summing up of individual activities difficult but allows the concurrent pursuit of contradictory initiatives. To illustrate, the EU supports the *Agenda 2063* flagship program on fostering African integration by establishing a continental free trade area. At the same time, it actively reaches out to individual African countries to negotiate special economic partnership arrangements (EPAs),[11] which could undermine Africa's continental integration. So far, most countries, which were approached, have shown reluctance to enter into such agreements. Of course, from an African perspective and the EU's claim to aim at promoting Africa's development, the EPA drive looks contradictory. However, when viewed from a European perspective, it can be seen as a well-targeted initiative aimed at moving toward the stated EU vision of an EU-AU-wide free trade zone.[12]

Similar contradictions appear to exist between the interventions aimed at "fostering investments, growth, and jobs" and those dealing with "policy dialogue and economic norm rollout." Statistics show increasing levels of private investment in Africa have been accompanied by increasing inequality, limited job creation, and poverty reduction, as well as slow progress in terms of Africa's moving up the value chain (see Clementi et al. 2019). Investments mobilized with EU's and EU member states' support seem to have done little to break this pattern (see Kappel and Reisen 2019). They thus call into question the notion that trade does more for development than aid. That could be so, provided, as past experience has shown, that the underlying growth model and the existing market-embedding policy frameworks guide private investments toward fostering inclusive and sustainable endogenous development. To create such coherence would require careful project selection and design so that publicly mobilized and guaranteed investments do not (if all goes well) just bring about any type of growth but growth that translates into inclusive and sustainable endogenous development. This precondition was, in the case of assistance facilitated by the EU and EU member states, evidently also not met.

Finally, what about mutuality of benefit? Certainly, many individual actors (e.g., persons, governmental entities, firms, and others) have in one way or the other benefitted from partnership activities. However, partnership documents and related policy statements tend to offer, if any, then only rather general ideas about the benefits the unions could derive from their partnering. Europe appears to be motivated by a mixture of publicly pronounced geopolitical, economic, and security considerations, aimed at maintaining and strengthening its position in the global order. Africa's motivations for partnering with the EU seem to be more development-oriented. Therefore, in reflecting on AU-EU partnering and assessing it from a development perspective, some African analysts wonder whether, on the whole, the partnership facilitated or hindered Africa's endogenous development.

[9] For more information, see https://www.un.org/en/africa/osaa/pdf/au/agenda2063-first10yearimplementation.pdf/.
[10] For an overview of the projects, see https://www.africa-eu-partnership.org/en/financial-support-partnership-programme/pan-african-programme.
[11] https://op.europa.eu/en/publication-detail/-/publication/c973c81f-4bc5-11ea-8aa5-01aa75ed71a1/language-en/format-PDF/source-search/.
[12] https://ec.europa.eu/commission/sites/beta-political/files/eu-co-sibiu-stronger-global-actor.pdf/.

Considering the mixed and divergent motivations of the partners, the vagueness of the stated priority areas, and the missing partnership framework, the mutuality of benefit is perhaps a moot point – unnecessarily so, I would argue, because a more effective partnership could potentially have served both sides better in meeting their respective self-interests.

In sum, in addition to the previously mentioned deficiency, namely the gap between the partner-equality rhetoric and the partner-asymmetry reality, the preceding review reveals a second deficiency of past and current AU-EU partnering: elusive results and, consequently, elusive mutuality of benefit.

THE PROPOSED NEW COMPREHENSIVE STRATEGY WITH AFRICA

In light of the foregoing discussion, it can be assumed that, at a minimum, a new partnership proposal would aim at correcting current shortcomings and entail more joint agency in the formulation of a new partnership proposal and pay greater attention to devising a coherent result-oriented partnership framework. As a careful perusal of the new document shows, it does neither.

As its predecessors did, the document presents a mere list of policy fields in which the EU might wish to engage with Africa. Most topics also figured in previous partnership agreements, now couched in slightly different terms and presented in a different order.

As regards joint agency, the document was presented to African partners at the 10th Commission-to-Commission meeting on February 27, 2020 in Addis Ababa, without prior consultation and only 10 days before it was submitted to the European Parliament and Council for their consideration. It seems the African partners merely added notes to the document.[13] Where is the principle of partner equality in that? Nevertheless, neither the preparatory process nor the document's substance offer indications that future AU-EU partnerships will significantly be different from past and ongoing ones.

Notably, the document was issued in early March 2020. This was before the disruptive effects of the Covid-19 pandemic became more evident and better understood in terms of their potential reach and ramifications; and, likewise, before the recognition of "we are all in it together" began to settle in and policymakers began to explore and launch short and longer-term response measures.

For all these reasons and because extraordinary times require extraordinary solutions (as frequently emphasized these days), now is certainly the time to press the reset button and begin a new era of AU-EU partnering.

GETTING READY TO PRESS THE RESET BUTTON

Before delving into how AU-EU partnering could function in the future, it is equally important to discuss how Covid-19 has already changed international cooperation and might further transform it in the post-pandemic era.

International Cooperation and Covid-19

A concept widely used lately is "global public goods" (GPGs). In a virtual meeting for the launch of the *Access to Covid-19 Tool Accelerator (ACT)* and convened by the World Health Organization (WHO) on April 24, 2020, political leaders, heads of international organizations, and philanthropies stated, "Covid-19 medical tools should be considered 'global public goods' and should be affordable, safe, effective, easily administered, and universally available for everyone, everywhere."

The medical tools mentioned in this quote are essentially private goods – goods that are rival in consumption and not too difficult to be made excludable. This concept also holds true for any Covid-19 vaccine that may be discovered. These vaccines will be patented and taken out of the public domain, thereby restricting their access from the general public. After the vaccine has been injected into a human body, it will no longer be available for anyone else. This makes vaccine a private good: rival in consumption and excludable. Therefore, a deliberate and decisive political decision backed up by requisite money – a bulk-purchase campaign – is needed to make the vaccine, as well as other medical equipment global-public in consumption, namely, available for all.[14]

As long as there is no vaccine, the best way of prevention is to make protective clothing, masks, soap, water, and other needed items available free of charge or at affordable costs – paid for out of humanitarian or development assistance funds. The motivation for "donors" could be solidarity, rational self-interest, or both.

I predict that soon after a vaccine is on the market, the concept of GPGs will again be seldom used; scarce development assistance money will, perhaps initially, be used to buy vaccines for the poor; current support for suspension or cancellation of developing-country debt will wane; and since also many poorer people in richer countries will have suffered during the acute crisis years, there will be less public support for extending acts of solidarity and compas-

[13] See https://ec.europa.eu/commission/presscorner/detail/en/IP_20_317/ and https://au.int/en/speeches/20200227/statement-he-moussa-faki-mahamat-chairperson-african-union-commission-au-eu/.

[14] See https://www.who.int/docs/default-source/coronaviruse/transcripts/transcript-who-actlaunch-24apr2020.pdf?sfvrsn=45977318_2.

sion, not to mention promotion of equity, beyond national borders.[15]

AU-EU Partnership Response Options

International cooperation could thus come under severe pressure in the post-Covid-19 era. Then how to make it work despite these constraints?

The key is to modernize the partnering modalities toward practicing (not just talking about) "partnering on equal footing." This would imply: (1) respecting each other's policymaking sovereignty, including divergence between partners' preferences and priorities; (2) agreeing on clearly defined goals and targets, expected effects and impact, as well as partners' respective basic commitments; (3) establishing rules of procedure and partnership governance arrangements, including procedures for joint decision-making, monitoring, and review. If these three conditions were met, there would be a good chance that mutuality of benefit would result.

Important, however, is to note that both partners would do their own calculations of the desired or expected financial and non-financial returns from partnering. These calculations of returns from partnering need to be distinguished from the cost/benefit analyses of particular partnership projects (e.g., for road construction or migration control). They would be rather rough and not necessarily public estimates of the political, economic, and other types of both the primary benefits and the co-benefits each partner expects to derive from the act of partnering. Partners' willingness to stay engaged will indicate whether or not the expected benefits outweigh the transaction costs involved.

As conceptualized here, "partnering on an equal footing" is essentially an exchange (or trade) between public actors in public-policy products (e.g., funding exchanged against the asset of political goodwill, or promises of delivering "green growth" or "enhanced gender equality" exchanged against development funding). And, just as is the case in private-good markets, the challenge in these public-policy-product markets would be to get the "price" right – not to take the partner's willingness to cooperate for granted but to devise attractive bargains.

In order to reflect on both the evolving global realities and their implications for international cooperation in general and AU-EU partnering in particular, extensive consultations will be required among all concerned on both sides and between the unions. This will surely take time.

Undoubtedly, there are pressing issues that require urgent attention and joint action as soon as possible. Therefore, at the next AU-EU summit event, leaders might consider pursuing, say, over the next two years, two closely interlinked lines of partnering:

LINE 1 – Formulating a draft joint partnership program for the post-Covid-19 world: The AUC and EC could be requested to organize consultations on future AU-EU partnership within and between the two unions and jointly formulate a draft future partnership program to be submitted for consideration and decision-making by the leaders, perhaps at an extraordinary summit in 2022.

LINE 2 – Identifying policy challenges demanding partners' immediate attention: Among the issues of pressing shared concern could be, for example, exploring areas of consensus on global policy challenges such as: a new issuance of special drawing rights; making use of the flexibilities foreseen in the Agreement on Trade-Related Aspects of Intellectual Property Rights; the implications of emerging shifts in global supply routes; needed changes in migration governance; and, of course, stimulating "green" growth.

Needless to say, both lines of partnering would benefit from close feedback links between them. And to start the new partnership era on equal footing, meetings could be co-chaired and background papers co-produced henceforth.

CONCLUSION

In sum, the past and current patterns of AU-EU partnering were examined to gather clues for how the union partnership will be taken to the "next level" in the coming years, as recently announced by the EC President. In brief, I conclude that a partnership reset is overdue. The global transformations in the pre-Covid-19 era, namely, the rising trend toward multipolarity and deepening policy interdependence among countries, will continue in the post-Covid-19 years. On top of that, more pressing challenges will inevitably emerge and will be more complex. On this account, policy effectiveness will exceptionally matter. For the future AU-EU partnership to work more effectively, a change in partnering modalities is required, namely, "partnering on equal footing," defined here as partnering that is sovereignty-compatible and result-oriented with established procedures of decision-making, monitoring, and review. For the consideration of AU and EU leaders, two concrete reform steps were presented to be undertaken in parallel so that urgent challenges of shared concern can expeditiously be addressed through partnership initiatives. This can be attained while the two commissions undertake consultations on and jointly formulate their next partnership program at an extraordinary summit, perhaps to be held in 2022.

[15] On the special provision challenges of GPGs, see, among others, Kaul (2017).

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E.A. Brett

The Development and Challenges of Aid Relationships: Where Is International Aid Heading?[1]

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The unity and stability of the global economic system has always depended on aid relationships that sustain the concessional transfers from rich donor countries to poor countries. These transfers depend on voluntary exchanges between sovereign governments, multilateral organizations, and civil society organizations and individuals, but they also form a partially coordinated system of aid relationships that impose real obligations on their participants, even if they are not subject to collective control and enforcement. This system of global governance is coordinated by the IMF and World Bank (the IFIs), the UN, the Development Assistance Committee (DAC) of the OECD, development ministries in donor countries, the international NGO community, and their counterparts in recipient countries. It has been established to address a variety of threats caused by international inequality and exclusion, economic, political, and humanitarian crises, mass migration, and environmental degradation. The agreements cannot be imposed on states, NGOs, and private donors, but they do represent an ordered system, even if it works according to what Bull (1977) calls anarchic principles, because it depends on voluntary but binding agreements and mutual benefits rather than centralized enforcement. This raises complex questions about the effectiveness of aid, and different kinds of aid relationships, especially in the least developed countries (LDCs), where their ability and willingness to implement agreements may be low.

Aid has made important contributions to global governance, but its practices, motivations, and achievements are heavily contested. While its supporters argue that aid increases the welfare of rich and poor countries by stabilizing the open global order, its critics claim that the system is driven by selfish national interest and perverse incentives, creating considerable waste and bad performance (Moyo 2009; Easterly 2006; Bauer 1972; Engberg-Pedersen 1996; Ferguson 1996; Bond and Manyaya 2002). Both views rest on credible evidence, which will be briefly reviewed in the following sections.

The article first outlines the historical development of the aid system. It then presents the policy challenges faced by donors and the system itself. Next, the strategies of Political Economy Analysis (PEA) and New Public Management (NPM) to improve aid effectiveness are presented and critically reviewed. Finally, the future role of EU-Africa cooperation is briefly discussed.

THE HISTORY OF AID RELATIONSHIPS

Changes in the global system, the political climate, and crises have produced significant changes in the power relations and political strategies that govern the international aid system.

Colonial powers began aid programs in the 1920s and 1930s to strengthen economic relations with their colonies, where they used aid to build the infrastructure needed to export raw materials and their own manufactured goods (Brett 1973). The modern aid system was created in the 1940s by the US, the IMF, and the World Bank to deal with post-war and then post-colonial reconstruction; it was transformed through Structural Adjustment Programs (SAPs) in the 1970s and 1980s, which promoted the shift from state- to market-led development (Bauer 1972; World Bank 1981; Little 1982; Lal 1984). This induced fundamental structural and political consequences for LDCs and post-communist states since SAPs forced them to cut deficits, devalue currencies, privatize state-owned enterprises, and reduce state controls over domestic and international markets. It produced radical changes in the allocation of wealth and power that benefitted strong firms and states, but were resisted by threatened groups, evaded by rent-seeking regimes, and imposed excessive demands on weaker states that lacked the capacities needed to implement them. Democratic reforms were included in SAPs in order to improve accountability by replacing weak regimes, and/or to strengthen the ability of excluded groups to influence their behavior, strengthening the "third democratic wave" that took place in the 1980s and 1990s (Acemoglu and Robinson 2006; Huntingdon 1991). This was accompanied by a critique of austerity-oriented SAPs and a shift to Poverty Reduction Programs (PRPs) that still focused on market-based policies, but also recognized the need to strengthen state capacity and invest in pro-poor services, small-scale enterprises, and micro-credit systems (Hickey, 2012).

In the 21st century, the focus shifted to global agreements turning democracy and poverty reduction into a binding obligation. This resulted in a series of high-level agreements, which were negotiated and led to the Millennium Development Goals (MDGs) in

[1] This article is a shortened version of Brett, E. A. (2016), "Explaining Aid (In)Effectiveness: The Political Economy of Aid Relationships," LSE International Development Working Paper, 16–176, 1–19.

2000, the Paris Declaration on Aid Effectiveness in 2005, and the Sustainable Development Goals (SDGs) in 2016.

These agreements represent a serious attempt to avert the tensions generated by earlier aid policies, but they ignore many serious obstacles that are caused by deeper and more persistent problems – conflicts over limited resources, growing poverty, exclusion, and inequality in fragile states that cannot compete effectively in increasingly open world markets, resistance from deep-rooted political and economic elites, the refusal of rich countries and individuals to forego unsustainable consumption levels, and the reluctance of poor countries to avoid increasing emissions to catch up. These problems will undoubtedly be greatly intensified in unpredictable ways by the economic dislocation caused by ongoing attempts to control the Covid-19 pandemic (Carboni and Casola 2020).

At the same time, the aid industry has become more complex and fragmented. New public donors such as China and private donors like the Gates Foundation, international and local NGOs, and private companies have gained influence.

THE COMPLEXITY AND CHALLENGES OF AID RELATIONSHIPS

Aid may involve mutual interests and cooperation, but it can also involve serious tensions, especially in LDCs where governments have limited resources, represent opposing groups, and operate in a context of intense poverty, insecurity, and contested power relationships.

In aid-dependent countries, aid makes a significant contribution to the budget and thus generates intense competition between different parties, such as government, civic organizations, etc. Donors play a key role as they can give or withhold support. However, their control is always incomplete because non-compliant rulers and their supporters have sovereign rights and can therefore evade unacceptable demands. Donors are often willing to fund under-performing programs in order to spend their budgets; they may disapprove of repressive regimes, but they cannot impose their decisions on them, and are obliged to avoid partisan political interventions that challenge their political authority or strengthen opposition parties and movements.

However, since their decisions play a key role in maintaining or undermining weak states and their leaders, their interventions have unavoidable political and policy consequences. The aid system is therefore based on asymmetric power relationships, disputed sovereignties, and competing, often contradictory objectives. Aid relations depend not only on the interests and capacities of the individual partners, but also on the tensions that arise in the negotiation and implementation of agreements between partners. They are governed by weakly enforced rules and divergent goals that produce contingent outcomes that depend on the bargaining power of each side. Thus, while donors try to promote programs that are consistent with global agreements, their own resources, and the interests of their supporters, the success of those programs depends on whether they are compatible with the interests of local governments and on their ability or inability to resist unacceptable demands.

Recognizing these tensions provides us with a realistic approach to the complex and contentious processes of negotiating mutually beneficial agreements and an appropriate regulatory framework. It also raises difficult questions about the role and effectiveness of aid conditionality, and the current commitment to local leadership and political ownership embedded in the Paris Agreement and SDGs.

A realistic approach shows that aid relationships do not depend on aid per se, but on the nature of the interests that motivate the behavior of the governments and social movements on both sides. Donors should learn from the failures and successes of the past, recognize the need to challenge the authority of repressive elites, and recognize the limits of the neoliberal assumption that free markets, democratic elections, and "local ownership" will produce pro-poor solutions.

The ability of weak states to evade formal conditionality in the 1990s led donors to shift support to stronger states with "good policies" (Collier and Dollar 2002, 1476; Ritzan et al. 2000), marginalizing the poorest people in the poorest countries. Despite the exclusion of formal conditionality in current aid agreements, donor judgements about the ability of any state to respond to their demands represent a powerful form of implicit conditionality and influence the scale and terms of their support. Thus, aid negotiations are relatively collegial in successful states like Ghana and Uganda, but heavily contested in fragmented states like Nigeria, Pakistan, and Nicaragua, where regimes are not committed to poverty alleviation and political and economic settlements are characterized by disruptive class, ethnic, or sectarian conflicts. The donors' ability to sustain viable programs in fragile states like Afghanistan, Somalia, and the DRC, which can no longer "exercise effective power within their own territories" (Clapham 1996, 21) is even more problematic.

Explanations for Success or Failure

Credible explanations for success or failure depend on the ability to identify the political and economic tensions that govern interactions between donors and recipients at local, national, and global levels as both donors and recipients attempt to reconcile their often contradictory goals and policy paradigms, especially in fragile and fragmented states. This requires a holistic and interdisciplinary approach, which has

produced excellent research on the national variables that influence the behavior of either donor or recipient governments (Gulrajani 2014; Brown 2013; Copestake and Williams 2013) but far less emphasis on the contradictory processes generated by the interactions between donors and recipients in different contexts and periods.

The tensions within aid relationships and resulting crises have led donor countries to address, rather than evade, the problem of bad governance and bad policies, and have confronted them with two key challenges: to persuade reluctant rulers to respond to democratic demands and implement pro-poor policies; and to strengthen the organizational systems required to do so. They have turned to Political Economic Analysis (PEA) to help them understand and respond to the first, and to New Public Management (NPM) to address the second challenge. Both attempts will be explored in more detail in the following section.

ATTEMPTS TO INCREASE AID EFFECTIVENESS

Political Economic Analysis (PEA)

The critical role of political variables in aid effectiveness is now widely recognized. Donors are aware of their role within recipient countries and have created a body of interdisciplinary policy theory referred to as PEA.[1] It should "encourage donors to think not only about what to support, but also about how to provide support," (DFID 2009) taking political feasibility into account.

Several studies have reviewed the impact of PEA on aid policies. According to Unsworth (2009) it has improved "the scope and quality of internal debate among donor staff" by increasing the awareness of political systems and their impact on development. However, most studies emphasize the limited nature of its impact, especially in weak states, as the fragile structures and contradictory norms, incentives, and political constraints impose serious constraints on applying PEA. Unsworth (2009, 884) also points out that it is "influencing specific aspects of donor activity, [but] it is not prompting a more fundamental reappraisal of the implicit model of how development happens."

Nevertheless, PEA provides the policy community with critical insights into the role of political variables in policy reform, and the limitations of formal conditionality in obliging weak states to adopt pro-poor programs. PEA recognizes that aid effectiveness indeed depends "primarily on efforts at the country level" and on the need for donors to "focus on facilitating these efforts, not on trying to replace them" (Booth 2011: 3), and provides us with the best informed analysis yet available of the challenges involved in combining "local ownership" with pro-poor policies.

The emerging consensus calls for interventions that work with local needs, capacities, and interests (Levy 2014). It tries to ensure that "functioning (or performance levels), achieved via whatever means enjoys political legitimacy and cultural resonance" (Pritchett et al. 2010). It seeks to replace governance reform by a "theory of change"[2], where micro-level initiatives provide a platform for the emergence of "islands of effectiveness" within a broader sea of dysfunction – securing some gains in the short term, and serving as a platform for cumulative gains over the longer run in both governance and poverty reduction (Levy 2014). However, PEA underestimates the need to transform the authoritarian institutions that enable their rulers and supporters to suppress the local movements.

Theorists argue that liberal democratic states are a necessary precondition for progressive cooperative solutions (for an extended analysis see Brett 2009). However, donors cannot rely on conditionality or moral exhortation to strengthen the ability of excluded elites and the poor to force repressive regimes to acknowledge their right to "binding consultation" (Tilly 2007) or invest directly in organizations involved in partisan politics. *However, donors can help them to develop the consciousness and organizational capacities needed to do so.*

The PEA literature acknowledges this need, but could do more to strengthen civil society and the state by investing in the organizational capacity of business and labor organizations, civic associations, media and advocacy groups, and tertiary education, which has been neglected, thus weakening the society's leadership and organizational capacity that is an essential prerequisite for long-term democratic development (Brett 2017). This always involves an implicit threat to their political neutrality, so donor states need to find ways to do this without involving themselves directly in partisan politics – one good example being the role of the German political foundations like the Konrad Adenauer and Friedrich Ebert Foundations.

New Public Management (NPM)

The aid literature has concentrated on the macro-level relationships between donors and their local counterparts, rather than the micro-level "agency" problems involved in reforming the organizational systems that determine the terms that donors impose on the implementing agencies at the local level that carry out

[1] "Political economy analysis is concerned with the interaction of political and economic processes in a society: the distribution of power and wealth between different groups and individuals, and the processes that create, sustain, and transform these relationships over time" (DFID, 2009).

[2] "A theory of change is a detailed description of the mechanisms through which a change is expected to occur in a particular situation. A theory of change identifies the goals, preconditions, requirements, assumptions, interventions, and indicators of a program, providing important insight into and guidance on intervention and impact evaluation design" (World Bank, 2020).

their projects and programs. These agency problems need to be addressed by reforming the incentive and authority systems that govern public and private service delivery systems.

Donors formerly focused exclusively on state-managed projects, but state failure and the shift to neoliberal theory has led them to fund private firms and NGOs that are directly accountable to donors or consumers. This can undermine state capacity, but adoption of a pluralistic strategy that tailors solutions to the differing needs and capacities of different kinds of community and society now dominates the policy agendas of all DCs as well as LDCs. It is informed by NPM theory, which identifies the strengths and weaknesses of the authority, incentive, and accountability systems that motivate governments, firms, and civic organizations and enables practitioners to make informed rather than ideological choices between them.

These capacities differ in strong, weak, or conflicted states, which enables donors to tailor their interventions to suit their specific needs by funding projects that increase the ability of recipients to use voice and/or exit to demand better services from their agencies (Hirschman 1970; Paul 1992). This approach gives practitioners a menu of organizational options, rather than an externally designed template, and one that incorporates the possibility of "hybrid" solutions that combine external and local practices in creative ways in order to take account of the weaknesses and conflicts that characterize fragile and fragmented states (Malinowski 1945/1961; Brett 2009; 2016). Thus, while NPM can be used to weaken the state and lead to regressive "public-private partnerships," it can also be used not only to strengthen the ability of the state to regulate the whole system but also to redistribute resources and weaken the ability of repressive rulers to use old-style monopolistic state bureaucracies to extract rents and suppress opposition.

The ability of private firms and civics to function effectively also depends on the ability of progressive social and political movements, including donors themselves, both to strengthen their capacity to demand progressive reforms and to resist attempts by their opponents to block them. Thus donors need to develop long-term programs designed to support a long-term transition to "best-practice" institutions in weak states by combining PEA and NPM strategies by investing in the organizational systems that represent excluded classes and the awareness of the beneficiaries that receive them, as well as the actual agencies that supply pro-poor services. However, they should also accept the need for "second-best" hybrid solutions in the short run, which may not meet the standards set by the SDGs, but do incorporate and adapt local institutions and thus enable them to generate new and better solutions that local people can actually "own".

CONCLUSION: THE FUTURE OF EU-AFRICA COOPERATION

This analysis shows how PEA and NPM could still be used to improve EU-Africa cooperation, but our ability to do so will be severely tested by the disruptive impact of Brexit and the Covid-19 pandemic. Brexit will end the UK's contributions to the EU aid budget and the country's ability to influence EU aid policies, while the global lockdown has forced all states to control social behavior and rescue the private sector from its disruptive effects. This has generated the deepest economic recession in modern history, which has taken neoliberal policies off the agenda and imposed potentially unsustainable strains on already weakened state apparatuses across Africa.

Our ability to rescue the liberal global order from a potential catastrophe now depends on the ability of DCs to mobilize the resources needed to get their citizens back to work by refinancing the corporate and private sectors now threatened by bankruptcy, and to help African states to manage their fiscal crises and restore their productive capacity. This challenge is comparable to the post-war crisis that gave birth to the modern aid system, but is taking place when European aid budgets will be subjected to intense stress. We need a comparably radical response now that will demand major changes in all of the structures and economic policy regimes that have dominated the aid system since the structuralist crisis of the 1980s.

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Ann-Sofie Isaksson and *Andreas Kotsadam*

Chinese Aid to Africa: Distinguishing Features and Local Effects

The global economic landscape has changed dramatically since the turn of the millennium: low and middle income countries have been driving global economic growth, new sources of development finance have emerged, and the development cooperation arena has seen continued diversification of actors, instruments, and delivery mechanisms (Kharas and Rogerson 2012; Mawdsley et al. 2014). Largest among the "new" donors is China, and with the explosion of Chinese funds, concerns over its donor practices have followed.

Critics claim that Beijing uses its development finance to create alliances with the leaders of developing countries, to secure commercial advantages for their domestic firms, and to prop up corrupt and undemocratic regimes in order to gain access to their natural resource endowments (see the discussion in e.g., Tull 2006; Naím 2007; Penhelt 2007; Brazys et al. 2017). Others praise China for its responsiveness to recipient needs and its ability to get things done in a timely manner without placing an extensive administrative burden on strained public bureaucracies in the developing world (see the discussion in e.g., Bräutigam 2009; Dreher et al. 2019).

In the 2018 Forum on China-Africa Cooperation, China made a USD 60 billion pledge for new projects in Africa (Washington Post 2018). Despite its massive scale, studying the motivations behind and effects of Chinese development finance has, until recently, been very difficult. Unlike the OECD-DAC donors, the Chinese government does not routinely publish information on its foreign assistance. This lack of transparency has made evaluation of Chinese aid notoriously difficult, and as a result, China's aid to Africa is the subject of much speculation. However, with a new comprehensive dataset on Chinese Official Finance to Africa issued by the AidData research laboratory (AidData 2017), systematic quantitative analysis of Chinese aid flows is now possible.

This article draws on our recent work on Chinese development finance to Africa. We highlight a number of distinguishing features of Chinese aid, and how these may translate into local aid impacts that differ from those of other donors. In particular, we discuss the arguments and findings in Isaksson and Kotsadam (2018a, 2018b), Isaksson (2019), and Knutsen and Kotsadam (2020). In these studies, we geographically match the new geo-referenced dataset on the subnational allocation of Chinese development finance projects to Africa with comprehensive survey data for a broad range of African countries, and evaluate the local effects of Chinese aid on corruption, trade union involvement, ethnic identities, and incumbency support, respectively.

DISTINGUISHING FEATURES OF CHINESE AID

A number of features make Chinese aid stand out from that of western donors. First, China is well-known for its policy of non-interference in the domestic affairs of recipient countries (see e.g., Tull 2006; Bräutigam 2009). The principle is explicitly spelled out in official Chinese documents: "When providing foreign assistance, China adheres to the principles of not imposing any political conditions, not interfering in the internal affairs of the recipient countries, and fully respecting their right to independently choosing their own paths and models of development" (State Council 2014). While recipient country governments tend to see the principle as a sign of China respecting their countries' sovereignty, critics view it as a convenient rationale for economic involvement in undemocratic and corrupt regimes and suggest that it makes Chinese aid easy to exploit for politicians.

Second, Chinese development finance tends to mix commercial interests with concessional flows (see e.g., Tull 2006; Bräutigam 2009). As with the non-interference principle, China explicitly states that its development policy should result in a win-win situation for both sides (Tull 2006). The blurring of concessional finance with other financial flows means that it is difficult to distinguish between China's commercial interests and transfers with a development intent; their projects tend to contain elements of both.

Next, the Chinese aid allocation process tends to be demand driven (see e.g., Brautigam 2011). As described in detail in Dreher et al. (2019), China's aid allocation is often based on requests from recipient-country governments. Its aid packages and projects tend to be negotiated in high-level meetings with political leaders rather than publicly outlined in country

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development assistance strategies, with the initiative generally coming from the recipient side. Interpreted favorably, this could again be seen as a sign of ensuring partner country ownership of development policy. At the same time, however, a request-based system of aid project delivery may provide opportunities for recipient country governments to use funds strategically by promoting a subnational distribution of funds that favors their patronage network.

Finally, China stands out in terms of its degree of control over aid project implementation. Unlike other donors that often use local implementing agencies, China tends to maintain control over the projects it funds from the project initiation phase to the project completion phase, often using Chinese contractors for work performed in the recipient countries (see e.g., Bräutigam 2009).

POSSIBLE EMPIRICAL IMPLICATIONS

In light of these distinguishing features of Chinese development finance, the studies reviewed in this article explore whether the local effects of Chinese aid stand out from those of other donors.

In one study (Isaksson and Kotsadam 2018a), we investigate whether Chinese development projects affect local corruption in Africa. A potential effect could work both via economic incentives, i.e., through the presence of donors affecting the costs and benefits of engaging in corrupt activity, and by means of norm transmission. Two of the above features of Chinese aid are particularly relevant in this respect. First, China's policy of non-interference in the domestic affairs of recipient countries suggests that it is unlikely to take an active role in fighting corruption in the same. Unlike donors with a clear anti-corruption policy, such as the World Bank, it thus seems unlikely that the Chinese presence should involve increased monitoring and delegitimization of corrupt practices. Second, and conversely, considering reports of corruption among Chinese firms operating abroad (Transparency International, 2011), its tendency to maintain control over development projects throughout the entire implementation phase implies that Chinese development projects may stand out in terms of the use of corrupt practices. The Chinese presence could thus affect descriptive corruption norms for the worse.

In another study, we examine the impact of Chinese development projects on labor union involvement in African recipient countries (Isaksson and Kotsadam 2018b). Anecdotal evidence points to violations of international labor standards at Chinese investment sites in Africa (e.g., Human Rights Watch 2011; and Akorsu and Cooke 2011). Again, the distinguishing features of Chinese development finance are relevant to consider. Since China tends to maintain control over development projects throughout the implementation phase, its presence could reasonably exert an influence on local labor market institutions. Considering that Chinese firms have little tradition of unions and organized labor at home (ITUC 2010), this could mean that Chinese labor relations are transplanted to the recipient countries. Furthermore, and related, the fact that Chinese development finance tends to mix commercial interests with concessional flows likely implies that cost cutting, e.g., with respect to labor expenses, is an important dimension at the project implementation phase.

Based partly on the results from these previous studies, we also examine the effects of aid on incumbency support at the local level (Knutsen and Kotsadam 2020). If aid affects corruption, unionization, and local economic conditions differently it is reasonable to expect that it also affects incumbency advantage differently. If aid has overall positive effects at the local level, voters may reward incumbent leaders who locate aid to their area. Aid may also lead to lower support for the incumbent leader if it has negative effects at the local level or undermines the capacity and legitimacy of recipient governments. One can also expect Chinese aid to be different with respect to incumbency effects due to the stated non-interference of Chinese aid in combination with its demand driven nature.

Our most recent study explores whether Chinese development projects fuel local ethnic identities in African recipient countries (Isaksson 2019). In line with the findings of Eifert et al. (2010), who find that ethnic identities are mobilized in the struggle for political power and economic resources, competition for the inflow of resources that aid constitutes could mobilize ethnic identities across the board. A second possible mechanism, in line with a "reactive ethnicity" approach (Çelik 2015), is that perceived ethnic bias in the delivery of aid gives rise to ethnic grievances, and thereby more salient ethnic identities, in groups that perceive themselves as disadvantaged. Recent empirical evidence suggests that Chinese aid may be particularly easy to exploit for politicians who are engaged in patronage politics (Dreher et al. 2019). Both the demand-driven nature of the Chinese aid allocation process and China's policy of non-interference in the domestic affairs of partner countries arguably make Chinese development funds prone to elite capture, and thus to possible ethnic bias. The next section provides an account of how we evaluate these questions empirically.

DATA AND EMPIRICAL STRATEGY

To explore the local effects of Chinese development projects in Africa, we geographically match spatial data on China's official financial flows to the continent over the period 2000–2012 with Afrobarometer survey data for a large sample of respondents from a broad range of African countries.[1] The data on Chi-

[1] In the corruption paper, 98,449 respondents from 4 Afrobarometer survey waves in 29 African countries; in the trade union paper,

nese aid projects is obtained from geo-referenced project-level data of AidData's Geocoded Global Chinese Official Finance Version 1.1.1 dataset (AidData 2017). Since the Chinese government does not release official, project-level financial information about its foreign aid activities, this data is based on an open-source media-based data collection technique, synthesizing and standardizing a large amount of information on Chinese development finance to African countries (described in detail in Strange et al. 2015). The coordinates of the surveyed Afrobarometer clusters are used to match individuals to aid project sites with precise point coordinates. We measure the distance from the cluster center points to the aid project sites and identify the clusters located within a cut-off distance – e.g., 50 km – of at least one project site.

Since the distribution of aid within countries is not random – implying that some individuals and sub-national areas, with certain characteristics, will be more likely than others to be targeted by aid – we use a spatial-temporal estimation strategy resembling that in Knutsen et al. (2017). While the fact that the Afrobarometer is not a panel hinders us from following specific localities over time, before and after a project was initiated, with this estimation strategy we can still make use of the time variation in the data. In particular, we compare the estimated effect of living near sites where a Chinese development project is currently under implementation with the estimated effect of living near sites where a project will be opened but where implementation had not yet been initiated at the time the Afrobarometer covered that particular area. The baseline regression takes the form:

$$(1) \quad Y_{ivt} = \beta_1 \cdot Ongoing_{it} + \beta_2 \cdot Future_{it} + \alpha_s + \delta_t + \gamma \cdot \mathbf{X}_{it} + \varepsilon_{ivt}$$

where the outcome variable *Y* for an individual *i* in cluster *v* at year *t* is regressed – in the benchmark setup using linear probability models – on a dummy variable *Ongoing* capturing whether the individual lives within the specified cut-off distance of an ongoing Chinese development project, and a dummy Future for living close to a site where a Chinese project is planned but not yet implemented at the time of the survey (those with no Chinese project site within the cut-off distance are the omitted reference category). The regressions include spatial (country or sub-national region) fixed effects (α_s) and year fixed effects (δ_t), and a vector (X_i) of individual-level controls (age, age squared, gender, and urban/rural residence). The standard errors are clustered at the geographical clusters.

The coefficient on *Ongoing* (β_1) captures any causal effect of aid plus potential selection effects. The coefficient on *Future* (β_2), on the other hand, captures only a selection effect, as the concerned aid projects had not yet started at the time of the survey and so cannot have had a causal effect. The idea is that by taking the difference between these two parameters, we subtract the selection effect from the combined selection and causal effect, leaving behind the causal effect of aid on the outcome variable in focus. The parameter difference between *Ongoing* and *Future* ($\beta_1 - \beta_2$) thus gives a difference-in-difference type of measure that controls for unobservable time-invariant characteristics that may influence selection into being a Chinese project site. The key assumption behind this approach is that the selection process relevant for ongoing and future projects sites is the same. We evaluate this assumption in a range of robustness tests. The incumbency paper uses a different approach, whereby area fixed effects are added so that the coefficient on Ongoing captures differences only in areas before and after aid projects start.

EMPIRICAL FINDINGS

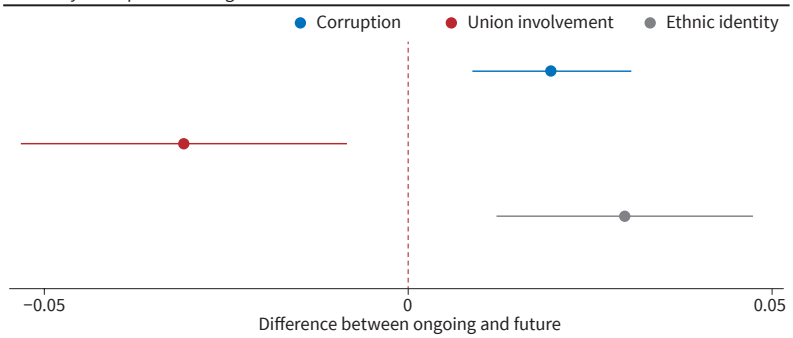
Figure 1 provides a brief summary of the main empirical findings.[2] It shows the parameter difference between *ongoing* and *future* from estimations like that in equation (1), with citizen experiences with corruption, union involvement, and ethnic identities as the respective dependent variables.[3]

To begin with, the results consistently indicate that Chinese aid projects fuel localcorruption. Respondents with an ongoing rather than a future Chinese project within 50 km are, for instance, significantly more likely to report that they have been asked for a bribe when dealing with the police. Investigating possible underlying theoretical mechanisms, the effect does not appear to be driven simply by an increase in economic activity. Rather, suggestive evidence seems to indicate that the Chinese presence

41,902 respondents from 18 African countries obtained from rounds 2 and 3 of the Afrobarometer survey; in the incumbency paper, 101,792 from 5 rounds; and in the ethnic identities paper, 50,527 respondents from 11 African countries obtained from rounds 3–6 of the Afrobarometer survey.

[2] As Knutsen and Kotsadam (2020) employ a different estimation strategy, we do not include the estimates in this figure.
[3] For detailed results, sensitivity estimations, and comparisons with other donors, see the original studies.

Figure 1
Local Effects of Chinese Aid
Summary of empirical findings



Note: Figure shows the parameter difference between ongoing and future from estimations similar to equation (1), with citizen experiences with corruption, union involvement, and ethnic identities as the respective dependent variables.
Source: Isaksson and Kotsadam (2020).
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impacts local norms. Running equivalent estimations for World Bank aid projects, for which there is also geo-referenced data available for a large multi-country African sample, the estimations provide no consistent evidence of a corresponding increase in local corruption around project sites. In particular, whereas the results indicate that Chinese aid projects fuel local corruption but have no observable impact on local economic activity, they suggest that World Bank aid projects stimulate local economic activity without any consistent evidence of it fueling local corruption.

Also in line with predictions, the results suggest that Chinese development projects discourage trade union involvement in the surrounding areas. These results do not translate to other forms of citizen participation not directly connected to the workplace, seemingly indicating that the lower unionization rates observed near ongoing as compared to future Chinese project sites stem from direct anti-union policies rather than from more general institutional change. Again, China clearly diverges from other donors in this respect. In particular, in line with World Bank efforts to promote civil society development and community participation, World Bank projects are found to stimulate rather than to discourage union involvement.

Based on the previous findings it is interesting to see whether the effects on incumbency support also differ for Chinese aid versus aid from other donors. Knutsen and Kotsadam (2020) find that aid from the World Bank increases incumbency support whereas there is no robust evidence that this is the case for Chinese aid. A possible explanation for the differential impact of aid on incumbency support is the negative effects described above. In addition, we find that aid from the World Bank increases trust in politicians whereas we do not find an effect for Chinese aid.

Finally, the empirical results indeed suggest that living near an ongoing Chinese project makes ethnic identities more salient. The effect is not uniform though, but driven by people who belong to the outgroup – i.e., who are not co-ethnics of the country president at the time – arguably signaling that it is driven by ethnic grievances originating in perceived ethnic bias rather than ethnic competition for resources more generally. Furthermore, a comparison across donors reveals that Chinese development projects stand out from those of other influential donors in this respect. Replicating the key analysis for World Bank projects, the results in fact indicate the reverse, i.e., that living near an ongoing as opposed to a future project comes with weaker ethnic identification. This too seemingly speaks against the general ethnic competition mechanism.

CONCLUSIONS

This article drew on our recent work on local effects of Chinese development projects in Africa. We highlighted a number of distinguishing features of Chinese aid – its non-interference principle, its tendency to mix commercial interests with concessional flows, the demand driven aid allocation process, and its control over projects throughout the implementation phase – and discussed how these may translate into local aid impacts that differ from those of other donors.

Our empirical findings indeed indicated that important local effects of Chinese aid stand out from those of other donors. Unlike aid from other major donors, Chinese aid projects were found to fuel local corruption, discourage trade union involvement, to not increase political incumbency support, and to make ethnic identities more salient in the local areas. As such, our findings highlight important donor heterogeneities as well as the need to consider not only to what extent aid achieves its explicit objectives, but also its potential unintended effects, or externalities.

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Olivier Godart, Holger Görg, and *Aoife Hanley*

Harnessing the Benefits of FDI in African Countries

In this article, we briefly review our own work, and related studies, on the impact of FDI in African countries using firm level data. Overall, research suggests that foreign multinationals can indeed benefit local firms in terms of productivity growth and technology transfer. We also discuss a number of policy options host countries can apply in order to improve their attractiveness to foreign investors. Here we particularly focus on what might be called "Quality FDI," i.e., those investments which maximize the benefits for the local economy.

Global stocks of foreign direct investment (FDI) increased from USD 20.3 trillion in 2010 to USD 33.5 trillion in 2017. The continent of Africa attracts only a fairly small share of this global FDI – USD 598 and 867 billion in 2010 and 2017 respectively (UNCTAD 2018). Much research shows that FDI and the associated activities of affiliates of multinational companies can have beneficial effects on host country economies (e.g., Görg and Greenaway 2004, Farole and Winkler 2014, Javorcik 2015). Therefore, increasing FDI flows to Africa could stimulate its economic development.

In the next section of this paper, we will discuss how foreign firms located in Africa can – under certain conditions – help domestic African firms to boost their performance. To support our arguments, we will summarize the findings of a number of empirical papers we have written on the subject of foreign-firm spillovers. All the evidence presented here will be underpinned by econometric analysis. For the latter, we apply a range of firm-level datasets containing information on multinational and domestic firms in Africa.

In the third section of this paper, we will then briefly discuss measures that can be taken by policy-makers in developing countries to, first, attract foreign direct investment and, second, help domestic firms capture productivity or knowledge transfers from foreign firms with whom they transact e.g., through supplier relationships.

The overarching aim of our paper is to consider, empirically, the arguments for FDI in Africa. But we also aim to highlight some of the challenges presented by foreign firms, when benefits to domestic firms fail to materialize.

In this paper, we look at two channels through which domestic firms may benefit from FDI. First, the *movement of workers (in particular managers) from foreign to domestic firms.* Second, *active assistance of the foreign firm in upgrading the production technology* of domestic suppliers within its value chain. We focus on each of these mechanisms for foreign spillovers in turn.

BENEFITS OF FDI FOR DEVELOPING COUNTRY FIRMS

In this section, we will provide a snapshot of what our own empirical studies conclude about the benefits of FDI for developing country firms. Specifically, we will focus on firms located within Africa.

The rationale for foreign firms stimulating development in the host country is straight forward. According to theory, multinationals generally need to be in possession of some sort of superior technology that enables them to operate successfully abroad. This is what Markusen (2001) refers to as a "firm-specific asset." This knowledge can then dissipate into the local economy for a number of reasons (Görg and Greenaway 2004). First, domestic firms may just imitate the multinationals in terms of products, production, or management techniques. Second, workers may move from multinationals to domestic firms, taking with them some of the knowledge. Third, domestic firms supplying to or purchasing inputs from multinationals may be exposed to the superior technology and, as a result,

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be able to upgrade their own production techniques. Fourth, competition from multinationals may force domestic rivals to update production techniques to become more productive and competitive. This is frequently referred to as a "competition effect." However, as Aitken and Harrison (1999) point out, this competition effect may also reduce productivity in domestic firms if multinationals siphon off demand from their domestic competitors, forcing domestic firms to reduce output and, therefore, productivity.

Spillovers from Worker Mobility between Foreign and Domestic Firms

Görg and Strobl (2003) is one of the first studies to look empirically at the impact of movement of employees from multinationals to domestic firms. Employees transferring from these firms to the local economy can transfer with them the knowledge they have accumulated during their employment period at the foreign firm. The empirical study uses firm level data for Ghanaian manufacturing covering the 1991–1997 period. The data was collected as part of the *Regional Programme for Enterprise Development* (RPED), a larger data collection effort for a number of African countries, organized by the World Bank. Their most important finding is that firms run by owners who worked for multinationals in the same industry directly before opening their own firm are more productive than other domestic firms.

They measure the Total Factor Productivity (TFP) of domestic firms. Importantly, they control for the fact that high productivity domestic firms are more likely to recruit the most efficient local employees, a priori. In order to circumvent this problem, they look only at firms that were newly set up by entrepreneurs. Furthermore, the researchers are careful to control for years of schooling and a dummy indicating whether the individual had previous experience in the same industry. Furthermore, their regressions include a rich variety of training and work experience variables as well as their interactions. To quote from this study:

> "For within-industry experience (FE_{ij}) we now find a positive and statistically significant coefficient, suggesting that owners who gained experience in multinationals in the same industry indeed run more productive firms. Thus, this provides evidence in support of the idea that there are spillovers through worker movements, where domestic entrepreneurs bring with them knowledge accumulated in the multinationals and put it to use in the domestic firm," (Görg and Strobl 2003, 702).

Spillovers through Active Assistance by Foreign Firms in Domestic Firms

Görg and Strobl (2005) provide empirical evidence only for Ghana and consider only spillovers through movements of workers. Another mechanism that has been highlighted in the literature is that of backward linkages, i.e., positive effects on domestic suppliers selling output to multinationals (e.g., Javorcik 2004, Godart and Görg 2013). A study for a sub-Saharan African country, Bwalya (2006), which analyzes firm level panel data on manufacturing firms in Zambia, finds evidence for such spillovers from foreign firms to domestic suppliers.

More recently, a number of papers have used data from the Africa Investor Survey conducted by UNIDO, which provides firm level information for 19 African countries for a cross-section in 2010. For example, Boly et al. (2012) find, inter alia, that larger, newly established and more productive domestic firms are more likely to benefit from interactions with foreign affiliates.

Using this data, Görg and Seric (2016) provide an appraisal of the extent to which domestic firms that act as suppliers to foreign multinationals are helped by the foreign firms with whom they transact within the value chain. Their most important finding is that domestic firms supplying multinationals can expect to benefit in terms of upgrading their product and improving their productivity only if the foreign firm actively assists with the technology transfer.

There are intuitive reasons why a foreign multinational would want to help a domestic supplier to upgrade its production. A multinational procuring some of its inputs or services from a domestic firm does not want the quality of these inputs compromised, nor does it want to attract negative headlines that would damage its reputation for producing products in a sustainable and responsible way. Accordingly, there are already good reasons why foreign firms help to upgrade the production of domestic firms (see also Moran 2006). These reasons depend, however, on the motives of the foreign firm (consistently high-quality product vs. cheap production by any means).

We can see from Table 1, taken from Görg and Seric (2016), that some countries in Africa (Mozambique, Tanzania, Uganda, Ghana, Nigeria, Ethiopia, and Kenya) are major recipients of FDI, where multinationals connect with local suppliers. In Tanzania, for example, 57 percent of domestic firms that sell to multinationals report that they receive assistance from the multinational in terms of workforce upgrading, 61 percent in terms of technology transfer. Interestingly, the aggregate data shows that such assistance is not automatic, but differs significantly across countries. Burkina Faso is one example where no domestic suppliers report to have received assistance. Government support to benefit from spillovers, on the other hand, is very limited. The exception is Rwanda, where almost 1 in 5 firms received assistance with recruiting key staff. Of course, this data is not very granular. It hides differences in policies and products across countries. Nevertheless, it throws an interesting point into relief

Table 1

Support for Domestic Firms Received from...

Support from	government matchmaking	government technology upgrading	government find key staff	multinational workforce up-grade	multinational technology transfer
Burkina Faso	0.00	0.00	0.00	0.00	0.00
Cameroon	0.00	0.00	0.00	0.00	0.08
Cape Verde	0.17	0.00	0.17	0.17	0.00
Ethiopia	0.04	0.04	0.04	0.09	0.09
Ghana	0.00	0.00	0.00	0.27	0.30
Kenya	0.10	0.10	0.10	0.24	0.24
Lesotho	0.00	0.00	0.00	0.00	0.00
Madagascar	0.00	0.00	0.00	0.00	0.17
Malawi	0.00	0.08	0.08	0.31	0.69
Mali	0.00	0.00	0.00	0.00	0.00
Mozambique	0.02	0.03	0.00	0.34	0.21
Niger	0.00	0.00	0.00	0.00	0.00
Nigeria	0.06	0.06	0.06	0.09	0.16
Rwanda	0.00	0.00	0.17	0.33	0.00
Tanzania	0.13	0.11	0.07	0.57	0.61
Uganda	0.09	0.07	0.09	0.24	0.41
Zambia	0.04	0.00	0.04	0.16	0.28
Total number	19	17	17	92	104

Note: The table shows percentages of local firms (between 0 and 1) reporting to receive assistance of a certain type from either government or a multinational customer.

Source: Görg and Seric (2016); Table 3, p.6.

– FDI can be harnessed to help local suppliers. It is a matter of finding the appropriate triggers.

Görg and Seric (2016) elaborate their investigation into supplier relationships by going beyond the simple breakdowns. Instead, they formulate the question within an econometric framework, controlling for country and industry fixed-effects. The resulting findings underpin the importance of supplier relationships in leveraging technology from foreign firms.

Specifically, they regress productivity, as well as measures for whether firms engaged in product or process upgrading, of domestic firms on indicators of whether domestic firms supply multinationals, as well as other controls. Results clearly show that African firms supplying foreign multinationals are significantly more likely to upgrade their product and technology. This finding is strongest for MNE partnerships within their own country as opposed to supplying MNEs abroad.

Taking a deeper look at assistance from multinational buyers, the analysis shows that suppliers can be helped to boost their process innovation, where this assistance comes in many forms. Suppliers can benefit from being matched up with a compatible multinational (matchmaking), assisted in upgrading their production technology, or receiving help from local government in recruiting key workers. Surprisingly, there are many instances of multinationals helping domestic suppliers to upgrade their workforce. Additionally, the productivity of the domestic supplier correlates positively with the receipt of technology transfer from the multinational customer.

Additional Aspects of Positive Links between Multinationals and Domestic Suppliers

What can we take from the Görg and Seric (2016) findings regarding the positive link between supplying MNEs and supplier performance? To cite from their paper:

> "These apparent performance advantages for suppliers are in line with two, not mutually exclusive, explanations. One is that the supplier relationship with a multinational allows the firm to improve its performance, because of performance requirements set by multinationals combined with possible technology transfer and assistance. In other words, domestic firms learn from multinationals (…) The other explanation is that multinationals pick only the best-performing domestic firms as their suppliers, that is, there is a selection effect as described in Javorcik and Spatareanu (2009). It is likely that our result is a combination of these two effects," (Görg and Seric 2016, 8).

In a paragraph above, we alluded to one powerful intuition for multinationals to provide assistance to domestic suppliers – namely, the motivation of many multinationals to enhance their public image through Corporate Social Responsibility (CSR). However, we do not rule out the purely philanthropic motive by which some multinationals are prompted to invest in their local suppliers. In other words, CSR represents

a further reason for multinationals to assist domestic firms.

In Görg et al. (2017 and 2018), using the Africa Investor Survey data, we investigate this question of supplier relationships and CSR in greater detail. What we find is that multinationals that export from Africa to the economic north (e.g., Germany) frequently rate CSR concerns as their main reason for cooperating with a local supplier in Africa. However, this declaration does not always translate into tangible action. Only when this CSR concern is accompanied by a tangible investment by the multinational (in terms of having a dedicated department for supplier development) does it translate into enhanced technology transfer to the local supplier. Therefore, broad statements about sustainability and responsibility are insufficient if policy makers want to discern any outcomes from the stated intentions of a multinational. A far more informative step is the setting up of organizational structures to mediate the relationship with the African supplier, as many multinational firms in the dataset appear to have done.

Finally, when considering benefits from FDI, one question is whether the quality of FDI may differ depending on whether the multinationals are from the economic north or south. In Gold et al. (2017), we set out to compare the effects of homegrown multinationals within Africa. Using the UNIDO data we discover that, while productivity growth is generally not different in southern and northern MNEs, employment growth is generally higher for firms receiving FDI from African multinationals. Additionally, we find that affiliates of African MNEs receive more technology transfer from their HQ than MNEs from other origins.

In Table 2, we illustrate the breakdown of FDI investment by multinationals from the economic south. We see that investment by African multinationals is dwarfed by investment by non-OECD countries (including China) and by other developing countries. Although investment from African multinationals is comparatively small, it nevertheless brings benefits. In Table 3 we endeavor to distinguish the outcomes for different types of FDI from the economic south. Controlling for a myriad of factors in a regression framework, FDI from African multinationals is associated with higher employment growth than in a comparable multinational from other countries. The take-home message from this study is that multinationals represent a mixed bag of firms, even considered within narrower categories (economic south). The result of this heterogeneity is that some multinationals invest more in the local economy and induce more benefits than others.

Table 2

Share of Southern FDI Recipients for Different Definitions of South

Definition of South	Percent of "Southern" firms
Africa	24.1
Developing countries	30.1
Non-OECD	53.6

Source: Gold, Görg, Hanley, and Seric (2017)

MEASURES TO ATTRACT FDI

Given the above findings that FDI can bring benefits to host countries, it is particularly sobering to note – as remarked at the beginning of this article – that countries in Africa generally receive fairly low levels of inward investment. This section therefore considers policies and strategies to attract and facilitate FDI and to enhance its benefits in emerging and developing countries.

FDI inflows are hampered by the poor quality of political, economic, and legal institutions, as well as information asymmetries. These factors are particularly relevant for African and other developing countries, where such institutions are often not sufficiently developed (e.g., Busse and Hefeker 2007; Asiedu and Freeman 2009). Furthermore, transparent information about business conditions is often scarce in developing countries, constituting a further barrier to foreign investment (Harding and Javorcik 2013). To increase

Table 3

North-South FDI Differences w.r.t. Firm Performance

	productivity_gth		lnsales_gth		lnemploy_gth		ln_productivity_LFY	
VARIABLES	coeff	std	coeff	std	coeff	std	coeff	std
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Foreign investment	0.271***	0.249***	0.325***	0.263***	0.005	0.012	0.736***	0.433***
	(0.063)	(0.058)	(0.079)	(0.064)	(0.015)	(0.040)	(0.080)	(0.047)
Foreign investor is South (Africa)	− 0.027	−0.025	0.037	0.030	0.050**	0.129**	0.178	0.104
	(0.049)	(0.045)	(0.070)	(0.057)	(0.019)	(0.049)	(0.110)	(0.064)
Adj. R-squared	0.251	0.229	0.0836	0.167				

Notes: OLS regressions with standardized coefficients, robust p-values in parentheses, standard errors clustered at country-level. *** p < 0.01, ** p < 0.05, * p < 0.10. Other covariates (lagged logged productivity levels, lagged logged employment size, firm age, location, technology). We exclude lagged productivity levels in columns 7–8. Sector dummies comprise broad categories and distinguishes by the technology level in the category e.g., High-tech manufacturing.

Source: Gold, Görg, Hanley and Seric (2017).

the attractiveness for foreign investors, efforts to improve institutional quality at the country level can be accompanied by targeted economic policy measures to overcome specific obstacles to investment, as recently discussed by Glitsch et al. (2020).

First, in order to improve the institutional framework in a country, policies should aim to provide open, transparent, and predictable conditions and regulations for all kind of firms, whether foreign or domestic. This includes improvements in the ease of setting up and operating a business, access to foreign markets and inputs of production, relatively flexible labor markets, strengthening contract enforcement, and protecting intellectual property rights.

Second, policies that reduce such institutional barriers to FDI should go hand in hand with a well-planned and executed strategy to actively promote investment on the African continent. This includes the establishment of an investment promotion agency (IPA). The latter has an important role to play in targeting suitable foreign investors and acts as a one-stop shop for providing information, e.g., about local suppliers (Harding and Javorcik 2013). Additionally, it can actively search for synergies with countries that are on the other side of the investment chain and are trying to encourage FDI by their own firms. For example, by engaging with foreign chambers of commerce, IPAs can further bridge information gaps that hinder FDI. Moreover, their role can also be extended to engaging in post-investment care and services, acknowledging the invaluable role of word of mouth from satisfied investors in attracting new investors and facilitating future investments. The ultimate aim is to spawn geographic clusters of new investments, rather than one-off, single investments.

Third, another instrument of an investment promotion strategy that has become increasingly popular is the setting up of Special Economic Zones (SEZ). Unfortunately, the SEZ experience has so far been mixed (Hachmeier and Mösle 2018). SEZs can certainly counteract weaknesses in the national investment climate by encouraging foreign investors to locate in a place dedicated to FDI, where investment carries the promise that multinationals will be surrounded by an attractive business environment. However, foreign investors should engage with local suppliers in a way that channels the spillovers from investment into the domestic economy, and SEZs should refrain from implementing restrictive regulations that hamper foreign-domestic linkages.

How the "Quality FDI" Woks?

Attracting and facilitating FDI, however, does not guarantee that a country will capture significant benefits from FDI, as was hinted at in previous sections. If FDI is to make an important contribution to the economy at large, development policy should be calibrated to be both inclusive and sustainable, focusing on what might be called "Quality FDI." The latter links foreign investors to the local host economy and contributes to the creation of decent and value-adding jobs.

Moran et al. (2017) discuss a range of policy measures that host governments may implement to maximize the benefits from such Quality FDI. They suggest that there is no one-size-fits-all approach. Rather, host countries' policies need to be tailored to overcome domestic imperfections, facilitating a smooth integration of indigenous and foreign firms into global supply-chain networks. They highlight the importance of providing necessary infrastructure to foreign investors (e.g., telecommunication or transport infrastructure), developing policies to strengthen linkages between foreign firms and local suppliers, and encouraging technology transfer and spillovers to the domestic economy. As we discussed above, Görg and Seric (2016) illustrate that such policies have the potential to raise the benefits from spillovers, whereby in rare instances governments (or more likely multinationals) provide assistance to local firms.

CONCLUDING REMARKS

This brief review of work by ourselves (and others) on the impact of FDI in African countries suggests that foreign multinationals can indeed benefit local firms. Our results have important policy implications. They show that (under certain conditions) FDI can boost employment, productivity, and facilitate technology transfer to domestic firms. The positive spillovers from FDI must surely be welcome in regions that have grappled with historically low FDI inflows and the poor performance of domestic firms.

Before we conclude, it is worth highlighting some findings that hold special relevance for the future perspective of FDI in Africa.

FDI from China, India, and ASEAN economies. We recall from our discussion on south-south FDI that the orientation of investment in Africa is changing. The ascent of China and other late developing economies, with implications for the composition of FDI, may well signal a change in the quality and quantity of spillovers that domestic suppliers can hope to extract from exchanges. It is still too early to say, on the basis of the available data, how FDI and the spillovers arising from it will evolve on the basis of this changing composition. Data relating to investment from China still suffers from the empirical "small numbers" problem. It is therefore difficult to comment on the quality of FDI from new investors until a critical mass of such investments accumulates. Likewise, investments from India are still in their infancy vs. investments from the traditional post-colonial sources (US, UK, and France). It is clear from data released by UNCTAD (2018) that FDI from China grew by at least 50 percent between 2011 and 2016, a growth rate easily outstripping that of investors from other country groups. At USD 40 billion, the investment le-

vel from China almost caught up with that of France (in third position).

Although it is too early to comment on the outcomes for this new wave of FDI from China and India, there is a further source of new FDI offering particular promise for local economies. Our analysis on a cohort of African multinationals (see Gold et al. 2017) reveals strongly positive effects. Specifically, investment by African homegrown multinationals is associated with positive outcomes for employment and technology transfer.

Government support for domestic suppliers, not just multinationals. Our evidence for 19 African countries (see Görg and Seric 2016) reveals that government assistance to domestic firms in supplier-multinational buyer linkages is a comparatively rare thing. On the other hand, various national governments in Africa are experimenting with the development of SEZs as a way to attract and support multinationals in a setting where infrastructure is prioritized. However, SEZs should not be seen as a substitute for poor infrastructure nationwide. Such a policy of exclusivity would compromise the growth of domestic firms, among them suppliers to the multinational firms. Policy should therefore address the needs of both domestic as well as multinational firms.

Overall, our analyses (and those of others) highlight the potential of FDI to boost local economies in African countries. It remains to be seen if this positive trajectory can be maintained for new country sources of FDI, e.g., from China. We highlight the need for development policy to be calibrated towards the twin targets of inclusivity (foreign multinationals *and* domestic suppliers) and sustainability, pursuing FDI investments that help to create decent and value-adding jobs.

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After the Great Economic Collapse: Germany's Stimulus Package to Recover the Economy in Times of Covid-19

ABSTRACT

At the beginning of June 2020, the German government launched a comprehensive economic stimulus package to promote economic recovery. With a volume of EUR 130 billion, this program far outstrips programs launched in the wake of the financial and economic crisis of 2008/09. We present the fiscal policy measures adopted, show how companies assess various policies and finally discuss the most important elements of the economic stimulus package. The temporary reduction in VAT is one of the less convincing elements. On the other hand, those policy measures which promote medium- to long-term investments in future technologies, infrastructure, and climate protection are to be evaluated positively. Policies to stimulate demand cannot solve the problem of limited productivity due to protective restrictions or the collapse of international value-added chains in times of Covid-19. In this respect, one should not expect great impact on economic growth. Nevertheless, it makes sense to use fiscal policy measures to support the economy in these critical times.

The corona pandemic has triggered a worldwide economic crisis that is likely to overshadow the global economic and financial crisis of 2008/09. Germany is threatened by the biggest collapse in gross domestic product (GDP) since the Second World War. Current forecasts predict that German GDP will shrink by between 6 percent to 9 percent in 2020.[1] A negative double-digit downturn is expected for some neighboring European countries.[2]

The global impact of the crisis and the measures taken to contain the virus are putting many companies in Germany in dire straits and jobs are at risk. The negative consequences run through all sectors and company sizes (Dorn et al. 2020a). Even if the SARS-CoV-2 virus is successfully contained in near future, the global spread of the pandemic will cause longer-lasting economic losses in many sectors of the economy. To cushion the negative consequences of the pandemic, economic policy measures must be taken to counteract this. It is important to take different phases of the crisis into account:

Phase 1: From March to May, the measures implemented by the Federal Government and the 16 German states concentrated on providing loans, guarantees and financial assistance to help companies, the self-employed and employees to enable their survival during the closure of parts of the economy and the loss of income. For example, the Federal Government provided an emergency aid of 50 billion euros to small enterprises and the self-employed for this purpose. In addition, the benefits of the short-time working allowance were extended and a series of tax relief measures (such as tax deferrals or the adjustment of tax advances) or state equity holdings and guarantees were intended to safeguard the liquidity of companies that have been affected by this crisis through no fault of their own.[3]

Phase 2: After the end of the nationwide shutdown in Germany at the end of April and a further gradual opening process, economic activity was resumed in many economic sectors in compliance with protective measures. The return to pre-pandemic conditions may take a long time and the

[1] In its June update, for example, the International Monetary Fund expects Germany's price-adjusted gross domestic product to fall by 7.8 percent in 2020 (IMF 2020). In its latest economic forecast, the ifo Institute assumes that economic output this year will probably be 6.7 percent lower than last year (Wollmershäuser et al. 2020). As early as March, the ifo Institute estimated the economic costs of the pandemic and a two-month shutdown for Germany at a total of 255 to 495 billion euros (Dorn et al. 2020b).

[2] Forecasts currently represent only one of many possible scenarios. The further course of economic development depends on a great deal of uncertainty regarding the further course and effects of the global pandemic, possible further waves of infection in Germany, and the effect of economic and financial policy stabilization and economic stimulus programs (IMF 2020; Dorn et al. 2020d).

[3] According to estimates by the Federal Ministry of Finance, the total volume of additional expenditure (including health protection measures) and tax relief affecting the budget amounts to over 350 billion euros (BMF 2020). In addition, in order to secure the liquidity of enterprises, the Federal Government provided a further EUR 600 billion for loan guarantees, capital measures and state guarantees. Including international equity participations, the funds for loans, guarantees and equity participations thus currently amount to more than EUR 800 billion.

economic impact of the corona pandemic may continue to be felt even after all restrictions have been lifted: demand in domestic and, above all, foreign markets will remain weak for a long time and many companies will have problems attracting new investors because of high levels of debt. Phase 2 is about stimulating economic activity and the economy. At the same time, the government can also stimulate the economy and promote sustainable growth during this phase through public investment. To this end, the German government launched a comprehensive economic stimulus package at the beginning of June 2020, which focuses on supporting economic recovery after the corona crisis. The core components are the temporary reduction in value added tax to stimulate consumption, support for families, assistance to local authorities to compensate for falling business tax (*Gewerbesteuer*) revenues, as well as public investment and programs to promote future technologies and climate protection. In addition, the program contains some elements that are still aimed at bridging the acute crisis period (cf. Phase 1), such as more generous regulations on tax loss carryback to secure the liquidity of affected companies. With a volume of EUR 130 billion, this package far outweighs the economic stimulus packages of the financial and economic crisis of 2008/09. At that time, the German government adopted two economic stimulus packages in November 2008 and January 2009 with a total volume of almost EUR 72 billion.

In the corona crisis, the state has to bear great financial burdens and take on more debt than ever before in the history of the Federal Republic of Germany in order to finance aid and economic stimulus measures. It is therefore particularly important to design such economic recovery measures that are as precisely targeted and cause oriented as possible, while keeping an eye on the sustainability and fiscal costs of individual measures. Ultimately, the effectiveness of the measures is limited because necessary protective measures only allow for limited productivity and further waves of infection cannot be ruled out. The ifo Institute presented a report in May 2020 that discussed and evaluated various economic policy measures designed to support the economy and secure jobs during different phases of the crisis (Dorn et al. 2020c). As part of the expert report, Bavarian companies were asked in a survey conducted in April to evaluate various economic policy measures introduced to cushion the consequences of the corona crisis with regard to their suitability. Many of these measures are now reflected in the June economic stimulus package of the Federal Government.

In the next section, we present an excerpt from the June 2020 economic stimulus package, followed by the assessment of economic policy measures from a company's perspective. Finally, the measures taken by the Federal Government are discussed.

THE 130 BILLION EUROS ECONOMIC STIMULUS PACKAGE OF THE FEDERAL GOVERNMENT IN GERMANY

In June 2020, the German government launched a package to secure prosperity and strengthen Germany's future viability. This economic stimulus and future package for the recovery and revitalization of the economy contains 57 individual measures including a reference to the plan to set up a fund for economic recovery at the European level. The core elements of the program are the temporary reduction in value added tax (VAT) to stimulate consumption, assistance to municipalities, subsidies for families, and the promotion of future technologies and climate protection. In this section, we present an extract of the measures adopted. We divide these into (A) fiscal measures and programs to provide liquidity and financial assistance; (B) funding programs and subsidies; and (C) public investment and assistance for municipalities.

(A) Tax measures as well as liquidity and financial assistance measures include:

- **Temporary reduction of VAT:** in order to stimulate consumption, the standard VAT rate will be reduced from 19 percent to 16 percent and the discounted rate will be reduced from 7 percent to 5 percent for the period from 1 July to 31 December 2020 (estimated fiscal costs: EUR 20 billion). Prior to this, the VAT rate for the gastronomy was already reduced to the discounted rate for the period from 1 July 2020 to 30 June 2021.
- **Reduced electricity costs:** the EEG[4] levy, which is used to finance subsidies for producers of renewable energies, will be reduced from 2021 through subsidies from the federal budget (EUR 11 billion). Without such an intervention, the EEG levy would rise sharply, and electricity costs would increase.
- **Limiting social security contributions:** due to the increased costs resulting from the pandemic, non-wage labor costs are also under pressure. With the 2021

[4] *Erneuerbare-Energien-Gesetz* (EEG).

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social guarantee, social security contributions will be capped at a maximum of 40 percent (EUR 5.3 billion) with the help of tax-financed subsidies. Both companies and employees will benefit from this measure.

- **Tax loss offset:** the tax-loss carryback in corporate taxation will be extended for the years 2020 and 2021 – up to a maximum of EUR 5 million, and EUR 10 million in the case of joint assessment (shift effect of EUR 2 billion with an effect on the government budget, of which EUR 1 billion is with the federal government).
- **Investment incentives and tax-based research allowance:** to provide incentives for firms' investment and R&D activities, more generous tax depreciation options and research allowances are offered for 2020 and 2021 (EUR 7 billion).
- **Support for families:** families receive a child bonus of 300 euros per child (EUR 4.3 billion). For single parents, the allowances are doubled (EUR 0.75 billion). This will support families and single parents particularly affected by the restrictive measures caused by the corona crisis.

(B) Funding programs and subsidies encompassing:

- **Purchase premium and bonus program for investments in new technologies:** the automotive industry will receive EUR 2 billion for investments in innovations and new drive technologies as part of a bonus program. Instead of the preferred general purchase premium for vehicles (including combustion engine), the existing purchase premium for electric cars will be increased (EUR 2.2 billion). However, the premium will also apply to hybrid vehicles, which generally consume as much CO_2 as vehicles with modern combustion engines and exhaust systems.
- **Fleet renewal support:** fleet renewal of buses, trucks, aircraft and ships will be supported to reduce the environmental damage caused by transport (EUR 3.2 billion). There are also smaller fleet exchange programs for social services and craftsmen.
- **Trainee bonus program:** SMEs maintaining the number of training places in 2020 will receive a bonus for each training contract concluded (EUR 0.5 billion).

(C) Public investment in infrastructure and future technologies, and support for municipal finances:

- **Public investment** already decided on for the **digitization** of public administration as well as the **security and armaments projects** with a high domestic value-added share will be brought forward (EUR 10 billion).
- **Investments in future technologies:** 7 billion euros are being invested in the development of hydrogen technology, and a further sum of EUR 6 billion in quantum technology, artificial intelligence (AI) and communication technology.
- **Investment in electro mobility:** research and development in the field of electro mobility, new charging points and battery cell production will be supported by EUR 2 billion.
- **Modernization of the railways:** the German Federal Railways will receive a 5-billion-euros capital increase from the federal government to invest in the expansion and electrification of the railway network.
- **Mobile communications and nationwide 5G network:** among other things, an additional EUR 5 billion will be invested to accelerate the rollout of a nationwide 5G network.
- For **energy-efficient building refurbishment** the federal government is providing EUR 2 billion.
- **Day-care centers, nurseries, all-day schools and all-day care** will be expanded in 2020 and 2021 at a cost of EUR 3 billion; this will also include conversion measures to improve the hygiene situation.
- **Municipalities** receive support to finance social expenditure (housing for the needy), to compensate for the collapse of revenues from trade tax ("Municipal Solidarity Pact"), and to strengthen public transport (a total of EUR 12.5 billion). Among other things, the financial support is intended to prevent local authorities from cutting back on investments during the crisis.

In addition, there are measures to expand the health system and aid for African countries to cushion the consequences of the corona pandemic there. Not included, on the other hand, are previously discussed measures such as the car purchase premium for cars with combustion engines (car scrappage schemes like the "*Cash-for-Clunkers*"), which was launched in response to the 2008/09 economic and financial crisis. Likewise, no taxes on profits and income have been reduced at present.

EVALUATION OF ECONOMIC POLICY MEASURES BY COMPANIES

To obtain an insight on the extent of the economic consequences of the corona pandemic for the economy, we conducted a business survey in cooperation with the Bavarian Chambers of Industry and Commerce (IHK) as early as April (Dorn et al. 2020c). Between 20 and 24 of April 2020, a total of 817 member-companies of the Bavarian Chambers of Industry and Commerce took part in an online survey, where they were asked to assess how helpful various economic policy measures would be in securing their existence and preserving jobs. We presented the companies with a list of nine measures and asked them to rate the suitability of each measure on a scale of

1 (not suitable) to 5 (very suitable). The list included those measures which had already been implemented by the time of the survey, such as the possibility of government loan guarantees and equity investments, as well as a number of other measures that were discussed as possible components of an economic stimulus package (some of them were actually included in the June economic stimulus package). The list of measures included in the business survey are:

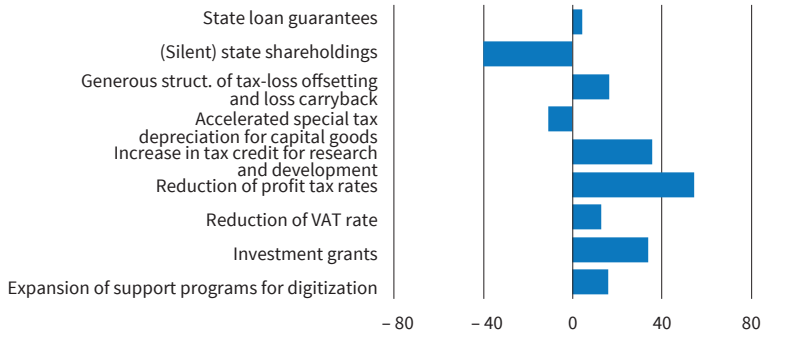
(i). State loan guarantees
(ii). Increase in equity capital through (silent) state shareholdings
(iii). More generous structuring of tax-loss offsetting and loss carryback
(iv). Accelerated special tax depreciation for capital goods
(v). Increase in tax credit for research and development
(vi). Reduction of profit tax rates (corporate and business taxation, or income taxes)
(vii). Reduction of VAT rate
(viii). Investment grants
(ix). Expansion of support programs for digitization ("digital bonus")

The results of the evaluation of the measures by the companies are demonstrated in Figures 1 to 3. Figure 1 shows the results across all enterprises, Figure 2 by sector, and Figure 3 by enterprise size. In order to facilitate the presentation of the results, we have rescaled the answers into a continuous measure that can take values in the range from – 100 (lowest possible suitability) to + 100 (highest possible suitability).[5] The results make it clear that tax measures are regarded by companies as particularly suitable for supporting the economy. More precisely, a permanent reduction in profit taxation, investment grants, and a more generous design of the tax balance sheet were assessed by companies of all sectors and sizes to be strongly required for overcoming the crisis. In the following section, we describe the measures and results in detail.

Liquidity and Financial Assistance (i)–(iv)

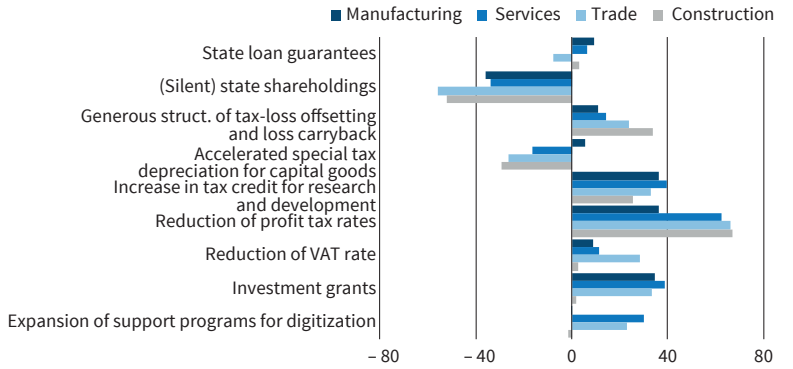
Measures (i) and (ii) serve primarily to secure liquidity. While the loan guarantees facilitate the supply of debt capital, the state participation targets the purpose of strengthening the equity base of companies. The main advantage of equity financing compared to debt financing is that the former reduces the risk of a debt overhang. Debt overhang implies that it is unattractive for new investors – both equity providers and new lenders – to provide a company with new capital

Figure 1
Evaluation of Differnet Measures
All Sectors



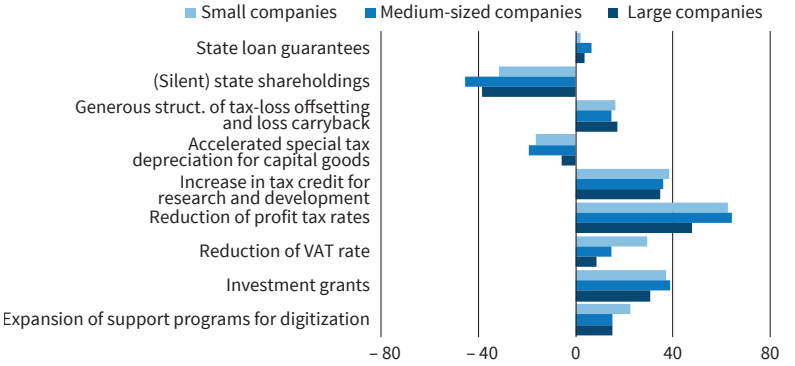
Source: ifo/IHK special survey. © ifo Institute

Figure 2
Evaluation of Different Measures
By Sector



Source: ifo/IHK special survey. © ifo Institute

Figure 3
Evaluation of Different Measures
By Size



Source: ifo/IHK special survey. © ifo Institute

for investment. This problem can arise when companies run up heavy debts as a result of the crisis, for example, because they have to secure their liquidity by taking out additional loans. From the perspective of the companies, one disadvantage of state investments is that a part of the income generated goes to the state. In addition, state participation could be made conditional on the possibility for the state to influence business decisions.

Assessment by companies: According to the assessment of the companies in the survey, an expan-

[5] To calculate this measure, we first centered the scale around zero so that the values of the underlying variable can assume values in the range from – 2 (not suitable) to + 2 (very suitable). We then multiplied the values by 50 and calculated averages.

sion of the possibilities within the framework of tax loss offset is generally considered to be highly suitable for overcoming the consequences of the crisis. By contrast, the state participations meet with great skepticism among companies in all sectors and of all sizes.

Implementation: The possibilities of state loan guarantees and state participations were already implemented in the first package of measures adopted in March 2020. This action aimed to provide bridging facilities for those companies which were particularly affected by the crisis by making capital available. For example, the Federal Government established the Economic Stabilization Fund endowed with EUR 400 billion for guarantees, EUR 100 billion for capital measures, and a further EUR 100 billion to refinance KfW programs that had already been adopted. A prominent example of the state's involvement as new shareholder is the Federal Government's investment in Lufthansa of just under EUR 9 billion.

Measures (iii) and (iv) are tax instruments that can generate a significant liquidity effect. At the same time, the fiscal costs of the two measures are low because they are in principle merely a postponement of tax payments. A lower tax revenue in the present is therefore offset by correspondingly higher tax revenue in the future.[6] A "loss carryback" (*Verlustrücktrag*) enables companies to offset losses in 2020 against taxable income in 2019. As a result, companies suffering from losses in 2020 will receive a refund on income taxes paid for 2019. However, before the decisions of June 2020, the possibilities for offsetting losses were quite restrictive. For example, the loss carryback was allowed to an amount corresponding to a maximum of 15 percent of the income in 2019 and, at the same time, should not exceed an amount of EUR 1 million (EUR 2 million in the case of joint taxation). An extension of these maximum limits could lead to a significant increase in liquidity for companies that yielded profits in 2019 but are suffering losses in the current year due to the corona pandemic, since they could be reimbursed a larger portion of the income taxes paid in 2019. Combining the expansion of loss carryback opportunities with the introduction of accelerated tax depreciation for capital goods would further increase the liquidity effect.

Assessment by companies: In general, an expansion of the possibilities within the framework of tax loss offset is assessed by the companies as highly suitable for overcoming the consequences of the crisis. The introduction of the accelerated depreciation rule for capital goods is also generally considered to generate a positive effect. Accelerated depreciation is most strongly advocated by companies in the construction industry.

Implementation: In the most recent economic stimulus package of June 2020, the possibility of tax loss carryback was extended to a maximum of EUR 5 million (or EUR 10 million in the case of joint taxation) in corporate taxation for the years 2020 and 2021. A mechanism will be introduced to make this carryback usable in the 2019 tax return, e.g., through the creation of a tax "corona reserve" (*Corona-Rücklage*), thus achieving an immediate liquidity effect. An accelerated special tax depreciation for capital goods was also introduced. For the tax years 2020 and 2021, a geometric-degressive depreciation with a factor of 2.5 compared to the otherwise applicable tax depreciation rule and a maximum of 25 percent per annum for movable assets (equipment) will be introduced as an additional tax investment incentive.

Permanent Tax Relief (v)–(vii)

Unlike measures (iii) and (iv), *the measures (v) and (vi)* would provide a permanent tax relief to the companies and thus create a loss of tax revenue for the state. Moreover, the cyclical stabilizing effect of an increase in the tax credit for R&D and a reduction of profit tax rates would be limited, since companies currently incurring losses would not benefit from these measures at this moment. However, both measures could have a positive medium- to long-term effect on Germany's attractiveness as a location for business and innovation, and on the investment climate. Moreover, companies with a viable business model would be the main beneficiaries in the future.

Assessment by companies: The reduction of profit tax rates is considered by the companies, regardless of sector and size, as the most appropriate instrument to secure their existence and jobs. However, tax credits for R&D are an unsuitable instrument for coping with the crisis according to the companies in the survey. Only a larger share of firms in manufacturing industry still assume positive aspects, probably due to the fact that eligible expenditure on R&D has a greater role in manufacturing than in other sectors.

Implementation: In the most recent economic stimulus package, it was decided to grant the subsidy rate of the tax research allowance retroactively as of 1 January 2020 and limited to 31 December 2025 on an assessment basis of up to EUR 4 million per company. This is intended to create an incentive for companies to invest in R&D and thus in the future viability of their products despite the crisis. So far, tax relief in the area of profit taxation (income taxes, business and corporate income taxes) has not been granted. Only the corporate income tax law has been modernized by introducing an option model for corporate income tax.

[6] However, in certain cases, a permanent tax relief (and therefore a loss of tax revenue for the state) may arise if a company ceases its activities permanently soon or in the coming years due to persistent losses and tax losses would have been incurred without the possibility of loss carry-back. In this case, the loss of tax revenue today is no longer offset by future tax revenue.

A reduction in VAT (*measure (vii)*) could have a positive impact on domestic demand, provided that the reduction is passed on to consumers. If not, companies will benefit from the reduction through higher net prices.

Assessment by companies: According to the survey, a reduction in VAT would be particularly welcome by the companies in the trade sector. Moreover, this instrument is considered more effective by small businesses than by large companies.

Implementation: In the latest economic stimulus package, the German government decided to reduce the standard VAT rate from 19 percent to 16 percent and the discounted rate from 7 percent to 5 percent for a limited period from 1 July 2020 to 31 December 2020.

Funding Programs and Subsidies (viii)–(ix)

In addition to liquidity assistance and tax relief, the state can also support the economy via subsidies and funding programs. At present, investment grants (*measure (viii)*) are an instrument of regional policy, and consequently primarily benefit companies in structurally weak regions. It would also be possible to support only investments in certain branches or specific technologies considered particularly promising for the future. One example is subsidies for investment in digitization (*measures (ix)*).

Assessment by companies: The companies' assessment of investment grants depends on the sector. While companies in the manufacturing, services and trade sectors rate this instrument quite positively, the firms' assessment in the construction sector is rather neutral. An expansion of the subsidy programs for digitization is seen as a suitable instrument for overcoming the crisis by the companies in the trade and services sectors, but not by the companies in manufacturing and construction.

Implementation: Investment grants or funding programs for investments in digitization have been largely dispensed with to date. Only the automotive industry receives 2 billion euros for investments in innovations and new drive-technologies within the framework of a bonus program.

DISCUSSION OF THE GERMAN STIMLUS PACKAGE

Overall, the economic stimulus package is expected to provide a positive economic impulse, which will benefit companies and private households alike. Current simulations conclude that the program will increase German GDP by 0.9 percentage points in 2020 (Wollmershäuser et al. 2020), which corresponds to an increase of around 30 billion euros. It is assumed that the expenditure and tax relief will take effect of EUR 88 billion in 2020. The expected growth effect is therefore much smaller than the volume of the stimulus package. This is partly because a part of the additional demand is flowing into imported goods or pure deadweights (*Mitnahmeeffekte*). The overall effect of the economic stimulus package will depend heavily on the way how the measures are implemented in detail. An assessment of all 57 individual measures of the stimulus package would go beyond the scope of this paper. Nevertheless, in addition to the assessment of the companies, some core components are evaluated below.[7]

Several Convincing Elements in the Recovery Plan

The latest economic stimulus package contains several elements that can make a targeted contribution to the recovery of the German economy. Many measures are designed to promote medium to long-term investments in future technologies, infrastructure and climate protection. In the following section, we discuss some of the central measures of the program.

(1) Tax loss statements and accelerated depreciation for capital goods

The rules on accelerated depreciation for capital goods and the agreed extension of tax loss relief for companies are positive elements of the package. Many companies with a functioning business model have incurred losses through no fault of their own during this crisis year 2020, but had profits and paid taxes in 2019. Loss relief will allow them to partially recover taxes paid for 2019, which will provide them with liquidity to overcome the crisis. However, the tight limitation to a maximum of EUR 5 million (or EUR 10 million in the case of joint taxation) must be viewed critically. A higher limit would have been appropriate, especially with regard to larger companies. Accelerated depreciation of capital goods could also provide a stimulus, especially if extended loss compensation also allows companies with current losses to benefit from the additional depreciation. Fiscal costs are kept within limits because it is primarily a matter of shifting tax payments into the future.

(2) Strengthening of communities and families

Families and single parents are particularly worse off during the crisis due to the restrictions placed on schools, kindergartens and daycare centers. Parents not only have to deal with additional tasks such as home schooling and childcare, but often suffer from additional financial loss as a result. Supporting families financially and investing additionally in childcare facilities are understandable and welcome measures. It is also right to prevent local authorities from cutting back their investments because of collapsing business tax revenues (as major revenue source of German mu-

[7] The discussion of the components is largely based on the comments in Dorn et al. (2020c) and Fuest (2020).

nicipalities). Once again, the crisis shows that business taxes are not a good municipal tax because its revenue fluctuates too strongly. Municipalities need more steady revenues than those from the business tax. A reform of municipal finances is therefore urgently needed in Germany.

(3) Public investment

In the current economic situation, expanding investment in digitization, infrastructure, R&D, and environmental and climate protection sounds promising. It also makes sense for the state to bring forward those investments which were planned anyway, because their rapid realization can timely generate a positive effect on the economy. To secure tomorrow's economic prosperity, investments in new technologies can also be important for ensuring new economic growth and new jobs in the medium to long term. In this regard, it will be crucial to assure that the supported projects are of high quality. If a great deal of money is suddenly made available for investment, there is a risk that less useful projects will also be supported.

Controversial: The Temporary Reduction of the Value Added Tax (VAT)

While most companies are more in favor of a permanent reduction in VAT as shown above, the German government decided to introduce a temporary reduction from 1 July to 31 December 2020. A positive element of this tax measure is that it initially benefits all sectors of the economy during the crisis and thus has advantages against sector-specific subsidies. Yet the effect of the temporary VAT reduction is particularly controversial.

The VAT reduction could have a positive effect on domestic consumer demand if the reduction is passed through on to consumers. The extent to which this will happen is questionable, however. On the one hand, for many companies the temporary reduction involves a double effort and additional administrative costs. Especially when prices are low, many companies will think twice whether the price change is worth the effort.[8] Furthermore, enterprises could benefit from the reduction through higher net prices. It is therefore expected that the reduction in VAT will benefit consumers at best in part. If a tax cut does not lead to falling prices, this does not mean that it cannot have an economic effect. It may even be desirable in the crisis for the relief to benefit companies. However, it is precisely those companies that could benefit the most from this which are currently generating high turnover and are actually winners in the crisis, such as large supermarket chains like Lidl or Aldi and the currently booming online trade. The tax cut is likely to have a stimulating effect above all on demand for durable consumer goods such as cars or household appliances, as consumers will pay closer attention to whether the tax cut will have an impact on prices.[9] Many consumers may therefore prefer to opt for purchasing durable goods.

However, to be effective, consumers must be willing and able to demand more services. Since many consumers themselves are experiencing severe revenue shortfalls and access to credit for major expenditures is becoming more difficult due to the crisis, the actual demand effect is rather questionable. In addition, many consumers are worried about their future income and are therefore increase savings. In such a situation of high uncertainty they will react less strongly than usual to a marginal price reduction.

Irrespective of these fundamental objections, it is worth looking at the experiences other countries have had with temporary VAT reductions. Several studies examine (temporary) VAT changes in different European countries and have concluded that tax cuts are often not passed through on to consumers (Dorn et al. 2020c). There is rather a risk that a greater burden will arise for consumers in the medium term if the price increase due to the return to the original VAT rate is higher than the initial price reduction led by a temporary reduction (Benzarti et al. 2017; Benzarti and Carloni 2019). Crossley et al. (2014) examine the temporary VAT reduction in UK in response to the economic and financial crisis of 2008/09 and conclude that although the tax reduction was partly passed through on to net prices, there was merely a minor economic stimulus. The effect was extremely short-lived, only visible for consumer durables and, moreover, no longer discernible after the first few months. German experience with the VAT increase in 2007 (announced at the end of 2005) shows that effects similar to those in the UK can also be expected for Germany. According to D'Acunto et al. (2016), the announcement of the tax increase led to a growth in sales figures for consumer durables before the higher tax rate was implemented.

Wollmershäuser et al. (2020) have simulated the economic impact of the temporary VAT reduction for Germany. They conclude that the economic impact of the temporary VAT reduction is limited. Although the measure is offset by tax losses of around 20 billion euros in 2020, this simulation analysis shows an overall increase in the price-adjusted GDP in the same year of only 0.2 percentage points or around EUR 6.5 billion.[10] This is mainly because consumption is not growing to

[8] The gastronomy sector is particularly affected by this, as it also receives the reduced VAT rate for one year. As things stand at present, the VAT rate for the gastronomy will be reduced from 19 to 5 percent by December 31, 2020. Thereafter, the tax will increase to 7 percent until June 30, 2021, when it will rise again to 19 percent. Here, political demands are already being made to leave the VAT for the gastronomy at the reduced rate on a permanent basis.

[9] The temporary reduction is therefore also seen as a replacement for the absence of a car scrappage scheme for the automotive industry.

[10] Including the stimulating effects for subsequent years, the economic stimulus increases to a total of EUR 9 billion (Wollmershäuser et al. 2020).

the extent of the tax cut and moreover a part is flowing into the demand for imported goods. This does not necessarily mean that the VAT cut should be rejected as a measure of economic policy. It is certainly desirable to support companies and ease the burden on consumers in the current crisis, even if there is not a strong rise in consumer spending.

However, when the VAT reduction expires at the end of 2020, the economic situation could still be problematic. This is particularly likely to happen when a new major wave of Covid-19 infections in the autumn chokes off the economic upswing. The increase in VAT at the end of the year could further slowdown demand in 2021. At that time, claims can be expected to arise to keep tax rates low for a longer period or permanently. As we have shown above, most of the survey companies would tend to rate a permanent VAT reduction as positive. However, this could reflect the fact that companies hope to benefit from it because the tax cut will only be partially passed through on to the demand side. This does not take into account that at some point in time counter-financing will be required by the state through increases in other taxes or expenditure cuts.[11]

Not Included: Car Scrapping Schemes and Permanent Profit Tax Cuts

In the run-up to the economic stimulus package, there was also talk of the possibility of a purchase premium for cars (car scrapping scheme), which was demanded by the automotive industry. Moreover, there were also calls for a reduction in profit taxation, which would be a very welcome instrument in the view of the companies. In the discussion on the reduction of profit tax rates, for example, an early partial abolition of the solidarity surcharge (*Soli*)[12] or its complete abolition are discussed. Ultimately, these measures were not taken into account in the economic stimulus package of June 2020.

(1) Car scrapping scheme (scrappage bonus)

A purchase premium for new motor vehicles was discussed in the *Autoland* Germany in the run-up to the stimulus package. In 2009, as part of the second economic stimulus package (*Konjunkturpaket II*) to overcome the economic crisis at that time, Germany introduced a car purchase premium including car scrapping scheme. The bonus was paid if the purchase of a new car was combined with the scrapping of an old one. The obligation to scrap and thus destroy vehicles that are principle in function is critical from both an economic and ecological point of view. This should be avoided. Empirical studies on earlier car scrapping scheme programs also show that this policy first and foremost achieves shifting effects over time. A large share of the short-term increase in sales figures is attributable to the incentive to bring forward the decision to buy a new car by a few months (Mia and Sufi 2012; Li et al. 2013). It can therefore be assumed that the premium will generate positive sales effects in the car market immediately after it comes into force and thus contribute to an immediate stimulation of the economy. Thereafter, however, there will be a negative economic effect. Nevertheless, fleet renewal programs, an increase in the purchase premium for electric and hybrid vehicles and a bonus program for investments in new drive technologies were ultimately included in the latest economic stimulus package of June 2020 – all of which the car industry directly benefits from.

(2) Reduction of income and profit taxation (income tax, business and corporate income tax)

Proponents of a reduction of income and profit taxes hope that this will stimulate the economy. Positive effects of nationwide income and profit tax relief are assumed to lead to a strengthening of overall economic demand. Such tax cuts, however, are probably less suitable as a cyclically motivated instrument for stimulating demand in the short term. The instrument would benefit many taxpayers who have not been hit so hard by the crisis. Tax cuts would therefore not directly lead to increased consumption or investment demand in these groups. For higher income groups, for example, it is hardly expectable that a reduction in income taxes would lead to an immediate rise of expenditure. For companies that have been hit particularly hard by the crisis and expect to make losses in 2020, the reduction in profit taxation would also have no effect. Therefore, income tax cuts or reductions in corporate taxes are less suitable as targeted instruments for stimulating the economy in the short term. The medium-term consideration is more in favor of lowering corporate tax rates, for example for positioning Germany as an attractive location for innovation and business with lower corporate income taxes. There are also other arguments in favor of reforming income taxation, but these go beyond the discussion of economic recovery.

CONCLUSION

The corona pandemic has plunged the European and global economy into a deep economic crisis. It makes sense and it is necessary for the states to take extensive measures to support the economy by monetary and fiscal policy measures. These measures cannot eliminate the losses caused by (partial) shutdowns of economic activity. However, they can help to prevent a downward spiral towards a deeper crisis and depression. Because of the sharp rise in government debt,

[11] In their simulation study, Wollmershäuser et al. (2020) come to the conclusion that a permanent VAT reduction of the same order of magnitude would permanently increase the level of GDP by 0.6 percent.
[12] The "Soli" (*Solidaritätszuschlag*) is a special supplementary charge to income and corporate taxes in Germany.

however, it should be critically assessed when selecting economic policy measures whether the benefits of the expected economic stimulus justify the costs.

Whether the economic stimulus packages in Germany implemented to date are sufficient to stabilize the German economy depends on the further course of the epidemic and the political reactions. As export oriented country, Germany is particularly dependent on how the economy develops in the rest of the world. Therefore, the effect of national economic stimulus programs is naturally limited.

For fiscal policy programs to be effective in times of Covid-19, it is of central importance that a second, widespread wave of infections, which again would require nationwide shutdown measures, is prevented. Such a wave would probably lead to massive uncertainty among consumers and investors.

Ultimately, it is necessary to normalize the economic process as much as possible despite the existing threat from the coronavirus. To achieve this "new normal" situation, increased testing for infection and immunity is required in addition to precautions to protect against infection.

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Centralizing EU Policy in Fighting Infectious Diseases: Status Quo, Citizen Preferences, and Ways Forward[1]

ABSTRACT

We confront the traditional role of the EU in the domain of health with the urgent need for collective action triggered by the coronavirus pandemic. In the face of such a crisis, we argue that the joint procurement, stockpiling, and allocation of medical countermeasures is a key component of true European solidarity, besides maintaining the integrity of the single market. We present the first results of a survey experiment taken before the current crisis on citizens' attitudes toward centralizing at the EU level of policies to combat infectious diseases, which indicates considerable support.

The world is in the throes of the outbreak of Covid-19. Healthcare systems are overburdened, while the economic implications are devastating. This paper addresses the question of what the best policy options for organizing EU solidarity are with regard to medicinal countermeasures to infectious diseases. This question is analyzed against the backdrop of a legal and economic policy analysis, informed by research on public attitudes. We first discuss what "EU health solidarity" means. Second, we analyze the current options for collective EU action to address pandemics. The EU's competences in health remain limited, even after several contagious disease outbreaks in the past two decades (De Ruijter 2019). Third, we empirically report results from a survey experiment among a representative sample of Dutch citizens surveyed before the outbreak of the current crisis.

The conclusions from these three steps are clear: there are good social, economic, and legal arguments, and likely also meaningful public support, for procuring, stockpiling, and allocating medical countermeasures to infectious diseases at the EU level. This eliminates the inefficiency associated with excess demand and excess supply co-existing in various parts of the EU. More importantly, it allows massive firepower to be instantly targeted to wherever an outbreak starts. And, if well-organized ex ante, it secures credible commitments by all Member States (MS) to the cooperation that is needed ex post, once a crisis hits.

EU SOLIDARITY IN HEALTH

Solidarity is explicitly recognized in EU law and policy. In the case of disasters, such as a pandemic, the European Treaties set out a clear mandate, at least in principle. Article 222 of the Treaty on the Functioning of the EU (TFEU) stipulates that solidarity demands that in case of a disaster, MS are to provide assistance to one another and act jointly and in cooperation.

Simultaneously, there has always been a tension between the domestic principles of solidarity and the principles of market integration that underpin the single market. In the application of the internal market rules, any national health laws that created a barrier to the free movement of goods or services were suspect and needed to be justified as a valid exception to the free movement principle. In fact, some of the important "constitutional moments" for the creation of the European internal market revolved around health exceptions to the free movement of goods.

Although health is mentioned throughout the Treaty as an exception to the free market principles and as a general EU goal, Article 168(5)(7) TFEU, which outlines the EU's role and responsibility in health, simultaneously reinforces the premise that the EU does not have the power to create health law outside of specifically outlined situations. EU scrutiny of national public health laws is highly developed in EU *case law*, particularly as it comes to the free movement of goods. This is a relevant legal backdrop for the organization of solidarity via the public procurement of vaccines at the EU level that followed after the swine flu outbreak.

EU HEALTH SOLIDARITY IN THE FACE OF DANGER

In order to understand the current role the EU can have with respect to organizing solidarity for responding to Covid-19, particularly with regard to the public procurement of pandemic medicines and medical countermeasures more generally, we should go back

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to 2009 with the global spread of a new virus, swine flu. There was a fear that the virus would have a mortality rate comparable to that of bird flu (over 60 percent) and would spread more easily. Luckily the swine flu turned out to be no more deadly than a seasonal flu, but the current difficult choices in terms of the organization and acceptability of EU solidarity regarding the Covid-19 outbreak in Europe already came to the fore with the 2009 swine flu. That experience has led to at least some of the elements in the EU policy landscape within which we now find ourselves.

In the year of the swine flu outbreak, new provisions in the Lisbon Treaty created the basis for the current EU role, by adding to Article 168 TFEU: "Union action, which shall complement national policies, shall be directed toward improving public health, [...]. Such action shall cover the fight against major health scourges, by promoting research into their courses, their transmission, and their prevention, as well as health information and education, and monitoring, early warning of, and combating serious cross-border threats to health."

At the time of the 2009 swine flu outbreak, no secondary EU legislation had been adopted on the basis of this added paragraph in Article 168 TFEU. However, a major problem arose with respect to the availability of pandemic vaccines and antivirals. The European Commission had been trying for years to create a stockpile of antivirals. Nevertheless, this was deemed unacceptable by the MS that wanted to keep the ability to procure medication at the MS level.

Following Commission efforts in order to address some of the problems identified above, in 2013 Decision 1082/2013/EU of the European Parliament and the Council was adopted dealing with serious cross-border health threats. Again, however, MS did not agree to a binding system for public procurement. Instead, Article 5 of the Decision created the legal basis for voluntary public procurement of medical countermeasures in case of a health emergency. The Joint Procurement Agreement (JPA) that further implements Article 5 entered into force in 2014. This agreement applies to joint procurement of medicines, medical devices and "other services and goods" needed to mitigate or treat cross-border threats to health.

The procedure per procurement is agreed among the contracting parties (participating MS and the Commission). One condition is that it should not impede the functioning of the internal market. Importantly, with each tender, participating MS need to decide on the criteria governing the allocation of the available amounts of medical countermeasures among themselves. In principle, they should receive the amount that they have ordered. In urgent situations, MS may request derogation from these general allocation criteria and receive the countermeasures at a faster rate than other participating MS. Furthermore, the agreement allows MS to donate countermeasures acquired under the joint procurement procedure.

The EU can play an important role for Covid-19 in organizing health solidarity through a European public procurement process. The current system already has created a centralizing effect in a pre-purchase that was done with 15 MS in 2019, and currently more of these processes are on the way.

Another route for a more central role for the EU could be under the heading of EU solidarity proper, rather than under that of the EU health law regime. The EU Civil Protection Mechanism based on Article 222 TFEU depends on the willingness of MS to join forces. In 2019 the Mechanism was strengthened by "rescEU," in an attempt to centralize EU capacities. Article 12 of this Decision provides for the EU to use its internal funds, pre-committed national funds, and EU co-financed MS capacities at the disposal of EU efforts, to respond to a major emergency.

This mechanism also creates the possibility for joint procurement, parallel to the JPA under the health infrastructure. Here, the Commission can assume a more central role, because the Decision allows for central EU implementation of decisions toward distribution and allocation. Nevertheless, the actual capacity of rescEU still largely depends on the willingness of MS to contribute, and is likely substantially smaller than what can be nationally organized or through the JPA.

Importantly, the EU procurement of a pandemic medicine and other medical products can be severely undermined if MS, in the face of Covid-19, disrupt supply chains. The process within the JPA is intergovernmental, and runs the risk of playing out in the context of actual export bans. Solidarity is also undermined by hoarding and limitations in the supply chain. However, even if the Commission would adopt an "EU health solidarity-based" interpretation for scrutinizing whether national export bans fall under the public health exception to the free movement of goods, the question is whether at the current moment, the possibility of an infringement procedure from the Commission would scare MS politicians more than not having control over the stockpiles of particular goods.

WHAT WOULD CITIZENS WANT FROM EU HEALTH SOLIDARITY IN THE PROCUREMENT OF PANDEMIC MEDICINES?

In exploring the role of the EU for ensuring health solidarity when it comes to a pandemic, it is important to consider citizens' preferences. This is difficult, however, given the paucity of well-formulated survey questions and research designs – not least given the unfamiliarity among citizens with medical risk-pooling, and also given the tendency of people to express opinions about health matters in socially desirable ways rather than expressing true thinking.

To shed some light on public support for the EU's role in medical procurement, we conducted an original experiment as a pilot to a larger survey project on attitudes toward EU fiscal and medical policies. The pilot was administered in November 2019, just prior to the Covid-19 outbreak, and involved a broadly representative sample of 400 Dutch respondents, yielding a sample of 2,400 policy packages judged by respondents.

The experimental part of the survey was a so-called conjoint experiment. This involved asking respondents to judge pairings of policy packages that combined features on three dimensions of a hypothetical EU pooling of risk and purchases of pharmaceuticals. The three dimensions and possible answers for any given policy package were: (1) Do respondents prefer a program for a limited range of medicines crucial to large-scale disease outbreaks or for all medicines where collective purchases can be financially beneficial? (Possible answers: a. Only a narrow set of medicines; b. All medicines where pooling yields a financial advantage); (2) Do respondents prefer a program that lends access to the pooled medicines based on a country's own contribution, or instead priority access based on needs to stop epidemic spread? (Possible answers: a. Access based on a country's contribution; b. Priority access based on need); and (3) Do respondents prefer a program that is administered by national-level experts or by EU-level experts? (Possible answers: a. EU-level agency administers; b. National-level experts administer). In the conjoint experiment, respondents choose among and rate randomly assigned alternative packages that combine a random combination of policy features (from each of the three policy dimensions, one answer from the set of possible answers to that dimension). This experimental approach evokes more honest answers from respondents even with respect to socially undesirable answers.

This study reveals preliminary but important evidence about public support for EU medical procurement. First, there is a plurality of support for, as opposed to being against such EU pharmaceutical sharing. Figure 1 shows that the combination of somewhat and strongly support given to any given package garners almost 44 percent of the sample, while "only" 23 percent are opposed (32 percent are indifferent). These patterns are not significantly different across basic demographic sub-groups (younger versus older; more versus less educated; men versus women). This is a sign, however tentative, that EU-level procurement would command substantial support among the Dutch population.

Second, perhaps more interestingly, the respondents express preferences for a particular kind of EU procurement program with respect to the three dimensions of the procurement policy. These preferences are summarized in Figure 2, showing the predicted preference of respondents for a given value on a given dimension, based on an experimental inference of choice for a given package that exhibits the randomly assigned policy features per dimension. The dots capture the mean prediction, while the dark lines depict the range of predicted values within 95 percent confidence.

Figure 2 shows clear patterns regarding the preferred procurement policy. The sample is indifferent as to whether EU-level or national agencies administer such programs: on "Who administers?" respondents are very weakly less likely to prefer national-level to EU-level administration (the baseline). The difference is clearly not statistically meaningful; a substantial part of the confidence interval crosses the vertical line. By contrast, Figure 2 shows that the respondents clearly tend to prefer an EU program that covers a broad swath of medicines, potentially *all medicines:* respondents are about 15 percent more likely to choose an EU procurement policy that includes such coverage over a policy

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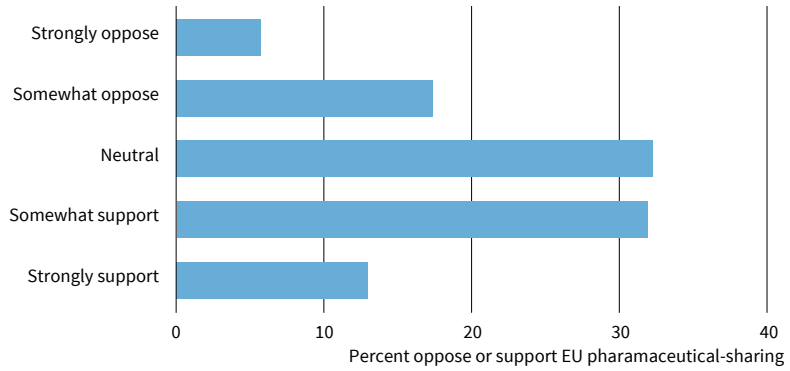
Figure 1

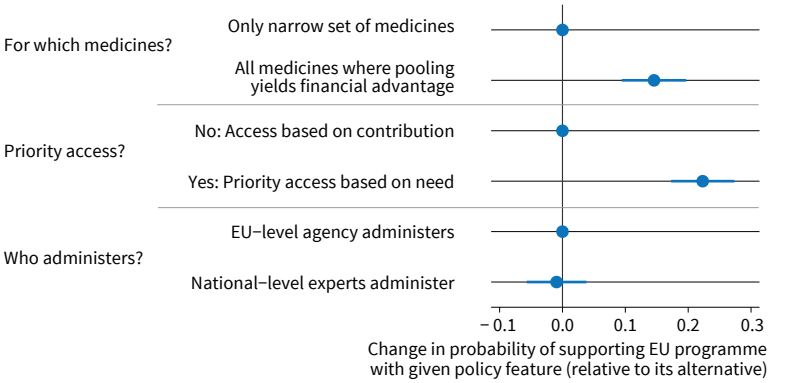
Percent of Dutch Respondents Supporting EU Medicine-procurement Sharing



Source: Authors' calculations.

Figure 2

Predicted Preference for Policy Features of EU Medicine-procurement Sharing



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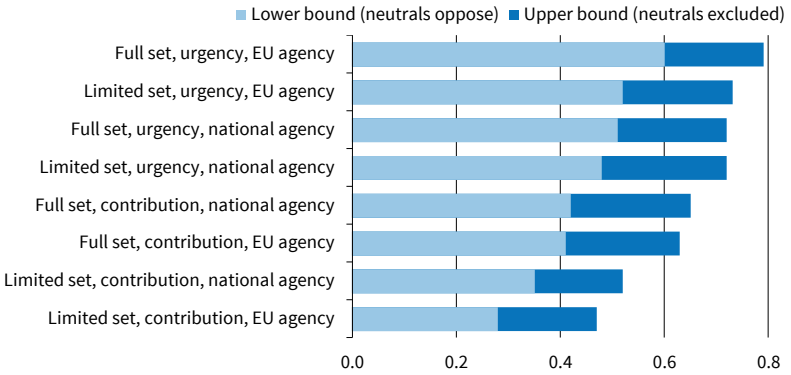
that focuses only on a narrow set of medicines (the baseline). Finally, Figure 2 shows that the respondents are even more likely to prefer an EU procurement policy that gives priority access to particular countries to prevent contagion: focusing on "Priority access" we see that respondents are about 23 percent more likely to choose an EU-procurement policy that gives priority access to countries where a contagion can be traced, i.e., based on need, to merely providing access based on a country's actual contributions (the baseline).

Finally, Figure 3 depicts the preference ranking over the eight possible policy packages. We show this ranking in two ways. The first, shown by the dark bars, is based on "Strongly support" plus "Somewhat support" as a fraction of all responses. The second, shown by the sum of the dark and light bars, focuses on the cases in which respondents are in favor or against, and is based on "Strongly support" plus "Somewhat support" as a fraction of all responses minus the "Neutral" responses. Both rankings are identical. Interestingly, the most preferred package is the combination in which the degree of policy centralization is at its maximum, i.e., joint procurement of all medicines, allocation based on urgency and execution at the EU level. The dimension "urgency based" versus "contribution based" seems the most important, since all urgency-based packages uniformly dominate all contribution-based packages. Next most important is the width of the package to be jointly procured, as "full set" always dominates "limited set," holding the other dimensions of the packages constant.

Figure 3

Preference Ranking over All Policy Packages



Source: Authors' calculations. © ifo Institute

Because the survey was conducted on a limited sample from one country at one moment, one should not overinterpret the outcomes. It is also well-known that the framing of a survey may have an effect on the outcomes. Moreover, our experiment took place at a moment when the described frame was still hypothetical and before any public debate about the centralization of policies in response to infectious diseases had taken place. Finally, if the same pilot were held now, respondents' answers might be shaped by the coronavirus crisis experience so far. Overall, we interpret the results of our pilot experiment as providing qualified but significant support for the view that there is meaningful political traction for EU-level pooling of procurement capacity.

POLICY SUGGESTIONS FOR AN EFFECTIVE WAY FORWARD

Across EU countries, there are large differences in healthcare systems. Systems differ not only in terms of the quality and available budgets, but also in terms of history, culture, and organization. There are valid reasons to respect the "subsidiarity principle" in healthcare matters, as deviations from this principle carry a danger of inefficiencies or may exacerbate inequalities: a central decision that ignores differences in national health arrangements could have widely varying impacts on MS healthcare systems. The issue is different, however, when it comes to decisions related to infectious diseases, because such decisions may have large cross-border spillovers. In this case, "national prerogatives" may create a problem of collective action that yields, in the end, bad outcomes for everyone.

If the line of argument is accepted that claims based on "national prerogatives" now have to give way to true European solidarity, then the EU must prove that it can also support the MS in a tangible way at the EU level. Therefore, the joint procurement initiatives both within the EU health regime (which can ensure size and volume) and the rescEU (which creates a central allocation authority for the Commission) are so important. However, "volume" and "central authority" do not coincide. It does not suffice for MS to say that the EU should merely ensure the integrity of the single market and allow for unfettered free movement. The EU will then also need to be empowered to set up real cooperation to keep citizens more safe.

However, the policy legacy since the swine flu epidemic shows that national policymakers prefer a domestic-centered equilibrium, whereby the reluctance to follow internal market principles is coupled with an equal reluctance by MS politicians to pool

the procurement of medicines as it would potentially transfer redistributive power to the EU level (WHO Regional Office for Europe 2016; Espín et al. 2016). Our poll among Dutch respondents suggests that such reluctance may be misguided. The fact that even Dutch respondents are prepared to pool medicine procurement and share risks at the EU level may be seen as quite remarkable as the Dutch are among the most skeptical when it comes to European-level economic stabilization arrangements. Hence, it is highly plausible that EU citizens are more willing than their leaders to accept solidarity arrangements when these are only there for emergencies.

Europe is now paying the price for a lack of a centralized policy in the face of pan-European health threats. Countries are competing with each other to acquire medical countermeasures, for example by imposing export bans. The result is a decentralized outcome that is suboptimal in the sense of these products not always being allocated where they are most needed. However, in the current circumstances, legal threats from infringements of the internal market rules likely have little effect.

So what needs to be done? The EU urgently needs to develop and use a well-embedded and efficient central capacity for a truly centralized EU procurement of medical countermeasures as is outlined in rescEU, without the inefficiencies that are currently there as a result of the intergovernmental and voluntary nature of the process under the health regime and the legally embedded possibilities for behavior lacking in solidarity.[2] Central procurement is needed for protective devices, and will certainly be needed for the vaccine against the Covid-19 virus once it becomes available. It will also be needed for *future* infectious diseases. Funding of the capacity can come from the EU budget or by levying a separate contribution from the MS linked to their GDP, population, and demographics. Demographics is relevant, because countries with an elderly population make more use of medicines on average. It cannot be excluded that the proposed policy centralization has redistributive elements, which is the case when contributions are linked to per capita GDP. However, the relatively limited redistributive effects should be weighed against the benefits of centralization.

What are these benefits? First, by centralizing procurement it will be more difficult for pharmaceutical companies to play off MS against each other by threatening not to supply to an individual MS if it tries to negotiate lower prices. Secondly, with a common stockpile of medical countermeasures managed at the EU level, excess demand in some countries and excess supply in other countries, an obvious economic inefficiency, can no longer co-exist. Thirdly, and most importantly, because the stockpile is common and, hence, larger than any potential national stockpile, there is much greater firepower to target outbreaks of infectious diseases wherever and as soon they emerge. In other words, risk sharing against the consequences of pandemics becomes much more effective than when each country is responsible for its own stock of medicines and equipment.

Finally, the decision of where to target the firepower should be made at the central level. This avoids that each country tries to deviate from the cooperative solution by securing as much of the medicine supply as possible at the cost of other countries. Although breaking away from the cooperative solution is likely self-defeating, because it reduces the chances to quell a disease outbreak where it starts, political decision-makers may not be able to see this or may be under political pressure to secure the safety of their own population first.

In other words, once a disease outbreak has started, cooperative agreements are not credible.[3] Ideally, the EU sets up arrangements ex ante that are ex post credible. Obviously, Europe has missed the "ex ante" of the current crisis. However, this crisis may also provide a chance to get to solutions that are normally unthinkable. We have seen that during the European debt crisis when crisis arrangements like the ESM were set up. Our proposal for the centralization of procurement, stockpiling, and deployment decisions of medical countermeasures to infectious diseases is ex post credible, provided the design is right. This requires centrally controlled guidance on the use of medicines based on the pooled expertise and instructions of the European Medicines Agency and the European Centre for Disease Prevention and Control. Such guidance must be laid down in advance, before an infectious disease emerges.

New diseases will obviously have unknown features. However, the optimal response to an infectious disease in its very first stages is likely to always be very similar, namely the concentration of substantial resources targeted at the first victims and containment within their direct environment. The optimal response to a crisis that is already in full swing, like the current one, is more difficult to define. In particular, once a vaccine for Covid-19 becomes available, it would be up to the experts to determine its best allocation given the availability and the objective, e.g., minimizing lost years of life or number of casualties. Ethical considerations will inevitably play an important role in determining the relevant objective. However, these are the domain of the politicians rather than the experts.

No doubt there will be hesitations and obstacles in place – despite the lessons learned from the swine flu epidemic and the tragic lessons from the Covid-19

[2] Costa-Font (2020) argues in favor of a European "health citizenship," based on the observation that European governments adopt widely differing policy responses to the Covid-19 crisis, which is hard to motivate as an optimal solution.

[3] Here, a cooperative agreement is to be understood as an agreement among *decentralized* decisionmakers, which is to be distinguished from the case of a *single* decisionmaker at the EU level.

crisis – toward centralizing policies for medical countermeasures to infectious diseases. One such hesitation could be the democratic basis of centralized EU distributive choices with regard to medicines. However, at the MS level it is likely that such distributive choices – which require difficult scientific and ethical choices – are also a matter for the executive. When it comes to centralizing policies in response to infectious diseases, there is accountability to the national parliaments for the delegation decision and to the European Parliament and the national parliaments for the specific design of the policy. When it comes to the actual execution in the face of an urgency, accountability to the European Parliament can only be exerted ex post. The situation may be seen as analogous to eurozone monetary policy, in which decisions are made by "technocratic experts," while the President of the ECB appears regularly for hearings in the European Parliament.

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Creating Sustainable Cooperation Strategies with Africa: A Glance at Development Aid and FDI

Western development policy has been undergoing a significant change. For many years, official development assistance (ODA)[1] from rich donor countries has been the main source of income for many developing countries. In recent decades, other capital flows – predominantly foreign direct investment (FDI) and remittances – have become equally or more important for some of them. FDI increased about tenfold from the early 1990s to the early 2000s but has fluctuated strongly in recent years. For the least developed countries (LDCs) in Africa, the economic importance of ODA has declined significantly since the beginning of the 2000s, yet it remains a more relevant and stable source of external funding than FDI (see Figure 1).[2]

It is not yet clear how the Covid-19 pandemic will affect ODA budgets and private investments. The crisis will certainly lead to tensions and likely to restrained spending, as most countries in the world are experiencing a drop in economic activity. In a statement issued in April 2020, the Development Assistance Committee (DAC) recognizes the importance of ODA, particularly in the light of the Covid-19 crisis, and commits itself to working toward protecting the development aid budgets of DAC donor countries (OECD 2020b) and help the most vulnerable who will suffer the most from this crisis.

The article begins with a description of the role of development aid and the complexity of the international aid system. While aid strengthens the public sector, investment increases the private sector, which could grow local enterprises and entrepreneurship and ultimately stimulate innovation. Thus, the article next looks at the increasing importance of foreign direct investment for Africa and highlights its potential to promote economic development. The article concludes with an outlook that stipulates the conditions under which both aid and foreign investments can be successful in the future.

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[1] Developing aid is provided by governments, international organizations, NGOs, and other private foundations and organizations, such as the Gates foundation or OXFAM. This article focuses on aid flows of the first two. For the purpose of simplicity, official development assistance (ODA) will be used synonymously with "aid" throughout the article.

[2] According to the World Bank, remittances are an even more important source of foreign funds for LDCs (World Bank 2014a).

THE ROLE OF DEVELOPMENT AID

ODA is a key element of the global development industry. It is defined as "government aid to promote the economic development and welfare of developing countries" (OECD 2020b) and is provided bilaterally from donor to recipient countries or channeled through an international organization, such as the UN or the World Bank. According to the UN, developed countries should devote 0.70 percent of their gross national income (GNI) to aid (OECD 2020b).

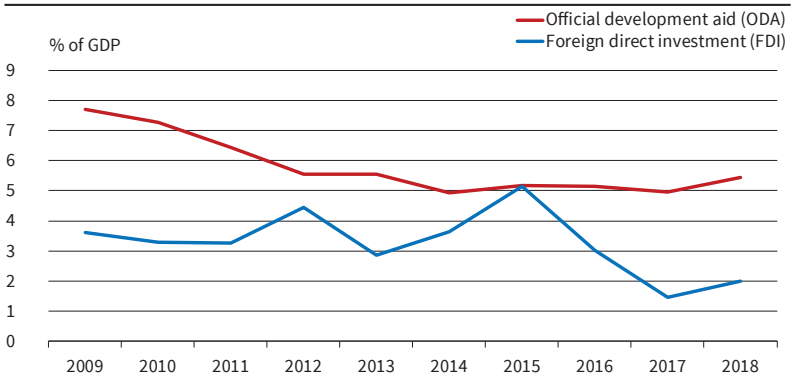
The Development Assistance Committee (DAC) coordinates aid donors and currently comprises 30 countries committed to promoting development cooperation, economic growth, and improving living standards in the world's poorest countries (OECD 2020c). In 2019, aid from DAC donor countries increased by 1.37 percent from 2018 and almost reached the 2016 peak of USD 155.6 billion (OECD 2020b).[3] In 2018, the greatest share of flows went to Sub-Saharan countries (23 percent), followed by South and Central Asia (12 percent) and the Middle East and North Africa (12 percent) (OECD and DAC 2020). Total ODA from DAC countries combined as a percent of GNI slightly fell to 0.30 percent in 2019 from 0.31 percent in 2018 (OECD 2020b). Figure 2 shows the development of ODA flows by DAC donor country in recent decades.

Figure 3 illustrates the largest aid donors worldwide in terms of US dollars, with the United States,

[3] The figure corresponds to a net ODA of USD 150.1 billion. In contrast to net ODA, the newly constructed grant equivalent figure takes principal and interest payments into consideration (OECD 2020c).

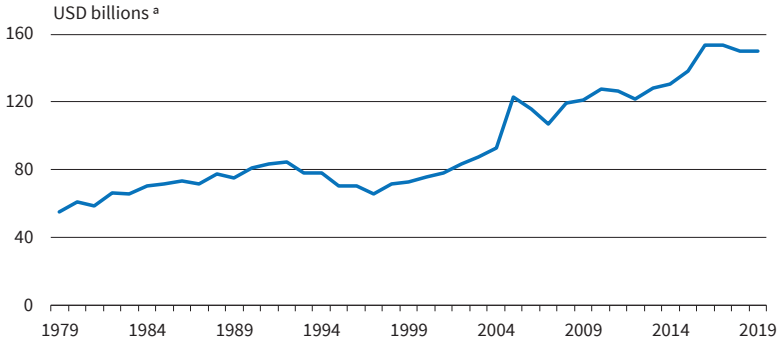
Figure 1

Economic Significance of ODA and FDI in African LDCs



Source: OECD Statistics (2020); UNCTAD Stat (2020).

Figure 2
Net ODA by DAC Countries



ª Constant prices, 2018 as base year.
Source: OECD (2020b).

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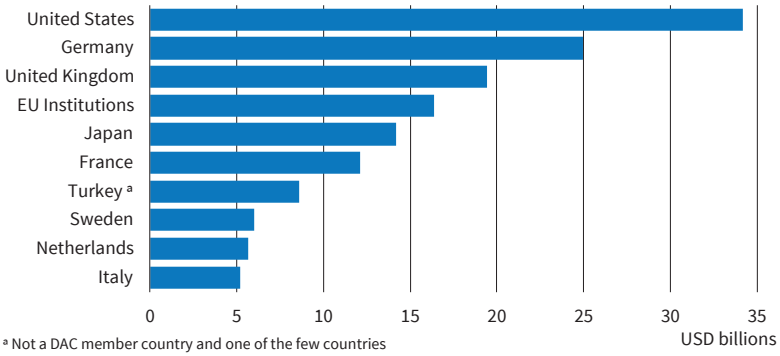
Figure 3
Top 10 ODA Donors (Grant Equivalents), 2018



ª Not a DAC member country and one of the few countries with an ODA to GNI ratio exceeding the UN target of 0.70%.
Source: OECD Statistics (2020).

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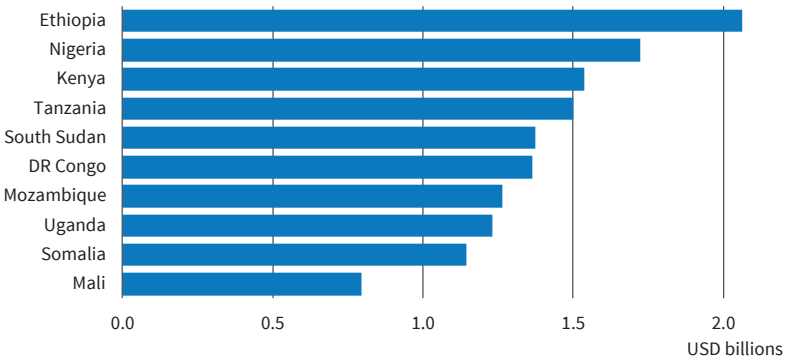
Figure 4
Top 10 ODA Recipients in Sub-Saharan Africa, 2018



Source: OECD Statistics (2020).

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Germany, and the United Kingdom in the lead and aid from EU institutions in fourth place. While the average contribution of DAC countries was below the UN target of 0.70 percent of GNI in 2019, five DAC member countries (Denmark, Luxembourg, Norway, Sweden, and the UK) as well as one non-DAC country (Turkey) met or exceeded the UN target (OECD 2020a).

More than 80 percent of all aid flowing to Africa goes to Sub-Saharan Africa (OECD Statistics 2020). In 2018, Ethiopia, Nigeria, and Kenya were among the main aid recipients (Figure 3).

In order to promote the development of less developed countries, aid is allocated to various purposes. Figure 5 shows for which sectors (lines) and other purposes (bars) aid has been provided in the last decade. Over half of all aid flows into social infrastructure – primarily education and health – or economic infrastructure. Social infrastructure also includes initiatives in the areas of water supply and sanitation, government and civil society (including matters related to conflict, peace, and security), as well as programs and policies targeting the general population and reproductive health.

Due to large infrastructure investments, Ethiopia has managed to reduce its dependence on agriculture and become more productive. Aid has thus helped to reduce the national poverty level (Woldekidan 2015). Also in Mozambique, aid has played an important role for economic development (Orre and Rønning 2017). It has contributed to growth, the development of key national institutions, and has been partially successful in the social sector. However, the country entered an economic crisis in 2016, which has further weakened government structures and accountability mechanisms. Despite the country's dependency on aid, aid has not contributed sufficiently to poverty reduction in the past (Orre and Rønning 2017).

UNDERSTANDING THE DYNAMICS OF AID

The modern development aid industry involves many agents, and despite many efforts, aid has not yet led to the anticipated results for many countries. Hundreds of bilateral and multilateral organizations direct aid to developing countries, often through several agencies and in various projects and activities. However, an international strategy is largely lacking (Haan 2009). Moreover, recent partnerships between public and private organizations have contributed to the complexity of the aid system. This has partially changed with the Millennium Development Goals (MDGs) of 2000, which provide the international community with a framework for setting targets and measuring progress. Nevertheless, the goals, aid activities, and programs as well as the measurement of success often vary from country to country (Haan 2009).

The use of aid and aid relationships have always been a deeply contested topic which gives rise to a strong divide within the academic community and policy world. At the heart of the debate is the question of whether aid is an effective instrument for development (e.g., Brett, 2016; Easterly, 2006; Sachs 2005).

In principle, the discussion is split between three camps (Haan 2009). Those in favor of aid believe that economic development requires substantial initial investment. Aid should therefore be scaled up and overseen by international organizations such as the UN (e.g., Sachs 2005). The opponents of this approach criticize that aid is not transferable from one coun-

try to another, and that instead development must be "homegrown" (Easterly 2006). A growing group in between focuses on how aid is provided and emphasizes the need for better evaluation (Haan 2009). Esther Duflo and Abhijit Banerjee, among others, believe in fighting poverty step by step and translating research and data into policies (see, e.g., Banerjee and Duflo 2011). This approach rests on the idea that a new understanding of poverty is needed and implementing change on a small scale may be more feasible than implementing change through large investments.

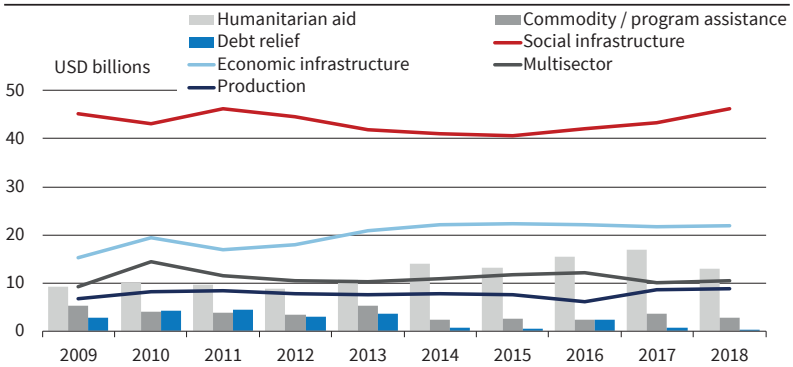
To better understand the complexity of the aid system, it is worth investigating what can happen in recipient countries when aid flows in. The size of the public sector increases without any notable increases in productivity or output, which could entail more opportunities for rent-seeking and corruption (Easterly 2006). The recipient government may treat aid as an alternative source of revenue and thus reduce its dependence on taxes, potentially causing the government to respond less to its population and more to its donors. While aid strengthens the public sector, investments flow into the market and grow the private sector. Private sector investments can be investments in local firms or investments in entrepreneurship; the latter is a key driver for innovation. Strengthening of market mechanisms through investments rather than empowering political systems through aid can be beneficial when corruption and limited accountability structures prevail in a country.

INCREASING IMPORTANCE OF INVESTMENTS

Foreign direct investment takes place when an investor buys shares of an existing local enterprise or establishes local business activities in another country, for example by building a subsidiary of the parent company. Investors usually exercise a high degree of control, reflecting the long-term interest in the recipient economy. FDI can be provided in the form of capital, knowledge, or technology (UNCTAD 2007). Unlike development aid, FDI stimulates the private sector, potentially benefiting local businesses without direct government assistance.

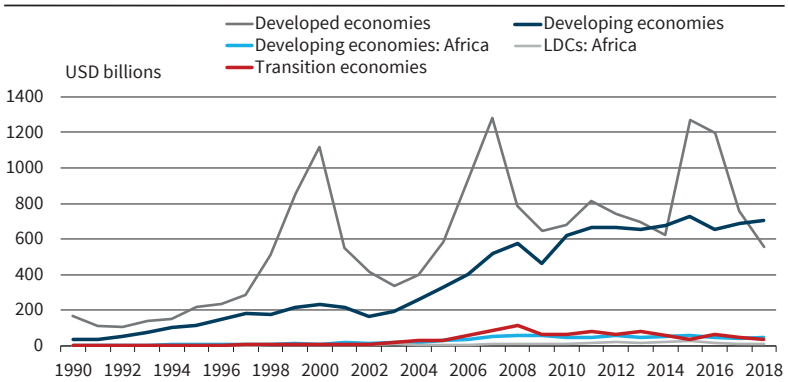
Figure 6 illustrates the development of inward FDI in different regions. The largest share of FDI flows goes into industrialized countries, where it has fluctuated with the economic situation since the 1990s. A general upward trend can be observed in developing countries. Especially in Africa and LDCs, however, FDI flows remain stable at a modest level. In contrast to aid, the majority of FDI to developing countries does not appear to flow to Africa. According to Velde (2006), FDI has always been concentrated in a few developing countries. Part of this may be reflected by weak institutions (e.g., Busse and Hefeker 2007) and in the inability to create the necessary infrastructure and business environment that FDI needs (Velde 2006).[4]

Figure 5
Development Aid [a] by Sector and Means



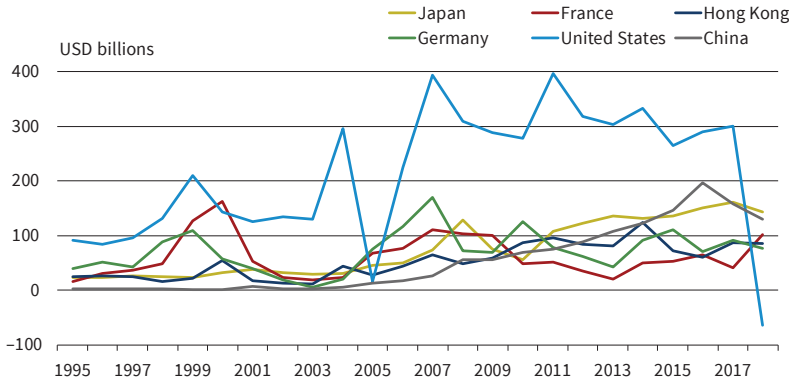
[a] Excluding aid flows that could not be allocated to a specific sector or purpose.
Source: OECD Statistics (2020). © ifo Institute

Figure 6
FDI Inflows in Developed, Developing and Transition Economies



Source: UNCTAD Stat (2020). © ifo Institute

Figure 7
Outward FDI over Time

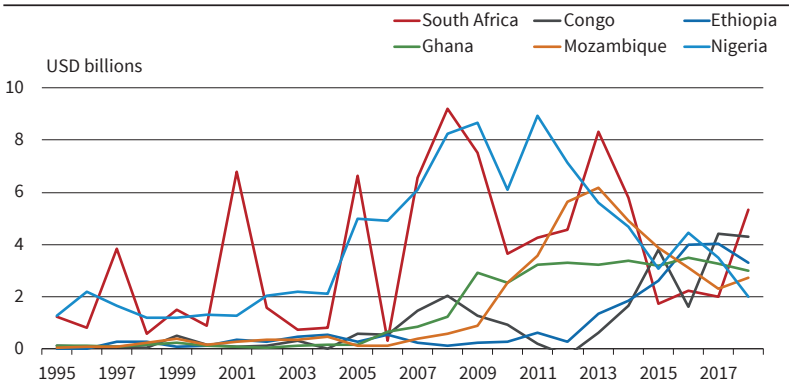


Source: UNCTAD Stat (2020). © ifo Institute

Figure 7 shows the world's largest sources of FDI in 2018. The US, usually the main investor in FDI, has negative FDI outflows in 2018 due to a tax reform and repatriations by US multinationals. Given their strong post-colonial ties, France and Germany are traditio-

[4] Gossel (2018) outlines the discussion on the relationship between FDI, corruption, and democracy and points to three different conclusions: corruption attracts FDI, corruption deters FDI, and FDI is attracted to less corrupt but less democratic countries.

Figure 8
FDI to Sub-Saharan Africa: Selected by Largest FDI Inflows in 2018



Source: UNCTAD Stat (2020). © ifo Institute

nally among the largest foreign investors in the world and in Africa. Other important FDI investors in recent decades have included Japan, Hong Kong, and China. China's FDI increased substantially – more than 50 percent – between 2013 and 2017 (UNCTAD 2019).

Despite strong fluctuation, South Africa is one of the most significant recipients of FDI (see Figure 8). In the 2000s, Nigeria also received significant investments. The country is trying to reduce its dependence on oil and integrate itself into global value chains by expanding its manufacturing sector. Changes at the country level included the merging of trade, industry, and investment, reflecting Nigeria's intention to effectively coordinate these key sectors and improve its trade and investment environment (Lloyds Bank 2020).

Inward foreign direct investment in Mozambique peaked in 2013, then dropped and increased again from USD 2.3 billion in 2017 to USD 2.7 billion in 2018 (see Figure 8). Investments of multinationals had only a limited positive impact on overall employment and poverty levels because FDI was mostly invested in sectors in which the majority of the population is not active (Orre and Rønning 2017). Instead, most of the investments went into existing projects for gas exploration and production and intra-company transfers, such as loans from parent companies to subsidiaries already located in the country (UNCTAD, 2019). In general, Mozambique, which is abundant in natural resources, is characterized by fragile political institutions, high levels of corruption, a lack of private property rights on land, and a low quality of public services (Orre and Rønning 2017). These are all factors that hinder foreign investments and the beneficial allocation of such investments in the country's economy.

Despite various attempts by some African countries to diversify economic growth away from natural resources, FDI for new projects still flows largely into extractive industries and construction (see Table 1). However, there are examples of FDI flowing into other sectors. In Sudan, for example, where FDI grew by 7 percent in 2018, small investments were made into innovative sectors, for example in a car-sharing agency in the capital city with plans to expand in the coming years. However, also in Sudan, the bulk of investment continues to go into oil and gas exploration and agriculture (UNCTAD 2019).

THE ROLE OF FDI FOR DEVELOPMENT

FDI can boost growth, competition, and productivity, and has the potential to contribute to Africa's integration into the world economy. Moreover, spillover effects can provide local workers and companies with technology and knowledge, making private sector investment an attractive component of future cooperation between European firms and firms in developing countries (World Bank 2014b). However, sustainable FDI demands free markets and liberal political systems, free of corruption.

In order for this to succeed, general and specific policies must be implemented to make FDI work for development and the right conditions must be created to enable "sustainable" investments. Policies should strengthen local human capital and technological skills (Velde 2006). Moreover, cooperation must take place on an equal footing and move away from the mere extraction of raw materials toward more productive investment (Velde 2006).

Europe and Africa should therefore work closely together to develop a comprehensive framework for foreign direct investment that benefits both home and host countries (World Bank 2014b). To this end, both partners should be autonomous and recipient

Table 1
Five Largest Announced Greenfield FDI Projects in 2018 in African LDCs

Host economy	Industry segment	Home economy	Estimated capital expenditure (USD million)
Ethiopia	Petroleum refineries	US	4,000
Angola	Oil and gas extraction	Italy	2,236
Mozambique	Natural, liquefied, and compressed gas	US	1,400
Malawi	Commercial and institutional building construction	China	668
Zambia	Industrial building construction	Egypt	668

Source: UNCTAD (2019).

countries should be involved in the decisions concerning how FDI is used and into which sectors it flows. In addition, the local population should be included and bottom-up approaches facilitated. Development aid could support the development of regulations and institutions that encourage private sector entrepreneurship and investment, e.g., how easy it is to set up a business, obtain loans, etc.

Regardless of the type of capital flow, flows should be context-specific, involve the destination country, and empower the local population. This can have a positive feedback effect on the political structure and institutional layout. Strengthening the capabilities of the excluded class will automatically lead to a participatory approach and institutional design. This initiates a smooth process toward greater accountability in the political structures, which may be more realistic than promoting a direct regime change (Brett 2016).

SUMMARY

We have looked at recent trends in development aid and private-sector investment, more specifically FDI. While aid flows have been stable but highly contested over the years, FDI in developing countries has increased many times over in recent years, albeit more hesitantly in the least developed countries in Africa. While aid in Africa flows predominantly into health and education, the focus of FDI remains on the extractive sector. Its extension to other sectors has the potential to take the cooperation between African and European countries to a new level, with countries on both continents becoming equal partners. Sustainable FDI requires strong institutions, liberal markets, and the strengthening of local communities; these are key factors for a favorable business climate and fundamental to the development of sustainable strategies for future cooperation, investment, and economic development. Perhaps aid can help create the conditions that FDI needs.

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World Economic Outlook for 2020 and 2021

ABSTRACT

The Covid-19 pandemic has now led to a severe economic crisis worldwide. This article briefly presents the IMF's first growth forecasts for 2020 and 2021, as well as the economic policy measures that should be urgently implemented to support the recovery.

The coronavirus crisis is creating serious consequences for economic activity worldwide. A large number of countries are currently confronted with a complex crisis, which includes a health shock, disruption of the domestic economy, a slump in foreign demand, capital flow reversals, and a collapse in commodity prices. According to the latest IMF World Economic Outlook,[1] global output is estimated to have grown by 2.9% in 2019, but is projected to sharply decline

* ifo Institute.

[1] *IMF World Economic Outlook Update June 2020,* https://www.imf.org/en/Publications/WEO/Issues/2020/06/24/WEOUpdateJune2020.

Table 1

Overview of World Economic Outlook Projections (%)

	2018	2019	2020[a]	2021[a]
World output	3.6	2.9	– 4.9	5.4
Advanced economies	2.2	1.7	– 8.0	4.8
US	2.9	2.3	– 8.0	4.5
Euro area	1.9	1.3	– 10.2	6.0
Germany	1.5	0.6	– 7.8	5.4
France	1.7	1.5	– 12.5	7.3
Italy	0.8	0.3	– 12.8	6.3
Spain	2.4	2.0	– 12.8	6.3
Japan	0.3	0.7	– 5.8	2.4
UK	1.3	1.4	– 10.2	6.3
Canada	2.0	1.7	– 8.4	4.9
Other advanced economies	2.6	1.7	– 4.8	4.2
Emerging market and developing economies	4.5	3.7	– 3.0	5.9
Emerging and developing Asia	6.3	5.5	– 0.8	7.4
China	6.7	6.1	1.0	8.2
India	6.1	4.2	– 4.5	6.0
ASEAN5[b]	5.3	4.9	– 2.0.	6.2
Emerging and developing Europe	3.2	2.1	– 5.8	4.3
Russia	2.5	1.3	– 6.6	4.1
Latin America and the Caribbean	1.1	0.1	– 9.4	3.7
Brazil	1.3	1.1	– 9.1	3.6
Mexico	2.1	– 0.3	– 10.5	3.3
Middle East and Central Asia	1.8	1.0	– 4.7	3.3
Saudi Arabia	2.4	0.3	– 6.8	3.1
Sub-Saharan Africa	3.3	3.1	– 3.2	3.4
Nigeria	1.9	2.2	– 5.4	2.6
South Africa	0.8	0.2	– 8.0	3.5

Note: [a] Projections. [b] Excludes the Group of Seven (Canada, France, Germany, Italy, Japan, United Kingdom, United States) and euro area countries. [c] Indonesia, Malaysia, Philippines, Thailand, and Vietnam.

Source: IMF.

by 4.9% in 2020, much worse than during the 2008–09 financial crisis.[2] It is highly uncertain, but under the rather cautious assumption that the Covid-19 pandemic will die down in the second half of 2020 and containment measures can be gradually relaxed, the global economy is forecast to grow by 5.4% in 2021, when economic activity can be normalized with political support (Table 1).

Growth in the group of advanced economies is anticipated to be − 8.0% in 2020. Most economies in this group are expected to contract this year, including the United States (− 8.0%), Japan (− 5.8%), the UK (− 10.2%), Germany (− 7.8%), France (− 12.5%), Italy (− 12.8%), and Spain (− 12.8%). Overall, in the group of emerging and developing countries, economies are expected to shrink by 3.0% in 2020: yet without China, the growth rate for the same group appears to reach − 5,8%. Other regions are also expected to experience a sharp slowdown or serious contraction in economic activity: Latin America (− 9.4%), emerging and developing Europe (− 5.8%), the Middle East and Central Asia (− 4.7%), and Sub-Saharan Africa (− 3.2%).[3]

The IMF argues that effective policies are urgently necessary to prevent the possibility of worse outcomes, and also that the measures required to reduce further infection and protect life should be seen an important investment in long-term human and economic health. As the negative economic impact is acute in many sectors (incl. not only key industries but also SMEs in general, retail, tourism, transportation, etc.) policymakers need to take targeted fiscal, monetary, and financial market measures to support affected households and businesses in their own country. And internationally, close and synchronized multilateral cooperation is essential for better overcoming the impact of the pandemic, including to help financially constrained countries facing "twin" health and financial shocks and to channel aid to countries with weak healthcare systems.

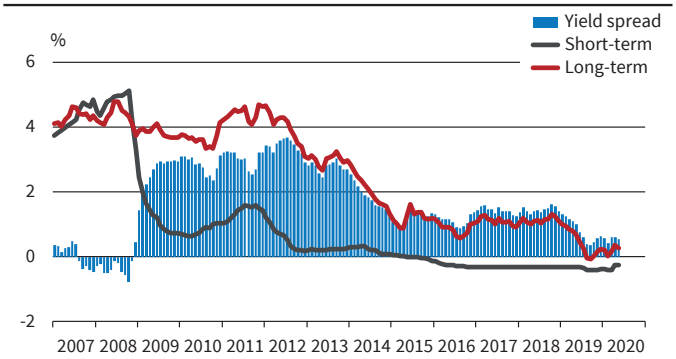
[2] In 2009 the growth rate of world output amounted to − 0.7% (see https://www.imf.org/external/pubs/ft/weo/2011/02/weodata/index.aspx).

[3] Following the dramatic decline in oil prices since the beginning of the year, near-term prospects for oil-exporting countries in the Middle East and Central Asia have also deteriorated significantly.

Statistics Update

Financial Conditions in the Euro Area

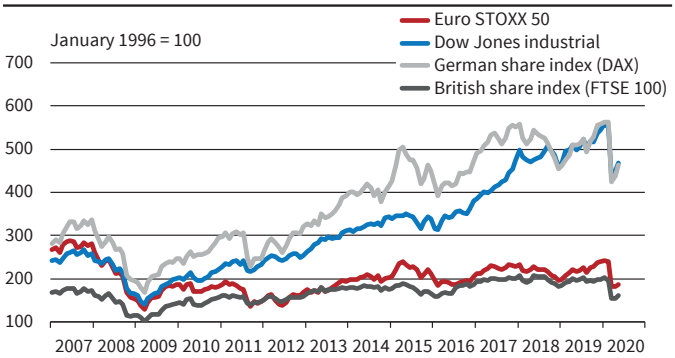
Nominal Interest Rates [a]



[a] Weighted average (GDP weights).
Source: European Central Bank; calculations by the ifo Institute. © ifo Institute

In the three-month period from March 2020 to May 2020 short-term interest rates increased: the three-month EURIBOR rate amounted to – 0.27% in May 2020 compared to – 0.42 in March 2020. The ten-year bond yields also increased from 0.18% in March 2020 to 0.27% in May 2020, while the yield spread decreased from 0.60% to 0.54% between March 2020 and May 2020.

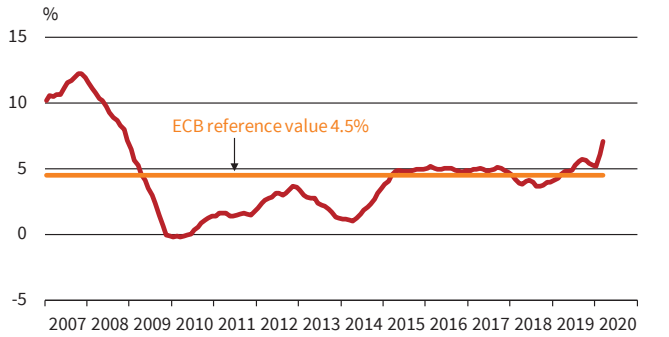
Stock Market Indices



Source: Deutsche Börse; Dow Jones; FTSE; STOXX. © ifo Institute

The global fears about the spread of the Coronavirus, oil price drops caused by an oil price war between Russia and the OPEC countries, and the possibility of a recession led to the stock market crash in March 2020, and global stocks saw a severe downturn in this month. Yet the German stock index DAX started to increase in May 2020, averaging 10,987 points compared to 10,034 points in March 2020, while the UK FTSE-100 also increased from 5,741 to 5,956 in the same period of time. The Euro STOXX amounted to 2,909 in May, up from 2,824 in March 2020. The Dow Jones Industrial also increased, averaging 24,280 points in May 2020, compared to 22,637 points in March 2020.

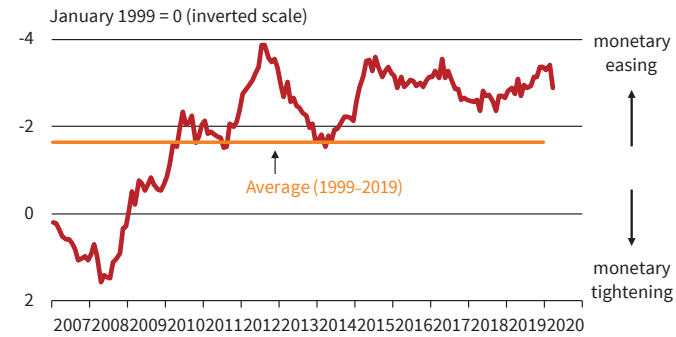
Change in M3 [a]



[a] Annual percentage change (3-month moving average).
Source: European Central Bank. © ifo Institute

The annual growth rate of M3 increased to 8.3% in April 2020, from 7.5% in March 2020. The three-month average of the annual growth rate of M3 over the period from February 2020 to April 2020 reached 7.1%.

Monetary Conditions Index

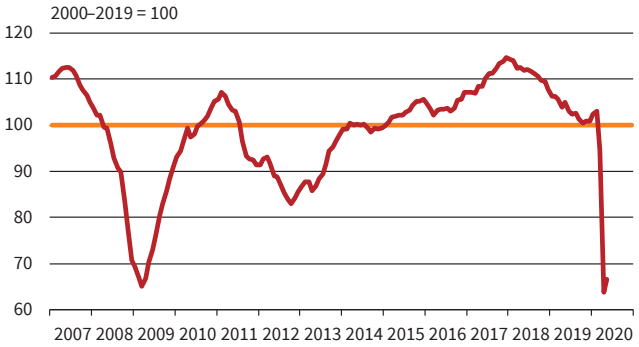


Source: European Commission. © ifo Institute

Between April 2010 and July 2011, the monetary conditions index had remained stable. Its rapid upward trend since August 2011 had led to the first peak in July 2012, signaling greater monetary easing. In particular, this was the result of decreasing real short-term interest rates. In May 2017 the index had reached the highest level in the investigated period since 2004 and its slow downward trend was observed thereafter. Since October 2018 a continuous upward development prevailed, yet this trend was abruptly stopped in March 2020 as the Covid-19 crisis started.

EU Survey Results

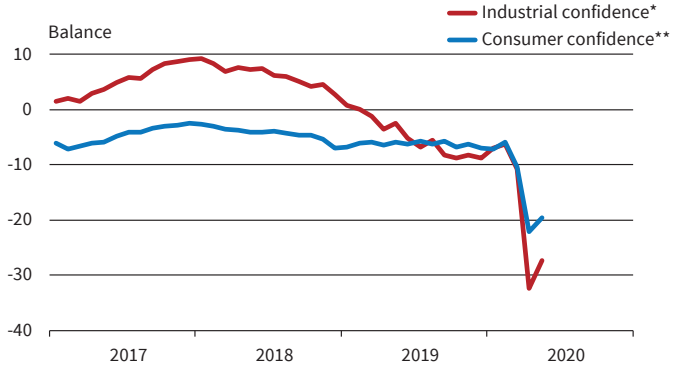
EU27 Economic Sentiment Indicator
Seasonally adjusted



Source: European Commission. © ifo Institute

In May 2020 the Economic Sentiment Indicator (ESI) showed first signs of recovery after the record slumps of March and April caused by the global Covid-19 shock: it increased in both the euro area (by 2.6 points to 67.5), and the EU27 (by 2.9 points to 66.7).

EU27 Industrial and Consumer Confidence Indicators
Percentage balance, seasonally adjusted

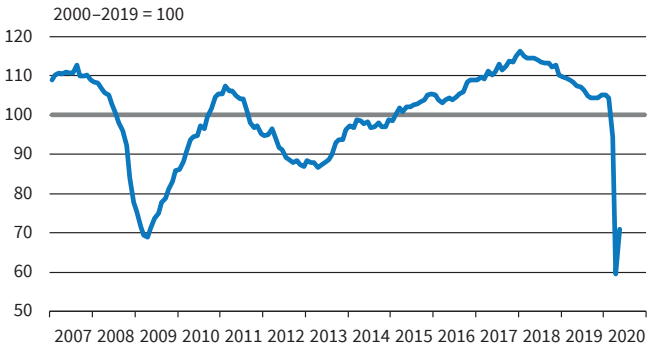


Source: European Commision. © ifo Institute

* The industrial confidence indicator is an average of responses (balances) to the questions on production expectations, order-books and stocks (the latter with inverted sign).
** New consumer confidence indicators, calculated as an arithmetic average of the following questions: financial and general economic situation (over the next 12 months), unemployment expectations (over the next 12 months) and savings (over the next 12 months). Seasonally adjusted data.

In May 2020, the *industrial confidence indicator* increased by 5.0 in both the EU27 and the euro area (EA19). The consumer confidence indicator also increased by 2.5 in the EU27 and by 3.2 in the EA19 in May 2020.

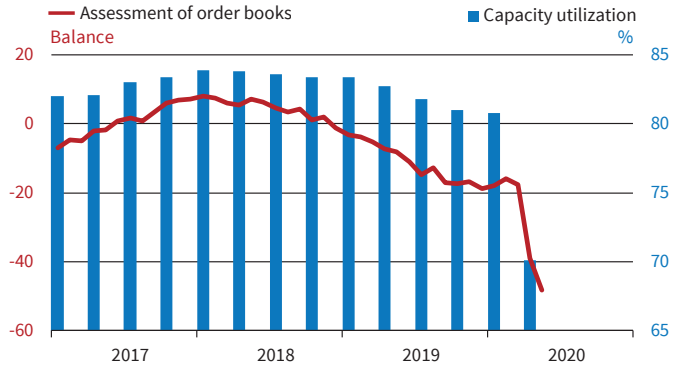
EU27 Employment Expectations Indicator
Seasonally adjusted



Source: European Commission. © ifo Institute

In May 2020 the Employment Expectations Indicator (EEI) led the way, bouncing back by 11.3 points in both areas to levels of 70.2 points in the EA19 and 70.9 points in the EU27.

EU27 Capacity Utilisation and Order Books in the Manufacturing Industry
Seasonally adjusted

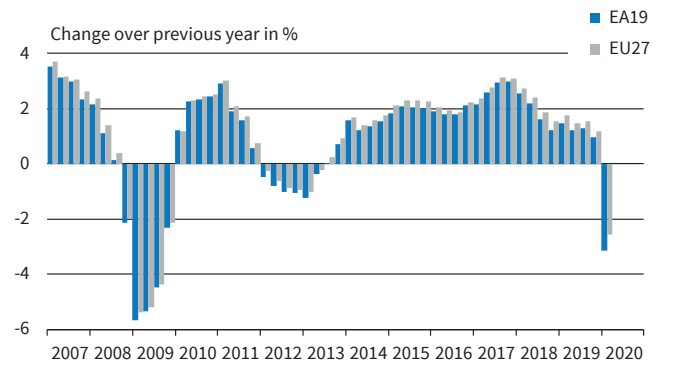


Source: European Commission. © ifo Institute

Managers' assessment of *order books* reached – 48.2 in May 2020, compared to – 39.1 in April 2020. In March 2020 the indicator had amounted to – 17.6. *Capacity utilization* stood at 70.1 in the second quarter of 2020, strongly down from 80.8 in the first quarter of 2020, again showing the severe effects of Covid-19 pandemic.

Euro Area Indicators

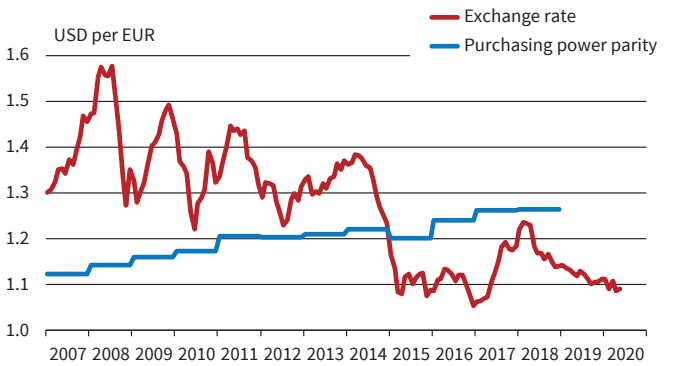
Gross Domestic Product in Constant 2015 Prices



Source: Eurostat. © ifo Institute

According to the Eurostat estimates, GDP decreased by 3.6% in the euro area (EA19), and by 3.2% in the EU27 during the first quarter of 2020, compared to the previous quarter. These were the sharpest declines observed since 1995. In the fourth quarter of 2019 GDP had grown by 0.1% in both the EA19 and the EU27. Compared to the first quarter of 2019, i.e., year over year, seasonally adjusted GDP decreased by 3.1% in the EA19 and by 2.6% in the EU27 in the first quarter of 2020.

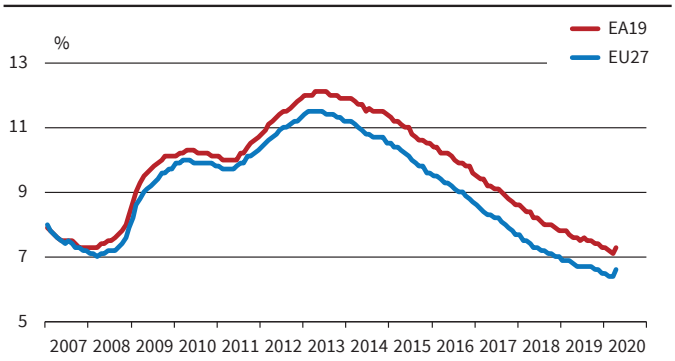
Exchange Rate of the Euro and Purchasing Power Parity



Source: European Central Bank; OECD; calculations by the ifo Institute. © ifo Institute

The exchange rate of the euro against the US dollar averaged approximately 1.09 $/€ between March 2020 and May 2020. (In February 2020 the rate had also amounted to around 1.09 $/€.)

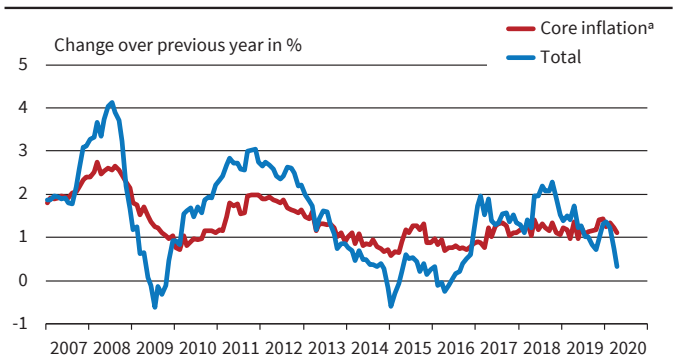
Unemployment Rate



Source: Eurostat. © ifo Institute

Euro area unemployment (seasonally adjusted) amounted to 7.3% in April 2020, up from 7.1% in March 2020. EU27 unemployment rate was 6.6% in April 2020, again up from 6.4% in March 2020. In April 2020 the lowest unemployment rate was recorded in Czechia (2.1%), Poland (2.9%), and the Netherlands (3.4%), while the rate was highest in Greece (16.1%), and Spain (14.8%).

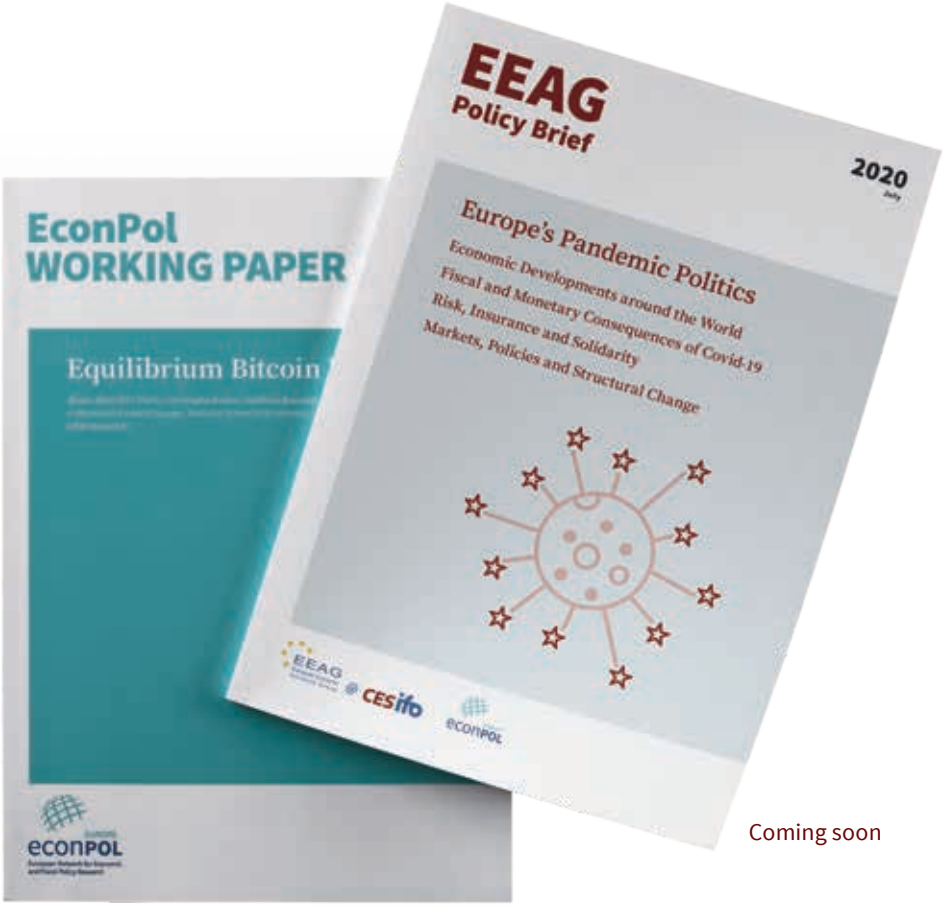
Euro Area Inflation Rate (HICP)



[a] Total excl. energy and unprocessed food.
Source: Eurostat. © ifo Institute

Euro area annual inflation (HICP) amounted to 0.1% in May 2020, down from 0.3% in April 2020. Year-on-year EA19 core inflation (excluding energy and unprocessed foods) also went down to 1.1% in April 2020, from 1.2% in March 2020.

ALSO AVAILABLE ONLINE:



Coming soon

EconPol Working Paper 48

Equilibrium Bitcoin Pricing

This EconPol Working Paper offers an equilibrium model of cryptocurrency pricing and confronts it to new data on bitcoin transactional benefits and costs. The model emphasises that the fundamental value of the cryptocurrency is the stream of net transactional benefits it will provide, which depend on its future prices. The link between future and present prices implies that returns can exhibit large volatility, unrelated to fundamentals. We construct an index measuring the ease with which bitcoins can be used to purchase goods and services, and we also measure costs incurred by bitcoin owners. Consistent with the model, estimated transactional net benefits explain a statistically signicant fraction of bitcoin returns.

EEAG Policy Brief July 2020

Europe's Pandemic Politics

The corona pandemic has created a health and economic crisis without modern parallel. As it hit affected countries ill-prepared and spread quickly within the EU, member states had to adopt more interventionist approaches than ever before – particularly in the areas of fiscal and monetary policy, labor markets and redistribution, and industrial policy. Member States started controversial discussions on how to support those who have been hit particularly hard. This debate has become a litmus test for solidarity in the world's richest bloc of nations. This EEAG policy brief examines how Europe can react to the crisis effectively and how political measures should evolve if the pandemic subsides.