CHAPTER 1

Can Africa Claim the 21st Century?

Africa's diverse economies reveal opportunities—and challenges

SUB-SAHARAN AFRICA (AFRICA) ENTERED THE 20TH CENTURY a poor, mostly colonialized region. As it enters the 21st, a lot has changed. Education has spread, and life expectancy has increased. Many countries have seen gains in civil liberties and political participation. Since the mid-1990s there have been signs that better economic management has started to pay off in many countries, with rising incomes and exports and, in some cases, decreases in severe poverty. Even as part of the region is making headlines with crises and conflicts, other countries are making headway with steady growth, rising investment, increasing exports, and growing private activity. Africa's countries are diverse in many ways, including history and culture, incomes, natural endowments, and human resources. And in considering Africa's potential, it is worth remembering that the region contains Botswana, one of the world's fastest-growing economies in recent decades.

The Challenge of African Development

STILL, AFRICA FACES ENORMOUS DEVELOPMENT CHALLENGES. Excluding South Africa, the region's average income per capita averaged just $315 in 1997 when converted at market exchange rates (table 1.1). When expressed in terms of purchasing power parity (PPP)—which takes into account the higher costs and prices in Africa—real income averaged one-third less than in South Asia, making Africa the poorest region in the world. The region's total income is not much more than Belgium's, and is divided among 48 countries with median GDP of just over $2 billion—about the output of a town of 60,000 in a rich country.

Unlike other developing regions, Africa's average output per capita in constant prices was lower at the end of the 1990s than 30 years before—and in some countries had fallen by more than 50 percent (figure 1.1). In real terms fiscal resources per capita were smaller for many countries than in the late 1960s. Africa's share of world trade has plummeted since the 1960s: it now accounts for less than 2 percent of world trade. Three decades ago, African countries were specialized in primary products and highly trade dependent. But Africa missed out on industrial expansion and now risks being excluded from the global information revolution. In contrast to other regions that have diversified, most countries in Africa are still

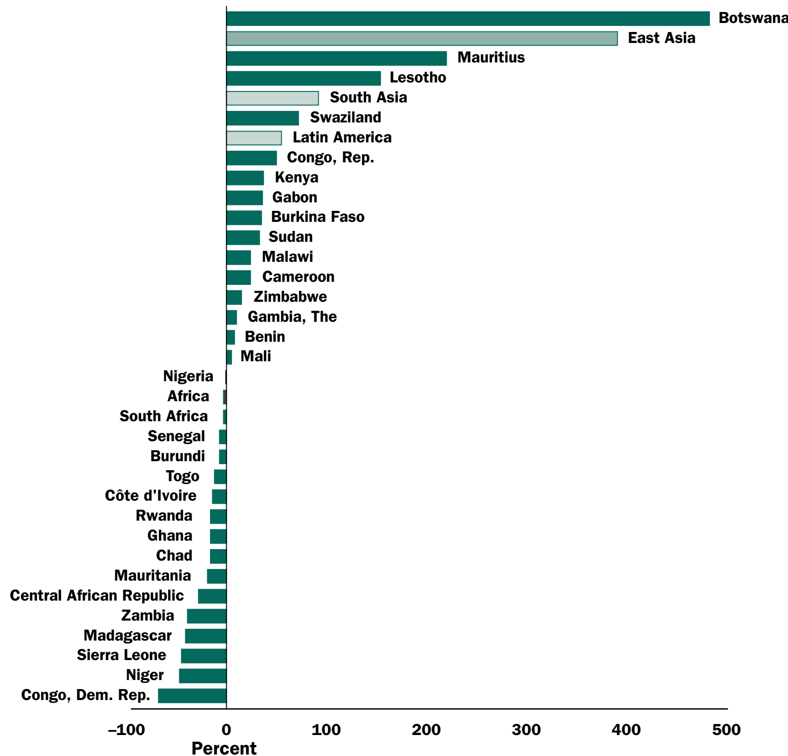
Africa's share of world trade has plummeted since the 1960s

Table 1.1 Population, Income, and Economic Indicators by Region

Indicator	*Africa excluding South Africa*	*Africa*	*South Asia*	*East Asia*	*Latin America*
Population					
Population (millions), 1997	575	612	1,281	1,751	494
Population growth (percent), 1997	2.9	2.9	1.8	1.2	1.6
Dependency ratio (workers age 15–64 per dependent)	1.1	1.1	1.4	2.0	1.7
Urban population share (percent), 1997	31.1	31.7	26.6	32.2	73.7
Urban population growth (percent), 1997	5.2	4.9	3.3	3.7	2.2
Income					
GNP per capita (dollars, at market exchange rates), 1997	315	510	380	970	3,940
PPP GNP per capita, 1997	1,045	1,460	1,590	3,170	6,730
Gini index, latest year available	45.9	46.5	31.2	40.6	51.0
Economy					
GDP per capita, 1970[a]	525	546	239	157	1,216
GDP per capita, 1997[a]	336	525	449	715	1,890
Investment per capita, 1970[a]	80	130	48	37	367
Investment per capita, 1997[a]	73	92	105	252	504
Exports per capita, 1970[a]	105	175	14	23	209
Exports per capita, 1997[a]	105	163	51	199	601
Savings/GDP (percent), 1970	18.1	20.7	17.2	22.3	27.1
Savings/GDP (percent), 1997	16.3	16.6	20.0	37.5	24.0
Exports/GDP (percent), 1970	36.4	32.1	5.9	14.6	17.2
Exports/GDP (percent), 1997	33.0	31.0	11.4	27.8	31.8
Genuine domestic savings/GDP (percent), 1997	2.8	3.4	7.1	29.7	12.1
Incremental output-capital ratio (percent), 1970–97	12	10	23	23	14

Note: PPP stands for purchasing power parity.
a. 1987 dollars.
Source: World Bank data.

Figure 1.1 Change in GDP Per Capita, 1970–97



Note: Measured in constant local currency. Regional estimates are weighted by population.
Source: World Bank data.

A few countries have gained, but many have lost

largely primary exporters. They are also aid dependent and deeply indebted. Net transfers from foreign assistance average 9 percent of GDP for a typical poor country—equivalent to almost half of public spending and far higher than for typical countries in other regions. By the end of 1997 foreign debt represented a burden of more than 80 percent of GDP in net present value terms.

Africa is the only major region to see investment and savings per capita decline after 1970. Averaging about 13 percent of GDP in the 1990s, the savings rate of the typical African country has been the lowest in the world. Rapid population growth and environmental degradation compound the low savings. Estimates of genuine domestic savings (Hamilton and Clemens 1999), which capture the effects of resource depletion, are just 3 percent for Africa (see table 1.1). This is far below the genuine savings rates for other regions, though they too suffer from severe environ-

mental degradation and resource overuse. And it is far below what is needed to sustain a major long-term boost in economic performance.

Africa's development challenges go deeper than low income, falling trade shares, low savings, and slow growth. They also include high inequality, uneven access to resources, social exclusion, and insecurity. Income inequality is as high as in Latin America, making Africa's poor the poorest of the poor. More than 40 percent of its 600 million people live below the internationally recognized poverty line of $1 a day, with incomes averaging just $0.65 a day in purchasing power parity terms. The number of poor people has grown relentlessly, causing Africa's share of the world's absolute poor to increase from 25 to 30 percent in the 1990s.

Because of high income inequality, Africa's poor are the poorest of the world's poor

Many people lack the capabilities—including health status, education, and access to basic infrastructure—needed to benefit from and contribute to economic growth. Health and life expectancy indicators are adverse, even taking into account low incomes: in many countries 200 of every 1,000 children die before the age of 5. Large parts of the population are locked in a dynastic form of poverty, progressively less able to escape because children lack the basic capabilities to participate in a productive economy—and so to contribute to growth. Despite recent gains, more than 250 million of Africa's people lack access to safe water. More than 200 million have no access to health services. In the only region where nutrition has not been improving, more than 2 million children a year die before their first birthday. More than 140 million youth are illiterate, and less than one-quarter of poor, rural females attend primary school. Disparities in social spending between poor African countries and rich industrial countries are massive. Education spending in poor African countries averages less than $50 a year—compared with more than $11,000 in France and the United States. Many Africans are excluded from basic services—and from the power to influence the allocation of resources.

Malaria typifies the tendency of many formerly global problems of basic development to have become mainly African. At the turn of the 20th century, Africa saw 223 deaths a year from malaria per 100,000 people, only slightly more than other developing regions. By 1970 the rate had fallen to 107 in Africa, compared with only 7 in other regions. But while the decline has continued elsewhere, the death rate has soared again in Africa to 165 per 100,000. Social upheaval and civil wars, a breakdown of health services in many countries, and growing resistance to antimalarial drugs are to blame (*The Washington Post*, 20 October 1999).

Then there is the HIV/AIDS pandemic. With 70 percent of the world's cases in Africa, AIDS has already had an enormous impact on life expectancy in the countries most affected. It is projected to reduce life expectancy by up to 20 years from today's modest levels—more than erasing the gains since the 1950s. AIDS orphans already make up 11 percent of the population in the most afflicted countries. This could rise to more than 16 percent in the next 25 years, with disastrous implications for traditional social structures. The ultimate economic impact of AIDS, not yet fully known, promises to be devastating.

Without action, Africa's problems will only worsen

Unless action is taken, the scale of these problems will only increase. Population growth continues to be faster than in other regions, so primary school cohorts will continue to grow rather than shrink as in most parts of the world. For every potential worker between 15 and 64, Africa now has almost one dependent, almost all of them young (see table 1.1). Even with a progressive demographic transition, Africa's dependency rates will fall only gradually through the next century.

These aren't the only hurdles. The spread of conflict threatens economic and social progress. At least one African in five lives in a country severely disrupted by an ongoing war. Governance issues loom large in explaining the economic record of African countries. If present trends continue, few countries are likely to achieve the International Development Goals for 2015 endorsed by the international development community—goals covering poverty reduction, health, education, gender equality, and environmental preservation (OECD 1996). Indeed, economic performance will have to improve just to keep the number of absolute poor from increasing.

Africa Can Claim the Century—with Determined Leadership

In view of all this, what does "claiming the century" actually mean? Is it a credible objective for Africans—and for their children? Economists (and social scientists more broadly) are not known for their ability to predict short-term developments, let alone provide a vision of societies one hundred years into the future. A more modest approach would be to ask how, over the next few decades, Africa can reverse years of social and economic marginalization in an increasingly dynamic and competitive world, and so be well placed, after the early decades of the century, to take advantage of the rest.

As described below, simply preventing an increase in the number of absolute poor over the next 15 years will require annual growth rates in

excess of 5 percent, almost twice those of the dismal decades after 1973. And reaching the International Development Goal of halving the incidence of severe poverty by 2015 will require annual growth of 7 percent or more—and a better distribution of income. If Africa's terms of trade continue to deteriorate as they have for many countries since the late 1960s, the growth requirement for reducing poverty will be even higher.

Africa has enormous unexploited potential and hidden growth reserves

Is the goal of reducing poverty impossible? Not at all. Africa is not doomed by its poverty or its poor development record. In the 1960s and early 1970s many prominent economists considered Asian countries, with their vast, poverty-stricken populations and limited resources, to be caught in a low-level development trap. It was inconceivable in the early 1960s that the Republic of Korea would emerge as an industrial power. The passing of time has shown how wrong such views were. The performance of other regions, the findings of cross-country studies, and the achievements of a number of African countries suggest that reversing the increase in poverty is possible.

Trends in Africa will need to change radically for a catchup process to materialize. This will require determined leadership within Africa. It will require better governance—developing stable and representative constitutional arrangements, implementing the rule of law, managing resources transparently, and delivering services effectively to communities and firms. It will require greater investment in Africa's people, as well as measures that encourage private investment in infrastructure and production. It will not happen without an increase in investment and efficiency. And it will require better support—and perhaps more support—from the international development community.

In facing these challenges, Africa has enormous unexploited potential—in resource-based sectors and in processing and manufacturing. It also has hidden growth reserves in its people—including the potential of its women, who now provide more than half of the region's labor but lack equal access to education and factors of production. African economies can perform far better. The region has great scope for more effective use of its resources—public and private, financial and human—and much scope for improving the delivery of the essential services needed to upgrade the capabilities and health of its people and increase their opportunities.

Even with better prioritization, the range of urgent challenges will strain Africa's limited capacity to make and implement policies and to nurture strong institutions. But the sheer number of challenges is not insurmount-

able. Development processes are cumulative, with success in one area opening up opportunities in others. Like other developing regions, Africa can benefit from "virtuous circles" involving different aspects of development.

It will not be easy. Required is a major effort by Africans and their development partners to reverse the economic marginalization and exclusion of recent decades. That will take more than changing the allocation of resources. It will require greater economic empowerment and greater responsibility—a shift in the power of decisionmaking on allocating and managing resources so that excluded groups can take more responsibility and be held accountable for their use. Moreover, this deeper reform agenda will need to build on the democratization that has marked the region since the early 1990s—in a way that strengthens the formation of effective and representative states. Economic empowerment is critical for four groups:

Reform will need to build on the democratization that has marked the region since the early 1990s

- *Civil society.* For economic empowerment to keep pace with increased political participation, governments need to include civil society in ways that surmount the problems associated with Africa's highly multiethnic states. Instruments of accountability need to be institutionalized. This process—an essential part of the formation of states able to provide for sustainable development—is gathering momentum in some of the region's more advanced reformers.
- *The poor and the excluded.* Deep deprivation and systemic exclusion, including gender discrimination, require strategic and proactive remedies, often at the community level. If pervasive inequalities are not addressed—in incomes and in access to human development services and essential infrastructure—growth will not be sustainable and will not reduce poverty.
- *Producers.* Many African governments still have an uneasy relationship with business, which suffers under poor services and regulations that raise costs, contribute to perceptions of high risk, and discourage investment. An essential part of empowering civil society must be to involve producers—in agriculture and other sectors—to foster higher productivity and more effective competition in global markets. Without strong producers, it will be impossible to reverse past trends and shift from aid dependence to trade dependence.
- *Governments.* Building on the movement toward participatory government in the 1990s, African states need to be strengthened and given the power and accountability for development outcomes. This will

require a fundamental change from Africa's donors because Africa's governments are one of the excluded groups: with high aid dependence, in many countries development policy is seen as being the prerogative of donors rather than governments. Africa's interests also need to be articulated more effectively in global forums, especially those dealing with trade and investment.

The many positive examples of African development show how some countries are approaching common issues

Within Africa there has been increasing research, analysis, and rethinking on these issues. Consensus has emerged on the failures of past policies, though there is still debate on how best to move forward and a sense that the region still needs to find its place in the world economy. Africa has been experiencing its own Renaissance, in the true sense of a rebirth of thought on governance and development policies, particularly in the context of an increasingly globalized and competitive world. This is not surprising: some 70 percent of today's Africans were born after the end of colonialism, and that proportion is rising rapidly.

Donors have also been reevaluating their role, especially since the end of the Cold War reduced the imperative to fund loyal allies rather than support effective development states. Donors have entered the new century in the midst of a feverish debate on how to make aid more effective, including a watershed change in the Bretton Woods institutions—the World Bank and the International Monetary Fund, widely seen as the main external architects of Africa's economic policies.

This report selects a number of areas that seem important in answering the question of whether Africa can claim the 21st century. It brings together the implications of this recent body of work—particularly that emanating from Africa. It does not claim to be exhaustive. Nor does it attempt to lay out a blueprint for individual countries. But it draws on the many positive examples of African development to show how some countries are approaching common issues. African economies and subregions are diverse, and each will have to find its way to address the challenges of the 21st century.

How Fast Must Africa Grow to Reduce Poverty?

The International Development Goals for the 21st century—adopted by the global development community and endorsed by many developing country governments—set targets for poverty reduction, education, health, gender equality, and environmental sustainability for 2015

(OECD 1996). Here we concentrate on one goal: halving the incidence of absolute poverty, defined by the international poverty line of $1 a person per day, from current levels.

Growth is not sufficient for poverty reduction, but it is essential—no country has achieved a sustained improvement in the economic fortunes of its citizens without substantial, as well as broadly based, increases in income. Indeed, where growth has been sustained and has increased consumption, poverty in African countries has been reduced (chapter 3). How growth affects poverty also depends on how it is distributed. Especially with Africa's high income inequality, it is essential that growth be broadly based rather than narrow. But while cross-country evidence shows a wide range of variation between changes in income levels and distribution, it finds a neutral overall relationship between growth rates and inequality. So, income distribution is assumed here to be constant.

Growth is not sufficient for poverty reduction, but it is essential

The performance needed to halve the incidence of absolute poverty depends on the period in which it is to be achieved. Demery and Walton (1998) consider a period of 25 years, corresponding to the interval between the latest data available (for 1990) when the goals were formulated and 2015. This also produces a useful minimal criterion for Africa. The region's population is doubling every 25 years at current growth rates, so achieving this target would mean that the absolute number of absolute poor is neither increasing nor falling. To achieve this minimum goal, consumption per capita would need to rise by almost 2 percent a year. With a constant savings rate, GDP would need to grow by 4.7 percent a year. But savings rates are too low to sustain the investment needed for rapid growth. Adding in an increase in the savings rate of 10 percentage points spread over 25 years suggests a target GDP growth rate of 5 percent a year just to prevent an increase in the number of the poor. Only a few African countries, including Botswana, Mauritius, and Uganda, sustained such growth rates in the 1990s—and a recent evaluation suggests that few countries have the conditions and resources to sustain such growth in the long run (UNECA 1999).

But the growth hurdle to halving poverty by 2015 is now far higher because, on average, income and consumption levels did not rise in the 1990s. Including the projected increase in savings, the average GDP growth needed would be more than 7 percent a year. And if Africa's terms of trade continue to deteriorate, or if the savings provided by foreign assistance continue to fall, the growth requirement will be even greater.

Africa's growth goal is higher than those for other regions for several reasons. First, consumption per capita needs to rise rapidly because of low

Savings must increase while also allowing consumption to rise fast enough to reduce poverty

incomes, large numbers of poor people, and a very high poverty gap. Second, Africa's population growth rate is the highest in the world. Unlike other regions—particularly East Asia, where the ratio of working-age population to dependents has risen sharply to around two to one—Africa's dependency ratio has remained close to one (see table 1.1). There are signs that Africa is embarking on a demographic transition, and some projections foresee a considerable decline in the dependency ratio in the middle of the 21st century. But today sharply lower fertility rates are limited to a small group of middle-income countries with far better reproductive health care, far higher contraceptive prevalence, and far higher health spending than the rest of the region (table 1.2).

A third factor raising the growth hurdle for Africa is the need to increase savings while also allowing consumption to rise fast enough to reduce poverty. Higher savings and investment are not sufficient for growth—the productivity of investment, as captured by the long-run incremental output-capital ratio, needs to double to place Africa on the same trajectory as fast-growing regions (see table 1.1). Africa can call on some hidden reserves. Countries can grow for a period with moderate investment rates when recovering from extremely depressed conditions, such as those caused by extended conflict. And reversing Africa's massive capital flight—estimated at almost 40 percent of private savings in the early 1990s (table 1.3)—could boost domestic savings.

Even so, in the long run investment rates would need to be sustained at around 30 percent for an extended period if growth is to make a major dent in poverty. Both agriculture and industry are severely decap-

Table 1.2 Indicators of a Demographic Transition in Africa by Income Group

Indicator	*Lowest*	*Low*	*Middle*	*All*
Fertility (percent), 1990	6.5	6.1	4.4	6.1
Fertility (percent), 1995	6.2	5.3	3.3	5.7
Infant mortality (per 1,000 live births), 1990	108	87	59	97
Infant mortality (per 1,000 live births), 1995	101	80	55	90
Maternal mortality (per 100,000)	1,015	606	277	822
Contraceptive prevalence (percent)	8	20	62	17
Health spending per capita (dollars), 1990–96	7.25	22.73	162.59	30.80
Public	3.19	9.58	71.99	11.22
Private	4.06	13.15	90.60	19.58

Note: Lowest-income countries are less than $300 per capita. Low-income countries are $300–765 per capita. Middle-income countries are more than $765 per capita.

Source: World Bank data.

italized. Estimates place levels of capital per worker at half those in South Asia (see table 1.3). Degraded infrastructure has emerged as a critical barrier to growth as other impediments have been relaxed by reforms (chapter 5). With costs up to three times world levels, transport now poses a potent obstacle to internal and external economic integration. Africa's economy is unusually sparse, with GDP per hectare one-sixth or less its value in other regions, so high transport costs are partly the result of geography. But in contrast to global transport costs, which have fallen continuously with deregulation and new technology, costs in Africa have risen because of poor road maintenance, regulatory barriers to competition, and, in some cases, long delays, heavy transit dues, and high taxes on vehicles and fuels. Power is another infrastructure barrier in countries that sustain growth, such as Uganda. Firms' investments in generators can consume more than one-third of their capital formation (Reinikka and Svensson 1998). Inadequate yet costly

Degraded infrastructure has emerged as a critical barrier to growth

Table 1.3 Human, Natural, and Physical Capital Indicators by Region

Indicator	*Africa excluding South Africa*	*Africa*	*South Asia*	*East Asia*	*Latin America*
Human capital					
Human development index, 1995	39.8	40.5	48.2	63.9	76.8
Life expectancy at birth (years), 1980	47.0	47.6	53.8	64.5	64.8
Life expectancy at birth (years), 1997	51.3	52.4	62.5	68.4	69.7
Infant mortality (per 1,000 live births), 1980	119.0	115.3	119.8	56.0	59.5
Infant mortality (per 1,000 live births), 1997	92.9	89.9	70.5	37.8	31.8
Under-5 mortality (per 1,000), 1995	—	157	116	53	47
Adult illiteracy (percent), 1980	57	57	58	30	18
Adult illiteracy (percent), 1997	46	43	51	17	13
Mean years of schooling , 1960	1.5	1.5	1.5	3.4	3.4
Mean years of schooling, 1990	2.4	2.4	3.4	6.2	5.2
Access to safe water (percent), 1996	45	47	81	77	75
Natural capital					
Land area per capita (hectares), 1970	8.03	7.85	0.67	1.42	7.09
Land area per capita (hectares), 1997	3.89	3.85	0.37	0.91	4.06
GDP per hectare (1987 dollars), 1970	65	70	357	111	172
GDP per hectare (1987 dollars), 1997	86	136	1,214	786	466
Average annual deforestation (percent), 1990–95	0.7	0.7	0.2	0.8	0.6
Physical capital					
Private capital stock per worker (dollars), 1990	1,069	—	2,425	9,711	17,424
Capital flight/private wealth (percent), 1990	39	—	3	6	10

Source: World Bank data; UNDP 1998; Wood and Mayer 1998; Collier and Gunning 1999.

telecommunications impede participation in the burgeoning information economy. The additional infrastructure investments needed to sustain rapid GDP growth have been estimated at about 5 percent of GDP over 10 years.

Especially for the poorest countries, there needs to be an emphasis on removing regulatory and other barriers to productive activity

The growth target differs for countries depending on their initial conditions. For the poorest African countries, consumption per capita will need to rise faster to halve the incidence of poverty. These countries also have faster population growth and lower savings. With 60–80 percent of their people below the $1 a day mark, there is also less direct mileage from redistributive policies. Especially for the poorest countries, there needs to be an emphasis on removing regulatory and other barriers (including gender-based barriers) to productive activity (World Bank 1998c; Blackden and Bhanu 1999). Richer countries have more scope for addressing poverty with redistributive policies, including trade and fiscal reforms.

Africa's Growth Crisis: A Retrospective

AT THE START OF THE 19TH CENTURY, AFRICA'S INCOME LEVEL stood at roughly one-third of Europe's. There then followed a long period of falling behind as industrialization, technology, and trade accelerated in the world's major centers (Maddison, cited in Bloom and Sachs 1998). African growth may have approximated that in Europe in the first half of the 20th century, and many countries performed well until the oil shock in 1973. But thereafter, Africa again fell behind, with most countries experiencing a steep economic decline that ended only with the recovery of the late 1990s.

Expectations and Outcomes

Africa's decline was not expected. During the decade that followed the independence of most African countries, Gunnar Myrdal wrote the three celebrated volumes of *Asian Drama.* This major work saw Asia, with its vast population and limited land resources, as doomed to stagnation. Meanwhile, Africa was poised to grow steadily along a path of relative prosperity. Indeed, in the 1960s many African countries were richer than their Asian counterparts, and their strong natural resource bases augured well for future trade, growth, and development.

In 1965, for example, incomes and exports per capita were higher in Ghana than in Korea. But projections proved to be far off the mark. Korea's exports per capita overtook Ghana's in 1972, and its income level surpassed Ghana's four years later. Between 1965 and 1995 Korea's exports increased by 400 times in current dollars. Meanwhile, Ghana's increased only by 4 times, and real earnings per capita fell to a fraction of their earlier value. The parallels are considerable between Africa today and Asia in the 1960s. Africa's economic and social indicators in 1995 were not much different from those of Korea in 1960 or Indonesia, Malaysia, and Thailand in 1975—although savings and school enrolment rates were somewhat lower (UNCTAD 1998). Many see Africa today as caught in a low-equilibrium development trap, just as Asia was viewed in the 1960s. Asia's experience shows that Africa's problems in accelerating development can be overcome. But why have African growth and development been so slow?

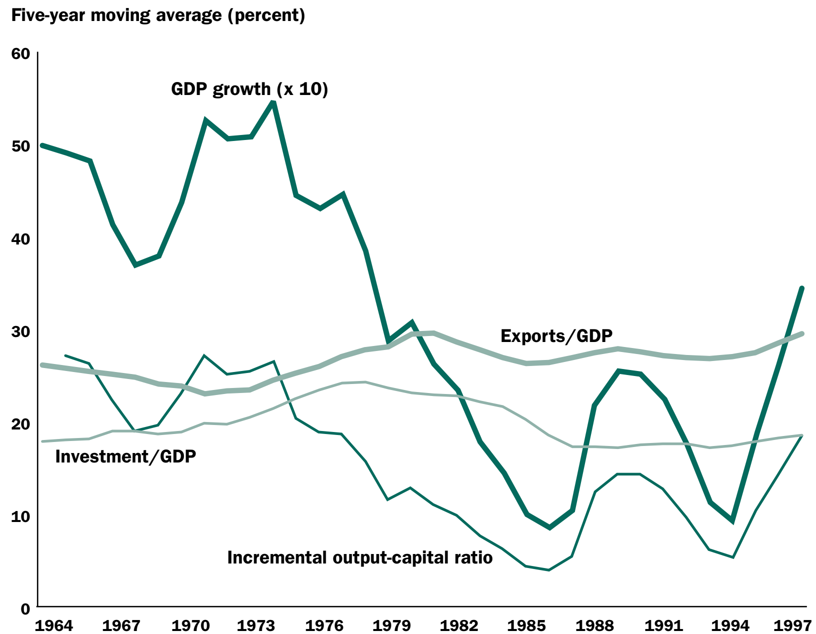
Asia's experience shows that Africa's challenges in accelerating development can be overcome

From Trade Dependence to Aid Dependence

Has Africa's low growth been due to a shortage of resources or to their ineffective use? Both. African investment rates, at about 18 percent of GDP, have been only slightly lower than those in East Asia and Latin America (22 percent). But when investment is measured in international prices that allow for Africa's higher costs, investment rates are a third lower in Africa than in other regions (Hoeffler 1999). Part of the reason for slow growth, then, is the fact that investment tends to be more costly in Africa than in other regions. For example, trucks in Southern and East Africa cost about twice as much as in Asia. These higher costs reflect outside factors as well as taxes and other policies.

But productivity differences also loom large in accounting for Africa's slow growth. Africa's investment productivity, as measured by the incremental output-capital ratio, was only half that in Asia in 1970–97 (see table 1.1). The deceleration of growth after 1973 from about 5 percent to barely 1 percent parallels the decline in investment productivity from 25 percent to 5 percent, even while investment levels in the earlier part of this period were at their highest (figure 1.2). As the return to borrowed funds fell short of the cost of borrowing, this phase saw a major increase in development assistance and a rise in external indebtedness. The growth recovery since 1994 has relied on productivity gains rather than an increase in investment.

Figure 1.2 Growth, Exports, Investment, and Investment Productivity in Africa, 1964–97

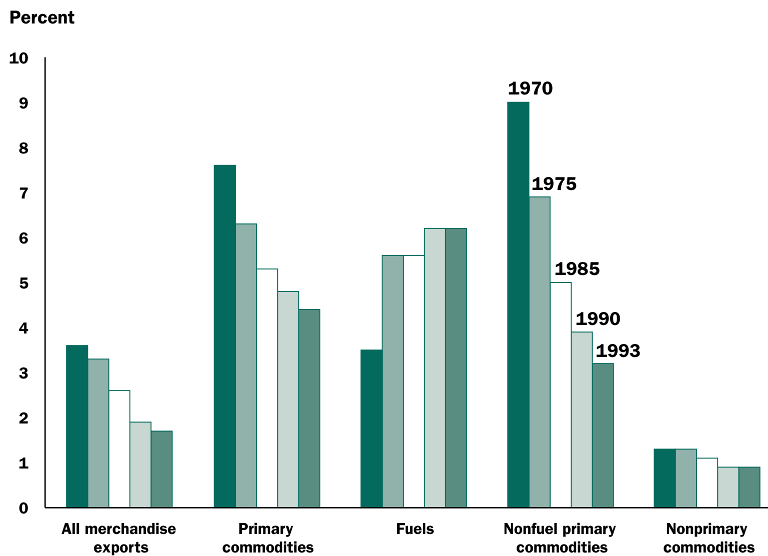


Source: World Bank data.

The erosion of Africa's world trade share between 1970 and 1993 represents a staggering annual income loss of $68 billion

What role did trade play in this story? Strongly trade oriented in the 1960s, Africa was the only region to then experience a decline in real dollar exports per capita (see table 1.1). Paralleling its slow income growth, Africa's share of world trade fell from more than 3 percent in the 1950s to less than 2 percent in the mid-1990s (and to only 1.2 percent, excluding South Africa). The erosion of Africa's world trade share in current prices between 1970 and 1993 represents a staggering annual income loss of $68 billion—or 21 percent of regional GDP. Part of this loss reflected the erosion of the trade share for traditional products, as well as policies that discouraged private investment and diversification into products for which world demand was growing more rapidly (figure 1.3). Only in fuels did Africa emerge as a substantial new presence in world markets. Relative to GDP, exports changed only modestly (in current prices), benefiting from hikes in world oil prices. The more recent recovery stems from policy reforms, including exchange rate liberalization and realignment to reduce overvaluation (which cut GDP in dollar terms) and reductions in other disincentives to exporting.

Figure 1.3 Africa's Share in World Exports by Product, 1970–93



Source: United Nations, *Handbook of International Trade and Development Statistics*, various years.

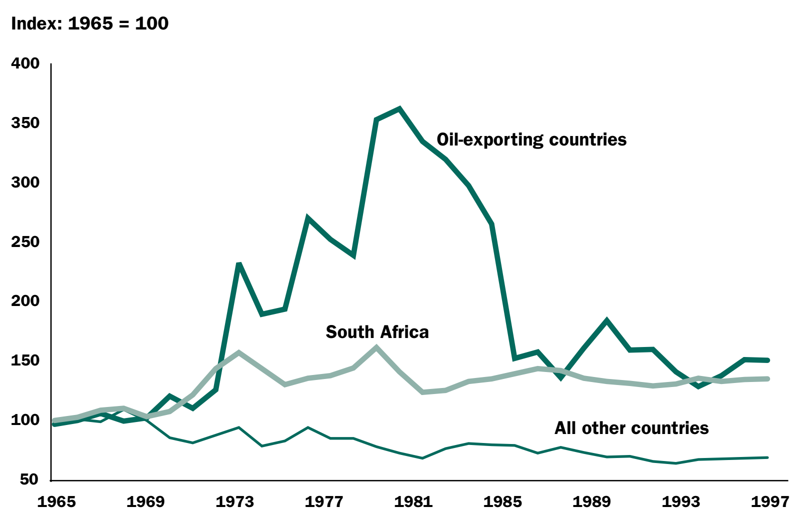
For many countries, aid transfers have been offset by terms of trade losses

Worsening terms of trade were another source of loss for many African countries (figure 1.4). For African countries that are not oil exporters, and excluding South Africa, cumulative terms of trade losses in 1970–97 represented almost 120 percent of GDP, a massive and persistent drain of purchasing power. In addition to the depressing effect on income and growth, external factors, coupled with a failure to diversify exports and attract private capital in previous decades, lie behind the aid dependence of the 1990s. From modest levels before the oil shock, aid increased sharply to meet the crisis, so that the nonoil-exporting countries (excluding South Africa) received large transfers from grants and concessional loans. Cumulatively, these transfers amounted to 178 percent of GDP (table 1.4). But the increase after 1970–73 (125 percent of GDP) was little more than the terms of trade losses. In addition, by 1997 this group of countries had accumulated external debt equal to their GDP, raising their debt service obligations.

Terms of trade losses are not the whole picture, however. Africa's oil exporters have benefited from massive terms of trade gains (see table 1.4). But as with most oil exporters in other regions, the gains have not been used to place countries on a path of sustainable growth. Excessively positive shocks, as shown by a number of studies, can destabilize development as much as negative ones (Gelb 1988; Auty 1998).

Excessively positive shocks can destabilize development as much as negative ones

Figure 1.4 Africa's Terms of Trade by Country Group, 1965–97



Source: World Bank data.

Table 1.4 Cumulative Terms of Trade Effects and Financing Flows in Africa, 1970–97 (percentage of GDP)

Indicator	*Oil-exporting countries*	*South Africa*	*All other countries*
Terms of trade effect[a]	483	189	–119
Gross resource flows[b]	196	—	288
Net resource flows[c]	124	—	234
Net resource transfers[d]	5	—	176
Grants and concessional flows	27	—	178
Foreign direct investment	–5	—	–10
Nonconcessional and portfolio flows	–18	—	7
Change in net resource transfers from 1970–73 level	27	—	125
External debt, 1997	94	20	106
Present value of external debt, 1997[e]	91	19	83

— Not available.

a. Capacity to import less exports of goods and services, in 1965 constant local currency prices.

b. Long-term debt (excluding IMF), foreign direct investment (net), portfolio equity flows, and official grants (excluding technical cooperation).

c. Gross resource flows less principal repayments on long-term debt.

d. Net resource flows less interest payments on long-term debt and profit remittances on foreign direct investment.

e. Sum of short-term external debt and the discounted sum of debt service payments due on public, publicly guaranteed, and private nonguaranteed long-term external debt over the life of existing loans.

Source: World Bank data.

Explanations for Africa's Slow Growth

Africa's aid dependence entering the 21st century thus mirrors its lock-in to primary export dependence, its weakness in attracting private finance and reversing capital flight, and its failure to diversify. But there is more to the story. Many other countries, including those in East and South Asia, have experienced declining terms of trade but have been able to adjust to the losses, attract investment to new industries, upgrade skills, and diversify into more dynamic industrial and service product lines. Why did this not happen in Africa?

Explaining Africa's slow growth remains a major challenge

Explaining Africa's slow growth in the second half of the 20th century remains a major challenge to economists and other analysts. But even though the large and growing growth literature both inside and outside Africa does not provide a simple answer on how to accelerate development, it does suggest important lessons for the future (see Collier and Gunning 1998 and Azam, Fosu, and Ndung'u 1999).

The debate on Africa's slow growth has offered many explanations. Some factors—such as geography (tropical location, a low ratio of coastline to interior and the resulting high transport costs), small states, high ethnic diversity, unpredictable rainfall, and terms of trade shocks—are taken to represent "destiny," or exogenous factors beyond the control of African policymakers. Others, such as poor policies (including trade and exchange rate policies, nationalization, and other restraints on economic activity) can, in principle, be changed. A second dimension distinguishes such factors depending on whether they are primarily domestic or external.

These distinctions are only somewhat helpful, because over the long run it becomes hard to assess what is exogenous and what is endogenous. Policies respond to social, demographic, political, and structural factors, many of which also reflect the influence of income levels and trends over long periods. Policies and capacity can also moderate the effect of geography: the effect of being in a landlocked or tropical location depends partly on the efficiency of the transport sector and the health sector. Some factors that depress Africa's growth—such as widespread and persistent gender inequality in access to productive resources—reflect both current policies and longstanding traditional and social practices (box 1.1).

Geography, health, and demography. Bloom and Sachs (1998) offer estimates of the impact of various factors on Africa's growth. Geographic factors and the spatial distribution of its population lower Africa's potential growth by almost 1 percentage point relative to other regions. Africa's

African women work far longer hours than African men

high dependency ratio lowers growth by another 0.6 percentage point. Low life expectancy (a proxy for a variety of health-related problems, including malaria) reduces growth by a massive 1.3 percentage points. A "catchup effect" due to Africa's low incomes partly compensates for these negative factors, adding almost 2 percentage points to Africa's growth potential. The remaining difference in Africa's growth rate, almost 1 percentage point, is explained by policies—a lack of openness to trade and weak government institutions and fiscal policies.

One interpretation of these results is that the potential advantages of Africa's low incomes for growth are more than offset by its unfriendly geography, its adverse public health, and its high dependency ratio. But poor health and high dependency are themselves influenced by income levels and public policies, as well as by the effectiveness of public service delivery, and so are not really exogenous. Even so, these findings are significant, especially for public policy.

Sparseness, ethnic diversity, and democracy. Low population density raises the costs of providing infrastructure services, disseminating information, and integrating production and markets. Low density is also associated

Box 1.1 Gender and Growth: Africa's Missed Potential

AFRICAN WOMEN WORK FAR LONGER HOURS THAN African men. On average, their workdays may be 50 percent longer, and their work is closely integrated with household production systems. Women are especially prominent in agriculture, particularly in processing food crops, and in providing water and firewood, although men predominate in agriculture in much of the Sahel. Income earned by women is more likely to be used productively—for children's food, clothing, and education.

But due to customary and legal restrictions, women in Africa have less access to productive assets, including land, and to such complementary factors of production as credit, fertilizer, and education. Women farmers receive only 1 percent of total credit to agriculture. Women are less likely to control the product of their labor than men, reducing their incentives to pursue productive, income-earning opportunities. And between 1960 and 1990 average schooling for African women increased by only 1.2 years, the lowest gain of any region. Some cross-country studies suggest that if African women were given equal access to education and productive factors, growth rates could be as much as 0.8 percentage points higher. In addition, patterns of capital formation tend to be biased against investments, such as wells and fuel-efficient stoves, with the potential to unlock more female time for high-productivity activities and education.

Thus Africa is losing out on the productive potential of more than half its effective workforce. So, measures to increase gender equality in Africa, in addition to their social and distributional implications, have considerable potential to accelerate growth. What is standing in the way? Longstanding traditions and power. Women's political participation is still low—only 6 percent in national legislatures and 2 percent in cabinets. Half the national cabinets have no women.

Source: Blackden and Bhanu 1999.

with higher ethnic diversity, which several studies find associated with lower growth. A common perception is that higher ethnic diversity reduces growth by raising the risk of conflict. But new research suggests that Africa's extensive ethnic conflict is explained by its poverty rather than by its diversity (chapter 2). An alternative explanation is that diversity increases the difficulties of cooperation, both in commerce and in policy formulation. Collier (1999), however, finds that diversity reduces growth by 3 percentage points in undemocratic countries but has no effect in democracies. One implication for Africa is that efforts to nurture durable democratic systems will pay off in better economic management.

Efforts to nurture durable democratic systems will pay off in better economic management

External shocks and social conflict. The small size of Africa's nations and their high export concentration in a limited range of primary commodities leave them exposed to terms of trade shocks that have often had an adverse effect on economic management and outcomes. But countries have responded differently to external shocks. Some have adjusted sharply and resumed growth, while others have launched into a long downward spiral of declining incomes and policy disarray. What made the difference? Indicators of social tensions—such as income inequality and weaker and less democratic institutions—are associated with deteriorating policies and lower economic resilience in the face of a volatile external environment (Rodrik 1998b). Domestic factors may therefore be more important than external destiny.

Aid dependence. There has been a long debate on whether aid has been beneficial or detrimental to growth and development—and on how much its effects come by causing changes in policies or through other channels such as appreciating exchange rates, discouraging the development of exports, and sustaining inefficient patterns of investment, as in Tanzanian manufacturing (box 1.2). Recent research suggests that, historically, there appears to have been no significant net effect of aid flows on policies and that aid has fostered growth—but only in good policy environments (Dollar and Burnside 1997).

Economic management. Postcolonial African governments developed economic controls—comprehensive in only a few cases but invariably involving extensive and arbitrary regulation and frequently the prohibition of trade (Collier and Gunning 1999; see also World Bank 1989, 1994). Interventions were domestically as well as externally focused; some countries even banned interdistrict trade in food. Since the political base of governments was urban, agriculture was heavily taxed, and

Box 1.2 Industrial Productivity in Tanzania

AT INDEPENDENCE, MORE THAN 80 PERCENT OF THE manufactured goods consumed in Tanzania were imported, and manufacturing accounted for only 4 percent of GDP. A succession of government plans placed heavy emphasis on import-substituting industrial investments for basic consumer goods, construction, and related capital goods. Between 1965 and 1980 real investment in manufacturing grew by more than 21 percent a year, and in 1986–90 investment rose to the remarkable level of more than 100 percent of manufacturing value added. Despite this massive expansion, output per worker fell as production rose slowly and capacity use collapsed.

What constrained capacity use? By far the most important factor seems to have been a critical shortage of imported inputs and spare parts following the balance of payments crises after 1974. What sustained heavy capital investments and capital goods imports in the face of severe capacity underuse? One important factor was a substantial inflow of foreign assistance tied to the capital content of projects. Tanzania's industrial drive failed because investments could not generate enough manufactured exports to fund continuing imports of the materials needed to sustain production. Foreign aid sustained this neglect of export emphasis.

Source: Ndulu 1986; Devarajan, Easterly, and Pack 1999.

highly centralized public administrations paid little attention to rural services. At the same time, trade and exchange rate policies encouraged firms to produce under noncompetitive conditions for small, captured, domestic markets, undermining the basis for industrial growth. Unstable, capital-hostile environments contributed to massive capital flight (see table 1.3).

Public employment was emphasized over service delivery. The economic decline after 1973 may have increased pressure to expand employment, which was reconciled with limited revenues by lowering wages, compressing pay at upper levels, and leaving little space for operations, maintenance, and nonwage spending. Civil service became the arena for ethnic groups to contest for resources, often with the costs of poor service and endemic corruption. Poor service raised costs to firms—weak telecommunications, for example, was estimated to lower African growth by up to 1 percentage point (Easterly and Levine 1997). Poor service also handicapped households through inefficient spending on education, health, and infrastructure. Simple quantitative data cannot easily capture many of these and other domestic policies. But growth studies and case studies show that they hurt Africa's economic performance in the second half of the 20th century.

How important were trade policies? On a range of indicators, Africa imposed higher trade barriers and sustained more severely overvalued

exchange rates than did other regions. These policies discouraged exports and may have been more damaging because of the small size of Africa's economies. But there is some controversy over the specific impact of trade restrictions relative to that of a policy environment that hurts efficiency, productivity, and investment. Supporting this view—that trade restrictions should be seen as part of a range of broader and more comprehensive policies and institutions that affect performance (Rodrik 1999)—is the fact that Africa's exports have changed little relative to GDP (see figure 1.2). They have moved together, influenced by common external factors and domestic policies. Trade reforms alone will not offer a simple fix, though increasing and diversifying exports will be critical in reversing Africa's marginalization.

Sound policies and strong institutions can moderate exogenous factors

The bottom line. Africa's performance is influenced by its history and its geography. But sound policies and strong institutions can moderate exogenous factors, and Africa's economies will, like others, respond to better economic policies. Studies suggest some of the focal points for ensuring that Africa embarks on a long-term process of rising incomes and falling poverty.

The first area is governance and leadership. Adopting sound, growth-oriented policies on a sustained basis will be all the more essential as further globalization brings risks of external shocks and instability. Successful countries must approach globalization armed with a "business plan" that includes developing indigenous institutions for mediating conflict without undermining economic stability and deterring investment and entrepreneurship, as well as improving public regulation and service delivery. Effective policies for Africa must therefore be win-win policies: to both strengthen the economy and to contribute to the formation of effective states (chapter 2).

A second important area is investment in people. Some of the most important "exogenous" variables in growth studies, including poor health and adverse demographics, are partly the outcome of ineffective policies and long economic decline. With its population growing rapidly relative to natural resources, Africa must reverse the marginalization of many of its people—notably its women—and strengthen their capabilities and capacity. Africa loses twice as much labor through illness as any other region. This disparity will only increase as HIV/AIDS incapacitates 2–4 percent of the active labor force and depletes skills (chapters 3 and 4).

A third area involves the high costs and risks of the business environment, which owe much to government policies since independence. Efficient

investment in infrastructure—physical, financial, and information—is essential if Africa is to overcome geographic isolation, and this requires the formation of public-private partnerships (chapter 5). Moreover, policies for productive sectors, particularly agriculture and industry, need to encourage investment, employment, and export diversification (chapters 6 and 7).

Finally, especially given Africa's high aid dependence and the important influence of donors, aid needs to be reassessed to ensure that it contributes to these objectives (chapter 8).

Most African countries have embarked on reform programs intended to regain macroeconomic balance, improve resource allocation, and restore growth

Where Is Africa Now? Reforms and Their Legacy

Most African countries have embarked on reform programs intended to regain macroeconomic balance, improve resource allocation, and restore growth. These substantial reforms contributed to the resurgence of growth in the second half of the 1990s. Nevertheless, Africa has emerged from the reforms with a difficult legacy. And at current and projected growth rates of 4–5 percent, the performance of Africa's poor countries still falls short of the levels needed to reduce poverty and offset decades of stagnation.

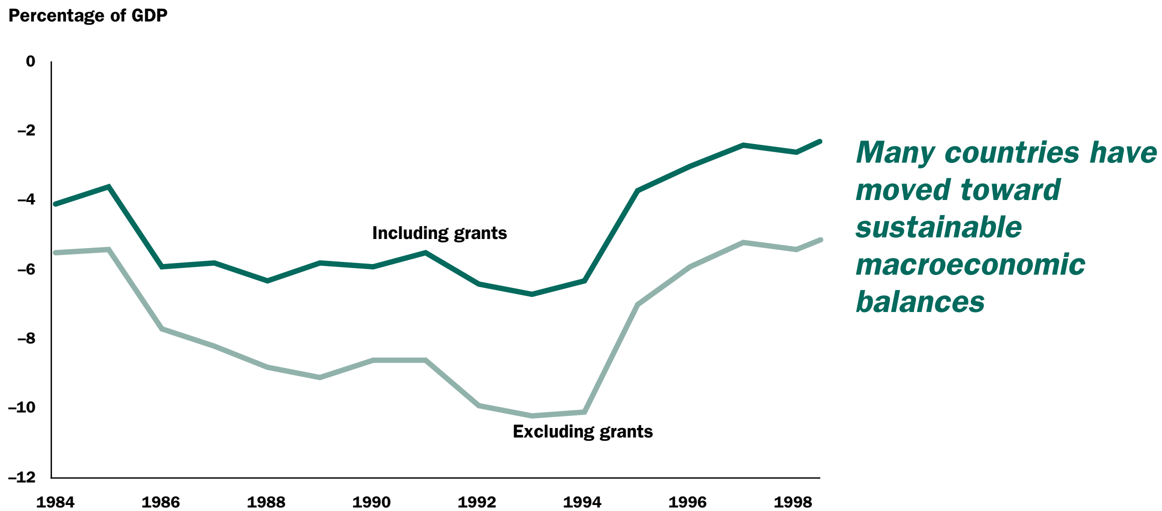
Progress with Reform

Reforms in Africa have been substantial in three important areas: macroeconomic balances, market forces, and private initiative.

Macroeconomic balances. Many countries have made major gains in macroeconomic stabilization, particularly since 1994. Consider the 31 poor, aid-dependent countries covered by the Special Program of Assistance for Africa (SPA).[1] Their fiscal deficits dropped to 5.3 percent of GDP in 1997–98 and averaged only 2.5 percent of GDP net of grant financing (figure 1.5). And most financed part of this residual deficit through concessional credits, making budgets more sustainable than otherwise.

Macroeconomic balances are still fragile, however. Although inflation is now less than 10 percent in most African countries, deficit estimates do not fully reflect quasi-fiscal losses and contingent liabilities, such as guarantees to state enterprises. Some governments still run sub-

Figure 1.5 Fiscal Deficits in Special Program of Assistance Countries, 1984–98



Source: World Bank data.

Many countries have moved toward sustainable macroeconomic balances

stantial arrears to suppliers. In addition to large external debt obligations, countries such as Ghana, Kenya, Malawi, Tanzania, and Zimbabwe face high domestic debt burdens, in some cases because domestic financial markets were liberalized before fiscal deficits were brought under control. Nevertheless, many countries have moved toward sustainable macroeconomic balances, assuming that concessional financing continues at recent levels.

Fiscal improvements have not been stress-free. Public capital spending, heavily supported by donors, has remained roughly constant as a share of GDP. But since 1993 tax revenues have increased relative to GDP while current spending has fallen. Many countries have taken steps to broaden their tax bases, creating autonomous revenue authorities, curbing arbitrary exemptions, and implementing value added taxes. But the combination of weak tax administration and rising tax effort on a narrow tax base has sometimes hit business profitability and reinvestment (Reinikka and Svensson 1998). Relative to other regions, statutory tax rates in Africa are quite high (table 1.5), and tax administration is sometimes seen as predatory by the small number of formal sector firms that contribute most direct taxes. High statutory taxes encourage informal activity and employment.

Table 1.5 Public Finance, External Support, Economic Management, Political Participation, and Risk Ranking Indicators by Region

Indicator	*Africa excluding South Africa*	*Africa*	*South Asia*	*East Asia*	*Latin America*
Public finance					
Government revenue/GDP, 1997	21	25	22	—	26
Government spending/ GDP, 1997	25	30	28	15	31
Highest marginal tax rate, 1998 (median, percent)					
Individual	35	35	35	37	30
Corporate	35	35	38	30	30
External support					
Debt stock per capita (dollars), 1997	338	358	120	373	1,426
Foreign direct investment per capita (dollars), 1970	1.49	1.49	0.10	0.24	3.86
Foreign direct investment per capita (dollars), 1997	4.61	7.13	3.40	35.71	120.09
Aid per capita (dollars), 1997	—	26	3	4	13
Economic management and political participation					
Country Policy and Institutional Assessment (CPIA) rating (scale of 1 to 6), 1998[a]	3.0	3.0	3.6	3.2	3.7
Top third	3.8	3.8	3.9	3.9	4.3
Middle third	3.2	3.2	3.7	3.1	3.9
Bottom third	2.2	2.2	3.1	2.8	3.1
GNP per capita (dollars, at market exchange rates), 1997 (CPIA countries)	315	511	384	1,244	3,957
Top third	344	866	616	1,324	5,134
Middle third	387	387	377	884	4,024
Bottom third	249	249	435	520	1,976
PPP GNP per capita, 1997 (CPIA countries)	1,045	1,466	1,587	3,507	6,775
Top third	1,081	2,198	3,261	3,650	8,623
Middle third	1,245	1,245	1,611	2,871	6,546
Bottom third	900	900	1,418	1,320	5,103
Political rights and civil liberties (scale of 1 to 7)					
1990/91	2.6	2.6	3.2	4.0	6.4
1998/99	3.5	3.6	3.5	4.4	5.4
Corruption perceptions index (scale of 1 to 10)	—	3.6	2.8	3.3	3.4
Euromoney *risk ranking* (average rank among 116 countries)					
September 1992	70	68	34	35	49
March 1999	83	81	49	40	41

Note: PPP stands for purchasing power parity.

a. The top third of countries under CPIA ratings for 1998 were Botswana, Cape Verde, Côte d'Ivoire, Eritrea, Ethiopia, Ghana, Lesotho, Malawi, Mauritania, Mauritius, Namibia, Senegal, South Africa, Tanzania, Uganda, and Zambia. The middle third were Benin, Burkina Faso, Cameroon, Chad, Gabon, The Gambia, Guinea, Guinea-Bissau, Kenya, Mali, Mozambique, Niger, Rwanda, Swaziland, Togo, and Zimbabwe. The bottom third were Angola, Burundi, Central African Republic, Comoros, Democratic Republic of Congo, Republic of Congo, Djibouti, Equatorial Guinea, Liberia, Madagascar, Nigeria, São Tomé and Principe, Seychelles, Sierra Leone, Somalia, and Sudan.

Source: World Bank data; Freedom House 1991, 1999; Transparency International 1998; *Euromoney*.

On the spending side, many countries suffer chronic shortages of current funding, especially for operations, maintenance, and nonwage inputs. There are also large deviations between planned and actual spending, partly due to the need for cash-based expenditure management to achieve aggregate fiscal targets. Tight fiscal restraints—including on public sector salaries—and the proliferation of donor-driven initiatives have created perverse financial incentives for public sector employees. These problems have probably worsened due to the intensity of aggregate fiscal pressure. And they need to be addressed in the next stage of reform, especially in countries that have most consolidated their macroeconomic balances.

Much of Africa has been opened to market forces

Market forces. A second area of reform has been the opening of Africa to market forces. Most prices have been decontrolled and marketing boards eliminated—except in a few countries for such key exports as cotton and cocoa. Current account convertibility has been achieved and, except in a few countries, black market premiums average only 4 percent. Trade taxes have been rationalized from high and arbitrary levels. Average rates of 30–40 percent of the mid-1990s have given way, in many countries (including those in the West African Economic Union), to trade-weighted average tariffs of 15 percent or less. Trade-weighted tariffs are now below 10 percent in more open countries such as Uganda and Zambia. Arbitrary exemptions, though still numerous, have also been rationalized.

This opening to market forces continues in West Africa through the movement to a common external tariff with a maximum rate of 20 percent—and in East and Southern Africa through country-by-country reforms supported by several regional associations. Trade policies are still more restrictive than in the world's more open developing countries, and many countries still confer substantial protection on domestic industry. But much of the gap in the early 1990s has been closed.

Private initiative. A third change in Africa's economic landscape has been wider space for private initiative. Thriving business networks have arisen in West, East, and Southern Africa, and in politically and economically stable countries private investment has increased by almost 3 percent of GDP in recent years. In a 1997 survey of 22 African countries, fewer businessmen saw the state as an opponent than had in 1987 (Weder, Brunetti, and Kisunko 1998). Foreign direct investment also rose in the second half of the 1990s—to about one-sixth the average level per capita for all developing countries. But it

was still concentrated in a few countries, especially those with mineral resources. The number of funds seeking investments in Africa has grown from almost none to about 30. So, Africa is becoming a viable business address.

Privatization is opening the door to domestic businesses and to better services

In many African countries privatization has accelerated and become more widely accepted. With more than 3,000 transactions totaling $6.5 billion, privatization has entered a new phase, one marked by private participation in providing infrastructure services (box 1.3). Private operators have substantial involvement in telephone systems in 18 countries and in water distribution in 23 countries. Railways and ports have been concessioned to private operators. Even when the lead investor is foreign (as is usually the case for the largest transactions), privatization is opening the door to domestic businesses, including as suppliers and distributors, and to better services.

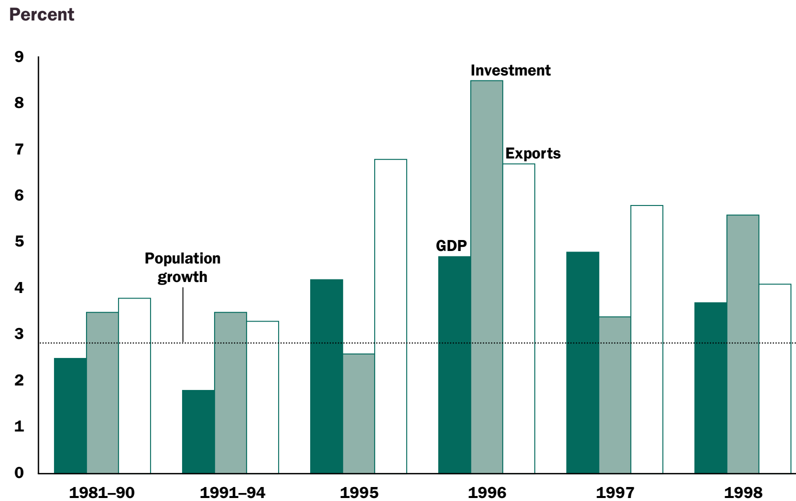
Regulations have not always advanced with privatization to ensure adequate competition, however, and most countries still need to expand the pool of investors. In some countries case-by-case privatizations have offered new owners exclusive rights to provide services to small national markets, whereas a subregional approach would have enabled more competitive service provision. Better regulations and more transparent privatization will need to remain a focus in many countries.

Box 1.3 Privatization in Côte d'Ivoire

Over the past eight years Côte d'Ivoire's ambitious privatization program has wholly or partly privatized more than 60 firms—and yielded more than $450 million in return. The program gained momentum after the 1994 devaluation, which restored the profitability of a number of agribusiness companies. It has been successful in attracting investors: in the past four years $1.4 billion were invested in agribusiness and more than $1 billion in infrastructure. The private sector is now involved in almost all infrastructure sectors. A recent study, conducted using the same methods as in other regions, concluded that the program has been a success: employment in privatized firms has grown by 4 percent a year (it had been falling before), labor productivity has risen, and so has government's corporate tax yield.

Despite this track record, a number of questions remain. Côte d'Ivoire has not yet succeeded in attracting a diverse group of private investors. Doing so would increase competition. The country also needs to nurture a solid base of small and medium-size enterprises. Regulations need to be rationalized to clarify the roles of technical ministries and regulatory bodies, including the Competition Commission. And despite the increasing participation of private firms in infrastructure, the public sector still bears a significant part of market risks. Most contracts—power, water, railways—are of the *affermage* (lease contract) type, with investment still the responsibility of the state. Further transfers of risk to private operators will require policies that emphasize transparency and the building of confidence.

Figure 1.6 Growth in Output, Investment, and Exports in Africa, 1981–98



Source: World Bank data.

By all indicators, Africa's performance improved in the second half of the 1990s

Recovery—and Other Legacies

No single measure captures the rhythm of Africa's economies. Aggregate output is dominated by South Africa, a country facing unique economic and political challenges. Population-weighted growth rates or median country performance offer broader-based measures. But all indicators show that performance improved in the second half of the 1990s (figure 1.6). In the typical country annual output growth rose to about 4.3 percent in 1994–98. Agriculture also performed well, growing 3.7 percent a year in the median country, well above previous levels. In 1995–97 exports also grew rapidly. While this period was one of exceptional growth in world trade, especially in demand for key African products, it also saw a reversal of falling trade shares—suggesting that African exports were becoming more competitive (Yeats 1999). Although estimates of poverty headcounts are available for only a few countries over time, they show that rising aggregate consumption usually results in substantial declines in the percentage of the absolute poor (chapter 3).

This improving picture came under stress in 1998 in a way that underscores Africa's vulnerability to external shocks and internal conflicts. Except for South Africa (where growth fell sharply), African countries were less integrated with world capital markets than most other regions and less exposed to the direct effects of the East Asian crisis. Still, many

countries suffered sharp declines in commodity prices. Oil exporters felt a massive terms of trade loss, but until late 1999 many oil importers were cushioned from the immediate effects of their slumping export prices by lower costs of oil imports (box 1.4). Even so, they faced intensified competition in depressed primary export markets. Another factor was the intensification of conflict in Central Africa, in parts of West Africa, and in the Horn of Africa with the resumption of war between Ethiopia and Eritrea. While many countries continued to grow strongly in 1998, the region's population-weighted growth slumped, leaving little growth space to cut poverty. Growth appears to have picked up in 1999 and 2000, though not to the peak levels of 1996, and sharp increases in fuel prices shifted terms of trade losses back to oil-importing countries.

Macroeconomic and structural reforms in Africa have been highly controversial

Reform and recovery. Macroeconomic and structural reforms in Africa have been highly controversial.[2] Some studies using information through the mid-1990s failed to find a link between reform and performance. Perhaps this is not surprising. It is not easy to disentangle the relative contributions of external developments, domestic economic policies, and deeper institutional factors over the long run, because they work together. Nor is evaluation easy in the medium run, because of lagged effects and

Box 1.4 The East Asian Crisis and Africa

THE SWING IN THE CURRENT ACCOUNTS OF EAST ASIAN countries in 1998 sent a massive deflationary shock through the global economy—equal to 3 percent of world GDP. But except for South Africa, which suffered from a speculative currency attack, Africa was less exposed to international capital movements than many other developing regions. The main transmission effects from the Asian crisis were through a halving of growth in world trade and 20–40 percent declines in terms of trade for primary products.

The net effects were felt sharply by African oil exporters, which suffered a terms of trade loss of 7 percent of GDP. While other countries also suffered losses (particularly those exporting metals and tobacco), until late 1999 most were shielded from the immediate effects of export price declines by sharp cuts in their oil import bills. The net effect of the crisis—coupled with increased conflict, adverse weather in East Africa, and political uncertainty in Nigeria—pulled growth down in Africa, especially in larger countries.

The longer-run impact of the crisis will be felt more widely. Second rounds of commodity price declines are hitting some producing countries severely. Oil prices doubled, benefiting producers but hurting importing countries. World trade growth may be slower than anticipated, and competition will come from other regions where exchange rates have depreciated sharply. For example, processed fish from Thailand has made severe inroads on Senegal's exports. Investors may also show less interest in projects to extract and process raw materials. Thus all the more pressing is the need to boost Africa's international competitiveness.

Source: World Bank 1998b.

because structural and institutional measures are difficult to quantify. Many African countries have moved in and out of compliance with macroeconomic and structural reform programs, so formally being on a program has meant little for the policies actually pursued over longer periods. And short-term reforms have failed to address some difficult underlying institutional problems—and in some cases may have worsened them.

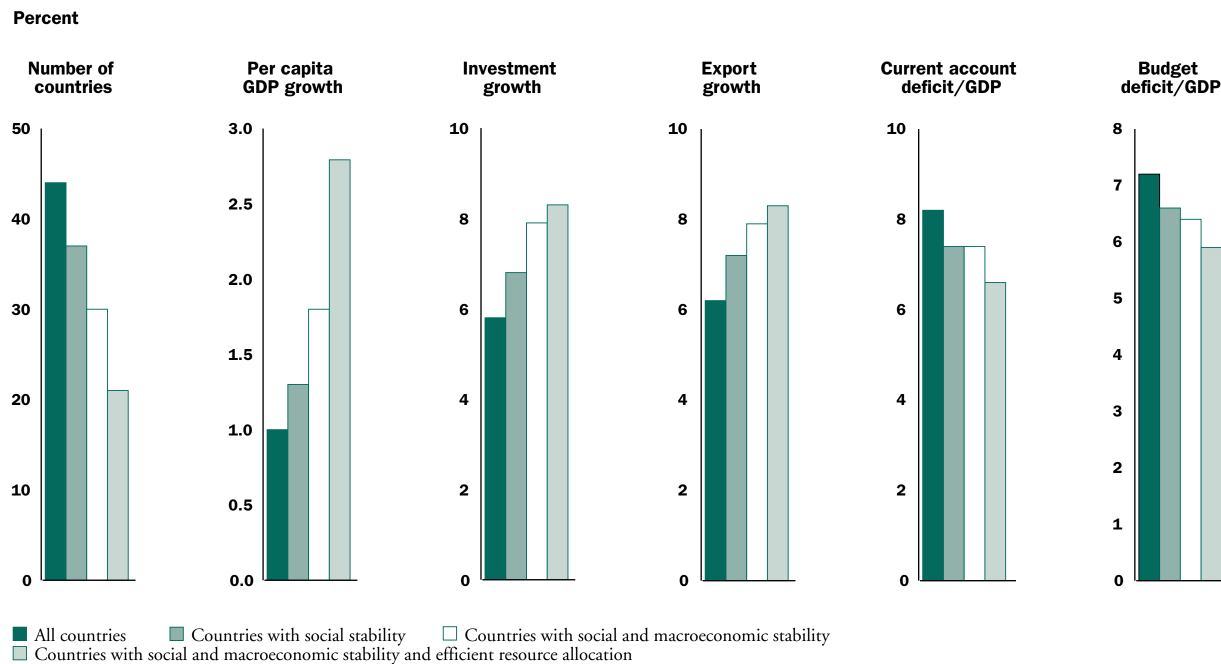
Good economic management must be sustained for some time but then has a substantial effect

Despite all this, and recognizing the difficulty of specifying a clear counterfactual, some recent studies indicate that adherence to sound policies pays off in the medium run. But good economic management must be sustained for some time to have a substantial effect. An independent assessment of the Special Program of Assistance (SPA) cited eight African countries as being generally "on track" in 1992–96.[3] This group did better in 1992–97, both relative to its previous record and relative to a comparator group of SPA countries: GDP per capita grew 1.1 percent in the on-track group but fell 0.5 percent in the others. Export growth, import growth, investment rates, and government spending were also higher for the on-track group. The combination of sustained reforms and financial assistance was associated with better performance, at least at the aggregate level. The on-track group also performed better on intermediate social indicators, though it still fell well short of what was required to achieve poverty reduction goals.

Another way to assess the impact of economic management on performance is to group countries by broader indicators of macroeconomic, structural, and social policies and economic institutions. One such measure is the Country Policy and Institutional Assessment (CPIA), carried out each year by the World Bank for all borrowing countries and used—along with population and income—to allocate International Development Association resources among recipient countries. Macroeconomic sustainability has a 25 percent weight in the CPIA, and structural and financial sector policies and legal institutions about 30 percent. The remainder is based on financial and budget management, social policies, safety nets, and environmental policies (IDA 1998). Worldwide, few if any countries appear able to make progress toward a middle-income level without also achieving a high CPIA rating.

CPIA ratings for the late 1990s suggest that an upper tier of African countries has a good basis for further development. But a lower tier, including many very poor countries, is in danger of slipping ever further behind. Africa has many well-managed economies, especially in macroeconomic terms (see table 1.5). The top third of its countries are not rated

Figure 1.7 Africa's Annual Growth, Investment, Exports, and Deficits by Country Group, 1995–98



Source: World Bank data.

much differently from their counterparts in other regions. And while this tier includes some of Africa's richer countries, it also includes many poor ones. But the lowest tier of Africa's countries is both poorer and rated far lower than their counterparts elsewhere.

Countries are also distinguished by whether they have preserved a peaceful base for development. As discussed further below, for many countries avoidance of conflict has been critical in the ability to sustain development. Figure 1.7 shows how growth, investment, exports, and current account and budget deficits have differed across countries according to whether they have been at peace and, if so, whether their economic management has been deemed effective. Both peace and good economic management have been important for Africa's recovery, with better-managed countries seeing higher growth per capita and investment and export growth of more than 8 percent. There have also been signs of export diversification (chapter 7) and, in some countries, such as Uganda, of a reversal in capital flight. A number of countries have also advanced in international risk ratings, although few (with the notable exception of South Africa) are at the level required to attract appreciable private capital.

Other legacies of the crisis decades. Thus reforms have been instrumental in Africa's recovery and have laid the basis for deeper changes. But the focus on macroeconomic management over an extended period has also left deeper and difficult legacies for African countries: "hysteresis effects," which are not quickly reversed.

Perhaps unavoidably, economic management focused on short-term concerns. Thus reforms—for example, of the civil service—have restored macroeconomic balance rather than increased effectiveness. Many countries have seen improvements in capacity within central banks and ministries of finance. But with weaknesses in governance and severe erosion of pay, especially at higher levels, the adjustment decades also saw a substantial deterioration in the quality of public institutions, a demoralization of public servants, and a decline in the effectiveness of service delivery in many countries. Together with falling incomes, these effects—which cannot be speedily reversed—translated into falling social indicators and capabilities in many countries, and to losses of human capital, especially (though not exclusively) in the public service.

The long period of macroeconomic adjustment also left some difficult legacies

Cash management limits to control aggregate spending and continued macroeconomic instability increase the difficulty of assuring a predictable flow of resources to agreed programs. The divergence between budgeted and actual spending is often gaping, with at least a 30 percent deviation in one of every five African countries for national budgets, and in half of African countries for sector and program budgets (Kostopoulos 1999). This discrepancy has undermined the accountability of sector ministries for agreed outcomes—and left programs poorly performing and subject to the diversion of funds.

As external funding became more critical, African governments increasingly turned to external advisers, often those connected with the provision of funding. Conditionality became ever more intrusive, and the shaping of reforms was seen to lie mainly outside the region. This further weakened internal capacity for economic management and reduced African governments' sense of ownership and accountability for economic outcomes. Reforms were not "marketed" or explained to the population. Arrangements between governments and donors often weakened the role of representative institutions, particularly parliaments, with essential legislative and budgetary functions. The effect was lower credibility for both the reforms and the programs that tried to enforce them. Foreign assistance, largely shaped by the strategic considerations of the Cold War, was not allocated in a par-

ticularly discriminating way between better-managed and worse-managed countries. This too did little to encourage credible reforms.

The long crisis also lowered expectations of Africa and within Africa. In the 1960s governments actively strove for accelerated development. By the mid-1990s simply restoring growth to allow rising per capita income was seen as an achievement for many countries.

The end of the 20th century marked the emergence of a fragile consensus between Africa and its donors

The end of the 20th century, however, marked the emergence of a fragile consensus between Africa and its donors, at least on broad principles. There was far greater understanding within Africa of the need for a stable macroeconomy, for working markets, for private initiative, and for the need to increase global competitiveness. Donors had accepted the limits of narrow approaches. Market-driven development could not succeed without strong social and institutional infrastructure—including a strong and capable state—and without active measures to alleviate severe poverty and raise the capacity of the population. Africans and their development partners had also begun to ask how to deliver assistance in ways that strengthen the accountability of governments to their people in Africa's emerging but aid-dependent democracies.

Toward An Agenda for the Future

> *It is not sufficient for African governments merely to consolidate the progress made in their adjustment programs. They need to go beyond the issues of public finance, monetary policy, prices, and markets to address fundamental questions relating to human capacities, institutions, governance, the environment, population growth and distribution, and technology.*
>
> ——World Bank 1989

WHAT, THEN, IS NEEDED FOR ACCELERATED PROGRESS? WITH so many challenges—and so many interactions among them—it is hard for governments and donors to set priorities. How can African countries develop comprehensive development plans or "business plans" that will help guide them through the increasingly competitive and fast-moving 21st century, but that are sufficiently prioritized to guide implementation?

Circles of Causation

One approach is to focus on blocks of issues with strong cumulative interactions—circles of cumulative causation, which can be virtuous or vicious (figure 1.8). Success in one element of a circle will ease improvement in others, but it is difficult to envision Africa claiming the 21st century unless there is progress in all the circles. The unfinished agenda can be framed in four such circles: improving governance and preventing conflict, investing in people, increasing competitiveness and diversifying economies, and reducing aid dependence and strengthening partnerships.

Circle 1: Improving governance and resolving conflict. Governance, conflict, and poverty intertwine on several levels in Africa. At one end of the spectrum, the countries that made the greatest gains in political rights and

Figure 1.8 Africa's Circles of Cumulative Causation

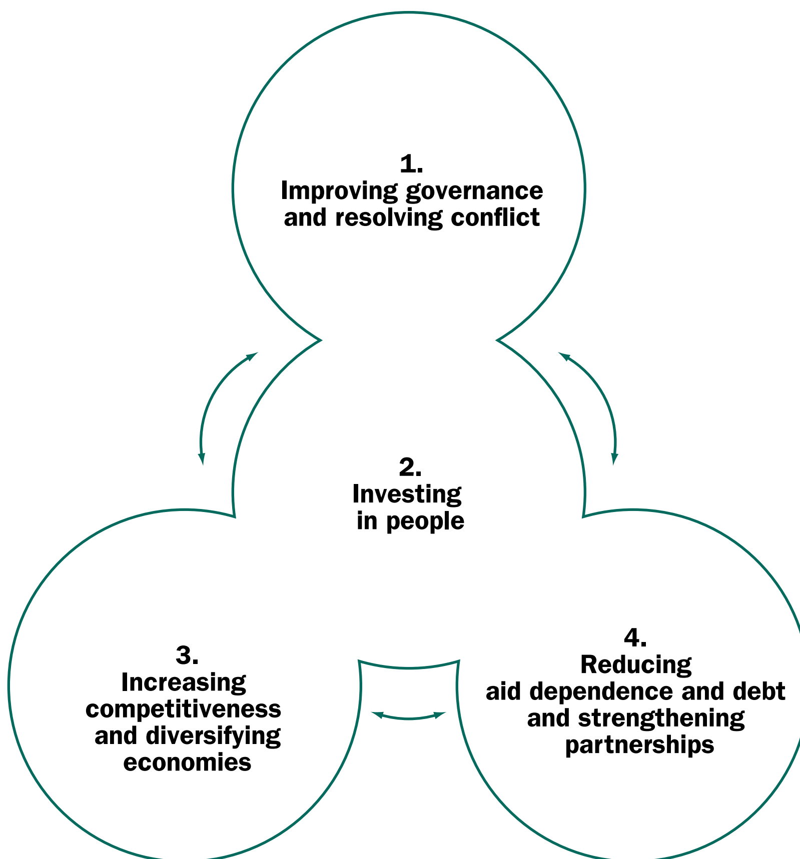
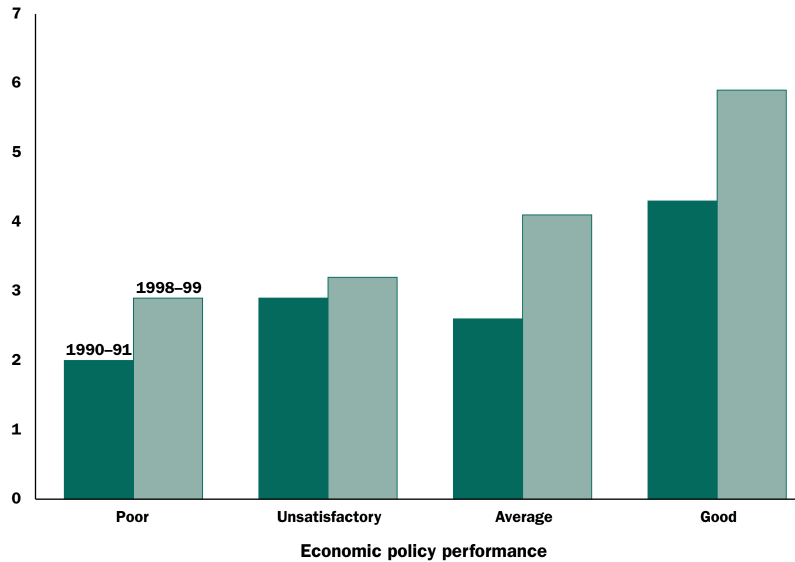


Figure 1.9 Political Rights, Civil Liberties, and Economic Management in Africa by Country Group, 1990–99



Source: Freedom House 1991, 1999.

With highly diverse, multiethnic states, African countries will need to search for inclusive constitutional models and institutions

civil liberties in the 1990s are also those with better economic management and performance (figure 1.9). This does not prove that political liberalization caused better economic management. But the relationship suggests that stronger and more accountable economic management has been associated with more participatory political systems and governments less accountable solely to narrow interest groups. Conversely, increased accountability and decentralized service delivery that comes closer to the people can strengthen political participation, contribute to a stronger state, and raise efficiency.

At the other end of the spectrum, about one African in five lives in a country formally at war or severely disrupted by conflict that, on average, lowers growth by at least 2 percentage points for every year that it persists. The direct annual costs of conflict in Central Africa and West Africa have been estimated at $1 billion and $800 million, and this does not include the costs associated with refugees and displaced persons—another $500 million in Central Africa alone. Indirect costs, including for neighbors not involved directly, are incalculable. Economic management has been far less effective in conflict-ridden countries, which make

up most of the lower third in the CPIA ratings. A growing body of evidence shows that poverty, lack of employment, and low education levels are important determinants of conflict—more so, perhaps, than ethnic diversity.

Economic development is vital for political stability. But with highly diverse, multiethnic states, African countries will need to search for inclusive constitutional models and institutions that build consensus, facilitate the participation of diverse groups, entrench good governance, and lay a stable basis for development. These are themes taken up again in chapter 2.

Confronting AIDS is essential if African countries are to prevent a long-term downward spiral

Circle 2: Investing in people. Even with hidden growth reserves such as reversing capital flight (Collier and Gunning 1998) and reallocating aid flows to better-managed countries (Collier and Dollar 1999), Africa's savings are too low to sustain growth in income and consumption at rates needed to rapidly reduce poverty. In addition, Africa's productive base is rapidly shifting from natural resources toward people. The second circle of causation facing African countries is the strong interrelationship between investing in people, accelerating the demographic transition, and promoting savings and growth.

Savings respond to higher and growing incomes, as well as to falling dependency ratios. Elbadawi and Mwega (forthcoming) suggest that a drop in Africa's dependency ratio to levels prevailing in East Asia could increase private savings by 9 percent of GDP. Demographic trends, in turn, respond to higher incomes and to better health and social services—including female education and contraceptives, demand for which is substantial in many African countries. Kenya shows that the demographic transition can be speeded by effective public policy even without rapid economic growth. Raising the efficiency of delivery mechanisms to invest in people—especially women and poor rural residents—is thus a key entry point into any poverty-reducing growth strategy, from a demographic perspective as well as for savings and productivity.

All this is threatened by a new factor, however. Although the full impact of the HIV/AIDS epidemic is not yet apparent, it promises to impart a massive shock to this interrelated system. Countries will experience a reverse demographic transition as life expectancy falls by up to 20 years. Population growth will be lower, but the number of children orphaned by AIDS will explode. Age-based dependency ratios will rise despite a decline in fertility, because AIDS mainly affects young adults in their productive years. With 2–4 percent of the potential workforce

incapacitated at any point in time, actual dependency rates will increase even further.

AIDS depletes scarce human capital. Firms, farms, and households are already seeing the impact in lower output, much higher health and funeral costs, increased family insecurity with the loss of breadwinners, and increased training needs to replace lost skills across a wide range of professions. AIDS will also further reduce the incentive to save, given the increased risk of mortality. And it will deplete public and private resources: caring for one AIDS patient costs as much as educating 10 primary school children (World Bank 1997). Confronting AIDS and reversing rising transmission rates are essential if African countries are to prevent this second development circle from turning into a long-term downward spiral. Political commitment to address this problem is urgently needed. These themes are taken up in chapters 3 and 4.

Africa's economies have not been sufficiently dynamic to diversify and create rapid employment growth

Circle 3: Increasing competitiveness and diversifying economies. With their close links to other sectors and importance for employment and exports, raising the productivity of agriculture and protecting the natural resource base are essential for Africa's structural transformation (chapter 6). Eighty percent of Africa's poor live in rural areas, but forested area per capita will halve in less than 20 years. And productivity in agriculture is rising only slowly.

Africa is also urbanizing rapidly. At 4.9 percent, urban population growth is the highest in the world. Rural-urban migration reflects many factors, including the lack of access to essential services in rural areas, low productivity and incomes in agriculture, and, in some countries, conflict and insecurity. On current trends, Africa's urban population will exceed the rural in the first quarter of the 21st century. By 2025 the urban population will be three times larger than today. But Africa's urbanization is unique—accelerating without rising incomes and without the usual structural transformation that accompanies development, including in agriculture.

Urban agglomeration can have advantages. It is easier to deliver services to denser populations, and urban concentrations offer possibilities for building new industrial and service sectors that are impossible for sparsely populated rural economies. But Africa's urban economies have not been sufficiently dynamic to diversify and create rapid employment growth. Real wages are down in most countries, and formal employment has been falling or stagnant, with informal activities taking up the slack. Open unemployment, which averages about 20 percent in a sample of

African countries, is becoming an urgent economic and political problem. Unemployment rates are higher among the young and the better educated. And recent studies suggest that spells of unemployment are getting longer (Agenor 1998; Dabalen 1999). Cuts in public employment contribute to this dismal picture in a few cases, but the real culprit is the wider failure of private employment to expand.

Why have Africa's economies failed to diversify and create jobs in response to macroeconomic reforms? Labor costs and flexibility are a key issue in South Africa. But business surveys and comparisons with other regions suggest that the problem lies elsewhere in most other countries—in poor infrastructure services, including for the information economy (chapter 5), and in other factors and policies that cause high costs and risks for investors (chapter 7).

The sharp decline in aid since the mid-1990s is cause for concern

The third development circle therefore involves the interaction of population growth, urbanization, and economic diversification. The political economy of this circle is important. Without productive urban centers, tensions will rise as cities fail to generate resources for their infrastructure needs and employment for growing populations. These trends will further undermine political and economic stability and degrade the business environment.

Export diversification is essential to avoid these outcomes (chapter 7). Without exports, including of agroindustrial products, producers will be confined to tiny home markets and have fewer avenues to import global knowledge. No strong exporter lobby will arise to press for competitive service standards, including those needed to facilitate trade, whether in agroindustrial products, tourism, or manufacturing. Some African governments still need to forge a trusting and supportive relationship with their business communities, stressing entry and competition while phasing out informal, personalized links between government and business. Understanding why Africa's economies have been slow to diversify and to grow strong productive sectors (including agriculture) is essential to understanding the challenge of the 21st century.

Circle 4: Reducing aid dependence and strengthening partnerships. Africa is in the midst of an intense debate on aid dependence—on the size and allocation of assistance, on delivery mechanisms (including debt relief), and on the relationship between donors and recipients. There is wide agreement that past aid programs have been disappointing, but also recognition that the objective of much of the Cold War aid flow was strategic and political rather than developmental.

Limited resources and ineffective delivery create massive inefficiencies in translating inputs into outcomes

Aid is a two-edged sword for Africa. On the one hand, foreign savings are essential to permit both higher investment for growth and higher consumption to reduce poverty. Even under favorable conditions for private inflows and Asian levels of investment efficiency, the typical African country faces a resource gap of more than 12 percent of GDP relative to the investment needs of a growth rate likely to achieve the poverty reduction goal for 2015. Continued assistance is therefore essential, and the sharp decline in aid since the mid-1990s is cause for concern.

On the other hand, while high aid dependence and debt service are not the direct cause of weak capacity and accountability, they can make these problems worse and prolong them, especially when the institutional and capacity base is already weakened. With few exceptions, African countries face severe constraints on capacity and skills. Although weak education systems are a serious concern, capacity constraints are not simply a matter of low supply. The region has been losing more than 23,000 professionals a year, partly replaced by some 100,000 foreign advisers funded by technical assistance at an annual cost of $4 billion. The factors underlying Africa's massive brain drain are not just economic. They also reflect security concerns and, in some countries, violent political upheavals. But economic factors have been important too. Since the mid-1970s capacity has been weakened in many countries by the politicization of service under autocratic governments, severe wage compression, and inadequate working conditions. Only in the 1990s have reforms begun to redress pay and working conditions in the public sector, and only in a few countries.

Political participation has increased, but Africa's civil society and representative institutions are far from economically empowered A survey of government audit institutions in 22 countries showed that few satisfied criteria for professionalism, standards, staffing, independence, timely reporting, and quality of follow-up. Only five produced timely reports, and in only two cases were these publicized to encourage scrutiny of public spending by civil society. Few African parliaments have access to the information and technical support they need to monitor the use of public funds.

Limited resources and ineffective delivery—and in some cases, administrative barriers to cost-effective procurement—create massive inefficiencies in translating inputs into outcomes. It has been estimated that Africa receives benefits worth only $12 for every $100 spent on medicines (chapter 4) and that, in parts of West Africa, achieving one 6-year primary school graduate can require the equivalent of 21 student-years,

given high dropout and repetition rates. Cross-country relationships between inputs and outcomes are therefore weak.

How does this relate to aid? Net transfers (which take into account debt service paid on public and publicly guaranteed debt) may have compensated for terms of trade losses (see table 1.4), but most of this assistance has not supplemented normal flows of private income and public revenue. Commitments under SPA programs, which are largely untied and represent the closest equivalent to budget support, represent about one-quarter of net disbursements and in total are less than the debt service payments made by recipient countries.

There is still a long way to go in improving aid effectiveness

The rest of the aid flow sustains a parallel, multidonor, multiproject economy, obscure to host governments and where donors are sometimes reluctant to share information. This parallel economy fragments public programs in key sectors—for example, donors are estimated to fund 40 percent of health spending in a typical African country (World Bank 1999b)—and makes integrated budget management impossible. Because donors prefer to fund capital spending on physical projects, aid also distorts recurrent and capital spending in favor of the latter. Recipient governments become cash poor and project rich, a trend exacerbated in the phase of fiscal stabilization with the tightness of current spending limits.

Recipient governments also cannot compete with better-paying project implementation units that draw the best-trained staff out of public service. Moreover, negotiating aid programs and debt relief with multiple donors absorbs valuable time of key officials in aid-dependent countries. Informal surveys suggest that these officials may spend half their time on donor-related activities rather than on internal administration.

Particularly in countries that have only recently moved toward participatory political systems, aid dependence can make governments less accountable to their civil societies. Donor flows are equivalent to half or more of fiscal revenues in many countries—and finance a major part of social and infrastructure spending. Donors are concerned about the financial integrity of their projects, so governments have to account for aid resources using a variety of donor-specific procedures. But at the same time, governments face less pressure to be accountable to their societies.

Institutions, accountability, capacity, and aid dependence thus constitute a fourth development circle. The weaker are the institutional capacity and accountability at the core of government, the stronger is the incentive for donors to rely on their own institutional controls, further

undermining government accountability and weakening capacity. Resolving this dilemma will require a fundamental rethinking of the relationships among Africa's civil society, governments, and donors. Major changes are under way, notably the World Bank's Comprehensive Development Framework and the initiation of country-led poverty reduction support programs (chapter 8). But there is still a long way to go in improving aid effectiveness—and in formulating a realistic long-run exit strategy from aid.

Globalization and new technology offer great opportunities for Africa

A Window of Opportunity

Africa faces daunting challenges. But the start of the new century offers a unique window to address them.

- *Political opening.* The sharp rise in political participation opens the way for greater public accountability and pressure from civil society for better management of public resources. Today's African leaders are more focused on proper economic management than many of their predecessors, and they have the maturity to address weaknesses of previous policies. These are crucial developments, because the fate of Africa in the new century will be determined not by outsiders, but by Africans.
- *End of the Cold War.* After World War II, Africa became a strategic and ideological battleground where external powers sought reliable allies rather than effective development partners. The end of the Cold War signaled a reduction in external support for peacekeeping and in aid flows due to waning geopolitical competition. But it also opened a window for donors and recipients to attend to development effectiveness.
- *Globalization and new technology.* Globalization and new technology offer great opportunities for Africa. World markets are far more open now than ever before. Trade will probably continue to grow faster than world GDP. And the pool of capital seeking diversified international investments is growing rapidly, partly because of the demographic transition in industrial countries. Advances in the information economy offer huge gains to Africa, historically a sparse region with a population largely excluded from information.

But these trends also pose risks. Technological change will continue to put long-run pressure on primary commodity prices. Countries that can-

not take advantage of trade and investment opportunities face further marginalization and a longer technological lag. As falling protection in major markets reduces the value of special concessions to poor countries, policies will need to emphasize competitiveness and productivity rather than (or in addition to) preferential trading arrangements.

Will Africa be able to take advantage of the window? Will Africa's development partners be able to support the needed trends? The first set of priorities emerging from these cumulative circles—the interaction of governance, conflict, and poverty—is perhaps the most difficult to address from the perspective of economics alone, but it is also the most fundamental. For countries able to maintain peace and security, entry points into the three other circles must be found. Investment in people is essential for the second circle—involving investment, growth, the demographic transition, and HIV/AIDS. The ingredients of effective programs are known; they can now be priced and budgeted. Addressing the structural and institutional issues in the third and fourth circles will also be fundamental for sustaining the transition from adjustment to growth, social development, and poverty alleviation. This will require more than simply "staying the course" and deepening current reforms in macroeconomic and structural areas, even though they are far from complete.

Notes

1. The Special Program of Assistance was created in 1987 to mobilize concessional, quick-disbursing assistance for poor, debt-distressed African countries with adjustment programs led by the International Monetary Fund and International Development Association. For more details, see OED (1998b).

2. IMF (1997) provides a detailed assessment of performance under Enhanced Structural Adjustment Facility programs; Guillamont and others (1999) find that consistent management contributes to good performance. IMF (1998) provides an external evaluation of the Enhanced Structural Adjustment Facility. For a critical view of adjustment programs, see Mkandawire and Soludo (1999).

3. The eight countries judged to be on track were Benin, Burkina Faso, Ghana, Malawi, Mali, Mozambique, Uganda, and Zambia, although Ghana and Zambia had lapses of discipline (see OED 1998b, p. 98).