

# Sub-Saharan Africa: Two Steps Forward, One Step Back

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**T**O THE CASUAL READER, THE DAILY news about sub-Saharan Africa must look rather depressing. Images of drought, famine, and misery mix with scenes of war and reports of fraud and corruption reaching the highest levels of government. It is not that the images and reports are false. It is just that they lack context and perspective.

The media report mostly on the spectacular events—which often include destruction and upheaval—and seldom about the patient efforts made to improve institutions and resolve conflicts. Even the more specialised analysts sometimes fall into this trap. For years, *Transparency International* dutifully ranked Cameroon on top of its list of the world's most corrupt countries, but it has not mentioned the current government's anti-corruption measures, which include the arrests of high officials suspected of fraud. Reports on Ethiopia rarely point out that the recent drought has been far less harmful than earlier episodes, owing to the government's efforts to stockpile grain and improve transportation and distribution. Compared to the "newsworthy" stories about military coups, like the recent one in Côte d'Ivoire, Senegal's peaceful and free transition to a new government has received relatively little attention.

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Negative events have real, and sometimes contagious, effects, with their inherent implications being projected onto countries that are not directly involved. The announcement of land invasions in Zimbabwe caused the South African rand to fall—despite Pretoria's strong macroeconomic policies and its official assurances to investors that similar events could not occur in South Africa. The "bad neighbourhood" syndrome compounds the media's prefer-

the French-franc zone, following the devaluation of the CFA franc in 1994, but very strong growth also occurred in Rwanda and Ethiopia (both recovering from civil wars), as well as in Uganda, Mauritius, and Malawi.

Unfortunately, this improvement did not last, as the accompanying table shows. In 1998, economic activity in most of sub-Saharan Africa (SSA) was seriously affected by three negative developments: the intensification of armed conflicts in the region; the sharp deterioration in the terms of trade, which distressed most countries but particularly the oil exporters (notably Nigeria, Angola, Congo, and Gabon); and the financial turbulence in emerging markets, which raised interest rates and weakened economic activity in South Africa, SSA's most advanced economy.

Real per-capita income in SSA again fell slightly in 1999. World petroleum prices increased sharply, providing some breathing space for the oil-exporting countries, but hurting the oil importers in the region (including South Africa, Ethiopia, Kenya, and most of the West African countries) who also suffered from weak prices for many export commodities such as cotton, cocoa, coffee, copper, aluminium, and gold. Moreover, in 1998-99, serious fiscal slippages occurred in some countries (like Zimbabwe and Guinea), exacerbating pressures on prices and external reserves. In Gabon and Côte d'Ivoire, budgetary problems threatened monetary stability within the central and west African currency unions, respectively.

On the positive side, South Africa's economic situation has improved over

Economic Summary of Sub-Saharan Africa									
	1982-91 Avg.	1991-94 Avg.	1995-98 Avg.	1995	1996	1997	1998	1999	2000 Proj.
	(Annual % changes)								
Real GDP growth	1.9	0.5	3.8	4.0	5.1	3.5	2.5	2.2	4.2
Real per-capita GDP	-1.3	-2.3	1.1	1.7	2.2	0.7	-0.4	-0.5	1.4
Inflation (annual average)	23.0	54.8	26.2	40.7	36.6	16.7	10.7	13.8	11.5
Terms of trade	-1.1	2.4	-0.9	1.3	-1.3	0.3	-4.0	-0.5	2.2
	(In % of GDP)								
Domestic investment	17.3	16.3	17.2	17.2	16.7	16.8	18.2	17.7	17.9
Domestic saving	16.2	14.8	16.1	15.9	16.9	16.2	15.3	15.8	17.8
Current-account balance, excluding grants	-5.2	-4.9	-4.9	-5.2	-3.5	-4.0	-6.8	-5.8	-4.7
Overall fiscal balance, excluding grants	-6.3	-7.8	-4.8	-5.3	-4.5	-4.5	-4.9	-5.0	-3.4

Source: IMF, African department database.

ence for dramatic news and provides an image of economic hopelessness that hurts Africa's reputation and discourages foreign investment.

## Glimpses of Hope

The pessimistic view of sub-Saharan Africa's economic record is not without foundation. In the 1980s and early 1990s, real per-capita GDP fell at an average annual rate of 1.5%—while in the broader group of developing countries output *increased* at an annual rate of about 3%. In the mid-1990s, however, things appeared to take a turn for the better. From 1995 to 1997, the growth of real per-capita GDP in sub-Saharan Africa averaged 1.5% per annum, mostly as a result of better policies. The improvement was particularly evident in

the past year, as prudent macroeconomic policies allowed interest rates to decline gradually in an environment of rising confidence—notwithstanding the rand's recent Zimbabwe-inspired turbulence. Nigeria has tightened fiscal policy, moved to address key governance problems, and embarked on a programme of structural reforms, although much remains to be done to correct the damage caused by decades of economic mismanagement and corruption. Successful adjustment efforts continue in several countries. Unfortunately some of the region's good performers have suffered setbacks—for instance, Mozambique (because of catastrophic floods) and Ethiopia (because of a severe drought aggravated by the war).

In 1999, some progress was made in resolving the major conflicts in the region. In the Democratic Republic of Congo (DRC), the warring parties, including troops from at least seven nations and an array of militias and rebel groups, agreed to a cease-fire. However, combat has flared up sporadically, including recently between two former allies, Uganda and Rwanda. After a last round of heavy fighting, Ethiopia and Eritrea agreed to a cease-fire that offers hope of a lasting peace between the two countries. After the collapse of an earlier peace agreement in Sierra Leone, West African troops led by Nigeria and supported by the United Nations are fighting to end the humanitarian tragedy brought upon that country by the Revolutionary United Front (RUF). In Angola's decades-old conflict, the government now appears to have gained control of most of the territory. The economic cost of these conflicts has been appalling. In the 1997-99 period, for example, real GDP fell at an average annual rate of more than 8% in both Sierra Leone and the DRC.

### Why Has Growth Been So Slow?

Economists have approached this question in several ways. One approach, proposed by Jeffrey Sachs (among others), emphasises SSA's unfavourable geography and climate. SSA is tropical and therefore suffers from diseases such

as malaria, the quality of its soil is poor, and many of its countries are landlocked. There are important elements in this theory. In particular, diseases such as malaria and AIDS have, and will continue to have, extremely serious economic repercussions. As a generalised explanation, however, this theory fails the test of history: tropical countries like Thailand, Malaysia, Singapore, and the coastal areas of southern China have achieved impressive growth rates for several decades.

Many among Africa's economic analysts, including notably Paul Collier, subscribe to a second line of argument, which singles out bad policies and weak institutions as the fundamental cause of the region's sub-standard economic performance. Broadly speaking, they emphasise the high risks and the high costs of doing business in Africa, and they stress the need to provide the infrastructure and environment needed for private investment to flourish. A third approach blames policies made outside of Africa, and particularly the imposition of a heavy external debt burden. Finally, the recent emphasis on poverty reduction has brought to the fore the failure of many SSA governments, and of their bilateral and multilateral partners, to provide the poor with appropriate education and health services and a chance to participate in economic decision-making. The growing concern with governance appears to provide a unifying theme for these theories.

### Investment and Growth

The fundamental determinants of growth are well known, at least in an accounting sense: capital formation, the growth of human capital, and the rise in total factor productivity (TFP). TFP includes all the technological, institutional and policy-related factors that affect productivity growth in a way that is not included in the measurement of capital and labour inputs. Historically, SSA has

performed poorly, if compared to other developing countries, as regards both capital formation and total factor productivity. For example, in the period 1995-98, investment in SSA averaged around 17% of GDP, compared with about 21% in the

developing countries of Latin America, nearly 28% in the developing countries as a whole, and almost 33% in the developing countries of Asia. These are large differences, and they translate into considerable differences in growth rates.

The empirical evidence clearly indicates that increasing investment as a share of GDP must be a key part of any strategy aimed at increasing growth and improving

living standards in Africa. The evidence also suggests that *private* investment in SSA has a significantly stronger, favourable effect on growth than does government investment—yet the ratio of private investment to GDP in the region is very low compared to other developing countries. This lack of private investment is a matter of concern because official development assistance, which provides the financing for a large share of public investment in Africa, is on a declining trend. The central task of a growth-oriented strategy in the continent is therefore to identify and remove the factors that hinder private investment, both domestic and foreign. But this is easier said than done.

### The High Risks and Costs of Private Investment

For a number of reasons, private investment in SSA appears to be subject to both high risks and high costs—to the point that capital projects that are intensive in unskilled labour, a relatively abundant factor of production in Africa, are unable to compete internationally. All of these reasons involve poor policies or deficient institutions.

*Macroeconomic Instability.* Sooner or later, unsustainable fiscal imbalances will result in high inflation, arrears, or

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default. Many countries in SSA have improved their fiscal position in recent years. As a result, the region's average budget deficit (excluding grants) declined from 9% of GDP in 1993 to 4% in 1999. But the fiscal situation remains fragile in many countries. A sudden deterioration in the terms of trade, political difficulties or a delay in disbursements of foreign aid can wreak havoc in the public finances. Given the political pressure to pay wages, these disturbances often lead to the re-emergence of arrears on both foreign and domestic debt, affecting the country's credibility and its attractiveness to investors. Yet, the build-up of a prudent level of reserves would have

allowed the country to weather the storm. In some cases, fiscal control has been lost. In 1998, Gabon experienced a major fiscal crisis because of massive slippages on the expenditure side, leading to an unprecedented gap of 19% of GDP between the projected and actual deficit. Since then, the new finance minister and his team have been struggling, with some success, to restore disciplined procedures of expenditure management and to root out rampant corruption from the budgetary sphere. One step backward, one step forward, as is often the case in Africa. Perhaps two steps forward in this case.

**Dysfunctional Judicial System.** Private investors often complain that judges in SSA make it very difficult for them to recover legitimate claims on domestic residents. Sometimes the judge is corrupt, and the other party has managed to come up with a sufficiently attractive bribe. Sometimes judges will not require a national in financial difficulty to pay his debt, or to release the collateral, because of a perception that it would be unfair to do so—particularly if the lender is a large company or bank, especially if

it is foreign. Sometimes courts are just slow to render justice because of poorly trained court personnel. Whatever the precise reason, the failure to enforce contracts and property rights reduces the risk-adjusted rate of return on capi-

litigation before businesses can recover their claims on the government.

**War.** Armed conflicts destroy human lives and physical infrastructure, disrupt the working of institutions, threaten macroeconomic stability, and crowd out spending on human capital and infrastructure. More than any other factor, they discourage private investment and imperil the viability of any growth-oriented strategy. Unfortunately, the underlying causes of Africa's conflicts—poverty, ethnic and religious tensions, the inheritance of colonialism and the cold war, and the presence of easily extractable wealth, notably alluvial diamonds—are not amenable to quick changes. Simple solu-

tions, like the imposition of a ceiling on military spending to all countries in SSA, would probably be ineffective. This kind of simple rule would also be unfair as it would punish equally the aggressor and the victim of the aggression, and hinder the latter's ability to deter aggression.

War is essentially a political problem and the solution requires political action by those who wish to help. The international community has unfortunately been slow in rescuing the victims of aggression, in supporting those African countries that are engaged in peace-keeping operations, like Nigeria, and those that must deal with large numbers of refugees, like Guinea. But things are changing. Recent actions by the United Kingdom and the United States to confront the RUF and its allies in Sierra Leone may well signal the end of the



*Living in a bad neighbourhood: Their future remains threatened by corruption, bad policies, and weak institutions.*

tal and discourages investment. Here again, however, there are positive signs. For example, the Organisation for the Harmonisation of Business Law in Africa (OHADA), founded by SSA's francophone countries, is helping to improve and streamline practices in this area.

**Government Corruption.** The relations between government and the business community—although they are good in some African countries—are periodically poisoned by disruptive or corrupt government practices. Red tape, fraudulent procurement procedures and, in some extreme cases, extortion, raise the cost and increase the risk of doing business on the continent. As noted earlier, government arrears are a major source of uncertainty for the private sector. They also involve large costs: even in the best cases, it may take many years of

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international community's tolerance for aggression and brutality. Furthermore, bilateral and multilateral donors have helped governments in Rwanda, the Republic of Congo, Guinea-Bissau, and most recently Sierra Leone, to start rebuilding their economies and their institutions (for example through the World Bank's *Disarmament, Demobilisation, and Reintegration* programme, and the IMF's *Post-Conflict Facility*). Most important, Africans themselves are increasingly helping to resolve conflicts in the region: the Organisation of African States played a major role in the peace talks between Ethiopia and Eritrea; troops from the Economic Community of West African States (ECOWAS) are fighting to re-establish a lasting peace in Sierra Leone; and former South African President Mandela is mediating the conflict between the government and the Hutu opposition in Burundi.

### **The Cost of an Uneven Playing Field**

Governments sometimes sin by favouring a particular group of enterprises and shielding them from competition. They do this in exchange for political or financial favours, as is known to have happened with some large foreign enterprises in parts of Africa, or out of ideological preference for domestic or for state-owned enterprises. By redistributing income to the favoured companies, such policies penalise other businesses and often the consumer. Moreover, the methods of protection—discriminatory export and import tariffs, tax exemptions, the granting of monopoly rights—usually involve a dead-weight loss that statistically shows up in lower total factor productivity. This kind of loss is incurred by the bulk of the population that, in most of SSA, means the poor majority. The tax system, for example, often discriminates in favour of certain enterprises that benefit from significant tax exemptions; the cost of maintaining fiscal revenue is borne by other enter-

*The lack of private investment is a matter of concern because official development assistance is on a declining trend.*

prises, and by taxpayers in general, in the form of high marginal tax rates. Complex and uneven systems of import duties also have served as an instrument of selective protection. But large steps are being taken to liberalise and rationalise trade systems in SSA. The recent move in the West African Economic and Monetary Union toward a simpler and lower common external tariff, coupled with a single-rate value-added tax (VAT), is an important example of trade liberalisation spurred by regional cooperation.

In the agricultural sector, a number of countries have introduced important reforms over the past decade. Nevertheless, government intervention continues to be a problem in parts of SSA. Export taxes are used to protect the domestic processing industry against more efficient foreign processors, as in Mozambique's cashew-nut sector, thus redistributing income away from poor farmers. Similarly, the monopsonistic position of certain companies in West Africa's key cotton and cocoa sectors has been a source of both inefficiency and exploitation of the farmer. Here too, however, important reforms are under way, with visible results in some countries like Mali and Benin (cotton) and in Côte d'Ivoire (cocoa).

In several areas such as transportation and banking, Africa needs an adequate legislative and regulatory basis coupled with strong government agencies to foster competition. While free and sophisticated financial markets thrive in South Africa, in many countries interest rates and exchange rates are not allowed to clear markets, allegedly because of fear of instability, but actually because these prices are set by cartelised banking structures, often in connivance with government officials.

Africa needs more, not less competition. By allowing efficient firms to enter the local market, competition will lead to lower prices and better quality of inputs for both the consumer and the enterprise sector. It will make efficient domestic producers more competitive and thus increase exports and foster economic diversification without relying on costly subsidies. Also, competition on a stable and level playing field will attract foreign companies that will bring in low-cost products, organisational expertise, and superior technology. Together with greater competition, the adoption of modern tech-

*Red tape, fraudulent procurement procedures, and extortion raise the cost and increase the risk of doing business on the continent.*

nologies in the areas of information processing and telecommunications should help to reduce any disadvantage that Africa may have because of its low population density, relatively large distances from ports and major world markets, and the geographic isolation of some of its landlocked countries. In this light, globalisation should not be seen as a danger, but as an important challenge for African policy makers.

### **Are Growth and Poverty Reduction Complementary?**

The recent emphasis on poverty reduction in Africa is now fully accepted among donors, NGOs and international organisations. The important question that remains to be answered is whether this emphasis is consistent with an approach focused on economic growth through efficiency and stability. It may be helpful to start with a simple proposition: the income of the poor can be raised by increasing the rate of growth of national income and/or by changing income distribution in favour of the poor. This seems incontrovertible, but it leaves two important questions unanswered. First, are there any tradeoffs, or any positive complementarities, between growth-enhancing policies and redistributive policies in terms of their poverty-reduction potential? Second, how powerful are growth-enhancing and

redistributive policies as instruments for achieving a *lasting* reduction in poverty?

In a few cases, policies may appear to involve a tradeoff between growth and redistribution. A lower marginal tax rate provides incentives to invest, to save, and to work, and therefore helps growth. But, in and of itself it reduces tax revenue and thus narrows the scope for the redistribution of income. From a practical standpoint, however, this tradeoff may be illusory: in most African countries, there is considerable scope for increasing revenue without raising marginal tax rates, by eliminating tax preferences and reducing fraud. It may also be argued that increasing the share of the fiscal pie devoted to health and education could be at the expense of infrastructure and therefore could reduce growth. But in many SSA countries, restraint on public sector wages and action to reduce corruption could provide ample room to improve both social services and physical infrastructure.

By contrast, there are many important examples of policies that have independently favourable effects on both economic growth and poverty alleviation. There is now a large body of empirical literature indicating that high inflation, and the uncertainty that it generates, is detrimental to economic growth. In addition, inflation appears to have a disproportionate, detrimental effect on the poor. This is not surprising: the poor are less able to protect themselves against the uncertainty generated by inflation because they have little access to education, the financial system, or to foreign assets.

Positive complementarities between growth and redistribution are also involved in the case of structural policies. The liberalisation of agricultural sectors in certain African countries

would involve an increase in efficiency and growth and also a redistribution of income to the farmers who constitute the majority of the poor. Education and capacity building improve the productivity of the labour force as well as the



*Allowing efficient firms to enter the local market will lead to lower prices and better quality.*

ability of the government to provide social services. On the whole, there is a strong positive correlation between policies designed to increase the growth of potential output and those designed to redistribute income toward the poor.

The second question is about the relative efficiency of growth and redistribution as instruments of sustained poverty reduction. In recent years, economists like Michael Roemer, David Dollar, and Aart Kraay have provided considerable evidence for the proposition that growth is a powerful force in reducing poverty. In particular, they find that an increase in per-capita GDP of 1% increases the average income of the poor by approximately 1%, reduces the proportion of the population earning less than US\$1 per day by 1.8%, and reduces the *severity* of poverty by 3.5%. Policies aimed at increasing growth should therefore be a key ingredient of any long-term poverty-reduction strategy, particularly since, in many

cases, these policies also have direct beneficial effects on the poor. There is also room for redistributive policies, particularly those that increase the effective provision of public services to the poor. However, given the very low levels of per-

capita income in most parts of sub-Saharan Africa, it is very difficult to see how a substantial and lasting reduction of poverty can be achieved without strong and sustainable economic growth.

### **Governance: The Unifying Theme?**

Corruption worsens the climate for private activity and encourages inefficient public investment projects at the expense of investment in operations, maintenance, and infrastructure. In addition,

corruption redistributes income in favour of the rich, who are politically connected and therefore better placed to capture rents (and who can afford to pay bribes). Corruption also hurts the poor by reducing the progressivity of the tax system via exemptions, by eroding fiscal revenue through capital flight, and by diverting public funds away from social investment.

On this basis, it is not very difficult to construct a list of the policies required to improve the standard of living of the African populations. But the problem is not just intellectual, it is largely political. Africans need to find a mechanism to help, to induce and, if needed, to compel their

rulers to adopt the right policies. Improved governance, and particularly the fight against corruption, are the necessary political foundations of an economic programme aimed at lasting growth and poverty reduction. ♦

*More than any other factor, wars discourage private investment and imperil the viability of any growth-oriented strategy.*