POLICY ESSAY NO. 22

PERSPECTIVES ON AID AND DEVELOPMENT

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CHAPTER 1

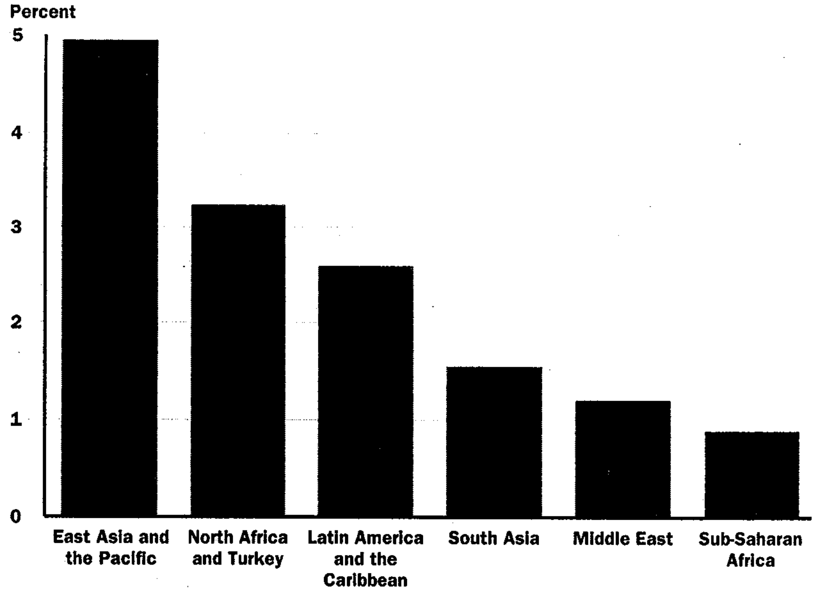
Why Africa Had to Adjust

SUB-SAHARAN AFRICA'S ECONOMIC GROWTH, NEVER spectacular, has been the weakest among developing regions (figure 1.1). The region most in need of growth to reduce poverty has had the least. Between 1965 and 1985, its GDP per capita increased less than 1 percent a year on average. More worrisome, its economic performance actually began deteriorating in the mid 1970s. After growing an average of 2.6 percent a year between 1965 and 1974, GDP per capita stagnated or turned down thereafter in most Sub-Saharan countries (figure 1.2). By the early 1980s, few Sub-Saharan countries had kept their per capita GDP growth in line with the rest of the world's, and many had a lower GDP per capita than before independence some twenty years earlier. The economic situation worsened in the first half of the 1980s, with further deteriorations in the terms of trade and sharply reduced access to international finance. For more than two-thirds of all Africans, real incomes were lower in 1985 than in the mid-1970s.

Southeast Asia presents a startling contrast. In 1965 Indonesia's GDP per capita was lower than Nigeria's, and Thailand's lower than Ghana's. Indonesia relied on oil as much as Nigeria did. Thailand, much like Ghana, was a poor agricultural country. Who could have predicted then that in 1990 Indonesia's GDP would be three times that of Nigeria? Or that Thailand would become one of the world's best performing economies, while Ghana would be struggling to regain its former income level?

Few areas of economic activity were exempt from the stagnation and decline. After healthy increases in exports in 1965–73, the growth slowed—and then plunged to negative levels between 1981 and 1986 (figure 1.3). Exports of manufactures declined slightly between 1970

Figure 1.1 Average Annual GDP per Capita Growth, 1965–85

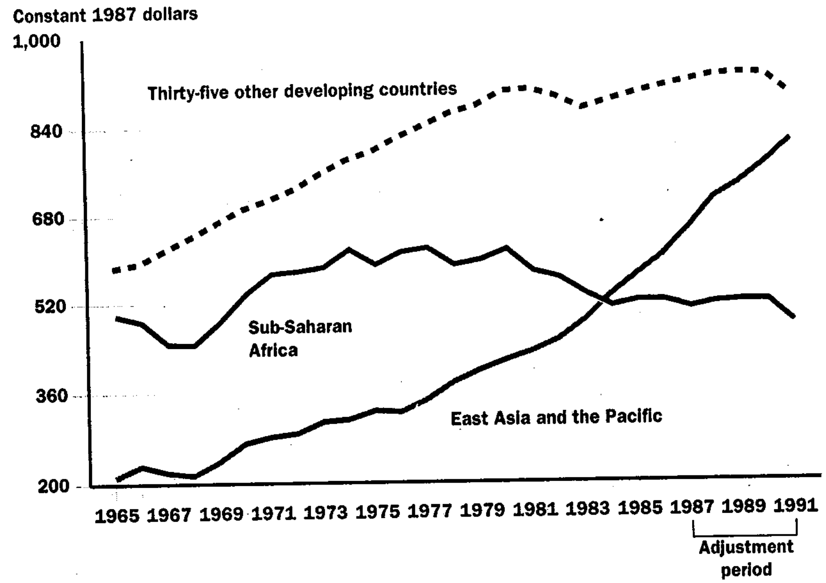


Note: Growth rates were calculated using the ordinary least-squares method.
Source: World Bank data.

and 1986, while increasing fivefold for Latin America, sixfold for the Middle East and North Africa, and thirteenfold for Asia's newly industrializing countries. Even agricultural exports slipped, as the region's share in developing-country exports of food and other agricultural products went from 17 percent in 1970 to 8 percent in the mid-1980s. The region also lost ground in its exports of ores and minerals. Only in oil did Africa improve its export share.

Most of the region's economies failed to diversify their export base and continued to rely on only one or two commodities. In the mid-1980s, primary products generated 80 percent of Africa's export revenue, roughly the same share as in the 1960s, and manufactured exports were significant in only a handful of countries. Meanwhile, exports of agricultural products became even more concentrated. Nine major commodities accounted for 76 percent of the region's agricultural exports in the 1980s—up from 70 percent in the 1960s (appendix table A.1). Countries elsewhere, by contrast, diversified their export base and increased their shares in world exports of primary commodities.

Figure 1.2 GDP per Capita



Source: World Bank data.

Agriculture, particularly important for Africa's growth, did worse than other sectors. Between 1965 and 1980, agricultural growth rose only 2 percent a year—less than the rate of population growth—and between 1981 and 1985, it fell 0.6 percent a year. Compare that with agricultural growth of 3.2 percent a year in East Asia, 2.5 percent in South Asia, and 3.1 percent in Latin America.

By the mid 1980s, symptoms of the malaise were evident almost everywhere. The returns on World Bank investment projects were much lower in Africa than in other regions, and more than a quarter of those projects failed to generate a positive rate of return. It was (and still is) almost impossible to attract foreign private capital—either in investment or loans—and portfolio investment flows were negligible. The international prices for Africa's government debt in secondary markets were the lowest for developing countries, reflecting the markets' perception of African countries as uncreditworthy. The physical infrastructure, already poor, deteriorated from lack of maintenance, and the quality of government services suffered. Health and education indicators, though better than in the 1960s, were still a long way below those for other developing countries. Clearly, it was time for African economies to begin to adjust.

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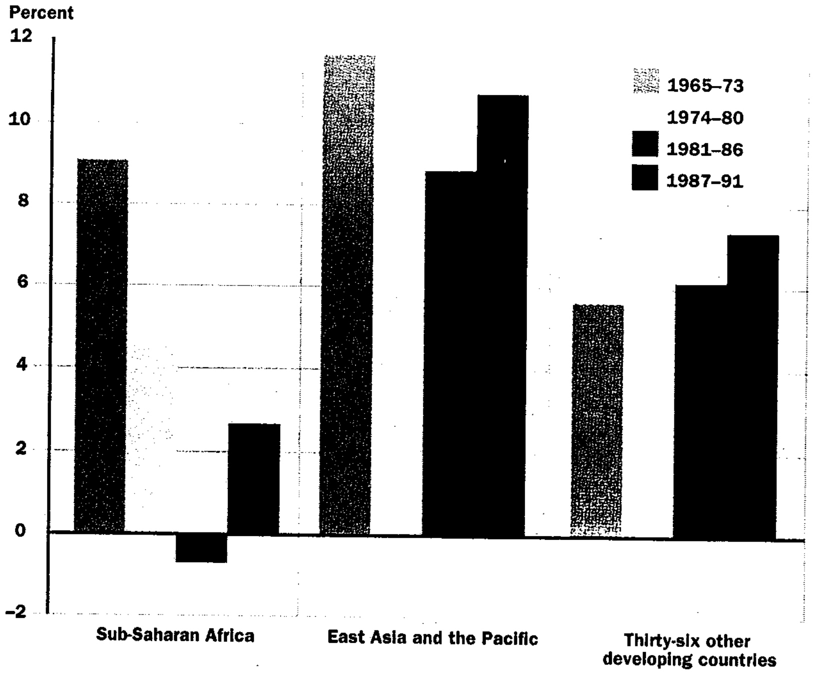
Figure 1.3 Average Annual Growth in Exports



Note: Exports valued in local currency, constant prices.
Source: World Bank data.

Understanding the Stagnation and Decline

THERE IS NO SINGLE EXPLANATION FOR AFRICA'S POOR PERformance before the adjustment period. The main factors behind the stagnation and decline were poor policies—both macroeconomic and sectoral—emanating from a development paradigm that gave the state a prominent role in production and in regulating economic activity. Overvalued exchange rates and large and prolonged budget deficits undermined the macroeconomic stability needed for long-term growth. Protectionist trade policies and government monopolies reduced the competition so vital for increasing productivity. In addition, the state increased its presence in the 1970s, nationalizing enterprises and financial institutions and introducing a web of regulations and licenses for most economic activities. More important, the development strategy had a clear bias against exports, heavily taxing agricultural exports, one of the largest suppliers of foreign exchange.

The choice of poor policies may be understandable in light of conditions in Africa after independence. Because of the lack of domestic capital and entrepreneurs, the unwillingness to rely on foreign capital, and the underlying distrust of the market, almost all African countries chose (with the full support of aid donors) to rely on the state. They had the company of countries in Eastern Europe, Latin America, and South Asia—and the encouragement of many development economists.

Industrialization was believed to be the key to rapid growth, because of declining prices for primary commodities and because of the benefits of reducing reliance on imported manufactures. Agriculture, rather than being stoked as the engine of growth, was taxed to provide the resources to build a modern industrial sector. Governments drew up five-year plans, created public enterprises, and enacted regulations to control prices, restrict trade, and allocate foreign exchange in pursuit of social goals. At the same time, countries were struggling to establish themselves as nations and put new governmental structures in place. But governments became overextended, particularly relative to their weak institutional capacities, as they tried to build national unity and deliver on the promises of independence.

Factors outside Africa also contributed to the decline of the 1970s and 1980s, though their importance is too often exaggerated. Non–oil exporters suffered falls in the terms of trade, but the losses, which actually began in the 1960s, were no larger than those for other developing countries. But the volatility of export receipts—and thus of foreign exchange earnings and fiscal revenues—complicated macroeconomic management. Depending on the availability of foreign exchange, imports went through cycles of compression and decompression, as did growth. Investment budgets and public sector employment expanded rapidly in boom years, hampering adjustment in bust years. Poor policies failed to encourage export diversification and increase international reserves to smooth the impact of adverse shocks.

Domestic Factors: Poor Policies Largely to Blame

There is ample evidence that sound macroeconomic and sectoral policies are associated with higher growth (see box 1.1). Policies in Sub-Saharan Africa, however, have generally been worse than those elsewhere.

Overvalued exchange rates. The presence of unofficial, parallel markets for foreign exchange—in countries with flexible exchange rates—

Box 1.1 Policies Matter for Growth

RESEARCH ON THE DETERMINANTS OF LONG-term growth shows that better policies typically mean faster growth (Barro 1991; Easterly 1992; Killick 1992). The most successful economies maintained good macroeconomic policies, as measured by low inflation, prudent fiscal stances, and realistic exchange rates. Among the macroeconomic variables, the absence of a parallel market—an indication that the exchange rate is not overvalued—generally has the strongest explanatory power. Sectoral policies, such as those for finance and trade, also matter. Countries with larger and more developed financial markets generally grow faster. The same is true for countries with more open trade regimes.

Estimates of how changes in indicators of country policies would affect growth suggest that policies matter a great deal (box table 1.1). For example, a reform package that in the long run raised enrollment ratios by 10 percentage points, eliminated a parallel market premium of 20 percent, raised the ratio of equipment investment to GDP by 3 percentage points, and increased financial depth (the ratio of M2 to GDP) by 10 percentage points would likely raise the annual per capita growth rate by 2.6 percentage points. And if policy reforms were helped by an improvement in the terms of trade of 1 percentage point of GDP a year, annual GDP per capita would grow between 0.4 and 0.8 percentage points. All these improvements, added to the 0.9 percent annual growth that Africa experienced between 1965 and 1985, would bring Africa's long-run GDP per capita growth rate to about 4 percent a year—close to East Asia's.

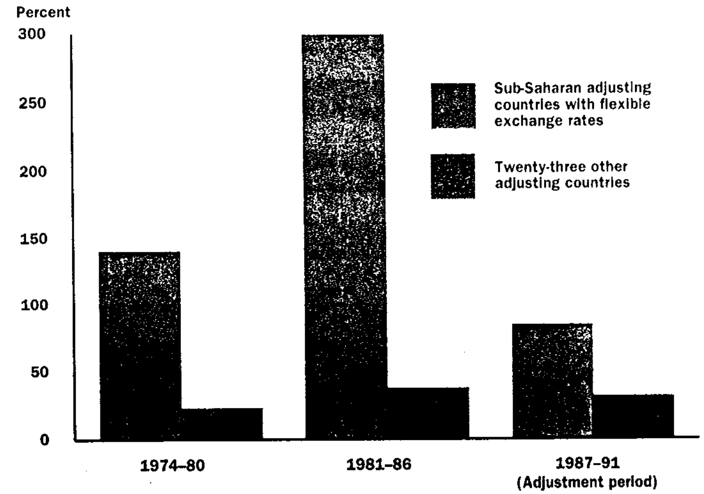
Box Table 1.1 How Would Changes in Selected Variables Affect GDP per Capita Growth?

Variable	*Increase in variable (percentage points)*	*Estimated change in growth (percentage points)*
Ratio of investment to GDP	1	+0.1 to 0.2
Primary school enrollment ratio	10	+0.2 to 0.3
Secondary school enrollment ratio	10	+0.2 to 0.3
Parallel market exchange rate premium	10	–0.4
Ratio of M2 to GDP	10	+0.2 to 0.4
Ratio of average producer input price to world market price	10	–0.4
Ratio of government consumption to GDP	10	–1.2
Ratio of equipment investment to GDP	1	+0.3
Ratio of average change in terms of trade to GDP	1	+0.4 to 0.8

Source: Easterly (1992), table 1.

reveals overvaluation of the real effective exchange rate.[1] Africa's parallel market premiums have been by far the largest in the developing world, and they increased significantly until the adjustment period (figure 1.4). During the economic crisis in the first half of the 1980s, the average premium was almost 300 percent. Rough estimates indicate that a 10 percent premium is likely to reduce GDP growth by 0.4 percentage points a year (box 1.1). But the impact wanes as the premium goes up, and a 100 percent premium cuts GDP growth by 2 percentage points a year. For Ghana between 1974 and 1980, the parallel market premium of more than 200 percent explains a slowdown in GDP growth of about 3 percentage points a year.

Figure 1.4 Premium on the Parallel Market for Foreign Exchange

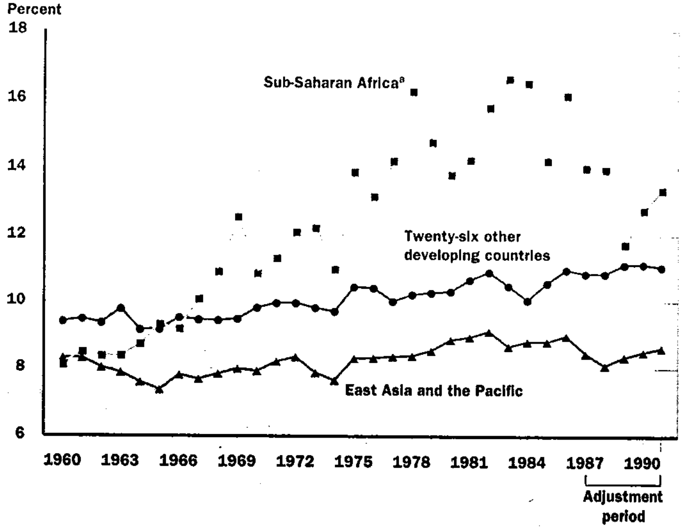


Note: The premium is calculated as the percentage difference between the parallel market exchange rate and the official exchange rate (in domestic currency at the end of the period).
Sources: International Currency Analysis, Inc. (various years); IMF data.

Heavy government spending. Among the more common indicators of good fiscal policy are a small budget deficit and a low ratio of government consumption (that is, current spending on goods and services) to GDP. Most Sub-Saharan countries had neither. However, while Africa's budget deficits were not much larger than those elsewhere, the ratio of government consumption to GDP was a different story. Consumption began to increase in the early 1960s and reached its peak—nearly 17 percent of GDP—in the early 1980s, exceeding the ratios of other regions by 5 to 6 percentage points (figure 1.5). That excess was important in deterring growth, for statistical analysis shows that over the typical range of government expenditure, each 10 percentage point increase in the ratio of government consumption to GDP typically reduces GDP per capita growth by 1.2 percentage points.

Inward-looking trade policy. Africa's trade policies have also been poor. Most Sub-Saharan economies followed an inward-oriented, import-substitution strategy, supplemented by widespread use of tariff and nments outspent others of goods and services.

Figure 1.5 Government Consumption as a Share of GDP

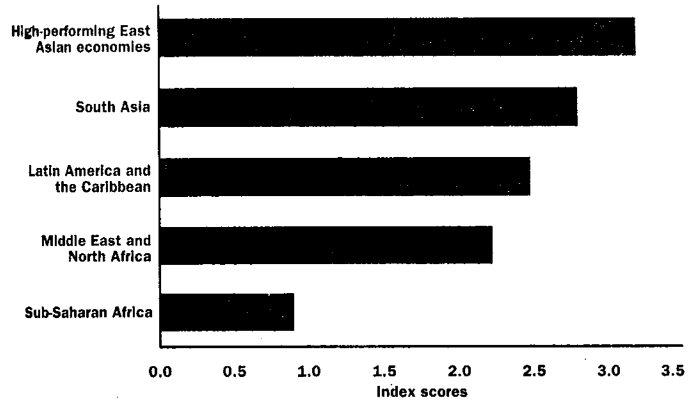


Note: Data are weighted by 1980 GDP in U.S. dollars.
a. Includes twenty-five countries only.
Source: World Bank data.

nontariff barriers to reduce external competition, mainly in manufacturing. Dollar's (1992) index of outward orientation showed Sub-Saharan African countries as the least outward-oriented—and Asia's high-performing economies as the most (figure 1.6).[2] Of the twenty countries with the highest nontariff barriers, eleven were in Sub-Saharan Africa (Pritchett 1991). This protectionism was another unfortunate policy choice, because competition increases productivity while trade restrictions increase input prices and the cost of capital, choking growth.

Political instability. Political and social stability also are usually associated with higher rates of growth (Barro 1991; Fosu 1992), and the instability in Sub-Saharan Africa partly explains its sluggish performance. More than half the region's countries have been rocked by civil war, uprisings against the government, and devastation from drought and famine, and their average per capita GDP growth was –0.5 percent a year for 1965–85. By contrast, the region's eleven stable countries had an average growth rate of 1.4 percent (Hodd 1991). But the strong

Figure 1.6 Outward Orientation of Selected Country Groups, 1965–85



Note: A high score corresponds to more outward orientation.
Source: World Bank (1993a), figure 6.4.

In openness to foreign trade, Af trailed the world.

association between stability and growth merely raises the question: which is the cause, and which the effect?

Other domestic factors. What about other domestic factors, such as human capital? Of all endowments, human capital probably does most to fuel long-term economic gains. Simply put, countries with skilled people grow faster. The fact that Sub-Saharan Africa trails other regions in social indicators can thus help to explain its slow growth. But how does one reconcile Africa's protracted decline with the fact that human capital, measured by several indicators, *improved* in Sub-Saharan Africa after independence? Primary school enrollments increased from 41 percent of the eligible population to 69 percent between 1965 and the mid-1980s, with girls accounting for much of the increase. Secondary school enrollments increased from 2 to 14 percent, with almost equal increases for boys and girls. Health and nutrition indicators also showed progress. Infant mortality was cut in half, the number of doctors and nurses per capita increased, and life expectancy at birth rose by eight years.

Financial strength is another important determinant of growth: countries with more developed financial sectors grow faster. And financial strength, measured by various indicators, improved in Africa. For instance, M2 as a share of GDP, a measure that indicates how well-developed the financial sector is, increased from about 15 percent in the early

1970s to 20 percent in the mid-1980s. So financial development, like human development, was stemming the decline, not causing it.

International Factors: Surmountable Obstacles

Changes in the terms of trade do have an impact on long-term growth. Easterly and others (1993) found that over the 1980s, for example, a negative terms-of-trade shock averaging 1 percentage point of GDP a year lowered growth by 0.8 percentage points a year. Like other regions, Africa suffered a fall in the terms of trade between the early 1970s and the mid-1980s. But on an annual basis, the terms-of-trade decline was small and thus not a major factor in Africa's poor growth record. Moreover, increased external transfers partially offset the falling terms of trade, limiting the downturn in growth.

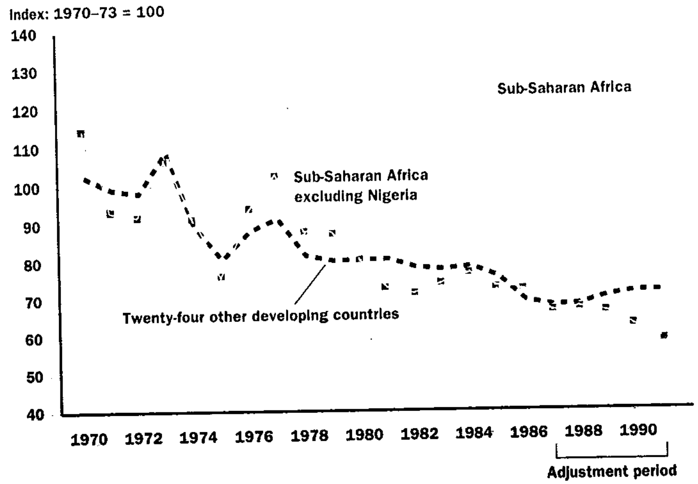
Of course, external income from terms-of-trade shocks and external income from transfers (grants or loans) differ in their economic effects and fungibility.

- External loans have to be repaid, while grants and export earnings do not.
- The windfall of additional foreign exchange from higher commodity prices can be used freely, while many grants-in-kind, such as food and medicine, do not provide readily available foreign exchange. Even the financial resources provided under grants and loans are often partially tied.
- Loans and grants primarily affect public income, while changes in the terms of trade have a larger impact on private income.

In practice, however, it is difficult to draw a sharp distinction between income from terms-of-trade gains and that from grants and loans. The reason: loans are often converted to grants or forgiven, and terms-of-trade changes affect the public sector because marketing boards and trade taxes have generally stabilized the real producer prices of exports. Because of the overlapping nature of these two sources of income, we examine their joint evolution.

Declining terms of trade. Most Sub-Saharan economies faced deteriorating terms of trade between 1970 and 1986 (figure 1.7). Oil exporters were the main exceptions, with improvements of more than 100 percent. Non–oil exporters suffered losses of about 30 percent, while mineral exporters were even harder hit, with losses of about 50 percent.

Figure 1.7 Barter Terms of Trade



Note: Data are means weighted by 1980 GDP in U.S. dollars.
Source: World Bank data.

Setting aside Nigeria, Afric of-trade losses resembled t other developing countries.

For Sub-Saharan Africa as a whole (excluding Nigeria because of its oil and sheer size), the declining terms of trade meant a drop in external income equivalent to 5.4 percent of GDP between 1971–73 and 1981–86.[3] Though large, the loss was spread over twelve years, for an average annual loss of 0.4 percentage points. Adding Nigeria to the picture reduces the twelve-year loss to just 3.3 percent of GDP, or 0.3 percentage points a year. Again, the losses were biggest for mineral exporters (about 1.5 percentage points a year) and more moderate for the agricultural exporters (about 0.3 percentage points a year). Oil exporters gained from higher prices, increasing GDP about 0.3 percentage points a year.

Although the worsening terms of trade hindered growth, they were not decisive in Africa's stagnation and decline. If an annual income loss of 1 percentage point from declining terms of trade reduces the annual rate of growth by no more than 0.8 percentage points (Easterly and others 1993), then the falling terms of trade can account for no more than 10 percent of the reduction in growth rates between the early 1970s and the mid-1980s. Even for Zambia, probably the region's hardest-hit country, the terms-of-trade deterioration explains only 1 percentage point of the 3.4 percentage point reduction in annual GDP growth. Moreover, Sub-Saharan Africa was not alone. Most low-income countries elsewhere had similar deteriorations in their terms of trade—around 20 percent on average since the early 1970s—and yet they enjoyed faster growth as a result of better policies.

Higher external transfers. Net external transfers increased during the 1970s, in part to compensate for the income losses from the weakening terms of trade. Although the rise in net transfers did not fully offset those losses, it would have been difficult for external sources to have given Africa more assistance. Almost all indicators show that Sub-Saharan Africa already received more assistance than any other region (table 1.1). Net transfers to Sub-Saharan Africa (minus Nigeria) increased from 3.7 percent of GDP in the early 1970s to between 6 and 7 percent of GDP in the late 1970s and early 1980s. By contrast, they remained under 2.4 percent of GDP for the low- and lower-middle-income countries in other regions. Africa was receiving almost $20 per capita in net external transfers, four times the amount going to poor countries elsewhere.

The higher external transfers, however, did not always coincide with African countries' needs for foreign exchange. The transfers in the second half of the 1970s rose with commodity prices, and they fell when commodity prices retreated in the early 1980s. But the average annual

…ternal Capital Transfers for Low-Income Countries

	1971–73	*1974–80*	*1981–86*	*Adjustment period, 1987–91*
…s (percentage of GDP)				
…n Africa	2.5	4.3	3.6	4.7
…ng Nigeria	3.7	7.0	6.4	7.0
…her countries[a]	1.1	2.3	1.7	1.1
…s per capita (U.S. dollars)				
…n Africa	5.14	19.18	18.23	16.30
…ng Nigeria	6.63	22.92	23.11	24.65
…her countries[a]	1.59	5.37	5.70	4.01

…transfers equal net transfers on debt (loan disbursements minus amortization minus interest) plus grants (excluding technical …us IMF net transfers.

…seven non-African countries with up to $1,200 GNP per capita in 1990.

…rld Bank data.

flow of net transfers in the late 1970s and early 1980s was about 3 percentage points higher than in the early 1970s, and the economic decline and stagnation started in the mid-1970s when external transfers were high—about 6 percent of GDP.

Moderate income losses overall. The external environment for Sub-Saharan Africa worsened only slightly between the early 1970s and the mid-1980s, because the increase in external transfers partly offset the income loss from deterioration in the terms of trade. If Nigeria is excluded, the decline in the terms of trade caused GDP to drop 5.4 percentage points between 1971–73 and 1981–86, but the increase in external transfers meant an increase in GDP of 2.7 percentage points (table 1.2). Adding these two effects, the total income loss between 1971–73 and 1981–86 was 2.7 percent of GDP, or 0.3 percentage points a year. From this perspective, the external environment was not much different in the mid-1980s from what it had been fifteen years before (and for the oil exporters, the external environment was better).

Meanwhile, Sub-Saharan Africa's GDP per capita growth rate sank 3.2 percentage points (from 2.5 to –0.7 percent). Only a small part of that decline, however, can be attributed to the reduced flows of external income (figure 1.8). Recall that an annual income loss of 1 percent of GDP is estimated to reduce GDP growth by 0.4 to 0.8 percentage points a year (box table 1.1). Between 1971–73 and 1981–86, the annual income

Table 1.2 Effects of Changes in External Income on GDP, 1971–73 to 1981–86

	Change in GDP (percentage points)		
Item	*Due to changes in the terms of trade*	*Due to changes in net transfers[a]*	*Total*
Sub-Saharan Africa			
Period average	–0.3	1.1	0.8
Annual average	–0.0	0.1	0.1
Sub-Saharan Africa excluding Nigeria			
Period average	–5.4	2.7	–2.7
Annual average	–0.5	0.2	–0.3

a. Net transfers equal net transfers on debt (loan disbursements minus amortization minus interest) plus grants (excluding technical assistance) plus IMF net transfers.

Source: World Bank estimates.

Changes in GDP per Capita Growth and External Income in Sub-Saharan Africa, Various Periods

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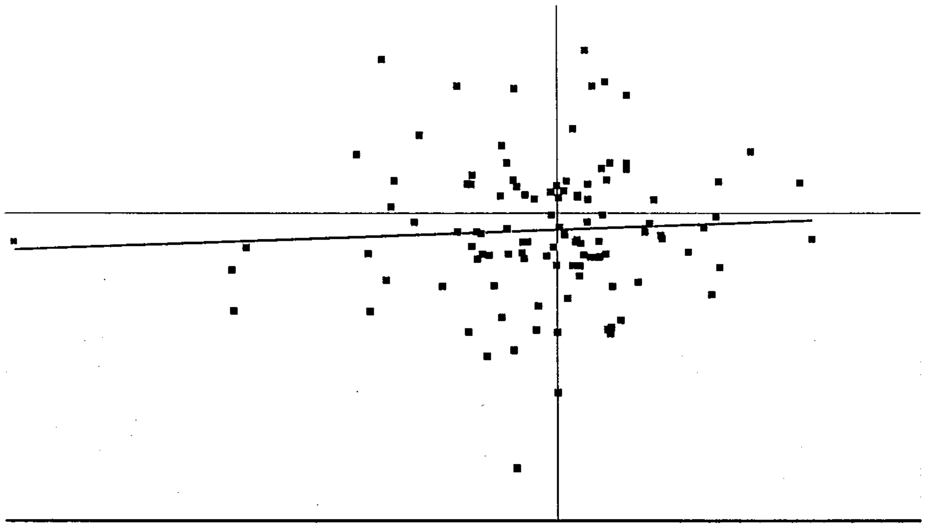


.ure plots three changes (between 1965–73 and 1974–80, between 1974–80 and 1981–86, and between 1981–86 and 1987–91)
:ountries.
l Bank estimates.

me shocks had only : on long-term GDP

loss from changes in net transfers and the terms of trade was only 0.3 percent of GDP. The expected effect on GDP growth would thus be a decline of 0.1 to 0.2 percentage points a year—far less than the 3.2 percentage point drop Africa actually suffered.

Failures to capitalize on better terms of trade. Long-term trends in the external environment played only a secondary role in Africa's long-term decline in growth. They may have had a much larger indirect influence on growth, however, to the extent that they contributed to poor policy choices. African countries' limited capacity to manage terms-of-trade fluctuations often led them to adopt exchange rate, fiscal, and agricultural policies that undermined growth over the medium term. Paradoxically, positive terms-of-trade shocks were often as costly as negative ones. A handful of countries had faltering growth despite a better external environment. For example, GDP per capita stagnated in Nigeria during its oil boom, when the country was flooded with foreign exchange from oil revenues and external loans (box 1.2). Why? The windfall financed wasteful current expenditure, ill-advised investment projects, and capital flight.

The main problem with a windfall is that governments increase spending as if the higher revenues were permanent. And once increased, government spending is difficult to reduce. Consider the coffee and cocoa booms in Côte d'Ivoire and Kenya during the late 1970s. Current and especially capital spending increased, leveraged by external borrowings. But once the booms were over, revenue could not continue to match the spending increases, and governments were left with large deficits. The high expectations generated by the boom made trimming the public sector politically painful. And increasing revenues to cover debt service obligations was difficult because export earnings were dropping. Many of Côte d'Ivoire's macroeconomic problems in the 1980s stemmed directly from expanding the public sector too much during the 1970s boom.

Explaining What Econometric Analyses Don't Explain

The evidence shows that poor policies clearly hurt Africa's long-term growth far more than a hostile external environment did. But neither policy choices nor external factors explain all of the low growth. Cross-country econometric analysis shows that Sub-Saharan Africa has grown more slowly than other regions even after differences in macroeconomic policies, endowments, political instability, and external shocks are taken into account (Easterly and Levine 1993). Other factors—the bias against agriculture, extensive government intervention in the economy, weak infrastructure, and the difficulties of the political and social transition following independence—have been suggested to account for the residual difference in growth performance.

Let us start with the bias against agriculture, perhaps the most important "omitted" variable in econometric analysis. Most Africans live in rural areas, and the region relies heavily on agriculture for foreign exchange. Yet agriculture has been heavily taxed, much more than in other regions (Schiff and Valdes 1992). Producers of agricultural exports—typically forced to sell their crops to marketing boards that monopolized exports—received real prices half those received by producers of similar crops in other countries (Akiyama and Larson 1989). This stifled the region's agricultural growth.

- Nigeria's real exchange rate had appreciated almost 50 percent by the end of the second oil price increase in 1981, and not until the big devaluations of 1986 and 1987 did it return to 1973 levels. Indonesia, by contrast, had greater real exchange rate appreciation than Nigeria after the first oil price shock in 1973–74, but it devalued its currency much sooner, with a big devaluation in 1978 that led to further depreciation of the exchange rate thereafter.

These different policy choices influenced the growth and structure of exports. Before the first oil price shock, oil made up more than 80 percent of Nigeria's exports, compared with 50 percent for Indonesia. Nigeria moved toward greater dependence on hydrocarbons, with oil exports rising to more than 90 percent of exports. Only after the big devaluations in the mid-1980s did Nigeria have any growth in its non-oil exports. Indonesia strengthened and diversified non-hydrocarbon exports during and after the oil price booms. With substantial growth in non-oil exports throughout the 1970s and 1980s, oil exports constituted only about 20 percent of Indonesia's total exports by the end of the 1980s.

Another reason why econometric analyses do not fully explain Africa's low growth may be that easily accessible policy indicators fail to capture the intricacies of policy intervention in the region. African governments took an active stance in setting prices, nationalizing banks, establishing price controls, rationing foreign exchange, creating public monopolies for agricultural exports, imposing licenses to restrict the activities the private sector could undertake, and creating many state enterprises and giving them special access to scarce credit and foreign exchange. None of these interventions nor their impact is easy to quantify, because the required data are generally either unavailable or unreliable.

Moreover, these interventions created a strong bias against the private sector, which also must have contributed to the economic decline. Administrative bottlenecks, rents from licensing requirements, and inefficient public services imposed high costs on private business. The gradual breakdown in judicial systems and the expropriation of private property in many countries in the 1970s left many private enterprises, particularly foreign ones, doubtful about the wisdom of continuing to invest. Some businesses continued only under special contracts or special trade restrictions that offset the high risks.

A third important factor is the extent and quality of infrastructure. Africa's slow growth may be attributable in part to its relatively inefficient transport system, telecommunications network, and public utilities. It is unlikely, however, that the infrastructure base actually deteriorated during the mid-1970s to early 1980s, which might have accounted for some of the decline in GDP growth, because investment in infrastructure burgeoned during this period.

A fourth possible factor that econometrics neglects is ideology, which has been important in setting the policy agenda in African countries. Classifying countries as African capitalists, African populist-socialists, and Afro-Marxists—according to the prevailing ideology—shows that the capitalists experienced the fastest growth (Young 1982). There were exceptions, of course. Some Afro-Marxist countries (especially Congo) did well thanks to the oil windfall, while some capitalist countries (such as Zaire) did not, because of political and social instability.

A fifth factor that should be considered is the widespread deterioration in governance in the 1970s and 1980s. As countries tried to meet the aspirations for rapid development that were unleashed at independence, and as they tried to consolidate their political base, they expanded the role of the state. Highly authoritarian and highly centralized governments were inimical to the development of local organizations and associations that might have demanded better governance. The costs associated with poor governance extend beyond what is usually captured in policy variables.

All these factors no doubt played some role in Africa's poor economic performance. But we can only speculate about their relevance, because they are difficult to quantify and test rigorously.

The Needed Switch in Policies

THE REFORM PROGRAMS THAT MANY AFRICAN COUNTRIES initiated in the mid-1980s—with the support of the International Monetary Fund, the World Bank, and other donors—reflected a new paradigm. The reforms attempted to reduce the state's role in production and in regulating private economic activity. They assigned more importance to exports, especially those from the much-neglected agricultural sector. And they placed more emphasis on maintaining macroeconomic stability and avoiding overvalued exchange rates. The process of revamping the policy framework in line with this new paradigm became known as structural adjustment.

One of the most fundamental shifts in the development strategy for Africa was to view agriculture not as a backward sector but as the engine of growth—an important source of export revenues and the primary means to reduce poverty. Improving the incentives and the infrastructure services for farmers is now a key element in adjustment programs. On the macroeconomic side, the focus is on keeping inflation low, exchange rates competitive, and budget deficits sustainable. Furthermore, to enable people to develop efficient and productive businesses, the state is pulling back from direct intervention in the economy and improving its capacity to provide basic services and a stable policy environment.

In the next three chapters, we assess the extent of structural adjustment reforms in Sub-Saharan Africa. We report on twenty-nine countries with adjustment programs in place during the latter part of the 1980s (see box 1.3). How far have those countries come in reforming their policies? And how much further do they have to go? Chapter 2 focuses on changes in macroeconomic policies, usually tackled early in the adjustment process to eliminate major distortions. Chapter 3 examines progress in trade and agricultural reforms, vital to making more efficient and productive use of economic resources. Chapter 4 examines reforms in the areas crucial to a reorientation of the role of the state: the financial sector, the public enterprise sector, and the public sector. These assessments provide a basis for examining the payoffs to the adjustment process, the subject of chapter 5. Chapter 6 reviews the evidence on the impact of adjustment on poverty and the environment. The book concludes with chapter 7, a look at the road ahead for African adjusting countries.

Will the shift in policies enable Africa to catch up? Standard growth theory predicts that low-income countries will grow faster than high-income countries, because they can borrow technologies from the rest of the world and increase the marginal productivity of capital more rapidly than advanced countries. But this requires actively taking advantage of the technology, knowledge, and experience of other nations. And in Africa, the commitment to an outward-oriented development strategy is not yet strong.

Even with good policies, catching up is not easy. So far, low-income countries have had less success than middle-income countries in growing quickly. Poor policies explain some of the lag, but poor endowments might also limit the potential for rapid growth in the short term, underlining the importance of investing in human capital and strengthening institutional capacity. Africa's high rate of population growth—over 3 percent a year—puts additional stress on the limited resources available for improving human capital. Adjustment programs can establish a framework that encourages sound investment and efficient resource use. They are no substitute, however, for the long-term development efforts needed to build the capabilities of Africa's people. (See box 1.4 for a discussion of the relationship between adjustment and development.)

What is encouraging is that in the 1960s, before their takeoffs, Indonesia, Malaysia, and Thailand had conditions similar to those in Africa in 1990 (table 1.3). GDP per capita was higher on average in Southeast Asia, but Indonesia's income was close to that in Ghana, Malawi, and Tanzania today, and Thailand's was comparable to that of

Box 1.4 Adjustment for Sustained Development

ECONOMIC AND SOCIAL DEVELOPMENT IS A process of achieving sustainable increases in health, education, material consumption, and environmental protection—in short, improving standards of living over the long term. Structural adjustment contributes to development by establishing the market-friendly incentives needed to put economies on sustainable, poverty-reducing growth paths. But adjusting the incentive framework to foster efficient production and private initiative will not alone bring about development. As *Sub-Saharan Africa: From Crisis to Sustainable Development* (World Bank 1989a) points out, development also depends on good governance, appropriate infrastructure and institutions, and better-trained people. Sound policies and a strong infrastructure create the conditions for economic growth, but growth will be raised and sustained only if human and institutional capabilities are built up. This requires investments in basic health and nutrition, education, and technical skills. It also requires that public and private institutions be restructured to create an environment in which capable people can work effectively, and that political leadership be committed to nurturing those institutions, not to politicizing them for narrow objectives.

Africa's structural adjustment programs, and those elsewhere, were almost always mounted in response to a crisis triggered by external shocks but engendered by poor policies. No economy can function well for long if it has rampant inflation, an overvalued exchange rate, excessive taxation of the agricultural sector, scarce supplies of needed imports, regulations on prices and production, deficient public services, and limited financial services. To shore up such economies, the first order of business should be fundamental policy reform—restoring macroeconomic balances and reducing the large distortions in the incentive framework. This sets the stage for the more efficient allocation of resources and capital accumulation needed for development to take place.

Often there is synergy between policy reform and a country's level of development. Greater technical and institutional capacity makes it easier to adjust policies to changing conditions, and stronger adjustment efforts increase the returns on investment and speed up the development process. Moving from a vicious circle of bad policies and a low level of development to a virtuous circle of good policies and a higher level of development is the challenge facing Africa.

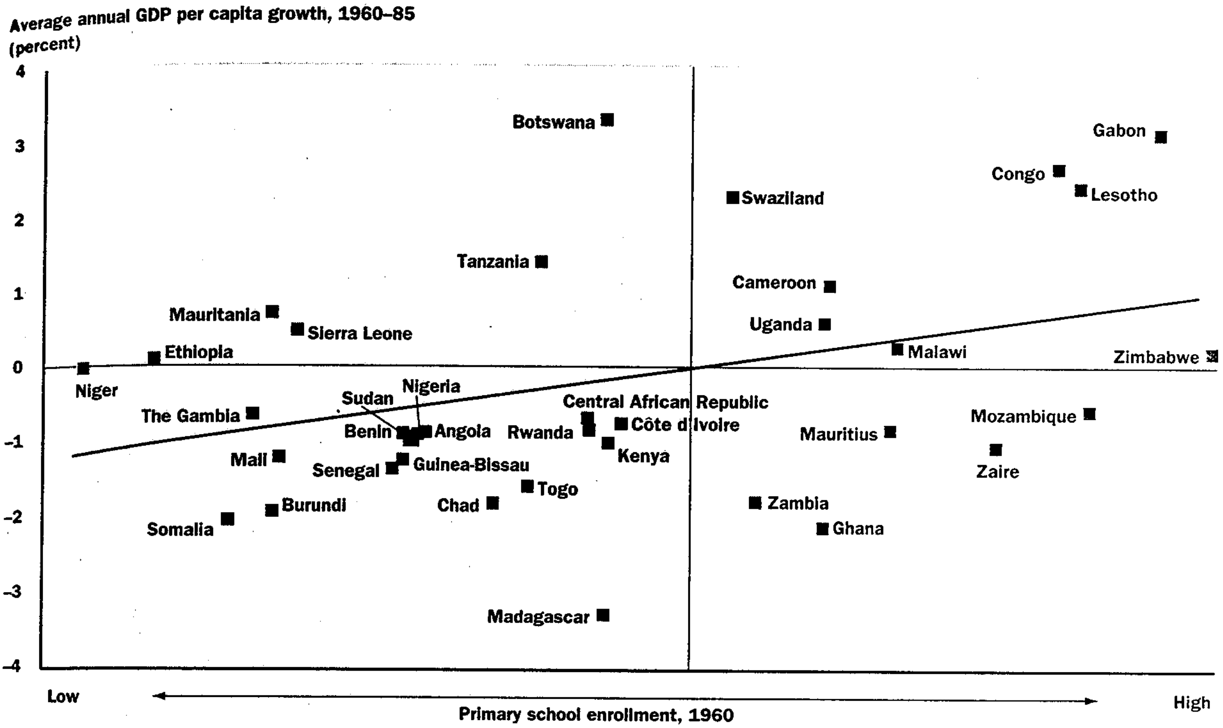
Table 1.3 Sub-Saharan Africa in 1990 versus Southeast Asia in 1965: Means for Selected Indicators

Indicator	*Sub-Saharan Africa, 1990*[a]	*Indonesia, Malaysia, and Thailand, 1965*[b]
GDP per capita (constant 1985 international dollars)[c]	1,030.0	1,320.0
Agriculture share of GDP (percent)	32.0	37.0
Manufacturing share of GDP (percent)	11.0[d]	10.3
Savings share of GDP (percent)	16.0	17.0
Investment share of GDP (percent)	16.0	16.0
Export share of GDP (percent)[e]	29.0	21.0
M2 share of GDP (percent)	19.4	19.6[f]
Urban share of total population (percent)	29.0	18.3
Primary school enrollment (percentage of eligible population)	68.0	80.0
Secondary school enrollment (percentage of eligible population)	17.0	18.0
Adult illiteracy rate (percentage of population over age 15)[g]	50.0	35.3
Population per physician (thousands)[h]	23.5	15.0
Infant mortality (number of deaths before age 1 per 1,000 live births)	107.0	90.3
Life expectancy (years)	51.0	52.5
Population growth rate (percent)	3.1[i]	2.7[j]

a. Data are weighted means for selected countries.
b. Data are unweighted means.
c. Data are based on results of the United Nations International Comparisons Program (ICP). For details on the calculations, see World Bank (1992d), pp. 299–301.
d. Data are for 1989.
e. Exports of goods and nonfactor services.
f. Indonesia data are from 1969.
g. Illiteracy is defined here as the inability to read and write a short, simple statement on one's everyday life.
h. Physicians here include medical assistants who have less training than qualified physicians but who perform similar services, including operations.
i. Average annual growth rate from 1980 to 1990.
j. From 1964 to 1965.
Sources: World Bank (1992d and 1993d); World Bank data; IMF data.

middle-income African countries today. One major difference between Asia then and Africa now: Africa has lower primary school enrollment. This is not inconsequential; emphasis on universal primary education was a key to achieving rapid and equitable economic growth in the best-performing Asian economies (World Bank 1993a). And African countries with a higher percentage of children enrolled in primary school in 1960 grew more quickly over the next two decades than countries with lower enrollment rates (figure 1.9). Africa's runaway population growth also puts it at more of a disadvantage than Asia in the 1960s. With half the population under fifteen years old, Africans of working age face an enormous challenge—bringing about the high rate of economic growth needed to provide a better future for the next generation.

Figure 1.9 Education and GDP per Capita Growth



Note: This figure is a partial scattergram based on a regression of primary school enrollment and other factors on GDP per capita growth.
Source: Barro (1991).

Higher primary school enrollments pay off in higher growth.

The importance of reforms for Africa's economic future cannot be overstated. With today's poor policies, it will be forty years before the region returns to its per capita income of the mid-1970s. But a sound development strategy and a dose of good luck can change the picture. Ghana, for example, has the potential to become a middle-income country by the fiftieth anniversary of its independence, as box 1.5 shows. We should be mindful that the Asian countries that have been stunning the world with their strong GDP per capita growth since 1960 had almost no growth between 1930 and 1960 (Maddison 1989). This does not mean that success will come easily to Africa in the next three decades. It does mean that rapid growth is possible, and that Africa's poor record over the past twenty years is no reason for undue pessimism about its future.