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UNCTAD'S CONTRIBUTION TO THE IMPLEMENTATION OF THE UNITED NATIONS NEW AGENDA FOR THE DEVELOPMENT OF AFRICA IN THE 1990S: AFRICAN ECONOMIC PERFORMANCE, PROSPECTS AND POLICY ISSUES

Report by the UNCTAD secretariat

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Introduction

1. In its consideration of the item on UNCTAD's contribution to the implementation of the United Nations New Agenda for the Development of Africa in the 1990s, the Trade and Development Board, at its forty-third session, concluded that the Africa item at the forty-fourth session should allow for an exchange of views and include an informal debate with the participation of experts. It called on the secretariat to prepare a report stressing specific themes. In this connection, when reporting on progress in the implementation of the Board's agreed conclusions 436(XLIII), the Secretary-General of UNCTAD reiterated at the fifteenth executive session of the Board that the discussions on Africa at the forty-fourth regular session would concentrate on performance, prospects and policy issues with regard to African economic recovery and development.

2. In the light of the above, the aim of the present report is to review Africa's recent economic performance, analyse the factors affecting its recent growth performance, and explore the medium-term prospects for maintaining this momentum and achieving sustainable growth. Recent trends in trade, external debt and agricultural policies are among the issues covered in the report.

3. Furthermore, as requested by the Trade and Development Board at its forty-third session, a number of experts have been invited as panellists to participate with delegations in informal discussions on economic recovery and development in Africa. The Board's deliberations on this item will also touch upon the themes of the Board's High-level Segment, which are Globalization, Competition, Competitiveness and Development, and the related findings will be transmitted to the High-level Segment.

A. Recent economic developments

4. At the beginning of the 1980s, sub-Saharan Africa (SSA) entered into a long period of economic decline, during which real income per capita fell until 1993. Investment and saving rates likewise declined during this period and, despite cuts in effective demand and fiscal austerity, high rates of inflation generally persisted (table 1). Except in East Africa, export revenue grew more slowly during 1986-1993 than before 1980. Despite import compression, trade and current account deficits remained largely unchanged. The debt burden of most countries in the region became unsustainable. External deficits were usually covered through new resource inflows and by allowing debt arrears to accumulate. By 1994, there were few countries in SSA that could be said to have strong prospects of sustainable growth.

5. However, three successive years of improved economic performance, beginning in 1994, have given grounds for more optimism. For the first time since the beginning of the 1980s, GDP growth rates have exceeded population growth, albeit by a small margin. Led by an impressive growth in export revenues and a substantial reduction of current account and trade deficits, external indicators improved overall. Nevertheless, with respect to growth, accumulation, savings and inflation, the performance of the last three years continues to be inferior to that achieved before 1980.

6. The recent upturn in SSA was underpinned by the continued and deepened implementation of economic reform programmes, as well as by reductions in political instability and civil unrest.[1] A major factor has been export growth, which according to the Economic Commission for Africa, went from -4.2 per cent in 1993 to 3.3 per cent in 1994 and 16.2 per cent in 1995. Buoyant external demand, higher commodity prices and improved terms of trade (an increase of 7.4 percentage points

[1] See Economic Commission for Africa, "Report on the Economic and Social Situation in Africa, 1997" (E/ECA/CM.23/3), paras. 3 and 4.

from 1994 to 1996) were the immediate and main factors responsible for these export gains. However, the volume of exports has shown little change from earlier periods.

Table 1

Africa: macroeconomic indicators 1975-1996
(Annual average, in per cent)

	GDP growth	Ratio of gross domestic investment to GDP	Ratio of gross domestic savings to GDP	Inflation
		Sub-Saharan Africa		
1975-1980	3.8	24.0	22.9	18.9
1981-1985	1.2	1.2	19.3	20.2
1986-1993	1.5	17.1	17.3	20.4
1994-1996	3.0	17.3	9.6	20.4
		North Africa		
1975-1980	6.2	33.1	22.0	8.0
1981-1985	4.7	29.3	21.1	10.6
1986-1995	2.2	24.5	19.5	10.7

Sources: 1975-1993: ILO, *World Employment 1996/97* (Geneva, ILO, 1996), table 5.6; 1994-1996: ECA, “Report on the Economic and Social Situation in Africa, 1997" (E/ECA/CM.23/3, Addis Ababa, 1997), table 2; and World Bank, *World Development Indicators 1997* (CD-ROM).

7. The price boom began with non-oil commodities in 1994. Export prices for Ugandan coffee soared by 167 per cent from 1993 to 1995, declined by 26 per cent in 1996, but rose to new heights in 1997. More modest, but none the less substantial, increases occurred for cocoa (an increase of 42 per cent in Côte d’Ivoire); tobacco (15 per cent in Malawi); and cotton (11 per cent in Côte d’Ivoire). The price boom also embraced crude oil by 1995; average prices in 1996 were 31 per cent higher than two years earlier. It is premature, however, to say whether the recovery in commodity prices has peaked. In general, it appears that price increases have been levelling off and a decline cannot be ruled out in the near future.[2]

8. In recent years there has been a sharp increase in food production in SSA, particularly in cereals, which has been the main factor responsible for the growth of agricultural output. Weather conditions favoured this improvement, as no doubt did also the reduced prevalence of civil and ethnic conflicts. On the other hand, there is little indication that price or marketing reforms have had an impact on food production, since they have been mainly directed at export crops.

9. Per capita growth rates were also negative in North Africa until the mid-1990s (the one exception being Tunisia). The factors responsible include the debt

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[2] For recent changes in commodity prices and prospects, see *Trade and Development Report, 1997* (UNCTAD/TDR/17), Part One, chap. I.

crisis of the 1980s, the decline in crude oil prices during those years, and reduced workers' remittances. Export markets in the Middle East were sluggish owing to slower growth in Saudi Arabia and the aftermath of the hostilities in the Persian Gulf. Consequently, there were fewer employment opportunities for North African labour. Recent increases in crude oil prices have favoured some of the countries of the region, enabling Algeria, for example, to achieve a 4.4 per cent growth in GDP in 1995 following a decade of negative growth. Rising prices for cotton (increasing by 28 per cent from 1994 to 1996) and oil have benefited Egypt, as have higher prices for phosphates (15 per cent in the same period) in the case of Morocco. As a result of these and other factors, the North African economies rebounded strongly in 1996 (see *Trade and Development Report, 1997*).

B. Sustainability of recovery in sub-Saharan Africa

10. Whether the recent economic upturn in SSA can be sustained depends not only on the behaviour of prices for its export commodities, but also on a number of other factors, and in particular on how successfully gains from increased export revenues are utilized to strengthen potential growth. The most crucial variable in this respect is the pace and pattern of capital accumulation.

11. As a result of persistent import compression, much of the existing capacity in industry has been underutilized since the early 1980s. Part of that capacity has become unusable, giving rise to the so-called phenomenon of deindustrialization. SSA industries had originally been established to supply domestic markets behind protective barriers; because of low productivity and inadequate know-how they were never in a position to compete internationally. Moreover, they have been hard hit by the contraction of domestic markets - the result of demand compression policies - as well as by trade liberalization. The main industrial challenge now is to utilize this capacity to the extent possible by expanding domestic demand, while at the same time encouraging rationalization and technological upgrading, leading eventually to the addition of new capacity.

12. A programme of sustained economic growth should also aim at a significant recovery in public investment in infrastructure, which in many cases has been run down after years of neglect. This would result in a number of positive spillovers, on both the demand and the supply side. First, such investment would allow incomes and aggregate demand to increase, thereby raising the rate of existing capacity utilization. Second, domestic and foreign investors would have an incentive to invest because such investment would remove supply bottlenecks affecting private activities. If accompanied by appropriate trade, exchange rate and agricultural policies, such an expansion could lay the basis for a recovery of private investment and help to initiate a process of diversification out of traditional exports that is essential for sustained growth.

13. Success in augmenting investment in SSA industries and infrastructure depends on increased export earnings to finance the import of capital and intermediate goods. The 23 SSA countries that succeeded in increasing their export earnings during 1994-1996 may be classified into four groups, according to their behaviour in imports and investments. In four of these countries (Group I countries) higher earnings were associated with rising investment ratios as well as higher imports.[3] In seven others (Group II countries) the investment ratio rose, but imports appear to have fallen, despite increasing export revenues.[4] Since there is no detailed country-specific information regarding the breakdown of investment between the tradeable and non-tradeable goods sectors, and of imports between capital, intermediate and consumer goods, it is difficult to identify the nature of these

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[3] The four countries are Congo, Côte d'Ivoire, Mali and Mauritius.

[4] The seven countries are Benin, Burkina Faso, Ethiopia, Ghana, Lesotho, Senegal and the United Republic of Tanzania.

changes in investment and imports. However, a number of possibilities can be distinguished, as discussed below.

14. A possible response to increased export earnings is to use them for investment in tradeable goods sectors. Since the sub-Saharan economies depend heavily on imports for capital goods, a faster rate of investment will give rise to an associated rise in imports of such goods. An association of rising export earnings with rising imports and investment is also compatible with increased investment in non-tradeable goods sectors, including infrastructure. Although the import content of such investment may be lower than for tradeable goods sectors, the investment could nevertheless give a strong stimulus to imports through its effects on aggregate demand and economic activity. Group I countries fit these patterns of rising imports and investment.

15. For countries in Group II, where the higher investment ratio has been associated with lower imports, there are a number of possible explanations. First of all, the increased investment is unlikely to have been in tradeable goods sectors since that would have involved a surge in imports of capital goods. The combination of reduced import demand and increased domestic investment suggests that imports may have been constrained through trade policy measures or currency devaluations. Secondly, the combination of increased export earnings and reduced imports suggests either an accumulation of foreign exchange reserves or increased debt servicing, including reductions in arrears. Indeed, in four countries in this group the ratio of interest payments on external debt to GNP rose during the two years in question, whereas in two countries it remained unchanged.

16. An association of rising export earnings with rising imports and incomes and falling or stagnant investment suggests a consumption boom. There are seven SSA countries (Group III) that appear to fit this pattern.[5] Such booms are typically associated with currency appreciation and trade liberalization. They cannot, however, be sustained if export prices are not constantly rising or high levels of external borrowing are not maintained.

17. Finally, in five SSA countries (Group IV), there has been a pattern of rising export earnings with falling imports and investment.[6] Again, in such cases increased foreign exchange earnings may have been used to accumulate reserves and/or to service debt. In all these countries except Botswana, there was an increase in the ratio of interest payments to GNP during 1994-1995. Alternatively, the increase may reflect the impact of restrictive policies introduced to prevent or slow down overheating of the economy.

18. In the absence of the necessary data, it is not possible to reach definitive conclusions about the implications of these changes in investment and trade in individual countries. It is, however, a matter for concern that the investment ratio appears to have fallen in more than half of the countries in which export earnings increased during 1993-1995. Indeed, for SSA as a whole, the ratio has continued to be only some 17 per cent of GDP.[7] Similarly, in almost half the countries, imports fell despite higher export earnings. It thus seems that in many countries there is direct competition between imports and investment, on the one hand, and external debt servicing, on the other. This certainly raises the question of how sustainable the recent recovery will prove to be.

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[5] The seven countries are Cameroon, Kenya, Madagascar, Malawi, Nigeria, Togo and Zambia.

[6] The five countries are Botswana, Burundi, the Central African Republic, Gabon and Guinea-Bissau.

[7] For a detailed analysis of the weak investment performance up to 1993 in SSA and its underlying causes, see *Trade and Development Report, 1993* (UNCTAD/TDR/13), chap. II, sects. 2 and 3, particularly table 39 and chart 3.

C. Balance of payments constraint and the debt burden

19. The foregoing overview highlights the importance of the balance of payments as a constraint on fuller capacity utilization and on investment in industry and infrastructure in SSA. While it was noted that the recent export upturn has helped some countries raise their investment levels, such events could prove to be one-off gains. In the majority of countries, investment and imports have remained depressed despite a rise in export earnings, which appear to have been used, at least in part, to finance increased interest payments on the external debt. For all countries, since the commodity price boom is unlikely to continue, and in view of their limited capacity to generate domestically the resources needed, sustained increases in investments will depend, at least initially, on external resource inflows. These flows, in turn, will depend *inter alia* on the effectiveness of measures taken by the international community to alleviate the external debt burden of heavily indebted African countries, which in SSA consists mainly of public and publicly guaranteed long-term debt.

20. Net resource flows and net transfers to SSA, though fluctuating, have been generally positive since the 1970s.[8] In 1995, net transfers amounted to $13 billion, thanks mainly to increased inflows of official development finance.[9] Foreign direct investment (FDI) and portfolio investments amounted to only 9.9 per cent and 2.1 per cent, respectively, of total net resource flows to the region, while FDI profit remittances slightly exceeded FDI inflows.

21. Until the recent economic upturn, however, resource inflows were more than offset by terms of trade losses. The World Bank has estimated that between 1971-1973 and 1981-1986 SSA (excluding Nigeria) experienced a cumulative decline of 5.4 per cent of GDP due to terms of trade losses, against a cumulative gain of 2.7 per cent due to net resource transfers; i.e. a net loss of 2.7 per cent of GDP.[10] During 1980-1990 only six of the 21 countries for which data are available were able to cover their terms of trade losses by means of net ODA inflows.[11] Another study, covering Burundi, Côte d'Ivoire, Ghana, Kenya, Nigeria, Senegal and the United Republic of Tanzania, reports that during the recent adjustment period (generally from the mid-1980s up to 1993) "allowing for terms of trade losses, six of the seven countries had declines in net external resource inflows, with Tanzania the lone exception".[12] In sum, from the early 1980s to at least the mid-1990s, SSA suffered a net loss of resources from positive capital flows and deteriorating terms of trade.

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[8] Net resource flows are defined as including net loan disbursements (including IMF and World Bank loans), net foreign direct investment (FDI) and portfolio flows, and grants other than for technical assistance. Net transfers are defined as net resource flows minus interest payments and profit remittances.

[9] See World Bank, *World Debt Tables 1996* (Washington, D.C., World Bank, 1996). See also Economic Commission for Africa, *Economic and Social Survey of Africa, 1994-1995* (United Nations publication, Sales No. E.95.II.K.8, Addis Ababa, 1995), paras. 652-660; and "Report on the Economic and Social Situation in Africa, 1997", para. 28.

[10] World Bank, *Adjustment in Africa: Reforms, Results and the Road Ahead* (New York, Oxford University Press for the World Bank, 1994), p. 29.

[11] *Trade and Development Report 1993*, Part Two, chap. II, sect. C.

[12] I. Husain and R. Faruqee (eds.), *Adjustment in Africa: Lessons from Country Case Studies* (Washington, D.C., World Bank, 1994), p. 7.

22. A satisfactory resolution of the external debt burden is necessary if SSA is to be successfully integrated into the world economy. The external debt of SSA amounts to roughly 10 per cent of the total debt owed by developing countries to official creditors. This debt burden is unsustainable for most of the African countries concerned. By 1995, SSA had the highest debt-to-exports ratio of any developing region (table 2). Moreover, it is the only one where the ratio of external debt to exports of goods and services rose from 1988 to 1995 - from 243 per cent to 270 per cent. Conversely, during the same period, the ratio of interest and principal payments to exports of goods and services declined, from 21 per cent to 15 per cent.[13]

Table 2

External debt indicators for developing countries, 1988 and 1995, by region
(Percentage)

Region	Debt export ratio		Debt service ratio		Arrears as a share of total debt
	1988	1995	1988	1995	1995
All developing countries	176.9	150.0	22.9	16.3	. .
East Asia	93.6	83.3	13.4	10.7	3.3
Latin America	332.6	254.2	39.6	30.3	4.9
Middle East & North Africa	155.7	136.9	17.5	13.7	5.1
South Asia	290.0	245.7	26.2	24.9	0.0
Sub-Saharan Africa	242.9	269.8	20.7	14.7	27.9

Source: World Bank, *World Debt Tables 1996* (Washington, D.C., World Bank, 1996).

23. The apparent anomaly of contradictory trends in these two ratios is explained by the continuous growth of arrears on interest and principal that have been accumulated in sub-Saharan countries over the years.[14] The stock of these arrears stood at $62.2 billion in 1995, corresponding to about 28 per cent of the debt stock. More ominously, the conversion of these cumulative arrears on interest payments into short-term debt accounts for one-third of the total increase in debt in the region since 1988. In comparison with other developing regions, the debt expansion attributable to rolling over interest arrears is therefore singularly large.

[13] The average debt service ratio (DSR) for SSA conceals a wide variation among countries. For example, 12 out of 47 countries had ratios exceeding 25 per cent in 1995. Nevertheless, the overall picture does not appear to be as dramatic as it was in Latin America and even North Africa during the 1980s.

[14] Apart from the chronic rise in arrears, SSA’s debt structure (i.e. the shares of short-term, concessionary or bilateral debts in the total) does not differ significantly from that of other regions. For example, South Asia’s DSR is 10 percentage points higher, but its concessionary debt ratio is also higher. Hence, the relative size of SSA’s concessionary debt cannot explain its lower DSR.

24. It is the accumulation of arrears, moreover, that is the fundamental problem underlying SSA's debt overhang. Unless sufficient relief is granted, regular and continuous servicing of the growing debt stock will become increasingly problematic. In fact, these arrears constitute a form of *de facto* rescheduling which could end in default. Protracted rescheduling negotiations and the associated onerous conditionalities are compounding the uncertainties facing policy-makers in the region.

25. The international community has not been indifferent to the debt problem in Africa. North Africa has benefited from major debt reschedulings since 1985. One such operation, during 1987-1990, significantly reduced Morocco's debt service ratio, from 36 per cent in 1986 to 23.7 per cent in 1992. Large-scale rescheduling and write-offs reduced Egypt’s external debt stock by $15 billion between 1987 and 1996. Likewise, Algeria has obtained substantial debt relief during the past two years. Such relief has helped improve the macroeconomic performance of North Africa.

26. With respect to heavily indebted poor countries (HIPCs), the majority of which are sub-Saharan, a new and welcome initiative was put forward in 1996 by the World Bank and the IMF, consisting of an integrated approach to debt relief that encompasses the totality of HIPCs’ external debt. It is still too early to evaluate the success of this initiative, but it is clear that not all indebted sub-Saharan countries will be eligible and that most eligible countries will not obtain full relief before the year 2000. However, the recent introduction of added flexibility in eligibility criteria, time-frame and interim financing is a welcome recognition of the problem, and should be pursued further.[15]

27. In sum, a speedy and substantial resolution of the debt overhang problem of SSA is critical if the present economic upturn is to be followed by sustained economic growth over the long term. Such relief would ease the balance of payments constraint and could induce increased private investment and growth. Because of the close linkages between external debt and the government budget, debt relief would also free resources needed for government investment in physical and social infrastructure.

D. Policies for growth

28. Recent experience shows that reducing the balance of payments constraint is a necessary but not always sufficient condition for promoting capital accumulation and exports. There is a major role for governments in creating conditions conducive to private investment in traded goods sectors. In the African context, two policy reform areas have gained increased acceptance in recent years - trade and exchange rate policies, and agricultural price reforms. This section evaluates these policies in terms of their implications for accumulation and growth. Policy conclusions are drawn in the final section.

1. *Trade and exchange rate policies*

29. Many African countries have opened their markets very rapidly. Despite the general provision in the Uruguay Round for LDCs to liberalize their import regimes more slowly than other WTO members, 18 sub-Saharan LDCs have already virtually eliminated their non-tariff barriers and a further nine have substantially reduced them. Many sub-Saharan countries have also reduced their tariff rates. Liberalization has progressed even further in North Africa, where Morocco and

[15] For a more detailed discussion of the HIPCs’ debt initiative, see *Trade and Development Report, 1997,* Part One, chap. II, sect. E.

Tunisia have reached agreements with the European Union to establish a free trade zone in the future.[16]

30. Unquestionably, protection of domestic industry in many sub-Saharan countries used to be excessive and did not always succeed in promoting infant industries. However, rapid import liberalization will have difficulty in enhancing productivity and promoting competitiveness when the industrial structure is weak. Nor is an across-the-board import liberalization necessary for promoting investment and exports.

31. The examples of successful export-oriented development strategies in East Asia show not only that firms must first be strongly established in domestic markets but also that export success preceded, rather than followed, the adoption of import liberalization policies. While it is essential to ensure that exporters have access to raw materials and other inputs at world prices, mechanisms such as duty drawback or export retention schemes can be effectively utilized for this purpose. There has been little effort to establish institutions needed for the effective functioning of such schemes in SSA. Instead, emphasis has been placed on general import liberalization as a way of promoting efficiency and competitiveness in traded goods sectors.

32. Export promotion policies in SSA have been largely confined to primary commodities, which have collectively proved vulnerable during the past 15 years to the fallacy-of-composition dilemma.[17] In this connection, SSA experienced a dramatic decline of 36 per cent in its terms of trade from 1985 to 1993 (table 3), which has only partly been corrected by the recent upturn. As a result, Africa's already meagre share of world exports declined from 3.2 per cent in 1985 to 1.9 per cent in 1993. Moreover, sub-Saharan Africa has been unable to diversify its export structure sufficiently. While in other developing regions the share of manufactures in total exports has grown since 1980, it shrank in 12 out of the 30 sub-Saharan countries for which data are available.

33. Preliminary estimates of the impact of the Uruguay Round indicate that SSA is likely to incur Round-related losses in the medium term.[18] These losses will arise mainly because of the erosion of preferential treatment of African exports in EU markets under the Lomé Convention and more generally under the GSP. The balance of payments situation of much of SSA will be further strained by higher import costs for foodstuffs due to reduced subsidies in major exporting countries.[19]

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[16] The agreements imply the elimination of tariff protection in the two North African countries in all industries, while providing temporary benefits to textile exporters. For a critical assessment, see Economic Research Forum for the Arab Countries, Iran and Turkey (ERF), *Economic Trends in the MENA Region* (Cairo, 1996), pp. 39 and 42-44.

[17] The term “fallacy of composition” refers to the possibility that the positive outcome of a particular action pursued by one country can be reversed if pursued by many countries. Thus, if one country increases its volume of exports, its foreign exchange earnings will increase. However, if many countries simultaneously increase their export of the same commodity, its world price will decline. As a result, the foreign exchange earnings of each country will also decline even though their export volume increases.

[18] The UNDP *Human Development Report 1997* (New York, Oxford University Press, 1997) estimates that SSA stands to lose up to $1.2 billion a year during 1995-2001 (p. 82).

[19] See *Economic and Social Survey of Africa, 1994-1995*, paras. 616-621, and A. R. Khan, “Reversing the Decline of Output and Productive Employment in Rural Sub-Saharan Africa” (Geneva, ILO, 1997, *Issues in Development Discussion Paper 17),* pp. 14-15.

Table 3

External trade indicators for developing countries and territories, 1985 and 1993, by region

Region	Terms of trade in 1993 (1985 = 100)	Share in world exports (per cent)		Share in world imports (per cent)	
		1985	1993	1985	1993
Latin America	78.7	5.6	4.3	4.2	4.9
Asia	73.7	15.8	20.8	15.4	21.6
North Africa	58.6	1.5	0.8	1.3	1.0
Sub-Saharan Africa	64.2	1.7	1.1	1.5	1.1
Major exporters of manufactures[a]	93.3	10.6	15.6	9.1	16.3

Source: UNCTAD, *Handbook of International Trade and Development Statistics, 1994* (United Nations publication, Sales No. E/F.94.II.D.24, New York and Geneva, 1995).

[a] Brazil, Hong Kong, Malaysia, Mexico, Republic of Korea, Singapore, Taiwan Province of China, Thailand, Turkey, former Yugoslavia.

34. Trade liberalization in Africa was initially accompanied by real currency devaluations to avoid a sharp deterioration in the balance of payments. However, many countries subsequently moved towards market-determined exchange rates and current-account convertibility. As of 1994, the CFA countries and a further nine sub-Saharan countries had convertible currencies. In North Africa, controls on foreign exchange operations have been gradually lifted. The liberalization of current transactions has spread to capital transactions, with many African countries maintaining only minimum controls on most categories of capital inflow. Governments have consequently been seriously restricted in their ability to manage exchange rates in a way conducive to export expansion.

35. With the opening up of the capital account, there has been a tendency for currencies to appreciate as a result of increased capital inflows. Overvalued exchange rates, in turn, have attracted more inflows by adding to arbitrage margins created by high interest rates. Indeed, exchange rate floating is making currency appreciation a recurring feature of some economies.[20] Real appreciations have taken place in Botswana (39 per cent over 1989-1995), Sierra Leone (23 per cent, 1992-1995), Uganda, (28 per cent, 1993-1994), Kenya (43 per cent, 1993-1995), Egypt (28

[20] An example is Kenya: “Foreign money is flowing to Kenya drawn by high interest rates...and a steadily appreciating, freely convertible currency...Investors have done quite well because the exchange rate has worked in their favor and they benefit on interest rates as well...The main draw...is the lucrative 20-25 per cent yield on 3-month Treasury Bills...The appreciation of the currency has been due to banks who’ve...been net buyers of [Kenya] shillings to buy the Treasury bills” (*Wall Street Journal*, 17 June 1997, p. 24).

per cent, 1991-1995), Morocco (69 per cent, 1985-1995) and Tunisia (30 per cent, 1985-1995).[21]

36. A consequence of real appreciations, of course, is to make imports less expensive. Where trade regimes have not differentiated between essential and non-essential imports, the tendency has been for imports of consumer goods to rise faster than those of intermediate and capital goods.

37. As recent experience has demonstrated, high capital inflows and overvaluation of currencies cannot be sustained indefinitely. Mounting current account deficits and currency appreciations lead eventually to financial flows being reversed, which puts pressure on the exchange rate and produces sharp depreciations that are often accompanied by difficulties in the financial sector. Such swings in exchange rates associated with boom and bust cycles in capital flows constitute a major impediment to investment in import-competing and export sectors by creating considerable uncertainty about the prospective yields of such investment. Since the real exchange rate becomes a key variable affecting investment under an outward-oriented development strategy, it is all the more important to secure its stability by exercising appropriate control over liquid capital flows.

38. There are also other measures that can promote exports, particularly non-traditional exports, but they have not always been effective. Policy recommendations, often in the context of structural adjustment programmes, have generally been confined to tax rebates, the elimination of red tape and the establishment of export-processing zones. Specific export incentives have been considered distorting, leading to a *de facto* system of multiple exchange rates, although they have sometimes been tolerated as a short-term means of correcting anti-export biases on the eve of liberalizing trade regimes.

39. In the absence of selective export promotion policies, competitiveness depends on the behaviour of real wages and the real exchange rate, as well as on productivity growth. There can be two types of improvement in productivity: productivity growth based on high and rising rates of investment associated with rising employment; and a one-off increase in labour productivity associated with static efficiency gains resulting from labour-shedding under conditions of stagnant or declining investment. A sustainable improvement in export performance requires not only productivity growth based on rising investment rates, but also policies that ensure that real wages do not increase faster than productivity growth, and that the exchange rate is maintained at a stable and competitive level.

40. For SSA there is a scarcity of data on the basis of which indicators of the competitiveness of manufactured exports can be computed. For North Africa, on the other hand, available data make it possible to identify the movements in key variables affecting competitiveness. Changes in real wages, productivity and exchange rates since 1986, shown in table 4, suggest that in all four countries distinguished (Algeria, Egypt, Morocco and Tunisia) competitiveness has improved. In Egypt, higher productivity has been attained under conditions of declining investment and rising employment. In Morocco, real wages have been stable despite significant and continuing real appreciations since 1986. In Algeria, real depreciations appear to have been accompanied by constant real wages and falling labour productivity. The most dynamic pattern has been exhibited by Tunisia, where rising investment rates have been associated with higher rates of productivity growth (nearly 19 per cent per annum), and with rising employment and real wages. However, that country’s competitiveness may have been adversely affected by its currency appreciation.

Table 4

[21] Calculations based on UNCTAD data. See also L. Kasekende, D. Kitabire and M. Martin, “Capital inflows and macroeconomic policy in sub-Saharan Africa”, in UNCTAD, *International Monetary and Financial Issues for the 1990s: Research Papers for the Group of Twenty-Four*, vol. VIII (United Nations publication, Sales No. E.97.II.D.5, New York and Geneva, 1997), table 8.

North Africa: competitiveness indicators for exports of manufactures, 1994
(Index numbers, 1986 = 100)

	(1)	(2)	(3)	(4)	(5)	(6)
					Memo items	
	Real exchange rate[a]	Real wage costs in manufacturing	Value added per worker in manufacturing	Aggregate competitiveness indicator[b]	Employment in manufacturing	Relative investment growth[c] (per cent)
Algeria[d]	132.5	94.6	79.0	110.7	108.2	-4.5
Egypt	163.8	68.8	140.4	334.3	121.6	-6.2
Morocco	81.8	100.7	143.8	116.8	149.8	-1.5
Tunisia[e]	98.9	198.7	334.4	166.4	115.1	+5.8

Source: World Bank, *World Development Indicators 1997* (CD-ROM).

[a] A higher real exchange rate signifies a real depreciation of the local currency.
[b] Calculated by multiplying the ratio of value added per worker in manufacturing (column 3) to real wage costs in manufacturing (column 2) by the real exchange rate (column 1).
[c] Percentage point change in investment/GDP ratio.
[d] 1986-1989.
[e] 1986-1993.

41. In SSA serious problems have been encountered in achieving greater competitiveness in non-traditional exports. First and foremost, there are significant financial and foreign exchange constraints impeding capacity-building, and productivity in existing capacity remains low. Another important consideration is that real wages have already been considerably depressed, and hence there is very little scope for further reducing real wages in the interest of competitiveness.[22] Furthermore, as already noted, the scope for an active exchange rate policy is being narrowed by financial liberalization. The difficulties facing African countries in these areas thus suggest the need for an extensive, if temporary, use of subsidy-incentive schemes to promote non-traditional exports.

3. *Agricultural price policies*

42. Development policies in SSA were for decades criticized for having an urban bias. It was maintained that SSA countries drew on resources generated by agriculture in order to foster industrial development, pay for government bureaucracies and provide subsidized services and goods to the urban non-poor. Overvalued currencies, interventions in input and credit markets, and marketing boards that were often a legacy of colonial rule were diagnosed as the vehicles by means of which governments controlled and "taxed" major export crops. Such

[22] From 1975-1979 to 1987-1991 manufacturing real wages declined by 32 per cent, 37 per cent, 40 per cent and 83 per cent, respectively, in Zimbabwe, Mauritius, Kenya and the United Republic of Tanzania (ILO, *World Employment 1996/97* (Geneva: ILO, 1996), table 5.9). Furthermore, with respect to labour laws and social security provisions, SSA lags far behind other developing regions (*ibid.*, pp. 184-187).

policies, it was argued, undermined agricultural development by discouraging farmers from investing in agriculture and improving productivity. Market-oriented reforms in agriculture have sought to redress these imbalances through relative price changes and improved institutional arrangements. In their extreme form, such reforms have called for dismantling marketing boards, ending government intervention in the agricultural sector and allowing markets to operate freely.

43. This reform agenda was launched in the early 1980s in SSA. Marketing board reforms have been carried out in 23 countries in connection with 11 crops. Of the 39 marketing boards that enjoyed monopoly positions in those countries, only 23 had retained the same status by 1992. Moreover, the number of countries in which there was discretionary pricing of export crops by governments declined from 25 (out of 28) before the reforms to 11 in the 1990s, with marketing board prices liberalized in varying degrees or closely linked to world prices. Apart from Nigeria, however, no sub-Saharan country has so far eliminated all its marketing boards.

44. As regards foodstuffs, strong control of food crop markets used to be exercised in 15 out of 28 sub-Saharan countries. In all but five countries these markets are now free, and in three of those five countries government intervention has been sharply curtailed. Fertilizer subsidies have also been eliminated in all but two countries, and most consumer price controls and food subsidies have likewise been abolished.

45. In North Africa, governments have adopted a more cautious and gradual approach to agricultural price and support policies. Conventional credit and input subsidy policies have been generally safeguarded, especially during years of drought. Only Egypt had liberalized its pricing and marketing arrangements by 1993.

46. Research carried out in UNCTAD and elsewhere has examined the extent to which agriculture in SSA has been “taxed" through pricing policies, as well as how far recent reforms have resulted in greater incentives for farmers. The results of this research into agricultural price movements in SSA (discussed in *Trade and Development Report, 1997)* can be summarized as follows:

- In export products, marketing boards have in the past extracted large surpluses, particularly during periods of international price booms and devaluations. However, extended periods of currency appreciation and depressed world prices have tended to be associated with declining rates of surplus extraction.[23]

- When changes in the domestic terms of trade for agriculture are compared with changes in the world terms of trade for food and agricultural raw materials, it is found that over the past two decades world terms of trade have fallen for both groups of agricultural products, while the domestic terms of trade for agriculture in SSA countries have improved (table 5). This divergence in the domestic terms of trade in comparison with movements in world prices existed during the pre-reform years as well as the reform years. However, contrary to expectations, the findings suggest that in recent years farmers in countries where the liberalization of prices and marketing institutions has been slower have in general fared better than farmers in countries where agricultural markets have been liberalized.

Table 5

[23] See V. Jamal, “Surplus extraction and the African crisis in a historical perspective”, in A. Singh and H. Tabatabai (eds.), *Economic Crisis and Third World Agriculture* (Cambridge University Press, 1993), p. 77; and International Fund for Agricultural Development, *The State of World Rural Poverty* (New York, New York University Press, 1992). See also Khan, *op. cit.*, p. 11.

Terms of trade of agriculture for sub-Saharan Africa and the world, 1973-1995

Agricultural terms of trade of:		1979 (1973 = 100)	1985 (1979 = 100)	1995[a] (1985 = 100)
(1)	Sub-Saharan Africa[b]	114.0	102.8	130.6
	World			
(2)	Food and beverages[c]	86.1	57.8	81.7
(3)	Agricultural raw materials[c]	77.0	85.6	93.0
	Ratio of sub-Saharan to world terms of trade and agriculture			
(1)/(2)	Food and beverages	1.32	1.78	1.60
(1)/(3)	Agricultural raw materials	1.48	1.20	1.40

Source: UNCTAD secretariat calculations, based on World Bank, *World Development Indicators, 1997* (CD ROM).

[a] Preliminary estimates.
[b] Unweighted mean of the ratios of the implicit GDP deflators for agriculture to those for manufactures in 13 countries (Benin, Burkina Faso, Cameroon, Côte d'Ivoire, Ghana, Kenya, Senegal, Zambia; Botswana, Burundi, Gambia, Nigeria and Sierra Leone). The deflator for total GDP was used for the five latter countries, where the share of manufactures in GDP was less than 10 per cent in 1973.
[c] Ratio of the index of free market prices for each group of commodities to that of the export unit value of manufactures.

■ With respect to the domestic terms of trade for export crops, the above findings on the terms of trade are supported by a World Bank study.[24] According to that study, in those countries which had continued with centralized producer pricing, there was an increase of 4.8 per cent in the domestic terms of trade for export crops, whereas there was a decline of 18.8 per cent in countries which had shifted from centralized pricing to indicative pricing or total deregulation.[25] The terms of trade changes dealt with in the World Bank study concern the changes in prices received by export crop producers compared with movements of the consumer price index.

■ A comparison of producer and border prices for cocoa, coffee, cotton, tea and tobacco indicates that, except in Côte d'Ivoire, private traders rather than producers have captured the benefits of liberalization (table 6). Indeed, the "scissors" between the two sets of prices "opened" in countries that had dismantled their marketing boards or substantially reduced their role. On the other hand, the outcome was mixed in countries with regulated markets.

Table 6

Ratio of producer prices to export unit values for major commodities in nine

[24] See note 10.

[25] Based on tables A.9 and A.18 of the World Bank study.

major exporting African countries, 1973-1994

		Average ratio in:		
Country	*Commodity*	1974-1979 (1973 = 100)	1980-1985 (1979 = 100)	1986-1994 (1985 = 100)
Cameroon	Cocoa	66.9	168.7	142.9
Côte d'Ivoire	Cocoa	88.1	136.4	163.6
	Coffee	82.5	115.5	307.1
Egypt	Cotton	93.4	149.0	88.6
Ghana	Cocoa	84.9	277.1	89.4
Kenya	Coffee	101.9	93.9	82.5
	Tea	110.0	105.6	83.7
Malawi	Tea	89.7	84.1	155.9
	Tobacco	91.0	103.8	68.3
Sudan	Cotton	109.8	93.8	169.6
United Republic of Tanzania	Cotton	106.3	148.1	16.2
	Tea	90.2	107.8	46.6
Zimbabwe	Tobacco	93.7	104.3	97.5
Average of nine countries		93.0	129.9	116.2

Sources: UNCTAD, *Handbook of International Trade and Development Statistics*, various issues; FAO database.

Note: The average ratio is obtained by dividing annual index numbers for producer prices by the annual index numbers for export unit values (multiplied by 100). A value above 100 indicates that between the base year and the period in question the rise in producer prices exceeded, on average, the rise in border prices, signifying a lower rate of "surplus extraction" from the producers by the exporting agent.

■ As for the comparative movements of SSA border prices and world prices, price "scissors" in such cases are indicative of changes in the respective price-setting influence of national agents and transnational corporations dealing with primary commodities. It was found that, on average, African countries in the post-reform period had been able to increase the margin between border and world prices for their export crops (table 7). Countries that did not implement reforms fared better in this respect than those that liberalized their marketing networks.

Table 7

Average ratio of border prices to world market prices, 1973-1995

Commodity/country	1974-1979 (1973 = 100)	1980-1985 (1979 = 100)	1986-1995 (1985 = 100)
Cocoa/Cameroon	109	92	125
Cocoa/Côte d'Ivoire	110	91	102
Cocoa/Ghana	125	94	118
Coffee/Côte d'Ivoire	97	96	85
Coffee/Kenya	95	101	127
Cotton/Egypt	150	89	110
Cotton/Sudan	153	81	98
Cotton/United Republic of Tanzania	154	90	159
Tea/Kenya	97	106	98
Tea/Malawi	85	106	68
Tea/United Republic of Tanzania	89	113	104
Average: non-reformers[a]	107	98	117
Average: reformers[a]	114	98	104

Source: UNCTAD secretariat calculations, based on UNCTAD's average indices of free market prices and various editions of UNCTAD's *Monthly Commodity Price Bulletin*, including TD/B/CN.1/CPB/L.47, May 1997.

Note: The average ratio is obtained by dividing index numbers for border prices by the index numbers for world market prices (multiplied by 100) for each year. A value above 100 indicates that during the period in question the rise in border prices exceeded, on average, the rise in world market prices, signifying an increase in the share captured by national agents versus transnational corporations.

[a] According to Husain and Faruquee (see note 12), Cameroon, Ghana and Kenya are "non-reformers" in commodity marketing and pricing, whereas Côte d'Ivoire, Egypt, Malawi and the United Republic of Tanzania are "reformers".

47. The above findings suggest that policies designed to remove price distortions are insufficient to provide greater incentives. The reasons for this insufficient impact vary from country to country. However, a common element has been that price-based reforms have left untouched existing severe market imperfections and shortcomings. Indeed, most of the reforms appear to have been undertaken as if the ingredients of an efficient private market already existed. Where marketing boards have been weakened or dismantled, markets for export crops have become dominated by a few traders. Producer prices in such cases have continued to be depressed, especially in regions with poor infrastructure and low population density, with farmers in these regions negatively affected by the abandonment of pan-territorial pricing policies. Over time, competitive forces may develop, but a more gradual transition to reforming agricultural pricing, by first establishing the necessary institutions and physical infrastructure, is preferable.

48. Given the crucial importance of agriculture in SSA, a number of elements need to be taken into account in formulating agricultural policies in the region. First, in view of the differing conditions among countries, there can be no single policy prescription that is universally applicable. Second, because policies aim to achieve various objectives, such as price and income stability for farmers, national food self-sufficiency, surplus extraction, and efficiency and productivity improvements, which touch on different facets of agriculture, some of these policies risk clashing with others. Current market-oriented reforms attribute greater importance than before to some objectives. Consequently, the lower priority accorded to others is a potential recipe for overall policy failure. Some of these objectives, and their interrelations, are discussed below.

Price stability. The volatility of world prices for traditional export crops, if passed directly on to farmers, tends to reduce their willingness to undertake investment because of increased uncertainty about prospective returns. A critical role of marketing boards has been to shelter SSA farmers from extreme price fluctuations. A consequence of their dismantlement and of the withdrawal of government intervention in agricultural markets is that there is no longer any instrument available to smooth out farm incomes during periods of volatile prices.

Food self-sufficiency. Food self-sufficiency is a major policy concern for sub-Saharan countries with rapidly growing urban populations. Moreover, the cost of food imports is expected to rise when the Agreement on Agriculture concluded in the Uruguay Round is fully implemented. There can thus be a trade-off between cultivating export crops and food crops for domestic consumption in countries with limited agricultural land. There is scope, however, for simultaneously increasing production of both export and domestic crops in many SSA countries by encouraging inter-cropping practices, which diversify the risk to and smooth the seasonal incomes of producers, and by adopting "green revolution" technologies that increase food production. Such policies call for increased involvement by the State in providing agricultural inputs and extension services.

Surplus extraction. In sub-Saharan agrarian structures, implicit tax measures were used to extract part of the value added by farmers. Experience shows that "taxing" agriculture through price policies is not incompatible with high rates of agricultural growth if there is at the same time appropriate government involvement in the provision and maintenance of necessary infrastructure and services.[26] To dismantle, rather than reform, marketing boards and related public or semi-public institutions risks creating a gap in this respect that the private sector may be unable to fill.

E. Policy conclusions

49. After so many years of stagnation and decline, the recent recovery in Africa has understandably engendered much optimism. But events call for caution rather than complacency. Cyclical and transitory factors have been important in the recent economic upturn. Only a few African countries appear to have been able to exploit the opportunities presented by the favourable conditions of 1994-1996. While market-based reforms can make a difference, they also present new challenges to African policy makers.

50. The present report has concentrated on the problems confronting African countries engaged in the reform process. The principal conclusions that can be drawn are the following:

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[26] On the experience of Taiwan Province of China along these lines, see *Trade and Development Report, 1997*, Part Two, chap. III.

■ Increasing investment in tradeable goods sectors and physical and human infrastructure is a prerequisite for sustained growth, and requires a considerable expansion of imports. However, such expansion is constrained by balance-of-payments considerations, which have been negatively affected by the external debt burden. Debt relief is therefore indispensable for a transition to a self-sustained growth process in SSA.

■ Export promotion in non-traditional sectors should be vigorously pursued. Increased competitiveness can best be achieved through improvements in productivity brought about by higher investment in physical and human infrastructure. Exchange rate stability is also essential for the success of an export-oriented development strategy, although such a strategy may also call for the adoption of selective and temporary incentives for exports in non-traditional sectors.

■ In the formulation of agricultural price policies a balance should be struck between food self-sufficiency, surplus extraction and price incentives and income security for producers. Care should be taken to avoid systematic biases against food crops. Policy instruments and institutions which can be used to pursue these objectives should not be dismantled. African agriculture requires substantial investments in and maintenance of infrastructure, which cannot always be undertaken by the private sector.