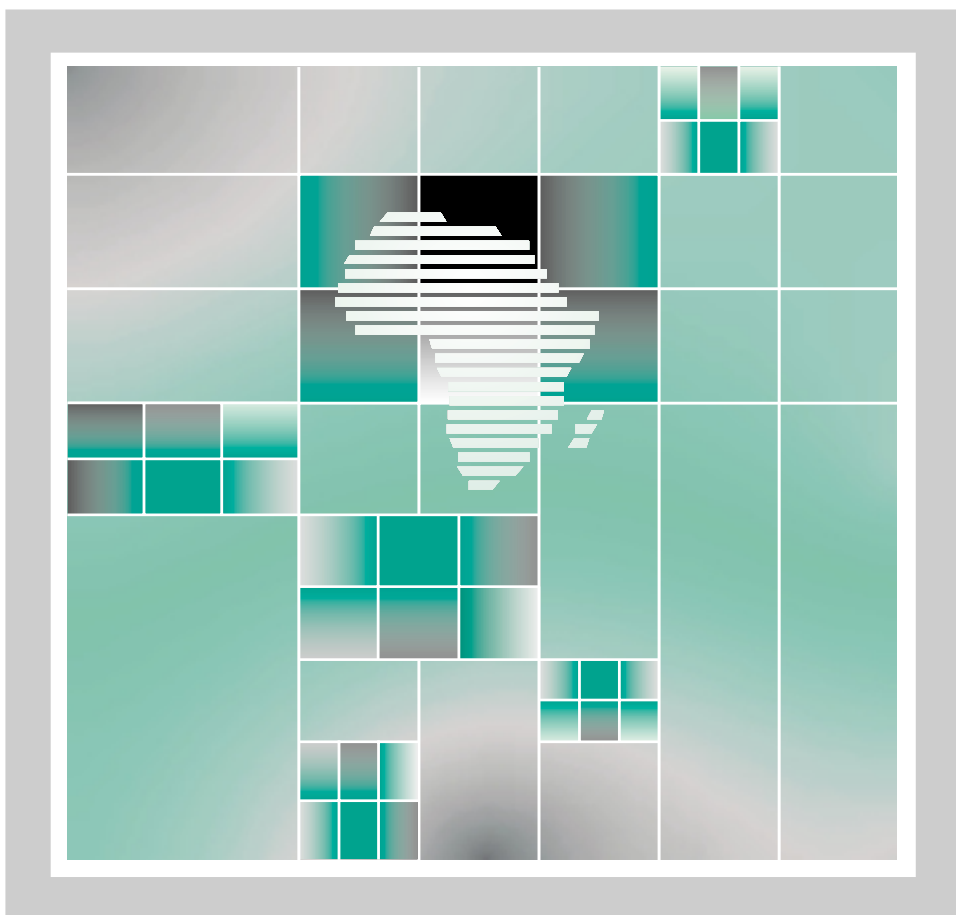


UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

CAPITAL FLOWS AND GROWTH IN AFRICA



UNITED NATIONS



UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

Geneva

CAPITAL FLOWS AND GROWTH IN AFRICA



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CAPITAL FLOWS AND GROWTH IN AFRICA

A. Introduction

The international community has long recognized that developing countries need a substantial inflow of external resources in order to fill the savings and foreign exchange gaps associated with a rapid rate of capital accumulation and growth needed to overcome widespread poverty and to lift living standards to acceptable levels. Among various developing regions, the need for external financing is nowhere more pressing than in Africa, particularly in sub-Saharan Africa,¹ where income levels are too low to generate adequate domestic resources for the attainment of even modest rates of investment and growth. Since private capital inflows, in particular foreign direct investment (FDI), lag behind rather than lead growth, the task of filling the resource gap inevitably falls on official financing. International efforts have indeed been taken over the past three decades in this regard through both multilateral and bilateral financing. However, while the savings and foreign exchange gaps in Africa have tended to widen since the beginning of the 1980s as a result of a combination of a number of factors, including adverse movements in the terms of trade and a sharp increase in the import content of growth brought about by rapid trade liberalization, capital inflows have failed to keep pace.

While official inflows² have stagnated or fallen, the region has not participated in the recovery in private capital inflows to emerging markets that began in the early 1990s. Efforts to integrate the region into the

global financial system and to attract private flows through a rapid liberalization of the capital account have resulted not in increased inflows of such capital, but in greater volatility, with attendant consequences for exchange rate instability and misalignments. A number of countries in the region have experienced considerable financial instability and payments difficulties, but these have been given little attention by the international community, largely because, unlike the recent bouts of financial crisis in emerging markets of Latin America and East Asia, they did not pose a serious threat to the stability of the international financial system and their damage has been confined to the economies concerned. Moreover, an increased proportion of net capital inflows has been used for purposes other than current account financing, i.e. for offsetting financial transactions (including private capital outflows) and for accumulation of reserves as a safeguard against speculative attacks on currencies and capital flight. Consequently, not only has the volume of net capital inflows continued to fall far short of the resource gap, but also the proportion of such inflows used for real resource transfers from abroad has fallen in the past 10 years.

Given that financial flows are inadequate and volatile and the region is subject to frequent terms-of-trade and natural shocks, it should come as no surprise that growth continues to be too erratic and slow to permit an increase in both living standards and domestic savings. Breaking this vicious circle requires, *inter alia*, a sustained injection of external financing in amounts large enough to give a big push to the region to accelerate and maintain growth at levels higher than in the past. This initial big push could only come from official sources of finance, and it would need to be combined with policies that recognize the need not only for market-based incentives, but also for a greater role for the State and for institution building.

Such a process would help break aid dependence in two ways. First, rapidly rising income would allow domestic savings to be raised faster than output, thereby raising total investible resources without additional external financing. Secondly, sustained growth would attract private capital, as a substitute for official financing. In other words, the only feasible way to end aid dependence is to launch a massive aid programme and to sustain rapid growth for a sufficiently long period so as to allow domestic savings and external private flows to gradually replace official aid. The

experience of the East Asian countries that successfully broke out of the vicious circle of poverty and inadequate domestic resources during the 1960s and 1970s suggests that if GDP growth could be raised to some 6 per cent per annum and sustained at that rate for a period of 10–12 years, through a large injection of official aid accompanied by appropriate domestic policies, the need for official financing would gradually diminish as these alternative sources of financing came forward. But if the minimum quantum of resources needed to initiate and sustain such a process is not provided, aid dependence is likely to continue unabated. To use a Keynesian metaphor, aid can thus be like a widow's cruse: it does not get wasted by expending more of it, but attempts to spare it can translate the cruse into a Danaid jar which can never be filled up.

This paper addresses these issues. The next section reviews recent trends in the capital inflows of Africa and is followed by an analysis of the use of such inflows for offsetting financial transactions and real resource transfers. Section D examines the size and stability of short-term capital flows. Section E presents various scenarios to analyse the possible evolution of domestic savings and private capital inflows through a process of rapid and sustained growth made possible by, *inter alia*, a large injection of foreign aid and the implications of this process for aid dependence. The final section briefly discusses the policy approach needed to ensure that aid is effectively translated into investment and growth, keeping in mind the policy mistakes made both during the pre- and post-adjustment periods.

B. Capital inflows of Africa: Trends and patterns

As examined in some detail in *TDR 1999*, capital inflows of developing countries as a whole have gone through three distinct phases since the mid-1970s. The period from 1975 to the early 1980s saw a rapid increase in the total capital inflow mainly as a result of a surge in syndicated bank lending; official financing was also sustained, even though its share

in the total fell. This expansion came to an abrupt end in the early 1980s with the outbreak of the debt crisis when the share of private inflows in total inflows fell as a result of reduced bank lending. The 1990s witnessed a sharp increase in total capital inflows, which reached 5 per cent of GNP of recipient countries, again as a result of a surge in private flows, notably portfolio and foreign direct investment, while official flows declined. However, this upsurge represented no more than a recovery after the blighted years of the 1980s, and a return to the levels observed in the 1970s and early 1980s.

In sub-Saharan Africa, total net capital inflows as a proportion of GNP have followed a somewhat different path. Unlike the trend in emerging markets, in SSA such inflows registered a moderate increase in the 1980s, compared to the 1970s, and fell somewhat in the 1990s (table 1). However, this pattern is strongly influenced by Nigeria, the largest economy in the region. Excluding Nigeria, total net capital inflows were lower in the 1990s than in the 1970s, although they recovered from the depressed levels of the 1980s. North Africa experienced a dramatic decline in capital inflows as a proportion of GNP during the 1980s compared to the 1970s, a trend that has also continued in the 1990s, largely due to a sharp decline in private inflows (table 2).

Net transfers show a similar trend in SSA: they were lower in the 1980s than in the previous decade, and the decline generally continued during the 1990s despite a fall in interest payments on external debt. Thus, almost 40 per cent of net capital inflows into SSA (including Nigeria) in the 1990s were transferred back to creditor countries as interest payments and profit remittances. For North Africa the turnaround in net transfers is even more dramatic: following a sharp drop in the 1980s, they became negative in the 1990s, implying a net transfer of resources from the region.

In spite of the efforts to attract private capital, such inflows as a proportion of GNP have been on a downward trend in both SSA and North Africa.³ Long-term bank lending has completely disappeared since the mid-1980s, and in SSA private inflows have mainly consisted of FDI and short-term bank lending, while equity inflows have been somewhat more important in North Africa. However, most countries in the region have

Table 1

**CAPITAL INFLOW OF SUB-SAHARAN AFRICA BY TYPE OF FLOW,
AND NET TRANSFER, 1975–1998**

(Percentage of GNP)

| <i>Type of flow</i> | <i>Including Nigeria</i> | | | <i>Excluding Nigeria</i> | | |
|---------------------------|--------------------------|-----------------------|-----------------------|--------------------------|-----------------------|-----------------------|
| | <i>1975– 1982</i> | <i>1983– 1989</i> | <i>1990– 1998</i> | <i>1975– 1982</i> | <i>1983– 1989</i> | <i>1990– 1998</i> |
| Total net inflow | 8.6 | 9.9 | 9.3 | 11.5 | 10.0 | 10.6 |
| Official inflows | 4.7 | 6.8 | 7.5 | 7.2 | 8.0 | 9.1 |
| ODA grants ^a | 1.7 | 3.3 | 5.4 | 2.6 | 4.0 | 6.4 |
| Official credit | 3.0 | 3.5 | 2.1 | 4.6 | 4.0 | 2.7 |
| Bilateral | 1.6 | 1.8 | 0.4 | 2.5 | 2.1 | 0.6 |
| Multilateral | 1.4 | 1.7 | 1.7 | 2.1 | 1.9 | 2.1 |
| Private inflows | 3.9 | 3.1 | 1.8 | 4.3 | 2.0 | 1.5 |
| Interest payments | 1.5 | 3.2 | 2.7 | 1.8 | 2.7 | 2.3 |
| Profit remittances | 1.4 | 1.1 | 1.1 | 1.1 | 1.0 | 1.2 |
| Net transfer ^b | 5.7 | 5.6 | 5.5 | 8.6 | 6.3 | 7.1 |

Source: UNCTAD secretariat calculations, based on World Bank, *Global Development Finance, 2000* (CD-ROM).

a This item corresponds to “Grants” as defined by the World Bank in the source and excludes funds allocated through technical cooperation.

b Net capital inflow less interest payments on external debt and profit remittances.

failed to attract FDI, which has been concentrated in a handful of oil and mineral-rich countries. While private inflows averaged about 4 per cent of GNP for developing countries as a whole, the proportion was less than 2 per cent in SSA.

Official inflows, including ODA grants and bilateral and multilateral lending, as a proportion of GNP rose in SSA both during the 1980s

Table 2

**CAPITAL INFLOW OF NORTH AFRICA BY TYPE OF FLOW,
AND NET TRANSFER, 1975–1998**

(Percentage of GNP)

| <i>Type of flow</i> | <i>1975–1982</i> | <i>1983–1989</i> | <i>1990–1998</i> |
|---------------------------|------------------|------------------|------------------|
| Total net inflow | 13.0 | 4.9 | 3.2 |
| Official inflows | 5.8 | 2.4 | 2.4 |
| ODA grants ^a | 1.3 | 0.7 | 1.7 |
| Official credit | 4.5 | 1.7 | 0.7 |
| Bilateral | 3.3 | 1.0 | 0.1 |
| Multilateral | 1.2 | 0.7 | 0.6 |
| Private inflows | 7.2 | 2.5 | 0.8 |
| Interest payments | 2.8 | 3.7 | 3.4 |
| Profit remittances | 1.2 | 0.5 | 0.4 |
| Net transfer ^b | 9.0 | 0.7 | -0.6 |

Source: See table 1.

a This item corresponds to “Grants” as defined by the World Bank in the source and excludes funds allocated through technical cooperation.

b Net capital inflow less interest payments on external debt and profit remittances.

and 1990s. The trend was flat in North Africa. Overall, while ODA grants have risen over the past three decades, multilateral and bilateral lending has either fallen or stagnated. Despite their limited volume, official inflows have accounted for an increasing proportion of total capital inflows due to even sharper declines in private capital. As a result of the exclusion of SSA from the boom of the 1990s in private inflows, together with the stagnation and decline in official flows, the share of the region in total capital inflows of developing countries declined to a mere 10 per cent in the 1990s from more than 20 per cent in the 1980s.

In per capita terms there was a pronounced downward trend in both total and official capital inflows (chart 1).⁴ From a level of less than \$20 per head in the mid-1970s, total net inflows of SSA had more than doubled by the end of the decade, reaching \$43 per head in 1983. However, they started falling subsequently and the decline accelerated in the 1990s; at the end of the decade per capita inflows were less than \$30. While part of the decline during 1994–1998 reflects the effect of the appreciation of the dollar vis-à-vis the currencies of most other donors on the dollar value of ODA disbursed in these currencies, it cannot alone explain the overall downward trend in official inflows.⁵

In real terms the decline is even more pronounced: at the end of the 1990s, real per capita inflows were less than half those of the late 1970s and early 1980s. Per capita official inflows of SSA rose both in nominal and real terms in the second half of the 1980s, but fell almost constantly during the 1990s (chart 2). In per capita terms, real official flows at the end of the 1990s were less than half those of the early 1980s.

There are considerable disparities in the distribution of capital inflows among countries in SSA at similar levels of per capita income. For instance, for countries with a per capita income of around \$1,000, the average annual per capita inflow in 1990–1998 ranged from \$7 to \$70 (chart 3).⁶ While such disparities should be expected to be less pronounced for official flows, this has not been the case. For instance, for the same group of countries, per capita ODA grants received during the same period varied from \$5 to \$50 (chart 4).

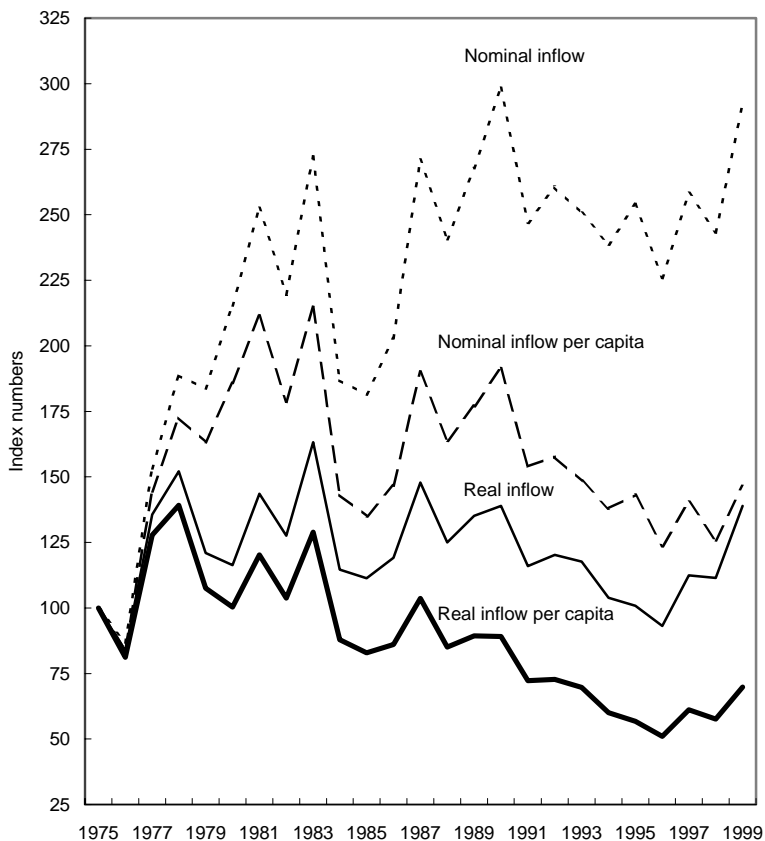
Clearly, private and official capital inflows are not completely independent, but they are also expected to respond differently to economic performance. An econometric study conducted by the UNCTAD secretariat to investigate these relations for the 16 largest economies in Africa⁷ yielded the following results:

- An examination of the relationship between lagged and contemporaneous official and private financial inflows shows that multilateral and bilateral lending tends to be a catalyst for private capital inflows. But this relationship does not hold between grants and private inflows. Thus, while an increase in IMF or World Bank lending to a

Chart 1

TOTAL AND PER CAPITA NET CAPITAL INFLOWS OF SUB-SAHARAN AFRICA, 1975–1999

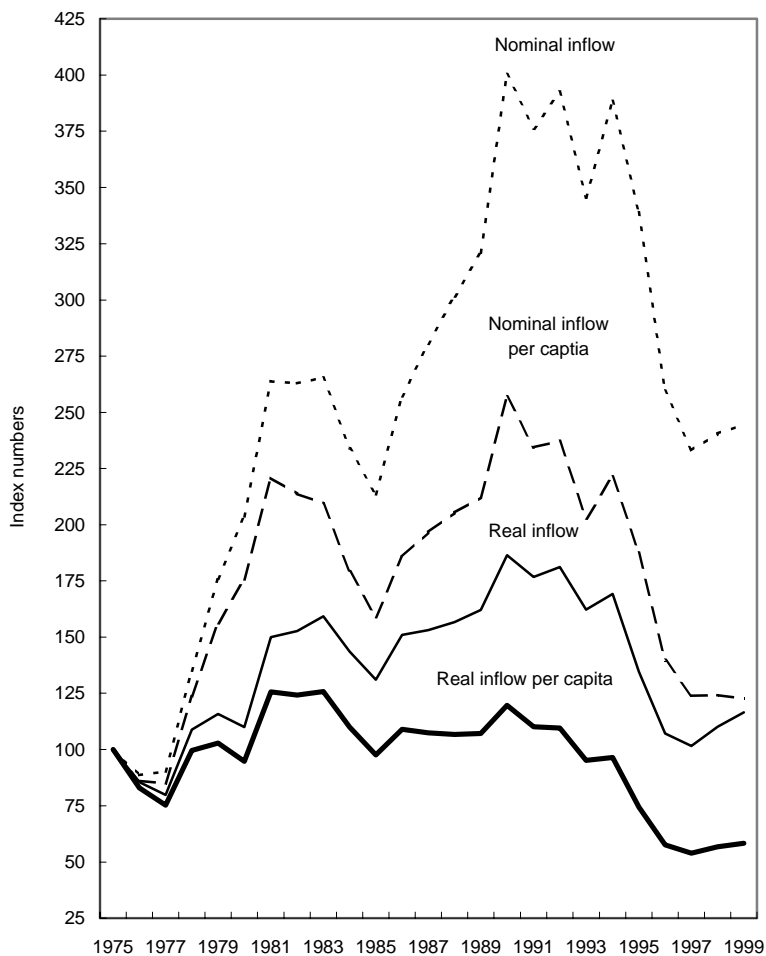
(Index numbers, 1975 = 100)



Source: UNCTAD secretariat estimates, based on World Bank, *Global Development Finance, 2000* (CD-ROM); UNCTAD, *Handbook of International Trade and Development Statistics*; IMF, *International Financial Statistics*.

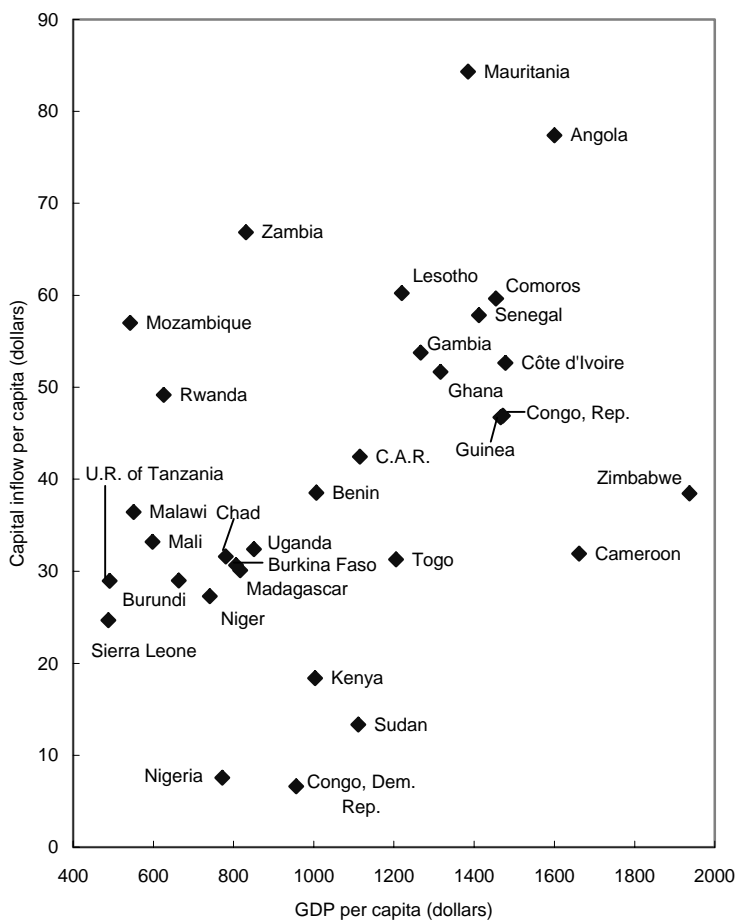
Note: Real flows are nominal flows deflated by the index of the dollar unit value of imports.

Chart 2

NET INFLOW OF OFFICIAL CAPITAL INTO SUB-SAHARAN AFRICA, 1975–1999: TOTAL AND PER CAPITA*(Index numbers, 1975 = 100)*

Source and note: See chart 1.

Chart 3

**AGGREGATE NET CAPITAL INFLOW AND GDP PER CAPITA
IN SUB-SAHARAN AFRICA,^a BY COUNTRY, 1990–1998**
(Annual average in current dollars)


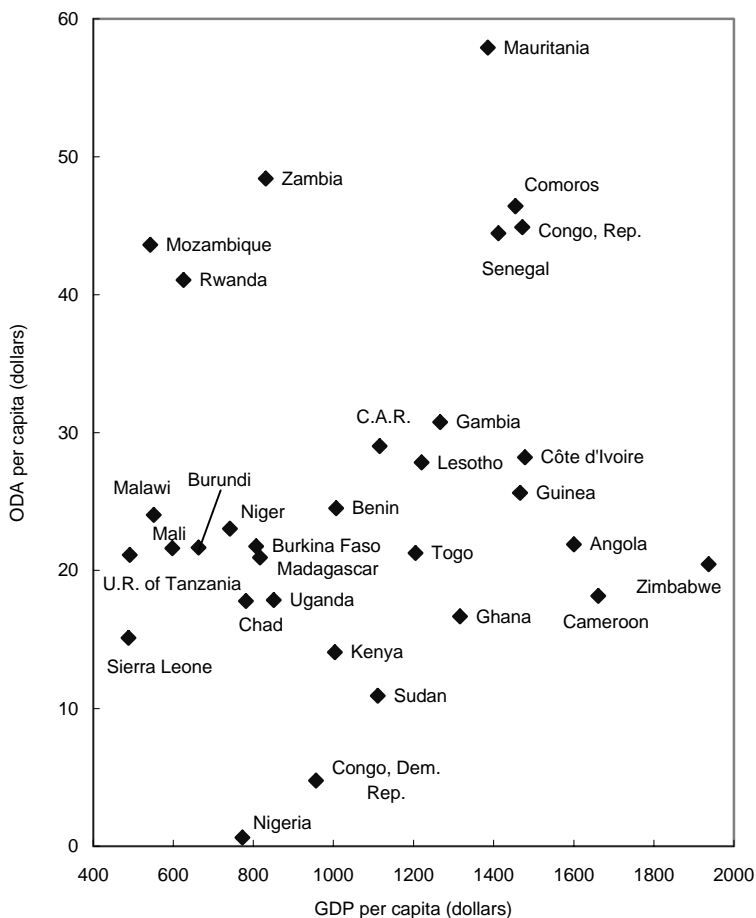
Source: See chart 1.

a Excluding countries with per capita GDP exceeding \$2000 (Botswana, Gabon, Mauritius and Swaziland).

Chart 4

**ODA GRANTS AND GDP PER CAPITA IN SUB-SAHARAN AFRICA,^a
BY COUNTRY, 1990–1998**

(Annual average in current dollars)



Source: See chart 1.

a Excluding countries with per capita GDP exceeding \$2000 (Botswana, Gabon, Mauritius and Swaziland).

country can be expected to be followed by increases in private capital inflows to that country, that is unlikely to be the case when grants are increased.

- Official inflows are inversely related to both contemporaneous and lagged private inflows; that is, they tend to be higher where private inflows are lower. This relationship, however, is due largely to grants; whether or not a country is receiving private capital does not appear to have a significant influence on multilateral and bilateral lending to that country.
- Total capital inflows are not significantly correlated with their past levels, i.e. they are not persistent. This is due to the behaviour of private inflows since official inflows, notably grants, show a reasonable degree of persistence.
- Official inflows are inversely related to contemporaneous and lagged growth rates in the recipient country. One implication of this is that they tend to rise when the growth performance is poor, but they are likely to fall when growth picks up. The inverse relationship is particularly strong between contemporaneous growth and multilateral and bilateral lending. Although causality is not explored, this may also reflect the effect of restrictive macroeconomic policies that often accompany the provision of such funds as part of conditionality.
- Finally, private capital inflows show a strong response to lagged growth rate but not to contemporaneous growth, confirming that they tend to lag behind, rather than lead, growth. This result also underlines that growth in Africa is erratic, rather than persistent and sustained.

These results have important implications for designing effective aid policies so as to reduce aid dependence. They also yield some lessons for an effective capital account management by the recipient countries. These issues will be discussed in the following sections.

C. Capital flows and current account financing

The external resource gap of a developing country is usually reflected in its current account deficit, associated with a given or a targeted growth rate. However, net capital inflows received by developing countries from non-residents do not always give the amount available for financing current-account deficits. Account has to be taken of net capital outflows by residents as well as additions to foreign exchange reserves. Such offsetting financial transactions directly compete with real resource transfers from abroad that could be financed by net capital inflows.

Evidence suggests that during the past decade a rising share of capital inflows of developing countries, including in particular emerging markets, has been channelled towards offsetting financial transactions, and that the association between capital inflows and financing of the resource gap (i.e. current account deficits) has grown weaker.⁸ Table 3 illustrates the extent to which this has also been the case in Africa. It gives a breakdown of the use that has been made of total net capital inflows by the 16 largest economies for which data are available for the 1980s and 1990s.

1. *Capital outflows*

Increased capital outflows through acquisition of assets abroad by residents has become a widespread phenomenon in the developing world, and particularly in emerging markets, as a result of increased liberalization of the capital account and greater integration into the global financial system. During the past decade a number of African countries have also liberalized outward capital flows, thereby facilitating the acquisition of assets abroad.⁹ Nevertheless, it should also be remembered that such outflows can take place under controlled capital account regimes, particularly

Table 3

**CURRENT ACCOUNT FINANCING AND OFFSETTING FINANCIAL
TRANSACTIONS AS A PERCENTAGE OF NET CAPITAL INFLOW
IN 16 AFRICAN COUNTRIES, 1980–1989 AND 1990–1998**

| Country | Current account financing | | Net capital outflow | | Increase in reserves | | BoP errors and omissions | |
|-------------------------|------------------------------|---------------|------------------------|---------------|-------------------------|---------------|--------------------------------|---------------|
| | 1980– 1989 | 1990– 1998 | 1980– 1989 | 1990– 1998 | 1980– 1989 | 1990– 1998 | 1980– 1989 | 1990– 1998 |
| Cameroon ^a | 80.9 | 78.6 | 12.8 | -8.6 | -0.5 | -3.8 | 6.8 | 33.8 |
| Côte d'Ivoire | 94.8 | 70.6 | 1.2 | 16.0 | -1.5 | 14.4 | 5.5 | -1.0 |
| Egypt ^b | 95.0 | -47.1 | 8.9 | 30.9 | 11.0 | 106.6 | -14.9 | 9.6 |
| Ethiopia | 84.4 | 1.9 | -7.7 | 16.5 | -0.9 | 13.6 | 24.2 | 68.0 |
| Ghana | 66.7 | 88.4 | 5.3 | 9.2 | 16.1 | 6.3 | -12.4 | -3.9 |
| Kenya ^c | 96.9 | 102.2 | 17.2 | -1.1 | -1.7 | 68.0 | -1.7 | -69.1 |
| Madagascar | -93.9 | 108.2 | -3.9 | 1.2 | 11.7 | -2.4 | 11.7 | -7.0 |
| Mauritius | 69.7 | 61.3 | 30.8 | 73.3 | 96.0 | 50.9 | 96.5 | -85.5 |
| Morocco | 87.6 | 55.3 | 15.7 | 2.2 | -0.1 | 56.3 | -3.2 | -13.8 |
| Nigeria ^b | 50.4 | -10.1 | 52.0 | 87.5 | -10.1 | 20.9 | 7.7 | 1.7 |
| Senegal | 90.8 | 74.0 | 9.1 | 11.7 | -0.2 | 12.4 | 0.3 | 1.9 |
| Sudan | 60.5 | 164.2 | 21.1 | 9.5 | 8.1 | 1.2 | 10.3 | -74.9 |
| Tunisia | 73.5 | 59.0 | 24.8 | 37.7 | 12.6 | 15.9 | 10.9 | -12.6 |
| Uganda ^d | 134.2 | 75.5 | -44.9 | 4.6 | 1.7 | 26.2 | 9.0 | -6.3 |
| U.R. of Tanzania | 102.2 | 97.6 | 0.0 | 2.0 | -0.8 | 14.3 | -1.4 | -13.9 |
| Zimbabwe ^c | 119.4 | 82.6 | 5.8 | 2.1 | -2.7 | 19.6 | -22.5 | -4.3 |
| Average: | | | | | | | | |
| Unweighted ^e | 87.5 | 66.4 | 9.3 | 18.4 | 8.7 | 26.3 | -5.5 | -11.1 |
| Weighted ^f | 92.1 | 57.9 | 9.5 | 23.5 | 0.7 | 21.5 | -2.3 | -2.9 |

Source: IMF, *Balance of Payments Statistics*, various issues.

Note: For definition of net capital inflow and net capital outflow, see text, note 2. A minus sign indicates a current account surplus and a decrease in reserves, respectively.

a 1980–1989 and 1990–1995.

b 1980–1989 and 1995–1998.

c 1980–1989 and 1990–1994.

d 1980–1989 and 1990–1997.

e Arithmetic average of percentages of the countries listed.

f Percentages based on aggregate values for the sample.

when such controls are ineffective and incentives for capital flight are strong.

Table 3 shows that for the 16 African countries taken together, capital outflows have absorbed a greater proportion of capital inflows in recent years: for each dollar of net inflow there was a net outflow of some 9 cents in the 1980s, but this figure went up to more than 23 cents in the 1990s. The corresponding figures for the 1990s are 24 cents and 31 cents for emerging markets and for all developing countries, respectively.¹⁰ Hence, during the 1990s the African economies experienced the same ratio of outflows to inflows as the emerging market economies.¹¹ It is also notable that this is a widespread phenomenon in the region, and is not simply due to the preponderance of the larger economies of North Africa and Nigeria; the unweighted average also shows an increase, from 9 cents to more than 18 cents. Eleven countries out of the 16 in the table experienced rising capital outflows as a proportion of inflows in the 1990s. The exceptions were Cameroon, Kenya, Morocco, Sudan and Zimbabwe, the last two of which are among the countries with tighter controls on capital flows.

The coexistence of capital inflows with outflows is a widespread phenomenon in the developed world and a natural outcome of increased global financial integration. A similar situation can be expected to prevail in developing countries as their incomes and wealth increase and dependence for growth on foreign capital declines. However, these conditions do not yet hold in Africa. Moreover, unlike in most emerging markets, there is an important asymmetry in SSA between asset holders abroad and international debtors, which makes it even more difficult to manage external payments: while external liabilities effectively belong to the public sector, a large proportion of assets held abroad is owned by the private sector.

In balance-of-payments statistics the “errors and omissions” is calculated as a residual, incorporating all unrecorded transactions on both current and capital account, and is traditionally taken as a measure of unrecorded capital movements by residents.¹² In Africa, unrecorded current account transactions can be expected to account for much of this residual item, since smuggling of both imports and exports was widespread in

many countries for most of the years to which the data in table 3 refer. Similarly, some of these transactions may be due to movements into and out of the formal sector, without any cross-border transactions taking place.¹³ These features of African economies may explain why this item turns out to be negative in table 3 for the 16 African economies taken together, while it is positive in the emerging markets and other developing countries. On the other hand, large variations among the individual countries in table 3 in the size and sign of this item and its movement over time suggest that different factors are at work in different countries and at different times. However, since this item constitutes less than 3 per cent of total capital inflows for these countries taken together, it will not be included in the subsequent analysis of capital flows.

2. Reserves

In a number of developing countries, notably the emerging markets, there has been a tendency in recent years to accumulate reserves as a safeguard against discontinuation or reversal of capital flows and speculative attacks on the currency. While reserves have followed a boom-bust cycle in line with the rapid surge and exit of private capital, on average they have absorbed an increasing proportion of net capital inflows, over and above what is typically needed to finance the flow of imports.

Table 3 shows a similar increase in Africa in the proportion of capital inflows used for reserve accumulation. For the 16 countries taken together, during the 1990s more than 20 per cent of total capital inflows were absorbed by additions to reserves, whereas the proportion was negligible in the 1980s. In 11 of the countries the ratio rose. Again, the rise was not due to the larger countries of the region, which are more likely to be subject to a boom-bust cycle in financial flows: the unweighted average for the 16 countries is even higher, showing that of each dollar of net inflow, more than 26 cents were added to reserves in the 1990s, three times the amount in the 1980s. These ratios are broadly consistent with the ratios observed for emerging markets and other developing countries.

It was undoubtedly the case that reserves in SSA were extremely low during the 1980s, when the region faced adverse external trading and

financial conditions which led to a massive import strangulation, and that there was consequently a real need to replenish them. However, available data show that most countries have been adding to reserves much faster than they have been increasing their imports of goods and services, particularly since the recent bouts of crisis in emerging markets. Between 1995 and 1998, while total SSA imports rose by some 8 per cent, reserves grew by some 50 per cent. The shift appears to be related to the liberalization of the capital account and to external financial vulnerability; five countries with the highest rates of reserve accumulation in the 1990s (Egypt, Kenya, Mauritius, Morocco and Uganda) are also the countries with more liberal capital account regimes. Given that growth in most countries in the region is constrained by the balance of payments, tying up international purchasing power through reserve accumulation entails considerable opportunity costs in terms of imports, investment and growth forgone.

3. *Current account financing*

Net capital outflows by residents, together with international reserve accumulation, have thus absorbed an increasing proportion of net capital inflows in recent years, and a declining proportion of such inflows has been allocated to real resource transfers from abroad in the form of current account financing. For the 16 African countries in table 3, the proportion of total inflows absorbed by offsetting financial transactions rose from less than 10 per cent in the 1980s to more than 40 per cent in the 1990s. During the latter period, therefore, less than 60 cent of each dollar mobilized from abroad has been allocated to real resource transfers.

Thus, African countries face two major problems in closing their savings and foreign exchange gaps. First, as seen above, the regions' capital inflow has been on a declining trend. Second, a reduced proportion of the inflow has been available for imports for current production and capital formation. Consequently, the region is facing a tighter external financial constraint in closing its resource gap and accelerating accumulation and growth.

D. Stability of capital flows

An additional problem in SSA is the instability of capital flows. As already noted, total inflows to SSA do not show any persistence, in large part due to the behaviour of private capital. Fluctuations in private capital inflows have different origins for different countries,¹⁴ but they largely reflect the fact that SSA has not been able to attain the rapid and sustained growth needed to attract a steady inflow of private capital. However, instability is also due to the behaviour of components of private capital unrelated to long-term profit opportunities. These include in particular short-term capital flows attracted by arbitrage opportunities and prospects of quick capital gain.

Such flows are known to be an important source of currency and financial instability in emerging markets. While for Africa both the magnitude and the share of private capital in total inflows are small in comparison, there are reasons to expect that such flows could still cause significant instability and difficulties for macroeconomic management.¹⁵ First of all, much of the flow, particularly grants, does not go through foreign exchange markets. The funds provided are often tied to imports, and the terms under which they are made available to users are not always linked to market conditions. Most grants are treated as current transfers rather than capital transactions, and excluding them from total official capital inflows of SSA in table 1 would raise the share of private inflows to almost 50 per cent of the total in the 1990s. Since currency and financial markets are rather thin in most countries, this means that private capital flows, including short-term flows, play a much greater role in currency markets in SSA than would be suggested by their share in total capital inflows.

Table 4 and chart 5 show the evolution of short-term arbitrage flows for selected African countries. The data exclude short-term trade credits, since these are not driven by arbitrage profits, but include other types of

Table 4

**SHORT-TERM CAPITAL INFLOW, OUTFLOW AND
NET FLOW OF SELECTED AFRICAN COUNTRIES,
1980–1989 AND 1990–1998**

(Millions of dollars)

| Country group | Short-term net inflow | | Short-term net outflow | | Short-term flow | |
|--------------------------------|--------------------------|---------------|---------------------------|---------------|--------------------|---------------|
| | 1980– 1989 | 1990– 1998 | 1980– 1989 | 1990– 1998 | 1980– 1989 | 1990– 1998 |
| Larger economies ^a | 4091 | 20862 | 11659 | 21610 | -7568 | -748 |
| Smaller economies ^b | 2679 | 2630 | 1907 | 2930 | 772 | -300 |
| All selected countries | 6770 | 23492 | 13566 | 24540 | -6796 | -1048 |

Source: UNCTAD secretariat calculations, based on IMF, *Balance of Payments Statistics*, various issues.

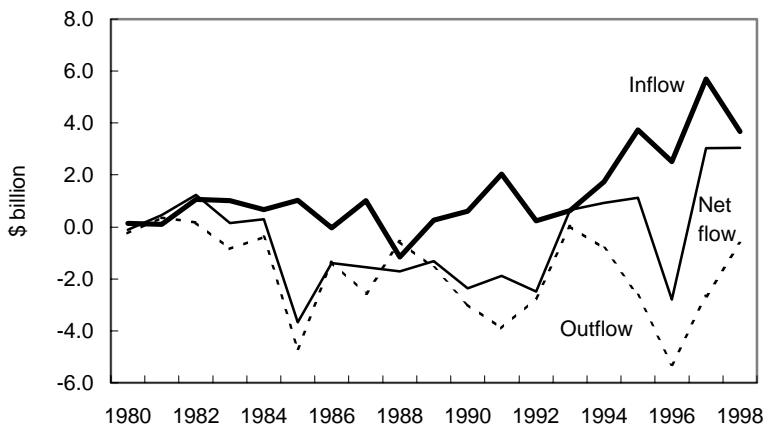
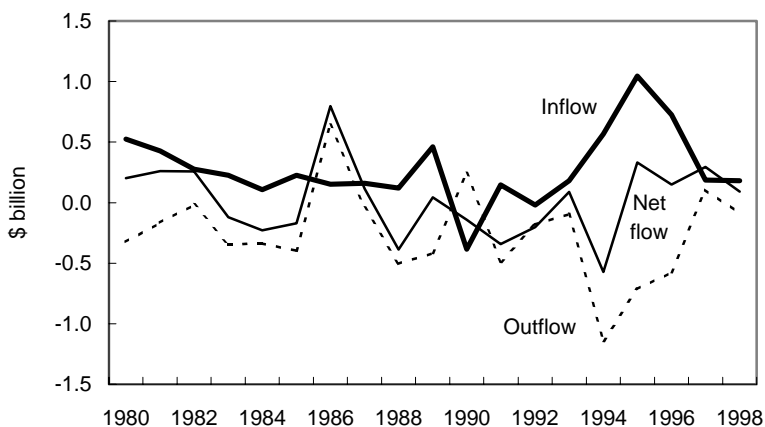
Note: Data are cumulative totals for each period.

a Egypt, Morocco, Nigeria, Tunisia.

b Cameroon (up to 1994), Côte d'Ivoire (up to 1996), Ethiopia, Ghana, Madagascar, Mauritius, Senegal, Sudan, Uganda (up to 1997), United Republic of Tanzania, Zimbabwe (up to 1994).

bank loans and portfolio investments and non-interbank deposit holdings; thus, they correspond to what is often referred to as “hot money”.¹⁶ Short-term net inflows by non-residents are separated from short-term net outflows by non-residents, and the difference between the two is given as short-term net flows. In order to facilitate comparison, countries are classified as small and large ones on the basis of the magnitude of capital flows received as well the aggregate levels of income. Analysis of this data suggests a number of conclusions:

- Short-term inflows were similar in both groups of economies in the 1980s, while in the larger economies outflows were considerably higher. Thus, while they were both unable to attract much private

Chart 5**ANNUAL SHORT-TERM CAPITAL INFLOW, OUTFLOW AND NET FLOW OF SELECTED AFRICAN ECONOMIES,^a 1980–1998***(Billions of dollars)***1. Larger economies****2. Smaller economies****Source:** See table 4.**a** See the notes to table 4 for the list of countries.

short-term capital, the larger economies suffered from capital flight on a much greater scale. There was a surge in short-term inflows in the 1990s to the larger economies but not to the smaller ones. While both groups witnessed increased outflows in the 1990s, the increase was much sharper in the larger economies.

- The overall balance of short-term inflows and outflows was more favourable in the 1990s than the 1980s, even though it was negative in both decades: for all of the selected countries, the cumulative net outflow over the period 1980–1998 amounted to \$38 billion and the cumulative inflow to \$30 billion. This overall trend is clearly dominated by the larger economies which experienced net outflows in both the 1980s and the 1990s, while in the smaller countries net flows turned negative only in the latter period.
- The evolution of short-term flows depicted in chart 5 is broadly similar to that of the short-term flows to emerging markets during the same period.¹⁷ However, while such flows in Africa do not show a complete boom-bust cycle of the kind experienced in emerging markets in Latin America and East Asia during the 1990s, there is a significant increase in the instability of both net short-term inflows and outflows during the 1990s compared to the 1980s.

The evidence from Africa thus lends support to the same conclusion as was reached for the emerging markets – i.e. that liberalization of short-term capital movements brings very little in the way of net flows of capital, while provoking significant instability. In the past few years net short-term inflows into the region as a whole have tended to exceed net short-term outflows, with the result that the region now appears to be enjoying a positive balance in such flows. However, if the experience of countries with better fundamentals, institutions and markets is any guide, such flows are unlikely to provide a reliable basis for bridging the external resource gap.

E. External financing, growth and aid dependence

1. *Payments deficits and growth*

It is generally agreed that in order to attain a marked improvement in living standards and a significant reduction in poverty levels, the African economies need to sustain at least 6 per cent growth per annum for a considerably long period. While there may be some scope to raise domestic resources to support the pace of capital accumulation needed, attaining such rapid growth depends crucially on the provision of external resources. Indeed, this dependence appears to have been rising in recent years.

The analysis in the *Trade and Development Report 1999* showed that, with few exceptions, trade deficits have been increasing faster than income in developing countries during the past decade, and in most countries the trend is one of widening trade deficits with falling and stagnant growth rates. Most countries in SSA fall in this latter category. Indeed, for SSA as a whole, excluding oil exporters, average growth fell constantly in the past three decades, while trade deficits rose. In the 1970s the region combined an average growth rate of almost 3.5 per cent with a trade deficit/GDP ratio of less than 1 per cent; in the 1980s, the average growth rate fell to 2.5 per cent, while the trade deficit ratio approached 3 per cent. Unlike most other developing regions, the decline in growth continued throughout much of the 1990s; during 1989–1998 the average annual growth rate was 2.2 per cent, while the trade deficit ratio rose further, exceeding 4 per cent. Again, for the sample of countries in table 3, including the North African ones, trade deficits rose by 1.5 per cent of GDP during the 1990s compared to the 1980s, while the growth rate remained virtually unchanged.¹⁸ A comparison of the 1970s with the 1990s of growth and trade deficits of 39 SSA countries shows that only three registered improvements in both respects. More than half had lower growth rates and higher deficits in the 1990s. While 11 had lower deficits, they

were generally attained at the expense of a sharp drop in growth rates, while in four countries growth rose alongside a widening of the deficits.

As analysed in greater detail in *TDR 1999*, three factors have generally been responsible for the deterioration of the relationship between trade deficits and economic growth in developing countries during the past decade: terms-of-trade deterioration, rapid trade liberalization that was not matched by increased market access in developed countries, and exchange rate instability and misalignments associated with greater capital account openness and increased volatility of private capital flows. Of these, adverse movements in the terms of trade are particularly important for Africa (table 5). Much of the consequent losses were incurred during the 1980s. Although the decline in the terms of trade during 1990–1997

Table 5

**TERMS OF TRADE, EXPORT VOLUME, AND PURCHASING
POWER OF EXPORTS IN AFRICA**

(1980–1981 = 100)

| | 1988–1989 | 1996–1997 |
|-----------------------------|-----------|-----------|
| All Africa | | |
| Terms of trade | 57.1 | 56.8 |
| Export volume | 98.8 | 131.2 |
| Purchasing power of exports | 56.4 | 74.5 |
| Non-oil exporting countries | | |
| Terms of trade | 88.1 | 84.3 |
| Export volume | 117.7 | 170.3 |
| Purchasing power of exports | 103.7 | 143.6 |
| Sub-Saharan Africa | | |
| Terms of trade | 65.7 | 64.7 |
| Export volume | 88.7 | 125.3 |
| Purchasing power of exports | 58.3 | 81.1 |

Source: UNCTAD *Handbook of Statistics, 2000* (CD-ROM).

was much more moderate than in the preceding decade, in the subsequent two years (i.e. from 1997 to 1999) the combined annual index of free market prices for primary commodities fell by 25 per cent, implying a further deterioration in African terms of trade towards the end of the decade.¹⁹ Consequently, despite rapidly rising export volumes in the 1990s, the purchasing power of exports remained significantly below the levels attained in the early 1980s, with the consequence of either a compression of import volumes and growth, or an increase in trade deficits.

While trade deficits showed a significant deterioration in the 1990s in relation to GDP, this tendency is much less pronounced for the current-account balance. For the non-oil SSA countries considered in table 4, the rise in the current-account deficit ratio was much smaller than in the trade deficit ratio between the 1980s and 1990s. Two important factors appear to have played a role. First, as a result of increased payments difficulties, many countries have accumulated arrears on interest payments during the 1990s, thereby adding to their external debt rather than to their current-account deficits. This at least partly explains why interest payments in tables 1 and 2 show a decline in the 1990s despite the rising debt ratios of the region.²⁰ For SSA as a whole, arrears on interest payments on long-term debt accumulated from 1989 to 1998 amounted to \$13 billion, or some 14 per cent of the total current-account deficit during the same period.

The second factor relates to grants. As already noted, in IMF's balance-of-payments accounting most grants are treated as current transfers rather than capital inflows. Since the composition of total official inflows has changed in favour of grants in the past decade (see table 1), current-account deficits thus defined have tended to fall. However, this does not imply an increase in transfer of real resources from abroad, since aggregate official financing, including grants, has declined.

2. Growth and aid dependence

Estimation of external financing needed to attain a given target rate of growth over a period of time is a complex exercise requiring detailed information on and analysis of such factors as the extent of unused production capacity, the impact of investment on production capacity,

productivity, foreign trade and balance of payments, the domestic savings rate and its response to income growth, and the extent to which capital inflows are used for real resource transfers. Clearly such an exercise should best be undertaken at the country level, allowing for specific circumstances. While an attempt is made here to estimate the increase in capital inflow that would be needed in order to attain a sustained SSA growth rate of 6 per cent per annum, the main purpose of this exercise is to illustrate how such a growth process can help reduce aid dependence by allowing domestic savings to be raised and by attracting a greater inflow of private capital.

In the simulations reported in table 6, the baseline refers to the experience of SSA over 1994–1998. During that period the region as a whole received an average net capital inflow, including grants, amounting to 8.7 per cent of their combined GDP, while achieving an annual growth rate of some 4 per cent. Of this inflow, just over 60 per cent was allocated to the financing of real resource inflows (i.e. current-account deficits, excluding grants), while the remainder was used for offsetting financial transactions, including net capital outflows and reserve accumulation. During the same period, investment amounted to some 18 per cent, and domestic savings to 13 per cent, of the combined GDP of these countries, with the gap being financed by net capital flows from abroad.

Estimates based on Latin American experience suggest that, in order to sustain 6 per cent growth, an investment rate of some 28 per cent of GDP is needed.²¹ Certainly, for less advanced economies, lower rates of investment may be needed to attain a given rate of growth than for more mature economies, particularly where there are rich and underutilized natural resources. For instance, from 1970 to 1980 Thailand attained an average annual growth rate of 7 per cent, with an average investment ratio of 26 per cent; Malaysia attained 8 per cent annual growth with a similar investment ratio, while in Indonesia growth averaged 7.8 per cent, even though the investment ratio was lower, at some 22 per cent.²² Again, from 1988 until the mid-1990s, growth rate in Chile averaged 6.5 per cent, while its average investment rate barely reached 25 per cent.

In table 6 scenarios I and II assume that an investment rate of 22 per cent of GDP would be needed for SSA to sustain a growth rate of 6 per

Table 6

**SIMULATIONS OF GROWTH AND AID DEPENDENCE IN SUB-SAHARAN AFRICA
UNDER ALTERNATIVE SCENARIOS**

(Per cent of GDP unless otherwise indicated)

| | <i>Baseline</i> | <i>SCENARIO I</i> | | <i>SCENARIO II</i> | | <i>SCENARIO III</i> | | <i>SCENARIO IV</i> | |
|---|-----------------|-------------------|-------------|--------------------|-------------|---------------------|-------------|--------------------|-------------|
| | | <i>t+0</i> | <i>t+10</i> | <i>t+0</i> | <i>t+10</i> | <i>t+0</i> | <i>t+10</i> | <i>t+0</i> | <i>t+10</i> |
| Investment | 18.40 | 22.00 | 22.00 | 22.00 | 22.00 | 25.00 | 25.00 | 25.00 | 25.00 |
| Savings | 13.02 | 13.02 | 18.00 | 13.02 | 18.00 | 13.02 | 18.00 | 13.02 | 18.00 |
| Current-account deficit | 5.38 | 8.98 | 4.00 | 8.98 | 4.00 | 11.98 | 7.00 | 11.98 | 7.00 |
| Current-account deficit as a percentage of net capital inflow | 61.84 | 61.84 | 61.84 | 75.00 | 75.00 | 61.84 | 61.84 | 75.00 | 75.00 |
| Total net capital inflow | 8.70 | 14.52 | 6.47 | 11.97 | 5.33 | 19.37 | 11.32 | 15.97 | 9.33 |
| Net private capital inflow | 2.00 | 2.00 | 3.00 | 2.00 | 3.00 | 2.00 | 3.00 | 2.00 | 3.00 |
| Net official capital inflow | 6.70 | 12.52 | 3.47 | 9.97 | 2.33 | 17.37 | 8.32 | 13.97 | 6.33 |

Note: The simulations are based on World Bank data on national accounts, balance of payments and external financing.

cent per annum over the next 10–12 years, while this figure is raised to 25 per cent in scenarios III and IV. In estimating the external financing requirement of this growth, scenarios I and III assume that the proportion of capital inflows used for real resource transfers from abroad would be the same as in recent years (namely 61.84 per cent), while in scenarios II and IV this proportion is raised to 75 per cent. In all cases the additional capital inflows needed to raise investment come initially from official sources, but the dependence on aid gradually falls over time as domestic savings and private capital inflows rise as a result of accelerated growth. However, it should be added that these simulations are based on the assumption that the region will not be subject to serious terms-of-trade or natural shocks. Accordingly, if such shocks should occur, their adverse impact on the balance of payments and resource availability would need to be compensated by additional official inflows in the form of grants to ensure that accumulation and growth are not interrupted. Clearly, debt reduction, as well as fresh money, could play an important role in the provision of resources needed to raise investment and growth, particularly for low-income countries.

An important determinant of the evolution of aid dependence is the response of domestic savings to faster growth. The experience of several East Asian countries sheds some light on the extent to which domestic savings could be raised throughout such a process if appropriate policies are pursued. For instance, Indonesia raised its savings rate from around 11 per cent of GDP to 23 per cent from 1963 to 1973, when it grew at an average rate of 6 per cent per annum.²³ Such a rapid increase in the savings rate is perhaps not very realistic for SSA. Indeed, on the basis of the relationship between income and savings observed in SSA during the past two decades, a steady growth of 6 per cent per annum for a period of 10 years could be expected to raise the savings rate to some 16 per cent. However, the experience during this period of economic stagnation and rising poverty cannot provide much guidance as to what could be achieved under accelerated growth and with different policies. Indeed, a relatively strong savings performance was observed in the region during the 1970s. Taking all this into account, in the simulations in table 6 the average savings rate is set to reach 18 per cent after 10 years of growth. Although this is a much weaker savings performance than that observed in the initial stages of development in East Asia, it is still unlikely to be generated

automatically by growth itself, and it would require a determined effort to reorient policies towards faster accumulation and growth. It should also be noted that, despite such an increase in the savings rate, per capita consumption could still rise relatively rapidly; with a population growth rate of 3 per cent and income growth of 6 per cent, per capita consumption would still be higher by some 30 per cent at the end of the 10-year period.

The empirical estimates for SSA noted above, as well as observations regarding the behaviour of private capital inflows into developing countries in recent years, show that private capital tends to respond strongly to economic growth, particularly with respect to long-term investment. Simulations in table 6 draw on these observations. In all cases, while net private capital inflows are set to grow faster than GDP, their contribution to capital formation, as a proportion of GDP, rises only moderately at the end of the 10-year period. It should be also noted that these figures do not refer to net private flows, since they exclude outflows by residents.

Starting with the most optimistic scenario II, the big push implies that initially (at $t=0$), as a proportion of GDP, the current-account deficit would have to rise by two thirds and official inflows by one half over the baseline (charts 6 and 7). This means that official financing would have to rise to \$15.1 billion from its baseline level of \$9.5 billion. Subsequently, the contribution of official financing as a proportion of GDP falls continuously as growth accelerates and domestic savings and private capital inflows rise, and at the end of the 10-year period the contribution of official financing falls to 2.3 per cent of GDP; that is, much below the baseline level of 6.7 per cent. In absolute terms, after the initial big push official inflows start to decline at an accelerated pace, and at the end of the 10-year period they fall to \$6.4 billion, that is below their baseline level. After a decade of growth at a rate of 6 per cent per annum, the region would have, as a proportion of its combined GDP, lower current-account deficits and a smaller external financing requirement, while a higher proportion of the latter would be met by private capital inflows (charts 6 and 7).

In the least optimistic scenario III, initially the current-account deficit as a proportion of GDP more than doubles, while official capital inflows rise by more than 150 per cent compared to the baseline. Current-account

deficits and official financing as a proportion of GDP both fall continuously throughout the growth process, but at the end of the 10-year period they are still higher than their baseline levels. Nevertheless, the composition of external financing changes in favour of private capital. In this scenario, it takes longer than 10 years for official financing to fall, both as a proportion of GDP and in absolute terms, below the baseline levels; in relative terms it takes almost 12 years and in absolute terms much longer.

Scenarios I and IV represent intermediate cases: in the former the investment rate and the proportion of capital inflows used for current account financing are both lower than in the latter. In scenario I, as in II, the current-account deficit as a proportion of GDP falls at the end of the 10-year period compared to the baseline. Official financing is lower in relative terms and is equal to the baseline level in absolute terms. In scenario IV, as in III, because of a higher investment ratio, the current-account deficit as a proportion of GDP is still higher at the end of the 10-year period than in the baseline, but because a greater proportion of capital inflows is used for current account financing, official inflows required after a decade of growth are lower in relative terms. In both scenarios I and IV, there is an increase in the share of private capital in total external financing.

Which of these various scenarios is likely to occur depends on domestic policies pursued. The simulations above suggest that a combination of a doubling of official capital inflows into SSA with policies designed to raise the efficiency of investment, the propensity to save, and the proportion of capital inflows retained and used for real resource transfers from abroad could set off an accelerated growth process that would reduce, in a decade or so, both the resource gap of the region and its dependence on aid. In this process official financing would play a catalytic role for domestic savings and private capital inflows, and this role is enhanced and the reliance on aid is reduced by a greater domestic policy effort.

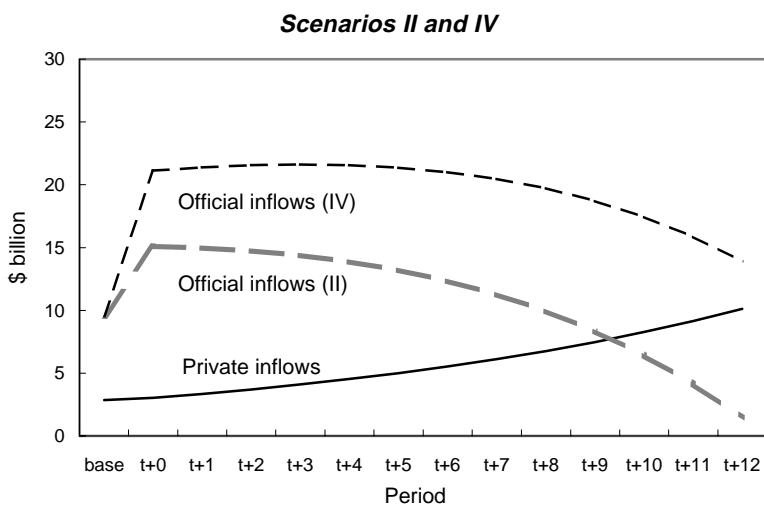
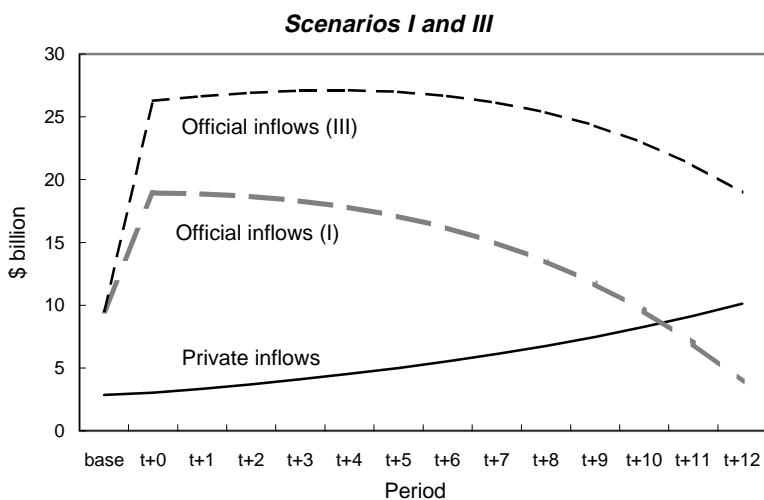
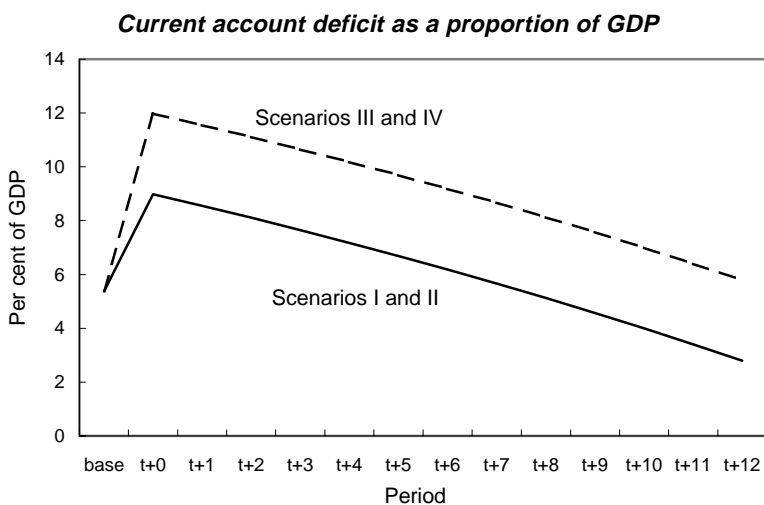
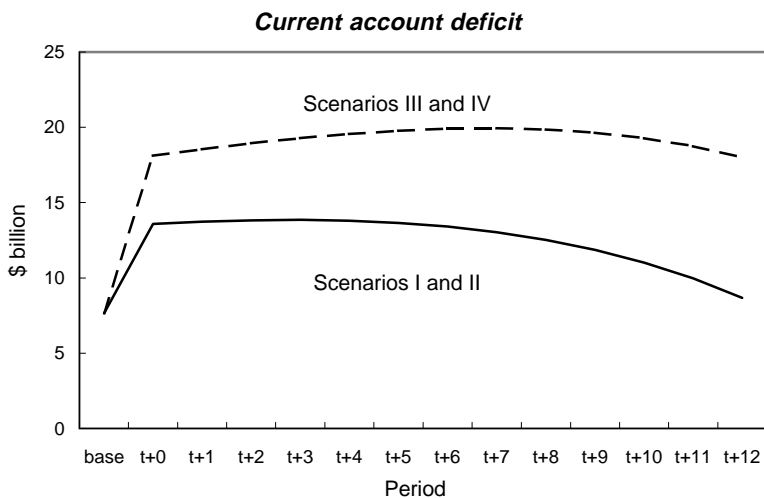
Chart 6**SIMULATIONS OF GROWTH AND AID DEPENDENCE:
CAPITAL INFLOWS UNDER ALTERNATIVE SCENARIOS***(Billions of dollars)***Note:** See table 6.

Chart 7

SIMULATIONS OF GROWTH AND AID DEPENDENCE: CURRENT ACCOUNT DEFICITS UNDER ALTERNATIVE SCENARIOS

(Billions of dollars and per cent of GDP)



Note: See table 6.

F. Reorienting policies

It does not necessarily follow that a greater injection of foreign resources will be translated into rapid growth capable of both raising living standards and generating domestic resources for investment. Policy challenges arise in many spheres. First of all, as indicated by the scenarios above, it is important to ensure that a larger proportion of foreign capital inflows is used for imports needed to operate and add to productive capacity, rather than for financing capital outflows or excess reserves as a safeguard against discontinuation or reversal of capital flows. A commitment by the international community to a steady provision of adequate external financing should by itself reduce the need to accumulate excess reserves. Furthermore, the readiness of the international community to compensate for adverse movements in the terms of trade and adverse external financial developments (such as increases in interest charges) through the provision of additional financing would reduce the need for reserves as a precautionary buffer against current account shocks.

However, effective utilization of capital inflows to raise accumulation and growth will not be possible without an appropriate management of the capital account, particularly without regulation and control of short-term capital flows. This is necessary not only to retain an important part of capital inflows for financing imports and productive investment, but also, and more fundamentally, to attain greater stability of exchange rates, which is a key to successful export performance and easing of the balance-of-payments constraint. As the experience of many developing countries indicates, attaining stable and competitive exchange rates depends not so much on choosing a particular exchange rate regime as on regulating capital flows so as to avoid the delinking of currency movements from the exigencies of trade and competitiveness.²⁴

More fundamentally, it is important to ensure that aid is effectively used to accelerate capital accumulation and growth, and to ease the bal-

ance-of-payments constraint. As discussed elsewhere in some detail, success depends on establishing a virtuous circle between investment, exports and savings.²⁵ In this process exports support investment because they earn foreign exchange required for the import of goods and technology needed for capital accumulation and growth, while investment supports exports by providing the basis for technological change, productivity growth, and increased competitiveness. As incomes and profits are raised through investment, they increasingly provide additional resources for capital accumulation. In such a process of early industrialization, domestic savings and exports typically rise faster than income and investment, gradually closing the savings and foreign exchange gaps.

The failure in Africa to initiate such a process of accumulation and growth despite significant amounts of foreign aid is often attributed to policy mistakes; it also appears to be the main reason for the “aid fatigue” in donor countries. However, as exemplified in various studies, additional aid provided since the early 1980s has barely compensated for the resource losses resulting from the decline in the terms of trade, let alone meeting the resource needs for rapid and sustained growth.²⁶ It should nevertheless be recognized that most African countries were unable to initiate a process of self-reliant growth even when external conditions regarding trade and transfer of financial resources were favourable, particularly during the 1970s. Some experienced rapid increases in investment and growth in the 1970s, at rates faster than even in some East Asian countries, but these were too often followed by investment slumps when the external environment deteriorated. Similarly, adjustment efforts in the past 15 years have failed to lift investment and growth, even though they have resulted in increases in output arising from better and fuller utilization of the productive capacity. More generally, since independence, there have always been countries in SSA that have performed well for a few years, but surges of growth have rarely been sustained.²⁷

Again, the reasons are extensively studied in a number of UNCTAD documents.²⁸ Certainly, in the post-independence period, various structural and institutional shortcomings inherited from colonial times made the task of sustaining growth and development particularly difficult, but policy errors also played an important role. Briefly, industrialization was pursued without adequate attention to agricultural productivity and growth

and to industrial competitiveness. Agriculture was neglected in that resources generated by that sector were not used to enhance agricultural productivity through public investment in rural infrastructure and various services so as to raise the net surplus, but were transferred to urban consumption or industrial investment. Further, infant industries established on the basis of resources transferred from agriculture (or abroad) never grew up and took off because they were not subject to the kind of a judicious combination of market and government discipline practised in East Asia,²⁹ but depended on continuous protection and resource transfers. Therefore, unlike the East Asian countries, where surges in investment and accumulation were accompanied by rapid growth of exports and domestic savings, and led to a reduction in dependence on foreign resources, in Africa, with the exception of a few countries such as Mauritius and Botswana, exports and savings lagged behind growth so that when external conditions deteriorated, investment and growth could not be sustained.

Policy errors during the more recent adjustment period were no less serious. Briefly, structural adjustment programmes have sought to leave accumulation and growth to market forces without adequate attention to shortcomings in markets, institutions and infrastructure. While the State has been withdrawn from economic activity in a number of areas, viable alternatives based on private initiative have not emerged as a result of such shortcomings. Freeing market forces has not always generated appropriate incentives to producers – for example, when the marketing boards were dismantled. Where incentives were generated, there was little supply response because of lack of physical and human infrastructure and other complementary factors (such as credits).

These experiences hold valuable policy lessons for setting off a dynamic growth process supported by a big push of the kind described above. Clearly, there is a need for a greater role for markets than was allowed under the policy regimes of the post-colonial period, and for a more active government role than permitted under adjustment programmes. There is considerable scope and need for public investment in human and physical infrastructure, and much of the initial increase in aid should be directed to these areas. Greater resources also need to be expended to strengthen administrative capacity in order to raise the effectiveness of the public sector. Finally, it is essential to ensure that private investment generates

the exports and profits needed to raise domestic resources and promote self-reliance.

It should also be recognized that rapid economic growth does not automatically translate into an increase in the proportion of national income saved. It has been observed that a number of countries had quite different experiences regarding the evolution of their national savings, despite sustaining similar growth rates for comparable periods of time. For instance, the average savings rate in some of the middle-income countries of Latin America failed to show a significant increase from the late 1960s to late 1970s, despite a relatively rapid growth of per capita income, while many late industrializers in East Asia, notably the Republic of Korea and Taiwan Province of China, managed to raise their savings at unprecedented rates throughout a similar growth process. The success of East Asian industrialization has depended very much on the role of the Government in promoting savings and accelerating capital accumulation. The policies needed naturally vary according to the stage of development reached, and have been discussed at some length in previous UNCTAD reports.³⁰ At the early stages of development, when agriculture is dominant and savings and investment decisions are not separated, agricultural pricing and investment policies play an important role in raising investible resources. At later stages of development, establishing a virtuous link between profits and savings, restraining luxury consumption and promoting institutional savings are policies that play an important role.

To sum up, a rethinking of international and domestic policy approaches is now called for, based on a realistic assessment of the resource needs of SSA, recognizing the shortcomings of pre- and post-adjustment policies, and addressing directly the structural constraints and institutional hiatus that pervade the region. Despite many years of intensive and widespread adjustment, barely any African country has successfully completed its adjustment programme and set off on a sustained growth process. Not only have there been serious shortcomings in the design and implementation of policies, but also adjustment has generally been underfinanced. A judicious combination of a big push in external official financing and a reorientation of domestic policies on the basis of the lessons drawn from the experience of the past three decades appears to be the only viable way of securing rapid and sustained growth in the region, and eventually eliminating its dependence on aid.

Notes

- 1 In this paper the term sub-Saharan Africa (and the abbreviation “SSA”) refers to all countries in Africa other than South Africa and the countries of North Africa (Algeria, Egypt, Libyan Arab Jamahiriya, Morocco and Tunisia), unless otherwise specified.
- 2 See *Trade and Development Report, 1999 (TDR 1999)*, United Nations publication, sales no. E.99.II.D.1, New York and Geneva. In line with the terminology used in *TDR 1999* (box 5.1: 100), **capital inflow** here refers to the acquisition of *domestic assets* by *non-residents*. Sales of domestic assets are defined as a negative capital inflow. Thus the term *net* capital inflow denotes acquisitions minus sales of domestic assets by non-residents. **Capital outflow** refers to the acquisition of *foreign assets* by *residents*. Sales of foreign assets are defined as a negative capital outflow. Thus the term *net* capital outflow denotes acquisitions minus sales of foreign assets by residents. **Net capital flow** refers to total net capital inflow less total net capital outflow as defined above. It is positive when net inflow exceeds net outflow. The term **net transfer** refers to net capital inflows less net factor payments abroad; the latter include interest payments on external debt as well as profit remittances. Net transfer is thus a broad measure of a country’s capacity to finance its trade deficits.
- 3 This observation regarding net private inflows of SSA has to be qualified due to the apparent under-estimation of such inflows on the basis of World Bank data compared with estimates based on national data. For example, a recent study found that cumulative net private inflows in 1990-1997 from banks to Uganda, the United Republic of Tanzania, Zambia and Zimbabwe were reported to have been \$251 million by the World Bank, but on the basis of the statistics of the countries concerned were \$676 million. Similarly, the World Bank data appear to underestimate portfolio inflows of Zambia and Zimbabwe; see N. Bhinda, S. Griffith-Jones, J. Leape and M. Martin, *Private Capital Flows to Africa*, The Hague, Fondad, 1999, tables 1.2 and 1.3. It has thus been concluded that “international data appear to be highly inaccurate. They are omitting large proportions of flows by failing to keep up with the liberalization of financial markets ...in Africa” (ibid.: 29). National balance-of-payments statistics used in analysing a sample of African countries in sections C and D of this paper thus appear to be more reliable for measuring private inflows.

- 4 It should be noted that changes in the ratio of capital inflows to GNP may be due to many factors unrelated to the volume of such inflows. Declines in the dollar value of GNP brought about by a devaluation of the currency or a decline in domestic production of the recipient country would result in an increase in this ratio without any change in the dollar value of capital inflows. Similarly, exchange rate changes among the currencies of major donors could alter the aggregate dollar value of official flows without any change in the aid budget of individual donors. Clearly, this effect can be expected to be relatively strong in SSA, where official flows account for the bulk of total capital flows. Such an effect is also present when analysis is carried out in terms of aggregate or per capita inflows.
- 5 Forty-five per cent of ODA flows to SSA is denominated in dollars, 42 per cent in continental European currencies, 7 per cent in yen, 5 per cent in sterling and 1 per cent in other currencies. For ODA flows in current and constant dollars see *Development Cooperation, 1999 Report*, Paris, OECD, 2000, p. 264 and table 29.
- 6 Countries above \$2000 per capita income (Botswana, Gabon, Mauritius and Swaziland) are not included in chart 3.
- 7 The 16 countries included are those covered by table 3.
- 8 See *TDR 1999*, op. cit., Part Two, chap. V, sect. C.
- 9 An overview of capital controls of African countries suggests that among the countries covered in table 3 Egypt, Kenya, Mauritius and Uganda had moved towards completely liberalized capital account regimes by the end of the 1990s. The table shows that, with the exception of Kenya, capital outflows by residents in relative terms rose substantially in all the countries during the past decade compared with the 1980s.
- 10 *TDR 1999*, op. cit., table 5.2: 106. That table also gives, for developing countries as a whole and for a sample of emerging markets, the proportions of net capital inflows accounted for by errors and omissions, reserve accumulation and current account financing, discussed below.
- 11 Only Egypt is in both groups, i.e. emerging market economies and the 16 African countries.
- 12 See, for example, B. Varman-Schneider, *Capital Flight from Developing Countries*, Boulder, CO, Westview Press, 1991: 50-51. Such movements could be inward as well as outward (i.e. capital flight); indeed, inward movement was observed in the 1990s in some countries (e.g. Chile and Colombia), which restricted capital inflows in order to avoid currency appreciation.
- 13 "Flows playing on arbitrage gains...in Kenya, Tanzania and Uganda...are virtually impossible to track, ...their scale cannot be reliably estimated, but transactions have often reached several million dollars per week. Many purchases are funded from foreign currency accounts maintained by nationals,

- implying that these flows may not be genuinely ‘foreign’ and may simply represent the ‘re-use’ of forex purchased from other sources.” (N. Bhinda et al., op. cit.: 83) Such operations are usually reflected under the errors and omissions item.
- 14 For instance, a discovery of minerals or a privatization wave could lead to an unsustainable surge in private inflows.
- 15 For an earlier account of such problems see 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*, Vol. VIII, United Nations publications, sales no. E.97.II.D.5, New York and Geneva, 1997.
- 16 See *TDR 1999* (op. cit.: 112) for the types of capital flows considered as arbitrage or speculative flows.
- 17 For the emerging markets, see *TDR 1999*, op. cit., chart 5.9: 113.
- 18 This is also true for the non-oil countries in this sample.
- 19 *Monthly Commodity Price Bulletin*, UNCTAD, Geneva, January 2000.
- 20 For the evolution of SSA debt see *TDR 1998*, United Nations publication, sales no. E.98.II.D.6, New York and Geneva, Part Two, chap. I, sect. E.
- 21 ECLAC, *Strengthening Development. The Interplay of Macro- and Microeconomics*, Santiago, Chile, 1996, chap. IV.
- 22 On investment rates see *TDR 1996*, United Nations publication, sales no. E.96.II.D.6, New York and Geneva, table 31: 110. On growth rates see UNCTAD, *Handbook of International Trade and Development Statistics 1994*, United Nations, New York and Geneva.
- 23 For the evolution of the savings and investment rates in East Asia in the past three to four decades see *TDR 1996*, op. cit., table 31: 110.
- 24 See *TDR 1999*, op. cit., Part Two, chap. VI, for further discussion of the relationship between capital account and exchange rate management.
- 25 See *TDR 1996*, op. cit., Part Two, chap. II, sect. B; *TDR 1997*, United Nations publication, sales no. E.97.II.D.8, New York and Geneva, Part One, chaps. V and VI; and *TDR 1998*, op. cit., Part Two, chap. IV. See also Y. Akyüz and C. Gore, “The investment-profits nexus in East Asian industrialization”, *World Development*, 27(1), 1996; and Y. Akyüz and C. Gore, “African Economic Development in a Comparative Perspective”, mimeo, UNCTAD, Geneva, March 2000.
- 26 See, for example, *TDR 1993*, United Nations publication, sales no. E.93.II.D.10, New York and Geneva, Part Two, chap. II, sect. C.3; and *TDR 1998*, op. cit., Part Two, chap. I, sect. C.
- 27 On these surges in Africa see *TDR 1999*, op. cit., Part Two, chap. I; Akyüz and Gore, 2000, op. cit.; and D. Rodrik, *Making Openness Work: The New Global Economy and the Developing Countries*, Washington DC, Overseas Development Council, 1999.

- 28 See, in particular *TDR 1998*, op. cit., Part Two. For a more recent and detailed statement of this experience see Akyüz and Gore, 2000, op. cit.
- 29 For this experience see Y. Akyüz, ed., *East Asian Developments. New Perspectives*, London, Frank Cass, 1999.
- 30 For a discussion of savings behaviour and policies see *TDR 1996*, op. cit., Part Two, chap. II, sect. B.2; *TDR 1997*, op. cit., Part Two, chap. V, sect. E, and chap. VI; *TDR 1998*, op. cit., Part Two, chap. IV, sect. C.1; Akyüz and Gore, 1996, op. cit.; and Akyüz and Gore, 2000, op. cit.