Chapter I

GROWTH AND DEVELOPMENT IN AFRICA: TRENDS AND PROSPECTS

A. Post-independence take-off

It has become increasingly common to describe Africa as a continent of missed growth opportunities, subjected to heavy-handed state interventions and misguided, inward-looking development strategies from which it is only now escaping. The historical record is not so simple. The conventional account downplays the challenges that faced many African countries at independence and overlooks the respectable, and for some countries spectacular, growth rates achieved immediately after independence. Nor is it always appreciated that Africa's integration into the world economy has been long and close, albeit shaped in large part by colonial ties and legacies.

Although there were considerable differences in initial conditions and income levels in African countries at independence, in almost all cases little had been done to create the necessary conditions for national economic development, including in particular physical infrastructure and sufficient educational opportunities. The main positive colonial legacy was the development of primary export sectors which appeared to offer strong growth potential.

Set against the very high expectations of the newly independent African States, the practical difficulties of building vibrant national economies and the problems posed by demographic transition, Africa's growth performance was quite strong from the mid-1960s until the first oil shock.[1] Although GDP growth in sub-Saharan Africa was faster than in the 1950s under colonial rule, averaging an annual rate of 4.5 per cent or more than 1 per cent per capita, it was lower than in other developing regions, with the exception of South Asia, during the same period.

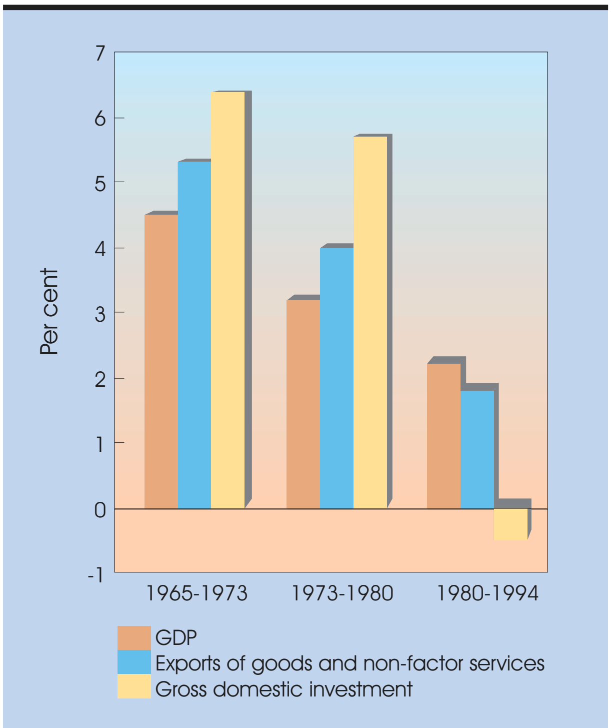
There were, however, considerable differences in growth among SSA countries, with average rates ranging from 0.5 per cent per annum (in Chad) to 14.7 per cent per annum (in Botswana). Many of the countries that performed least well after independence were ones that suffered years of civil turmoil. Others experiencing stagnation included those lacking natural resources in demand in the developed countries, and countries that were landlocked and did not have adequate transport links and port arrangements with neighbouring countries. On the other hand, a group of star performers emerged during this period with growth rates comparable to those of the best-performing economies elsewhere in the developing world. In this group of eight countries six achieved growth in excess of 8 per cent per annum (Botswana, Burundi, Côte d'Ivoire, Kenya, Nigeria and Zimbabwe) and two had growth rates of more than 6 per cent (Congo and Gabon).

This post-colonial growth was driven by a strong investment performance. On average, investment in SSA grew in volume by 6.4 per cent annually during 1965-1973 (chart 3). Investment shares were rising steadily everywhere, from less than 14 per cent of GDP in 1965 to over 18 per cent in 1973 for the region as a whole, and exceeding 20 per cent in many countries as protectionist

Chart 3

AVERAGE REAL GROWTH RATES OF GDP, EXPORTS, AND INVESTMENT IN SUB-SAHARAN AFRICA, 1965-1994

(Per cent per annum)



Source: UNCTAD secretariat calculations, based on World Bank, *Trends in Developing Economies 1990* (Washington, D.C., 1990); and World Bank, *World Development Report 1996* (Washington, D.C., 1996).

Note: The figures underlying the chart are unweighted averages.

barriers increased average returns on investment. In agriculture, investment in the cultivation of new land helped to increase output. In most cases, public sector investment played a leading role in the accumulation process, made possible both by development aid and by a growing revenue base.

Before independence, foreign direct investment (FDI) had been limited mainly to minerals and oil extraction, and in some cases to the production of wage goods such as beverages and textiles. This pattern continued after independence, albeit with a growing enthusiasm to attract FDI into infant industries by using various incentives, including import protection. The stock of FDI doubled between 1960 and 1970, and as a percentage of GDP was in fact twice the amount directed to East and South-East Asia at the time.[2]

It has become fashionable to dismiss Africa's post-independence performance on the grounds that it was accompanied by only weak integration into the world economy. This is a partial assessment. The colonial experience had led policymakers in Africa, as elsewhere, to adopt a cautious approach to integration into the world economy. Nevertheless, most post-colonial economic strategies accepted that Africa's growth prospects lay in exploiting its comparative advantage in natural resources, on which basis it could begin to industrialize and diversify its exports. Moreover, and contrary to accounts that assume a radical policy shift in the early years of independence, this starting point coincided in many cases with the establishment of institutions and structures towards the end of the colonial era, such as export marketing boards, multi-purpose state development corporations and import-substitution measures.[3]

Between 1965 and 1973 export revenues in SSA grew very strongly, averaging over 15 per cent per annum. Export volumes rose with rapid growth in key commodities such as tea, coffee and cocoa, and were helped by preferential treatment of exports by the former colonial powers. Moreover, the earlier trend of falling terms of trade came to a halt in 1965 and the share of exports in GDP grew steadily for most countries after independence. Increasing export revenues eased the foreign-exchange constraint in the non-CFA countries, and whilst import volumes grew more slowly than exports in this period, the share of imports in GNP remained high.

Faced with small domestic markets and restrictive colonial trading legacies, some African countries sought to create new regional trade arrangements or to strengthen existing ones. However, different initial conditions among members often led to tensions (as in East Africa), and more generally such arrangements were constrained by the export composition of most African economies, and by infrastructural weaknesses. Consequently, the share of regional trade in total external trade stagnated at around 5 per cent, and more than half of SSA's external trade continued to be conducted with Europe.[4]

The rhetoric of the post-independence economic strategy emphasized structural change away from dependence on primary sector employment and traditional exports. However, even as growth accelerated, the pace and pattern of structural change in many African economies lagged behind.

Box 5

NURTURING INDIGENOUS CAPITALISM IN SUB-SAHARAN AFRICA

Compared with other developing regions, indigenous capitalism developed late in SSA.[1] During the colonial period, little industrial investment took place that could have been a threat to foreign enterprises. Most manufacturing was in small-scale, light-industry consumer goods such as soap, beverages, textiles, footwear and furniture. Apart from isolated cases such as that of Kano in northern Nigeria, Africans owned very few of even these small enterprises. Indigenous entrepreneurs were largely relegated to artisanship and commercial activities in the informal sector. In the years leading up to independence, colonial businessmen in many cases sought to avoid expropriation by entering into partnership arrangements with African entrepreneurs.

As for the rural areas, the best land had been alienated to colonial settlers. Indigenous rural capitalism was discouraged by the colonial authorities, which preferred cooperating (through marketing boards) with small African cocoa and coffee producers with limited bargaining power. Other factors that conspired to discourage large-farm capitalism were the region's abundant land, which limited the number of landless labourers available to work for wages on large farms, and property systems that were based on traditional rather than freehold forms of tenure. Only starting in the 1950s did the colonial countries encourage the emergence of African agricultural capitalism as part of their effort to secure national successors for continuing production and export of those primary commodities that the metropolitan countries needed. Agricultural capitalism took root in those pre-independence years among, for example, the Bugandan producers of coffee in Uganda, the Yoruba cocoa farmers of Nigeria and the Kikuyu cash-crop growers of Kenya.

After independence, African farmers continued the process of accumulation in the countryside, but part of the rural surplus was channelled into urban property, and much of it was taxed to help finance government investments. In some cases, as in Côte d'Ivoire, the new land-based capitalists included many Africans holding high political and administrative positions after independence.

As for town-based investments, African civil servants were sometimes able to obtain loans to invest in urban businesses, but such credits were generally more easily available for investment in land and property, which, given the region's rapid urbanization, provided attractive and reasonably secure returns. Most private urban businesses and industries, therefore, were launched by African small-scale entrepreneurs with initial capital from private savings or relatives, and further capital for expansion coming mainly from reinvested profits. Many of these enterprises, however, found it difficult to compete with local subsidiaries of TNCs with superior access to imported technology. Also, indigenous capitalists were sometimes discriminated against by their governments, as when special privileges such as tax exemptions were conferred on foreign interests, or when large public enterprises were established with the aim of rapidly increasing the pace of industrialization and growth. Indeed, upon independence only a few countries, such as Kenya and Nigeria, nurtured indigenous capitalists as a primary vehicle for capital accumulation, modernization and economic growth. However, even under the best conditions it proved difficult for them to make the leap from micro- and small-scale to medium- and large-scale entrepreneurship in manufacturing. The principal constraints were high costs due to unreliable supplies, inadequate infrastructure and deficient human resources, as well as limited demand due to small market sizes.

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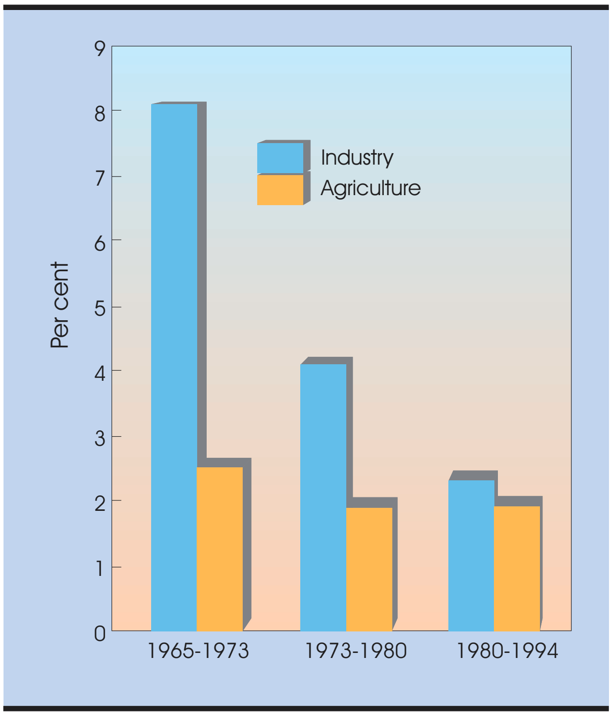
[1] For a more detailed account of the history of capitalist development in sub-Saharan Africa, see J. Iliffe, *The Emergence of African Capitalism* (Minneapolis: University of Minnesota Press, 1983).

Industry was the fastest-growing sector, thanks in large part to mining and transportation. Manufacturing activity grew by a robust 7.3 per cent per annum during 1965-1973, but in most cases from a very low starting point. By 1973, in only one country (Zimbabwe) was more than 20 per cent of output generated by manufacturing; in the large majority of countries the proportion was less than 10 per cent. However, in some countries, including Côte d'Ivoire, Kenya and Nigeria, robust infant industries emerged during this period. In some instances, private entrepreneurs were prominent in this early industrialization drive, but in most cases the State took the lead (see box 5).

Chart 4

GROWTH IN INDUSTRY AND AGRICULTURE IN SUB-SAHARAN AFRICA, 1965-1994

(Per cent per annum)



Source: See chart 3.
Note: See chart 3.

Despite these desirable structural shifts, a process of "positive" de-agrarianization did not begin in most African economies during this period. Growth of agricultural value-added in SSA was generally very weak, averaging only 2.5 per cent per annum (chart 4). This rate was much lower than in other developing regions, and in many countries agricultural growth did not keep up with population increases. While there was an expansion in the cultivated land area during this period, private and public investment was not forthcoming on a scale needed to transform the technological profile of agricultural production and to enhance productivity growth. Consequently, export expansion was in most cases based on very traditional commodities with little diversification, either vertically towards processed commodities and manufactures, or horizontally within the primary sector.[5]

In the light of these broad developments it is interesting to consider trends during this period in the group of star performers mentioned above. Investment took the lead in most cases, often linked to strong export performance. Even when export growth was relatively slow, as in Kenya, the countries concerned were often starting from a high level. In all these countries, an emerging investment-export nexus was linked both to a shift towards industrial activity, with an average rise in output of 11 per cent per annum compared with 7 per cent for SSA as a whole, and to strong agricultural growth, averaging close to 7 per cent per annum compared with only 2.5 per cent for the SSA average. Nevertheless, even for these star performers export diversification was quite limited.

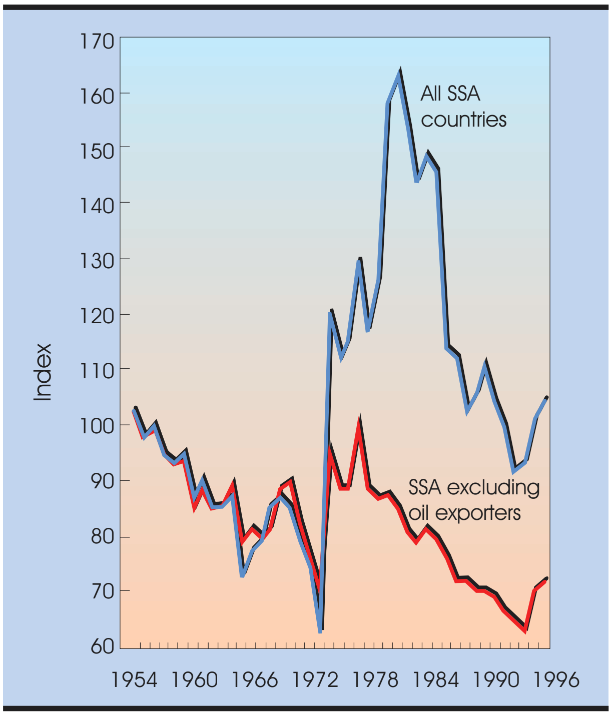
B. Faltering growth in the 1970s

The 1973 oil price increase and the subsequent slowdown of growth in the developed world had a particularly adverse impact on Africa, except for a few oil exporters, since exposure and vulnerability to external influences were greater than in other developing regions. Indeed, countries registering a break in growth performance between 1973 and 1980 were far more numerous than in other developing regions, where the break came primarily in the early 1980s.[6] With population growth still accelerating, this meant a fairly significant drop in average per capita growth rates in Africa, from 1.2 per cent per annum in the previous period to 0.7 per cent per annum. Moreover, almost half the countries in Africa actually experienced negative per capita growth rates in this period.

Chart 5

TERMS OF TRADE OF SUB-SAHARAN AFRICA, 1954-1996

(Index numbers, 1954-1956 = 100)



Source: UNCTAD, *Handbook of International Trade and Development Statistics*, various issues.

Two persistent features characterized African growth performance in the 1970s: increased diversity among economies and lack of continuity in growth. Variations among countries' growth rates increased significantly compared with the previous period, with declines in output reaching as much as 7 per cent per annum in some countries while other countries were growing at 10 per cent per annum. The lack of continuity resulted from the weakening performance of earlier star performers. Significantly slower growth occurred in all these economies, but the weakening of growth in some of the larger countries, which had grown strongly in the earlier period, was of particular importance. On the other hand, many smaller African countries witnessed a dramatic revival of growth.

The slowdown reflected a continued deterioration in agriculture, where the average growth rate for SSA as a whole fell from 2.5 per cent in the previous period to below 2 per cent during 1973-1980, failing to keep pace with population growth (chart 4). More significantly, industrial growth was halved compared with 1965-1973, and there was a sharp deceleration in manufacturing growth, which fell to 3 per cent per annum for the region as a whole. While a number of countries achieved high rates of growth in manufacturing during this period many countries, including Zimbabwe (which had been among the star performers in the previous period), experienced negative manufacturing growth, whereas in no country had manufacturing output declined in the earlier period.

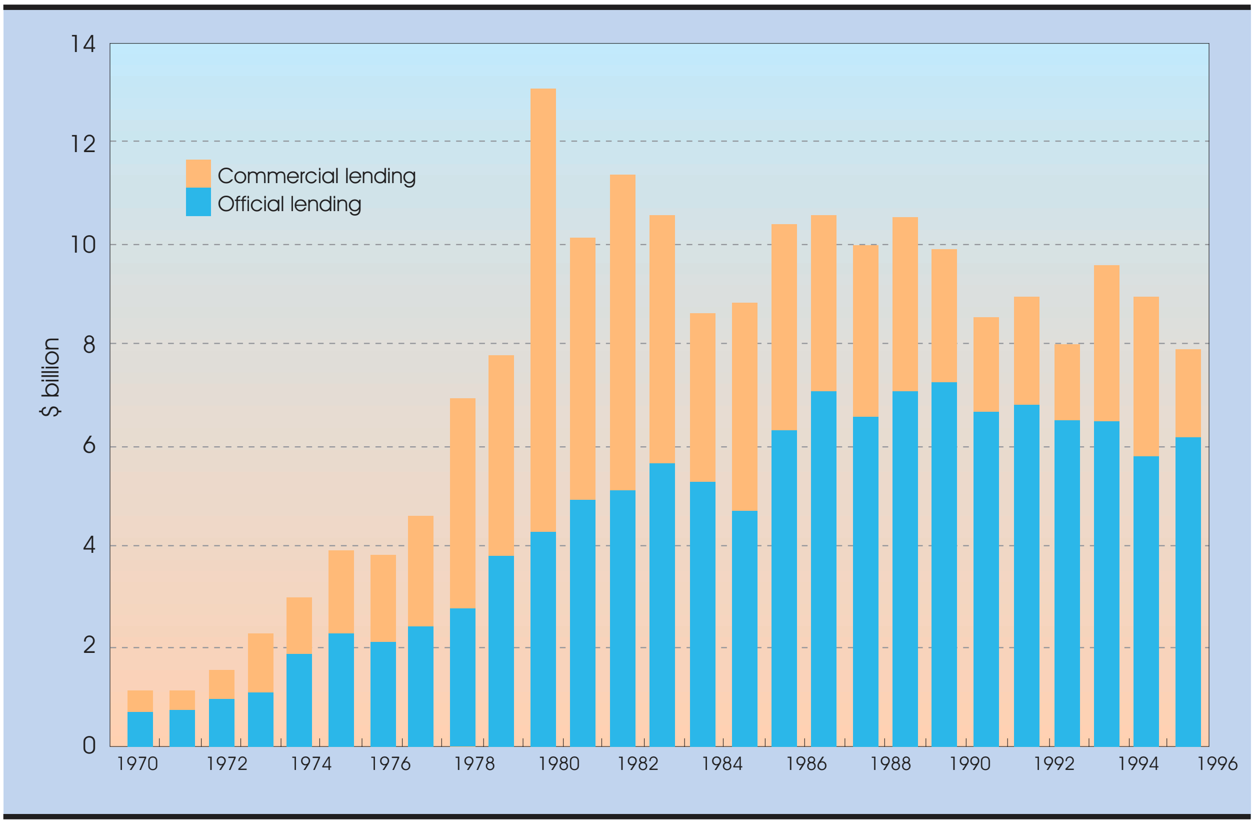
There was a significant volatility of growth rates from year to year that tended to coincide with fluctuations in countries' external terms of trade (chart 5). These fluctuations reflected not only the negative effects on most SSA countries of the 1973 oil price shock and the recession that followed in the developed countries, but also the short-lived boom that resulted from the rebound in world prices for a number of non-oil primary exports in 1976. While a large majority of SSA countries were hurt by the 1973 oil shock, oil-exporting countries such as Gabon and Nigeria benefited substantially from the 1973 windfall, although their growth subsequently contracted when oil prices declined during 1977-1979. For the non-oil-exporting countries in the region, export volumes, which had been increasing almost constantly for two decades, peaked in 1973 and showed a slight downward trend during the rest of the 1970s. Despite rising nominal prices of a number of non-oil commodities, export earnings slowed down, growing at an average rate of 4 per cent per annum during 1973-1980. However, as import prices rose dramatically because of oil and accelerating inflation in the industrialized countries, the purchasing power of the non-oil countries' exports stagnated in the mid-1970s, whereas that of the oil exporters increased sharply.

In the 1970s many SSA countries benefited from the expansion of international bank lending to developing countries. Initially, this expansion improved the access to international finance for a number of countries, and some countries, notably the oil exporters, used such lending to finance additional import growth. From 1976 onwards, however, bank lending was increasingly used to compensate export shortfalls due to terms-of-trade losses and declines in the purchasing power of exports in non-oil countries. Net new long-term borrowing by SSA from all sources rose from $3 billion in 1976 to $11.5 billion in 1980. The share of long-term commercial bank lending in total disbursements increased rapidly, accounting for more

Chart 6

DISBURSEMENTS ON LONG-TERM DEBT TO SUB-SAHARAN AFRICA, 1970-1996, BY SOURCE OF LENDING

(Billions of dollars)



Source: World Bank, *Global Development Finance 1997* (Washington, D.C., 1997).
Note: Figures are for public and publicly guaranteed debt.

than two-thirds of the total borrowing at the end of the decade (chart 6). The major borrowers from this source were Cameroon, Côte d'Ivoire, the Democratic Republic of the Congo, Gabon, Kenya and Nigeria. Short-term lending to SSA also rose dramatically, from $2.5 billion in 1976 to $22.6 billion in 1980.

This increase in international private lending to SSA coincided with sharp declines in the return on investment. Such declines were not generally experienced elsewhere in the developing world; indeed, figures for South Asia show that returns there increased slightly. Although investment decelerated during this period, it rose as a share of GDP, averaging over 20 per cent, compared with 15 per cent in 1961-1973. In a small number of countries, investment accelerated in response to favourable price shifts in traditional exports and export diversification linked to the exploitation of previously untapped oil and mineral reserves. By contrast, other countries experienced a sharp slowdown in investment growth and in some cases absolute declines.

Only government expenditure maintained its strong growth and consequently accounted for a rising share of GDP, with government consumption equivalent to 4 per cent more of GDP in 1980 than in 1973. However, declining revenues led to growing fiscal deficits and inflationary pressures. Because many SSA countries had pegged the value of their currencies to major convertible currencies, exchange rates appreciated significantly in real terms; according to some estimates, they appreciated on average by some 40 per cent between 1973 and 1980. The current account deficit (before official transfers) for SSA as a whole in this period more than doubled compared with the earlier period, averaging 15 per cent of the regional GDP. This situation was also reflected in a rapid rise in total SSA long-term external public and private debt, from 18 per cent of GDP in 1970 to 40 per cent in 1980. The growing fiscal and current account imbalances and rising debt and inflation levels of the 1970s were exceptional by the standards of the post-independence period.

Thus, many countries in SSA ended the decade with increased external indebtedness, greater macroeconomic imbalances and instability, a lagging agricultural sector, and a weak and uncompetitive industrial base. Coming on top of such structural weaknesses, the external shocks of the 1980s drove a large majority of the countries into a deep crisis that wiped out the earlier gains in living standards.

C. The crisis of the 1980s and thereafter

The period between 1980 and 1994 witnessed a noticeable deterioration in the performance of most SSA countries. Population grew faster than output, with per capita incomes falling, on average, by 0.6 per cent per annum. The dispersion of growth rates among countries, which had increased during the 1970s, was greatly reduced and there was a downward convergence of growth rates during these years of crisis. For every country which experienced positive per capita output growth during 1980-1994, two had negative per capita rates of growth. There were in fact only nine countries that had positive per capita growth and of these only in Botswana and Mauritius (both already middle-income countries in 1980) was growth sufficient to tackle the challenges of economic development and poverty alleviation. The fact that the star performers of the previous period also registered negative growth rates further underscores the damaging lack of continuity in Africa's growth performance.

The performance of agriculture did not deteriorate drastically in the 1980s compared with the previous decade: for SSA as a whole agricultural growth was maintained, on average, at about 2 per cent per annum between 1980 and 1994, mostly on account of a turnaround after the mid-1980s (see chapter II). In many countries, growth was faster in agriculture than in industry, where it dropped to around 2 per cent per annum – a dramatic decline from the 8 per cent attained in the initial post-independence period.

The factors underlying the poor economic performance in Africa are well known and were discussed in some detail in previous *TDRs*. Africa, like many other parts of the developing world, failed to adjust to a more hostile external environment characterized by terms-of-trade deterioration, sharp increases in international interest rates, and stagnation and declines in net transfer of external resources, resulting from a turnaround in the policy stance in the major industrial countries. However, Africa fell further behind than other developing regions, in large part because its structural weaknesses were deeper and its room for manoeuvre was narrower.

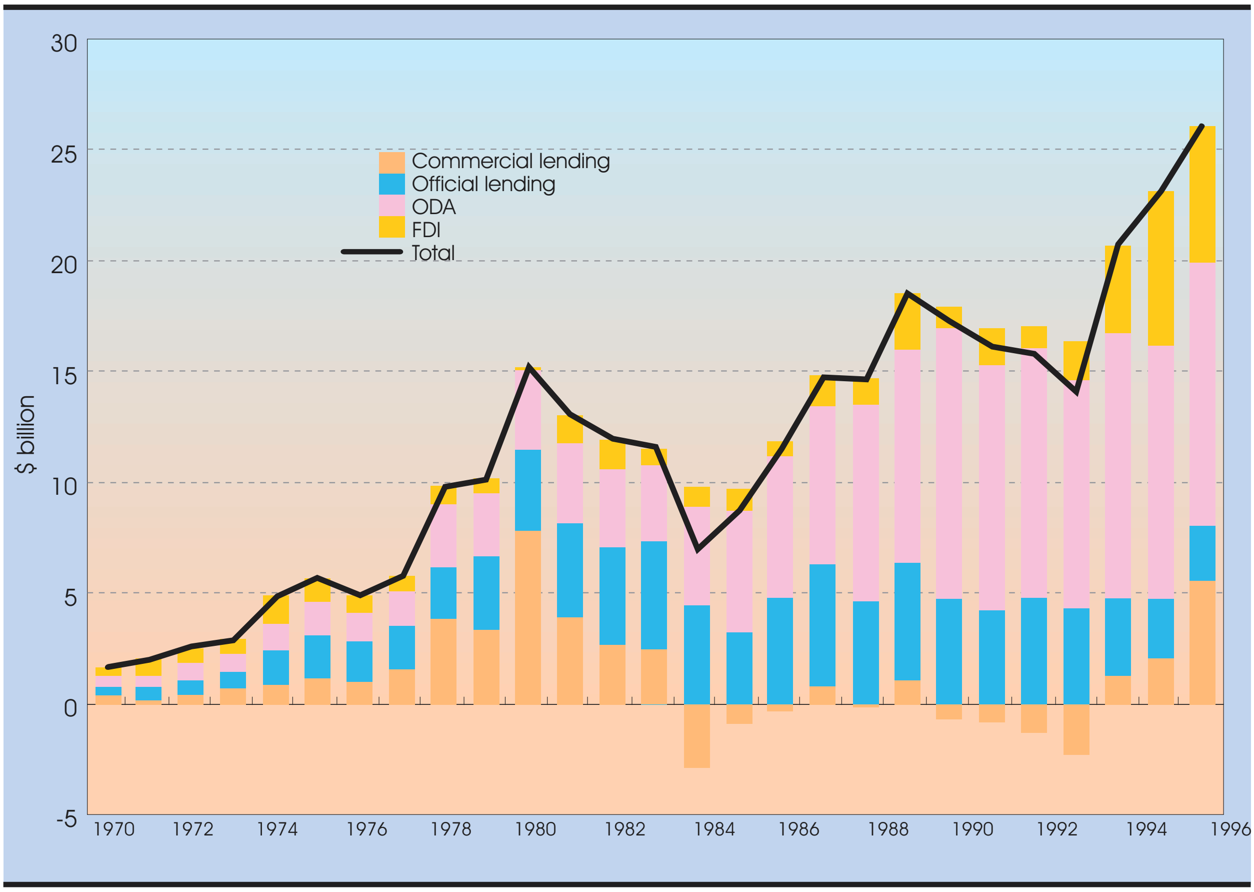
After peaking in 1977, the terms of trade of non-oil SSA countries declined almost every year until 1994 (chart 5). For North Africa and the SSA oil exporters the downward trend started after 1981; it was steeper but did not last as long. Unlike previous episodes, when the terms of trade declined in the context of rising prices of both primary commodities and manufactures, the declines in the 1980s were associated with rising prices of manufactures and falling prices of commodities. Deflationary policies in the major industrial countries took much longer to have a tangible impact on prices of manufactures than on commodity prices, which tend to be much more sensitive to market pressures.[7]

World prices for most commodities exported by SSA were at historically low levels in the late 1980s and early 1990s. In real terms, prices for coffee and cocoa – two of SSA's main non-oil commodity exports – were down from their levels in the 1950s by around 40 per cent. In 1992, coffee prices were at a 17-year low. Real prices of other

Chart 7

COMPOSITION OF NET RESOURCE FLOWS TO SUB-SAHARAN AFRICA, 1970-1996

(Billions of dollars)



Source: As for chart 6.
Note: FDI includes portfolio investment; ODA excludes technical cooperation grants.

major export items were also well below the level of the 1950s – by over 50 per cent for tea and cotton, one third for copper and sugar, and a quarter for tobacco.

The terms of trade of the SSA non-oil countries fell by more than one third between 1977 and 1993, compared with a decline of about 20 per cent for other non-oil developing countries. Thus, in 1993, the SSA countries would have needed to increase the volume of their exports by more than 50 per cent above their 1977 level in order to be able to import the same volume of goods as in that year. In the event, export volumes did rise, but not enough to compensate for this decline in the terms of trade. In some cases (e.g. cocoa) success in increasing export volumes proved self-defeating by depressing prices further.[8]

Of the 29 non-oil countries in the region for which data are available, there are only two (Mauritius and Zimbabwe) that did not suffer terms-of-trade losses between 1977 and 1993, while in 16 countries of the other 27 such losses exceeded 30 per cent. The countries relying heavily on exports of tropical beverages (Cameroon, Ethiopia, Ghana, Kenya, Rwanda, Uganda and the United Republic of Tanzania) were hit the hardest, with terms-of-trade losses of between 50 and 77 per cent. Among the 27 countries, only six (Benin, Cameroon, Côte d'Ivoire, Mauritania, Niger and Rwanda) were able to offset the fall in export prices by expanding export volumes.

The decline in export prices and earnings during the first half of the 1980s coincided with a sharp rise in international interest rates. The average interest payable on outstanding commercial debt rose from 8.4 per cent in the 1970s to 11.4 per cent because an increasing part of long-term loans had been contracted at variable interest rates, and the ratio of interest payments to export earnings rose from less than 2 per cent to more than 8 per cent. Simultaneously, new private lending collapsed, and this was responsible for the decline in the net new long-term borrowing by SSA from $10.8 billion in 1980 to about $7 billion per annum in the three years that followed. The region in fact started making net negative transfers to private lenders as interest payments exceeded net new lending.

However, aggregate net resource flows and aggregate net transfers to SSA as a whole remained positive as a result of the response of the international community to increasing payments difficulties in the region. Since 1980 SSA's external financing has increasingly been from official sources. ODA and official lending both rose, the latter in large part in the context of stabilization and adjustment programmes (chart 7), and there was a marked shift in total ODA flows in the 1980s in favour of SSA.

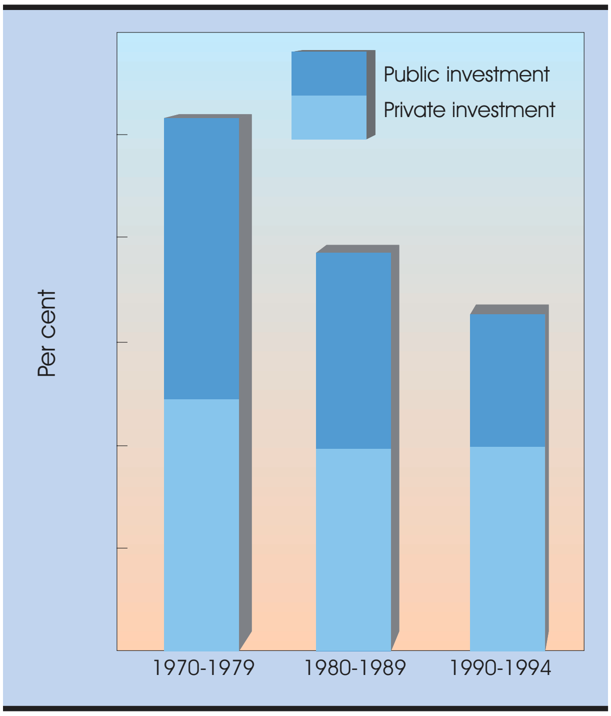
However, for the region as a whole and for most SSA countries individually, the additional resource flows were not sufficient to offset the impact of terms-of-trade losses on foreign exchange earnings, let alone the increased debt service. According to one estimate, between 1980 and 1990 only six out of 21 countries for which data are available were able to cover their terms-of-trade losses with net ODA inflows.[9] There was a GDP loss in SSA of $16.4 billion due to the terms of trade, and an ODA net inflow of $2.4 billion, which shows that less than 15 per cent of the terms-of-trade losses were compensated by ODA.[10]

The burden fell on imports and investment. Imports were reduced drastically during the first half of the 1980s. Although they recovered slowly from 1987 onwards, in per capita terms import volumes were still one third lower in 1993 than in 1980. The impact of the worsened terms of trade on import compression was particularly severe. Indeed, if the terms of trade had remained at their 1976-1978 levels, SSA imports could have been higher by one quarter of their actual value in every year between 1981 and 1993 even without any increase in export volumes. Additional ODA during that period made up for only one quarter of the loss in export purchasing power.

Chart 8

PUBLIC AND PRIVATE INVESTMENT IN SUB-SAHARAN AFRICA, 1970-1994

(Per cent of GDP, weighted averages)



Source: F.Z. Jaspersen et al., *Trends in Private Investment in Developing Countries - Statistics for 1970-1994,* IFC Discussion Paper, No. 28 (Washington, D.C.: World Bank, 1996).

Import compression inevitably led to a lower utilization of existing capacity and a fall in new investment. Part of that capacity became unusable, giving rise to the phenomenon of "de-industrialization". Investment fell continuously throughout the period and failed to recover. For 1980-1994 the average decline amounted to 0.5 per cent per annum, and in per capita terms it was much greater. The share of investment in GDP, which had averaged around 26 per cent in the 1970s, fell to below 20 per cent in the 1980s and to 16 per cent in the first half of the 1990s (chart 8). Public investment was cut by more than half, while private investment fell from over 12 per cent of GDP in the 1970s to around 10 per cent.

The decline in investment had a major influence on the pace of structural change. It meant that SSA was unable to make a positive adjustment to the changed global environment and shifts in key prices affecting its economic performance. Such adjustment would have required a restructuring of agriculture and industry, but the region was caught in a vicious circle whereby the existing accumulation and production structures were unable to generate the growth in export earnings needed to maintain imports, which in turn constrained investment and income growth. The dilemma was further accentuated by the downward trend in the terms of trade and insufficient aid flows to compensate the loss of purchasing power of exports.

D. Adjustment, recovery and prospects

The recovery that began in 1994 and continued during the subsequent three years has given grounds for renewed optimism. Indeed, in 1995 the African region as a whole achieved positive per capita income growth for the first time in many years, a performance that was repeated in 1996 and again, although to a lesser extent, in 1997. The recovery was greatly helped by much better weather conditions as well as by diminished civil strife in a number of countries. It was underpinned by strong growth in export earnings, and a consequent improvement in the trade and current account balances as well as in debt and debt servicing ratios. After a drop in 1993 and an increase of around 3 per cent in 1994, the export earnings of SSA rose by 16 per cent in 1995 and 10 per cent in 1996. Although export volumes improved, particularly in 1996, much of the increase in export earnings resulted from a sharp turnaround in non-oil commodity prices, which rose by 25 per cent between 1993 and 1996 and accounted for much of the 13 per cent improvement in SSA's terms of trade in that period.

In assessing whether the present recovery constitutes a turning point in Africa it is essential to examine the underlying economic conditions. These conditions have been influenced significantly by the structural adjustment programmes (SAPs) that many African countries have been pursuing since the early 1980s with the help of the Bretton Woods institutions. The main policy elements of the SAPs were discussed in *TDR 1993* and an assessment was made of their impact on economic performance. It was noted that despite a decade-long adjustment hardly any country had successfully completed its SAP with a return to sustained growth. The high frequency and persistence of SAPs suggested that SSA countries were locked into adjustment programmes, unable to restore self-sustained growth. A main shortcoming of these programmes was their failure to restore investment. Indeed, in many instances, application of SAPs was associated with declines in investment. However, this feature was considered at the time by the World Bank as the reflection of an "investment pause" resulting from stabilization measures and changes in key relative prices associated with the removal of distortions, rather than as an inherent weakness of the policies promoted.[11]

There can be little doubt that an improved policy environment and, in particular, greater macroeconomic stability have made an important contribution to economic recovery in a number of countries. Nevertheless, it is not clear whether the structural adjustment policies adopted so far have been able to reduce sufficiently the major structural and institutional impediments to the accumulation and structural change needed to initiate rapid and sustained growth. As pointed out in *TDR 1993*, assessing the impact of SAPs on economic performance is a tricky exercise involving a number of methodological difficulties. Nevertheless, experience strongly suggests that the link between adjustment and performance has been weak.

In 1993 the World Bank introduced a four-way classification of SSA countries in order to assess the adjustment experience; it identified 15 countries as a core group of adjusters that accounted for the bulk of Africa's population and income and were thought to have been able to put in place fairly good economic policies and to have introduced some significant institutional changes.[12] However, the subsequent economic performance of this group as a whole and, in particular, their contribution to the current recovery in SSA appear to have fallen short of expectations. Indeed, of these 15 countries, only three are among what IMF now classifies as "recent strong performers" (table 34). In other words, the large majority of countries that account for much of the recent faster growth in SSA were not among the World Bank "core group of adjusters" five years ago, and most of the countries that were thought to be pursuing relatively sound policies at the time are not among the strong performers today.[13]

Table 34

ADJUSTMENT AND PERFORMANCE IN AFRICAN COUNTRIES

Core group of adjusters[a]	*Recent strong performers*[b]
Burundi	Angola
Gambia	Benin
Ghana	Botswana[c]
Guinea	Côte d'Ivoire
Kenya	Equatorial Guinea
Lesotho	Ethiopia
Madagascar	Guinea-Bissau
Malawi	***Lesotho***
Mauritania	Mauritius[c]
Namibia	***Nigeria***
Nigeria	South Africa
Uganda	Togo
United Rep. of Tanzania	***Uganda***
Zambia	
Zimbabwe	

a E.V.K. Jaycox, *Africa: From Stagnation to Recovery* (Washington, D.C.: World Bank, February 1993).
b IMF, *World Economic Outlook*, April 1998 (Washington, D.C.: IMF), Vol. I, table 12.
c In the 1993 grouping by the World Bank Botswana and Mauritius were excluded as outliers.

Indeed, the rapid growth among some of the "recent strong performers" can largely be explained by some special circumstances that are of a one-off nature and unrelated to SAPs. Angola and Ethiopia certainly benefited greatly from the ending of civil strife, which had seriously disrupted economic activity. In Equatorial Guinea the exploitation of newly discovered oil reserves has been the main factor responsible for recent expansion.

These considerations once again highlight the problem of discontinuity of economic performance in SSA noted above. Since independence, there have always been countries that have performed reasonably well for a few years, but surges of growth have rarely been sustained.

The recent recovery in SSA appears to have been due primarily to increasing utilization of the existing capacity made possible by a relaxation of the foreign-exchange constraint, rather than to new investment. Indeed, evidence suggests that "the investment pause" has not come to a halt and the private investment response to SAPs continues to be weak. For SSA as a whole, the average ratio of private investment to GDP during 1995-1997 was only slightly above the rate achieved during the early 1990s, despite an acceleration of growth.[14] At around 17 per cent of GDP total investment in SSA remains below the average rate not only in the newly industrialized economies of Asia (about one third of GDP) but also in Latin America (slightly above 20 per cent).[15]

According to one view, the problem is not just the level of investment but its distribution. On this view the share of public investment in total investment in Africa is very high compared with other regions, constituting a major impediment to growth, since private investment tends to be much more efficient than public investment.[16] This view, however, not only ignores the mounting evidence regarding the complementarity between public and private investments, but also is misleading when absolute levels of investment are compared. According to a recent study of 53 developing countries, including 10 in SSA, in the 1980s public investment appears to have been generally more productive than private investment. This was explained by a shift of public investment projects to more productive uses as well as by a reduction in the productivity of private investment resulting from insufficient complementary public investment.[17] Moreover, the high share of the public sector in SSA is not due to excessive public investment. Indeed, as the figures in table 35 show, as a proportion of GDP the SSA governments invest less than any other region, in particular the Asian countries. It is also notable that the average share of public investment in the "recent strong performers" during 1990-1996 was greater than in other SSA countries by about one percentage point of GDP.

Table 35

PUBLIC INVESTMENT RATIOS, BY REGION, 1990-1996

(Percentages)

Region	*Public investment as a share of*	
	Total investment	*GDP*
Sub-Saharan Africa	28.9	4.8
Western Hemisphere	24.1	4.9
Asia (excluding Japan)	31.1	8.6
NIEs	22.0	6.8

Source: S. Fischer, E. Hernández-Catá and M. S. Khan, "Africa: Is this the turning point?", IMF Paper on Policy Analysis and Assessment 98/6 (Washington, D.C., 1998), table 3.

The need for public investment is much greater in SSA, where human and physical infrastructure is extremely inadequate, than in countries with higher levels of industrialization and development. Moreover, given the rudimentary state of the entrepreneurial class, the public sector may still find it necessary to invest in a number of areas which elsewhere are normally in the domain of the private sector. Certainly, there are serious problems in the allocation and efficiency of public investment in many countries in SSA, the resolution of which could provide significant one-off productivity gains, but there can be little doubt that a public investment rate of 5 per cent of GDP is barely adequate to ensure the improvement in the physical and human infrastructure needed for sustained growth.

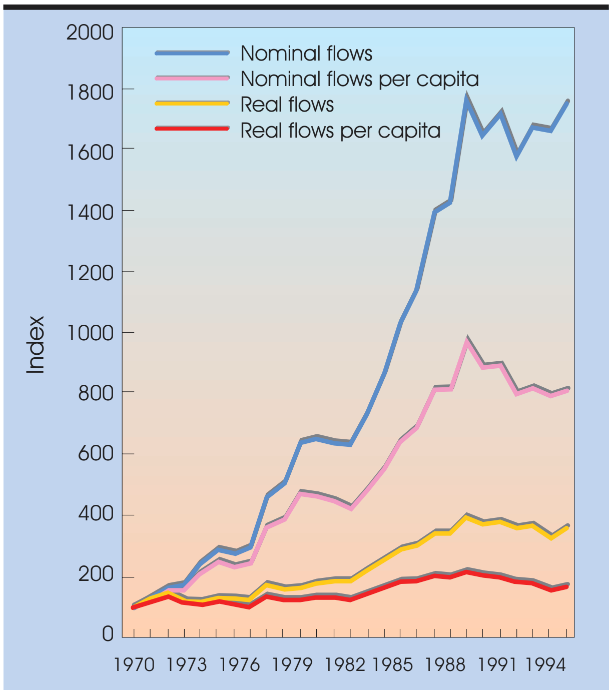
It thus appears that at the current rate of aggregate investment it would be very difficult to accelerate long-term growth in SSA regardless of how efficiently it is allocated and used. Current forecasts by the World Bank for the next 10 years give an average rate of growth of about 4 per cent per annum, i.e. maintenance of the average growth rate of the last three years. Even if this is realized, per capita income in the region would increase, on average, by 1 per cent per annum, so that "the coming decade would only represent the recovery of ground lost over 20 years".[18] But even achieving this performance is far from being assured. Since 1990 ODA has been declining both in real terms (chart 9) and in relation to the GDP of the recipient countries. Moreover, commodity prices have levelled off and turned downwards, a movement which has been accentuated by the weakening of global demand due to the East Asian financial crisis. In these conditions, and given the weak supply response to adjustment policies, even these modest growth projections may prove to be over-optimistic, as they have done in the past.[19]

It is generally agreed that greater policy effort is needed to translate the current recovery into stronger and sustained growth in Africa. There can be little doubt that an important reason for the continuing poor performance of countries undertaking SAPs is slippage in programme implementation. However, programme compliance has not always resulted in strong economic performance, a fact which suggests that there are also serious problems in programme design. In particular, there

Chart 9

FLOWS OF OFFICIAL DEVELOPMENT ASSISTANCE TO NON-OIL EXPORTING COUNTRIES IN SSA, 1970-1996

(Index numbers, 1970 = 100)



Source: World Bank, *Global Development Finance 1997.*
Note: ODA flows exclude technical cooperation grants; real flows are at 1970 import prices.

are reasons to believe that the emphasis on removing price distortions is not necessarily the best way to bring about a strong supply response and growth performance. The following chapters take a closer look at the question of incentives and supply response, seek to identify the main constraints and opportunities in agriculture, industry and trade, and discuss the policies needed to remove the constraints and to realize the opportunities.

There is also a consensus that restoration of economic growth in SSA is unlikely without a solution to the problem of external debt overhang. Indeed, the failure to address the debt problem and to provide adequate external financing is often seen as a major weakness in programme design. While the international community has recognized the need to support greater policy efforts with increased debt relief and net transfer of resources to most SSA countries through the HIPC Initiative, a number of issues remain unresolved. Past *TDRs* discussed many of these issues in detail. What follows provides a brief review, focusing on the link between debt relief and capital accumulation.

E. Improving the prospects: The role of debt relief

Debt overhang describes a situation in which creditors' demand for full debt servicing can reduce the present value of debt servicing in the future by depressing investment and growth. This would damage the interests not only of the debtor countries but also of the creditors. Such a situation could not be rectified by provision of liquidity (new debt) in order to overcome current debt-servicing difficulties. Rather, it calls for a reduction in the stock of debt and debt servicing.

Various debt indicators illustrate the extent and nature of the problem in SSA (table 36). Ninety-three per cent of SSA's external debt is public and publicly guaranteed, and almost 80 per cent of this amount is owed to official creditors, including a substantial and growing part to multilateral financial institutions (chart 10). The debt problem in SSA is therefore essentially one of official debt. Although its external debt is only a small part of the total debt of developing countries, as a proportion of exports and GDP it is the highest of any developing region (table 36). Moreover, unlike in other developing regions, these ratios have exhibited a rising trend since 1988, when creditors first recognized the need to introduce debt reduction as a central element of an international debt strategy dealing with the debt of poor countries.

The relatively low debt service ratio in SSA compared with other regions is not always explained by greater concessionality of the debt. For instance, concessional debt is relatively higher in South Asia, where the debt service ratio is also higher. Rather, it is explained by a continuous growth of arrears, which is perhaps the best indicator of the extent of the debt overhang. Accumulated arrears, on interest and principal payments, reached $64 billion in 1996, amounting to about 27.4 per cent of the total debt. More worrying, two thirds of the increase in debt since 1988 has been due to arrears (table 36).

There is ample evidence of the adverse effects of the debt overhang on investment and growth in Africa.[20] Since the external debt is mainly owed by governments, the debt overhang deters public investment in physical and human infrastructure as well as growth-enhancing current spending on health and education. Also, it creates a problem of policy credibility and considerable uncertainty for private investors, who run the risk that gains from investment could be taxed away to service external debt. This is true not only for domestic investors but also for foreign investors; the latter tend to stay out of countries with serious debt-servicing difficulties. Indeed, it is almost impossible for a country suffering from debt overhang to have access to private capital markets:

> All creditworthiness and ratings analyses on which foreign investors rely include strong negative debt elements. Those running

Table 36

EXTERNAL DEBT INDICATORS FOR DEVELOPING COUNTRIES, 1988 AND 1996, BY REGION

(Percentages)

	Debt/exports		*Debt/GNP*		*Debt service/ exports*		*Interest and principal arrears as a share of*			*Share of official debt in total debt*
							Total debt		*New debt since 1988*	
	1988	*1996*	*1988*	*1996*	*1988*	*1996*	*1988*	*1996*	*1996*	*1996*
Sub-Saharan Africa	244.2	236.9	67.7	76.2	20.8	12.4	11.8	27.4	64.8	75.6
North Africa/Middle East	175.4	126.8	41.7	34.0	19.7	12.1	6.8	5.5	0.1	72.4
East Asia	136.7	98.9	33.7	30.8	21.2	12.2	0.5	3.6	5.6	44.5
South Asia	294.6	208.8	28.2	28.3	26.2	23.1	0.0	0.1	0.1	76.3
Latin America	308.0	202.8	56.4	41.4	36.8	30.0	5.2	1.8	-0.1	33.0
All developing countries	175.6	146.2	35.7	37.0	22.0	16.4	5.4	6.1	1.1	50.2

Source: World Bank, *Global Development Finance 1997* (Washington, D.C., 1997).

> portfolio investment funds in Africa or attempting to promote investor interest in HIPC privatizations assess the existence of debt overhang as a key negative influence. Some incentives, such as export-credit guarantees, are directly cut off as a consequence of a debt overhang.[21]

A factor that has played a key role in the persistence of debt overhang in SSA is the short-leash approach adopted by the international community since the start of the debt-servicing difficulties in the early 1980s. While, as repeatedly urged by the UNCTAD secretariat, significant amounts of debt reduction would have been needed to eliminate the debt overhang, to restore growth and to reduce the debt ratios to sustainable levels, in much of the 1980s efforts to deal with the debt problem of low-income countries sought to ensure that debt forgiveness was the exception rather than the norm.[22] This approach started to change with recognition of the need for genuine concessionality in Paris Club reschedulings for poorer countries. The first major step was taken at the Toronto Summit in 1988, where creditor governments recognized the need to reduce the non-concessional official debt owed by low-income countries. However, the debt reduction operations have gone through many incremental steps, from Toronto terms to London terms (or enhanced Toronto terms) to Naples terms and to Lyon terms, as improvements made in each step proved inadequate in dealing with the problem.

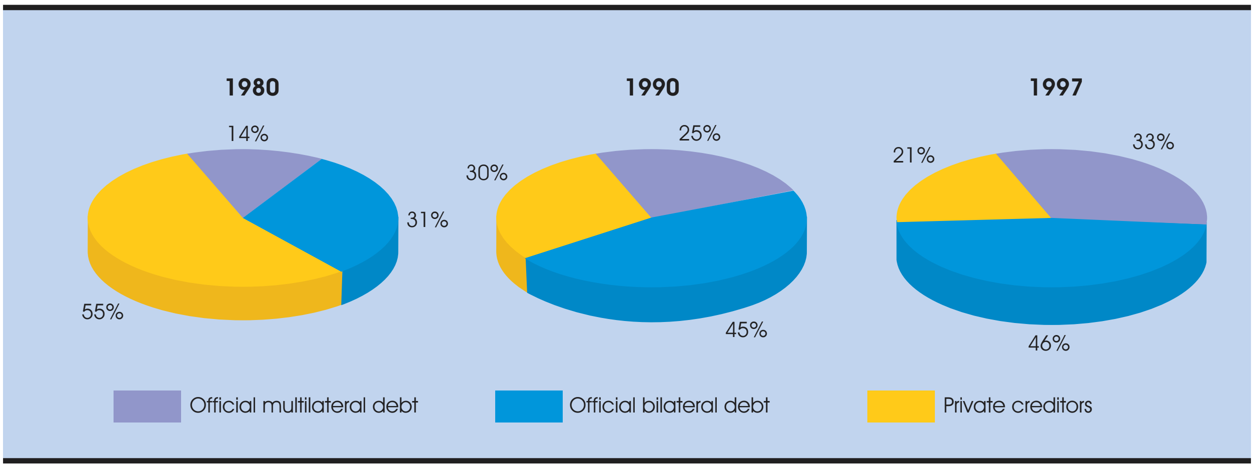
A major shortcoming of these steps was the exclusion of multilateral debt from debt reduction. Multilateral debt accounted for an increasing proportion of the total debt of the poorer countries as a result of the international debt strategy pursued in the 1980s, when lending was increased by the multilateral financial institutions with a view to avoiding a global financial crisis. Moreover, in most cases adjustment policies failed to restore external financial viability:

> Following the initial onset of the developing country debt crisis in the early 1980s, many developing countries borrowed heavily from multilateral sources in order to finance debt servicing to private creditors, thereby shifting the balance of debt from private to public creditors. In addition, many countries borrowed heavily in the context of IMF/WB structural adjustment programmes. The poor performance of countries under these adjustment pro-

Chart 10

COMPOSITION OF PUBLIC AND PUBLICLY GUARANTEED EXTERNAL DEBT OF SUB-SAHARAN AFRICA, 1980, 1990 AND 1997

(Per cent shares)



Source: World Bank, *Global Development Finance 1998, Analysis and Summary Tables* (Washington, D.C., 1998).

grammes ... has left much of the borrowing simply unpayable.[23]

The HIPC Initiative has thus received widespread support in the international community, not only as a comprehensive and coordinated approach, but also as a crucial step in recognizing that losses on bad loans should not be borne by the debtors alone, but shared also by the creditors, particularly in view of the key role that the multilateral financial institutions played in setting the policies in debtor countries. Moreover, the Initiative has been formulated in recognition of the need to reach a sustainable debt position in the context of growth and development.

However, the view is gaining strength in the international community that the HIPC Initiative needs a significant adjustment to become a decisive move to help re-establish the conditions for sustained economic growth. The basic issues relate to eligibility and the adequacy of the debt reduction to be granted, as well as the speed with which countries in need will actually benefit from relief.

There can be little doubt that, since all the debt has to be paid in foreign currency, export earnings are an important determinant of debt-servicing capacity. However, as a very large proportion of debt is owed by the public sector, the debt burden relative to government revenues is at least equally relevant in determining debt-servicing capacity. Even when the economy generates sufficient export earnings and faces no external financing gap, servicing of external sovereign debt could pose serious difficulties. It would necessitate a transfer from the private to the public sector through either cuts in public spending or increases in taxation, both of which might have serious consequences for stability and growth.[24]

Responding to the concern of the countries with high export-GDP ratios and low debt-servicing ratios, the Executive Boards of IMF and the World Bank approved in April 1997 the introduction of an additional sustainability criterion which would allow debt reduction if the debtor country has, *inter alia*, an export-to-GDP ratio of at least 40 per cent and a minimum threshold ratio of fiscal revenue to GDP of 20 per cent.[25] Two countries (Côte d'Ivoire and Guyana) have so far qualified on the basis of this additional criterion.

While, according to this criterion, eligibility will depend on having a minimum fiscal revenue ratio, one of the arguments advanced in favour of debt relief is that it would allow debtor governments to reduce high taxes, which "tend to undermine growth by introducing serious distortions in the economy, including heightened barriers to trade (via trade taxes), capital flight, tax evasion and reduced work effort".[26] More importantly, while the addition of the fiscal burden criterion has somewhat broadened the range of eligibility and the scope for debt relief, it does not appear to go far enough in restoring the financial viability of the public sector, which holds the key to restoring stability and growth. For instance, a non-eligible country with an export-to-GDP ratio of less than 40 per cent and a debt service ratio of less than 20-25 per cent can still face a considerable fiscal burden, of up to 10 per cent of GDP. The kind of problems this would create is illustrated by the following:

> For example, a well-designed budget might include current expenditures on education (mostly at the primary and secondary level) of some 5 per cent of GDP; public health outlays of some 3 per cent of GDP; costs of public administration of 2 per cent of GDP; and expenses on police and defence of some 3 per cent of GDP. Infrastructure spending is sure to require at least 5 per cent of GDP, even if the government leaves much of the infrastructure finance to the private sector (e.g. for power, telecommunications and ports) and focuses its attention on items (e.g. rural roads) that are much harder to finance through the market. The total outlays in this illustration total 18 per cent of GDP. Evidently, there is virtually no room for debt-servicing, nor for subsidies to households and firms or income transfer programmes other than in health and education. As experience has shown, attempts to collect more than a minimum in external debt servicing result in (a) serious budget deficits; (b) unacceptable cuts in education, public health, or basic infrastructure; or (c) tax rates at levels that jeopardize economic growth.[27]

These considerations suggest that greater attention should be paid to the fiscal burden of debt (e.g. by setting limits to the amount of debt servicing from the budget expressed as a proportion of GDP) in assessing debt sustainability, independently of the degree of export orientation of the economy and the extent to which debt servicing cuts into export earnings.

There are also more fundamental questions raised by the implementation of the HIPC Initiative. They can be illustrated by reference to the considerations set out in Part One, chapter IV above, on the relevance of the principles of bankruptcy codes to international debt workouts. The Initiative is addressed to countries which are unable to service their debts fully. Such a situation corresponds to the notion of insolvency under bankruptcy codes, which enables debtors to benefit from a number of arrangements, including debt standstill, debtor-in-possession financing and debt reduction. Judicial procedures would not permit practices such as requiring debtors to maintain debt servicing and forcing a long delay between the recognition of insolvency and debt reduction. Such procedures would also avoid a situation requiring unanimity among creditors as regards the debt-restructuring plan – a requirement which allows a minority of creditors to block a deal. Moreover, under insolvency procedures, the amount of debt reduction needed and the conditions attached would not be determined by the creditors, and the same principles would apply to all creditors in order to ensure comparability of settlements.

As discussed in Part One, chapter IV, there are serious difficulties in replicating the insolvency procedures for international debt through an international bankruptcy court, not only for sovereign debtors but also for private debtors. Nevertheless, it is possible to establish the key insolvency principles and apply them within the existing international framework. The application of these principles would dictate an immediate write-off of all unpayable debt in SSA, determined on the basis of an independent assessment of debt sustainability.

Experience so far demonstrates that the approach to debt reduction used so far has been inadequate. Not only has it perpetuated aid dependency, but it has also failed to promote "sound policies" and commitment to and ownership of the programmes. Resolving the crisis in SSA requires a bolder approach in order to secure the rapid and adequate debt reduction needed to restore the financial viability of the public sector and economic growth, and in order to ensure that the operation will never have to be repeated. ■

Notes

1 Here, in tracing post-independence performance, 1965 is taken as the cut-off date. Of the British and French colonies, Ghana (1957) and Guinea (1958), respectively, were the first to gain independence. Territories that gained independence after the mid-1960s include Botswana (1966), Mauritius (1968), Guinea-Bissau (1974), Angola (1975), Cape Verde (1975), Mozambique (1975), Sao Tome and Principe (1975) and Zimbabwe (first in 1965, with the Unilateral Declaration of Independence by Southern Rhodesia, and subsequently in 1980, when independence was formally granted by the British Parliament).

2 See J. Dunning, "Changes in the level and structure of international production: The last one hundred years", in M. Cassen (ed.), *The Growth of International Business* (London: Allen and Unwin, 1983), table 5.2. In 1970, FDI was equivalent to 0.52 per cent of GDP in SSA, versus 0.26 per cent in East and South-East Asia, and 0.74 per cent in Latin America and the Caribbean; see UNCTAD, *Foreign Direct Investment in Africa* (United Nations publication, Sales No. E.95.II.A.6), New York and Geneva, 1995, table 18.

3 See B. van Arkadie, "The State and economic change in Africa", in H. J. Chang and R. Rowthorn (eds.), *The Role of the State in Economic Change* (Oxford: Clarendon Press, 1995).

4 In the early 1970s Western Europe was the destination of 55 per cent of African exports, and the origin of 65 per cent of all African imports. In the first half of the 1990s more than 60 per cent of African exports went to Western Europe and about 55 per cent of African imports originated there. The share of intra-African trade in total imports of African countries fell to 3.1 per cent by 1980. It then doubled during the 1980s and had risen to 8.6 per cent by 1995. The issue of intraregional trade is discussed in greater detail in chapter IV below.

5 The issue of commodity diversification is discussed in greater detail in chapter IV.

6 See D. Ben-David and D. Papell, "Slowdowns and meltdowns: Postwar growth evidence from 74 countries", CEPR Discussion Paper No. 1111 (London: Centre for Economic Policy Research, 1995).

7 Moreover, the decline in commodity prices made a major contribution to disinflation in OECD countries; see *TDR 1987,* Part One, chapter II.

8 For a detailed discussion of the fallacy-of-composition problem see *TDR 1993*, Part Two, chapter II, p. 101.

9 See *TDR 1993*, Part Two, chapter II, pp. 97-99.

10 See G. Helleiner, "Trade, aid and relative price changes in sub-Saharan Africa in the 1980s", paper presented at the conference "From Stabilization to Growth in Africa", Marstrand, Sweden, 6-7 September 1992. See also *Adjustment in Africa. Reforms, Results and the Road Ahead*, World Bank Policy Research Paper (New York: Oxford University Press for the World Bank, 1994), p. 29; and for more recent years R. Faruqee and I. Husain, "Adjustment in seven African countries", in I. Husain and R. Faruqee (eds.), *Adjustment in Africa. Lessons from Country Case Studies* (Washington, D.C.: World Bank, 1994).

11 See *TDR 1993*, Part Two, chapter II, pp. 109-110.

12 E. V. K. Jaycox, *Africa: From Stagnation to Recovery* (Washington, D.C.: World Bank, February 1993).

13 This is also confirmed by the results of the World Bank's own assessment of adjustment programmes in Africa. Only one country (Nigeria) classified by IMF as a "recent strong performer" in 1998 was among the six countries which the World Bank had found in 1994 to have made "large improvements in macroeconomic policies"; and another recent strong performer (Uganda) was among those nine countries that had been found to have made "small improvements" *(Adjustment in Africa: Reforms, Results, and the Road Ahead, op. cit.*, pp. 57-59). The listing of Nigeria as a "recent strong performer" is somewhat surprising since GDP growth was, on average, below 3 per cent in 1990-1996 and only slightly above 3 per cent in 1997. Moreover, Nigeria benefited from the strength of oil prices; average prices in 1996 were almost a third higher than two years earlier, but with current trends in oil markets this performance may not be repeated.

14 IMF, *World Economic Outlook*, April 1998 (Washington, D.C.: IMF), table 12.

15 For a discussion of recent savings and investment performance in SSA, see S. Fischer, E. Hernández-Catá and M.S. Khan, "Africa: Is this the turning point?", IMF Paper on Policy Analysis and Assessment 98/6 (Washington, D.C., 1998).

16 *Ibid.*, p. 12 and IMF, *World Economic Outlook,* April 1998, *op. cit.*, p. 72.

17 R. Ram, "Productivity of public and private investment in developing countries: A broad international perspective", *World Development*, Vol.24, No.8, 1996.

18 World Bank, *Global Economic Prospects and the Developing Countries* (Washington D.C.: World Bank, 1997), Appendix I, p. 86.

19 In 1992 the World Bank growth projection for SSA for the 1990s was an average rate of 3.8 per cent per

annum; see *Global Economic Prospects and the Developing Countries* (Washington, D.C.: World Bank, 1992), annex. The actual rate until 1997 was about 2.5 per cent per annum. Thus, to achieve 3.8 per cent for the whole decade, the region would need to grow at a rate of no less than 6 per cent per annum during the rest of the 1990s. But the growth rate now projected for the remainder of the 1990s is in the order of 4 per cent. Even if this growth rate were realized, this would mean some 2.8 per cent growth per annum for the decade as a whole, i.e. one percentage point less than the original World Bank projections. The same considerations are broadly valid for the projections for 1992-2002 in the 1993 issue of *Global Economic Prospects and the Developing Countries* (see table 7.4).

20 For a survey of these studies and the underlying mechanisms see M. Martin, "A multilateral debt facility – global and national", in UNCTAD, *International Monetary and Financial Issues for the 1990s*, Vol. VIII (United Nations publication, Sales No. E.97.II.D.5), New York and Geneva, 1997.

21 *Ibid.*, p. 150.

22 See in particular *TDR 1988*, Part One, chap. IV.

23 J. D. Sachs, "External debt, structural adjustment and economic growth", in UNCTAD, *International Monetary and Financial Issues for the 1990s*, Vol. IX (United Nations publication, Sales No. E.98.II.D.3) New York and Geneva, 1998, p. 53.

24 This is, in effect, similar to the domestic budgetary transfer problem that faced a number of countries in Latin America in the 1980s when the public sector lacked the resources needed to service debt even though the private sector generated adequate foreign exchange earnings to make such payments; see *TDR 1989*, Part One, chapter IV.

25 See *TDR 1997*, box 2.

26 Sachs, *op. cit.,* p. 46. This criterion is indeed a reflection of donor concern that aid reduces tax effort and hence leads to aid dependency. However, if an extra dollar of aid indeed reduces taxation, this would mean that the aid is partly transferred to the private sector. It has been argued that "not only is there no evidence for this effect, but that had it happened it would have been desirable"; see P. Collier, "Aid and economic development in Africa" (Oxford University: Centre for the Study of African Economies, October 1997), mimeo, p. 1.

27 Sachs, *op. cit*., p. 49. The above does not necessarily imply net negative transfers by the country. As the author points out (p.54, note 1), "overall foreign assistance may exceed 5 per cent of GDP, but much of it will go directly to enterprises and households, and thus will not be available as a source of revenue support for budgetary outlays".