PDP/00/4

IMF Policy Discussion Paper

Raising Growth and Investment in Sub-Saharan Africa: What Can Be Done?

Ernesto Hernández-Catá

INTERNATIONAL MONETARY FUND

© 2000 International Monetary Fund PDP/00/4

IMF Policy Discussion Paper

African Department

Raising Growth and Investment in Sub-Saharan Africa: What Can Be Done?

Prepared by Ernesto Hernández-Catá [1]

May 2000

Abstract

The views expressed in this Policy Discussion Paper are those of the author(s) and do not necessarily represent those of the IMF or IMF policy. Policy Discussion Papers describe research in progress by the author(s) and are published to elicit comments and to further debate.

This paper argues that sub-Saharan Africa's growth performance needs to be improved substantially in order to raise standards of living to an acceptable level and achieve a visible reduction in poverty. The paper provides a broad overview of the explanations for sub-Saharan Africa's unsatisfactory growth performance in the past, paying particular attention to the empirical literature. It argues that growth has been hampered by economic distortions and institutional deficiencies that have increased the risk of investing in Africa, and lowered the rates of return on capital and labor as well as the growth of total factor productivity.

JEL Classification Numbers: 011, 019, 040, 055

Keywords: Growth, Investment, Africa

Author's E-Mail Address: Ehernandezcata@imf.org

[1] The author would like to thank Arvind Subramanian, David Coe, Gary Moser and Thomas Walter for helpful comments on earlier drafts. A previous version of this paper was presented at a seminar on "Structural Adjustment in Sub-Saharan Africa," Mauritius, May 12-14, 1999.

Raising Growth and Investment in Sub-Saharan Africa:
What Can Be Done?

I. Introduction

About two years ago, a paper entitled "*Africa: Is This the Turning Point?*" expressed with guarded optimism the view that the region could extend and strengthen its relatively good economic performance in the period 1995-97, provided it was able to deal successfully with the twin challenges of globalization and declining official development assistance.[1] Since then, however, economic activity in many countries of sub-Saharan Africa (SSA) has been seriously affected by the international crisis that started in East Asia, the related drop in world commodity prices, and the spread of armed conflicts in the region.

In light of these developments, this paper revisits the economic outlook for SSA, the task of African policymakers, and the role of the IMF in the continent. It concludes that there are reasons to remain guardedly optimistic about SSA's economic future, that good economic policies can make a decisive difference, and that the IMF and other international financial institutions can continue to play an important and useful role in Africa. Indeed, they have to extend and to broaden their role to deal effectively with new problems and challenges. Against this background, the paper first looks at the relation between growth and poverty reduction. It then provides a broad overview of the explanations that have been

---

[1] See Fischer, Hernández-Catá and Khan (1998).

offered for the unsatisfactory growth performance of SSA,[2] paying particular attention to the empirical literature, and focusing on the factors that affect the level and the efficiency of investment. The paper concludes with a number of suggestions about what can be done to increase growth on a durable basis and, in particular, about what the IMF can and should do.

II. Growth and Poverty Reduction

In recent years, poverty reduction has emerged as the central objective of development policy, especially in Africa. In particular, the IMF and the World Bank have emphasized the central role of poverty reduction strategies in their relations with poor countries. This paper takes the view that a substantial improvement in SSA's long-term growth performance is necessary to achieve a visible reduction in poverty. Many will argue that higher income per capita is not enough, and that poverty reduction also requires a better distribution of income and wealth. This is probably true in some countries. However, given the low level of per capita income in many SSA countries, it is difficult to see how redistribution alone could provide a lasting solution to the problem of poverty. Indeed, it seems clear that there can be no appreciable and lasting reduction in poverty unless the size of the pie is substantially increased.

In summing up their empirical analysis of growth and poverty reduction, Roemer and Gugerty (1997) concluded that "economic growth benefits the poor in almost all the

---

[2] Collier and Gunning (1999a and b) provide two excellent surveys of the literature on Africa's economic performance.

countries in which substantial growth has taken place. Indeed, economic growth appears to be one of the best ways to reduce poverty." They also concluded that "a policy that aims at redistributing income at the expense of economic growth will have very low payoffs in terms of poverty reduction." In a recent paper, Dollar and Kraay (2000) find that the income of the poor rises one-for-one with overall growth. They also conclude that openness to foreign trade benefits the poor just as much as it benefits the whole economy and that the harmful effects of inflation fall disproportionately on the poor.

Economic growth therefore must be the cornerstone of the strategy, the key intermediate goal required to reach the fundamental social objectives shared by most. Unfortunately, SSA's growth performance in the past few decades has not been good. In the 1980s and the first half of the 1990s, real per capita GDP in the region fell at an annual average rate of about 1½ percent, while in the developing countries taken as a group, it *increased* at an annual rate of approximately 3 percent. Then, from 1995 to 1997 real per capita GDP in SSA rose by 1.5 percent per annum. This was certainly an encouraging development, particularly because it reflected better policies in many African countries rather than favorable exogenous developments. What remains to be seen is whether this improved performance can be sustained in spite of the intensification of armed conflicts in the region and the sharp movements in the terms of trade in recent years.[3]

[3] The oil exporting countries were severely affected by the plunge in world oil prices in 1998 but recovered in 1999 as prices rebounded. The oil importing countries were hit particularly hard in 1999, as oil prices surged and other commodity prices fell.

III. GEO-CLIMATIC DETERMINISM

Why has growth been so low in sub-Saharan Africa? Some of the explanations that are in vogue today are based predominantly on geography and climate. David Bloom and Jeffrey Sachs (1998) have emphasized that SSA is tropical and therefore suffers from diseases such as malaria, that the quality of its soil is poor, and that many of its countries are landlocked. These factors, they claim, and not the deficiency of institutions and policies, are the major reasons for SSA's unsatisfactory growth performance.

This story is not very convincing. Location in the tropics has not prevented Thailand, Indonesia, Malaysia, Singapore, and the tropical Chinese regions of Hong Kong, Guangzhou, and Taiwan from achieving growth in per capita incomes that remain impressive, even after the downturn associated with the recent East Asian crisis. Along the same lines, the recent growth performance of some of the southern U.S. states (notably Arizona, Georgia, New Mexico, and North Carolina) has been significantly above the national average, notwithstanding earlier predictions that these states were doomed to perform poorly because their hot climate was inimical to work effort. As for the *landlocked* factor, if it were truly so growth-inhibiting the Swiss and Czech economies would have been given a very low probability of success in the seventeenth century, and the strong performance in the 1990s of Botswana—one of SSA's best and most consistent performer—would be inexplicable.

There are also serious problems with Bloom and Sachs's methodology. Because they rely on cross-sectional data only, their results could well be capturing other fixed effects that

are specifically African—but not necessarily related to climate or geography. In addition, there is the finding by Collins and Bosworth (1996) that the growth rates of output, capital, and total factor productivity in SSA fell sharply in the period after 1973. Clearly, this could not be explained by a factor like geography which is independent of time.

Thus, Bloom and Sachs overestimate the importance of geo-climatic factors and correspondingly underestimate the crucial importance of policy. Furthermore, they ignore the fact that geo-climatic factors, where they do matter, often can be changed by technology and/or policy. For example, globalization and technology are gradually weakening the importance of geography for economic performance by lowering transportation and communication costs. Economic distance is no longer synonymous with physical distance, particularly in regard to services. Trade liberalization and improvements in road and railway infrastructure lower the costs of being landlocked. And, as pointed out by Collier (1999), the disadvantages of a tropical climate can be overcome by the discovery of vaccines and various or new strains of crops.

IV. Investment and Growth

Most of the empirical literature on growth, in SSA or elsewhere, emphasizes the relationship between output growth and capital formation. The theoretical foundation of this relationship is solid, and the empirical results strong: a large number of combined cross-section/time-series econometric models find a significant positive relation between the rate of growth of real GDP and the ratio of investment to output--for example the studies by Barro

and Lee (1994) and by Collier and Gunning (1999a) among those that include a near-global sample of countries, and that of Ghura and Hadjimichael (1996) among those dealing with African countries only.[4] International comparisons also suggest that the problem of low investment is central to the explanation of low growth in sub-Saharan Africa. Throughout the 1990s, the ratio of investment to GDP for the entire region has hovered around 17 percent of GDP, well below the ratios attained in the developing countries of Latin America (20-22 percent) and Asia (27-29 percent). In sum, the empirical studies clearly suggest that raising investment ratios must be a key part of any strategy to increase growth and improve standards of living in Africa.

There are also several good reasons to believe that the effort will have to focus on raising the ratio of *private* investment to GDP. First, because the empirical evidence for several SSA countries indicates that private investment has a significantly stronger, favorable effect on growth than does government investment[5]—probably because it is more efficient and perhaps less closely associated with corruption. And second, because official development assistance (ODA), which provides the financing for a large share of public investment in Africa, is declining. Yet the ratio of private investment to GDP in sub-Saharan Africa is very low compared with other regions. IMF estimates put SSA's private investment

[4] Ghura (1999) shows that, contrary to the assertions of Devarajan, Easterly and Pack (1999), the empirical relation between growth and private investment in Africa is indeed robust with respect to changes in specification.

[5] This shows up in econometric results such as those of Ghura and Hadjimichael (1996), Ghura (1997), and Beddies (1999).

ratio in 1998 at 13.8 percent (its highest level in the 1990s), compared with 16 percent in Latin America, 18 percent in the advanced economies, and 16.5 percent in the newly industrialized economies of Asia.[6] All this does not mean that efforts to reverse the decline in ODA should be given up. It does mean that the prospects for higher growth will hinge on identifying and removing the factors that hinder growth by discouraging *private* investment, both domestic and foreign, or by lowering the efficiency of both capital and labor.[7]

Risk and the Profitability of Investment

Perhaps the main reason for the low level of private investment in sub-Saharan Africa is the perception by both domestic and foreign investors of *a low after tax, risk-adjusted rate of return on capital.* To be sure, there is evidence that very high gross, unadjusted rates of return on capital are available in Africa. But for the investor these high rates of return are cold comfort if they are eroded by high taxes and if there is a significant risk of capital loss associated with the investment. An important collection of studies edited by Collier and Patillo (2000) provides considerable evidence (both econometric and from risk rating surveys) for the negative relation between private investment and risk, and for the hypothesis that the business environment in Africa is particularly risky.

---

[6] This is a historical trough associated with the East Asian crisis. In the previous four years private investment in the newly industrialized Asian economies averaged about 25 percent.

[7] It is noteworthy that the contribution to growth of both capital per worker and total factor productivity in the period 1973-1994 was found to be significantly lower in Africa than in South Asia.

Three major sources of risk appear to be particularly relevant: macroeconomic instability; loss of assets due to non-enforceability of contracts; and physical destruction caused by armed conflicts. The first area, macroeconomic instability, is one in which much progress has been achieved in recent years: budget deficits in SSA have been cut significantly, reducing the risk that unsustainable fiscal imbalances would result in arrears, default, or higher taxes (including the inflation tax).[8] Nevertheless, arrears (domestic and external) remain a problem in many countries. More generally, the cases of Zimbabwe and Gabon have recently shown how quickly monetary and fiscal control can be lost. Macro-stability therefore should remain a central preoccupation in program design.

The second area, which involves the inadequacy of legal systems, is clearly one where much can and should be done in the period ahead. It is difficult to see how private investment could take off in countries where investors and lenders lose their capital because a dysfunctional courts fail to enforce contracts and property rights. Some progress is being made at the regional level—e.g. the work of the Organization for the Harmonization of Business Law in Africa (OHADA) in francophone countries. But much remains to be done and the Fund needs to reflect on what it could do to help the development of honest and efficient legal systems.

---

[8] In addition to the expectation of bad outcomes associated with poor macroeconomic policies, there is the problem of *policy instability*. Collier and Patillo (2000) show that, in the 1970s and 1980s, the volatility of real exchange rate changes and of the ratio of taxes to GDP in SSA was the highest among major country groups, implying a particularly high volatility in after-tax rates of return on capital.

Conflict and Post-Conflict Problems

Finally, there is the fact that armed conflicts have intensified recently to the point where, in the past few years, they involved tens of thousands of troops and, directly or indirectly, about one-third of the countries of sub-Saharan Africa. The reasons for these conflicts are complex, and some of the alleged reasons—like poverty, ethnolinguistic diversity, the inheritance of the cold war, and a rich endowment in natural resources—cannot be reversed, at least in the short run.

For an international financial institution like the IMF, armed conflicts raise particularly thorny issues. They destroy human lives and physical infrastructure, and they disrupt the working of institutions. Moreover, they can lead to higher government spending and thereby threaten macroeconomic stability. And they tilt government expenditure towards military outlays and therefore crowd out expenditure on human capital and infrastructure, thus threatening an important element of a growth and poverty reduction strategy. Thus, armed conflicts threaten the viability of Fund-supported programs. Yet, it would be wrong to conclude that countries involved in conflicts automatically should be sanctioned by denial or interruption of assistance. In many cases, this would amount to punishing equally the aggressor and the victim of the aggression. For similar reasons, the specification of technical rules, such as a maximum level of military expenditure as a share of GDP, would be inappropriate an inoperative: the predator likely will ignore the rule while the potential victim will be hindered in its efforts to deter aggression and, failing that, to defend itself. The

heart of the problem is that war is essentially a political problem which requires political judgments and decisions, not bureaucratic procedures or technical rules.

Yet there are some things that can be done to prevent armed conflicts and to repair some of the damage that they cause. First, it turns out that the connection between ethnolinguistic diversity and conflicts, stressed by Easterly and Levine (1997 and 1998), is not a simple one. Collier (1998) has argued, on the basis of empirical evidence, that ethnolinguistic diversity per se does not lead to armed conflicts . Rather it is the interaction between diversity and the low level of democracy and political rights that makes diversity a problem. It is not a coincidence that the economic performance of old democracies like Botswana and Mauritius has been above average, nor that the record of countries like Mali, Benin, and Mozambique has improved since the advent of democracy. Thus, assistance aimed at improving political rights and strengthening democratic institutions will tend to reduce the incidence of conflicts. Moreover, the international community could increase its assistance to those African countries that have been engaged in peacekeeping operations at their own expense, like Nigeria in Sierra Leone, and to those that must deal with large numbers of refugees, like Guinea.

The international community can also help those countries emerging from armed conflicts to rebuild their infrastructure and their institutional capacity. In SSA, the Fund has been involved in post-conflict programs in Rwanda and the Republic of Congo, and is currently involved in Sierra Leone. In 1999, the Fund's Executive Board expanded the scope for post-conflict assistance and opened the door for helping countries that are emerging from

conflicts but have been prevented so far from qualifying for Fund support because of protracted arrears to the Fund—including, potentially Liberia and the Democratic Republic of Congo.

Finally, there is an important point about the significance of risk. It is not only the decision to invest that is affected by risk, but also the decision of *how much to save* and *where to save.* The kind of risk that typically confronts investors in SSA affects the expected rate of return on assets held domestically and therefore contributes to a low saving rate and to capital flight, as well as to low domestic investment. Collier, Hoeffler and Patillo (1999) found that capital flight from SSA has been very high (they estimate it at 40 percent of private wealth), and that, in relation to the workforce, it has been much higher than in other developing country groups. They attribute this finding to SSA's relatively high degree of exchange rate overvaluation and indebtedness, and to the perception that investment in the region is particularly risky.

High Tax Rates

Another reason for the relatively low level of private investment in SSA is the erosion of net rates of return on capital by high marginal tax rates. This is a major problem, but it cannot be fixed by tolerating larger budget deficits. Larger deficits would discourage private investment by raising the cost of capital if they were financed by debt, by generating instability and imposing an inflation tax if they were financed by money. The problem is that the combination of high statutory tax rates, including on international trade, and pressures

from special interest groups has resulted in a vicious circle in which, rising exemptions lead to the erosion of the tax base and, ultimately, to further increases in tax rates in order to avoid rising budget deficits. For this reason, but also because they create microeconomic distortions and a fertile terrain for corruption, a decisive attack on tax exemptions should be an important part of a strategy for growth and investment with macroeconomic stability.

The Debt Overhang

There is no doubt that the external debt of many SSA countries is unsustainable and places a heavy burden on the public finances and the balance of payments. Unless it is forgiven, the debt represents a future government liability, one that eventually will require a steep rise in taxes. Therefore, the debt overhang discourages private investment by reducing the expected after-tax rate of return on capital. In the fall of 1996 the IMF and the World Bank launched the Initiative for the Heavily Indebted Poor Countries (HIPC) Initiative. Since then, assistance has been committed to seven countries (including five in sub-Saharan Africa). More recently, the Boards of the Bank and the Fund have endorsed proposals to enhance the initiative by providing faster debt relief (by advancing the "completion point," by providing for interim relief, and by front loading the delivery of relief subject to certain conditions;) deeper and broader debt relief (e.g., by lowering the debt/exports and debt/fiscal revenue target ratios, which could expand eligibility to 30 countries mostly in SSA); and by establishing a close link between debt relief and poverty reduction.

A thorough discussion of all the issues involved in the design of an enhanced HIPC is beyond the scope of this paper. However, three points are worth making briefly. First, the result of debt relief, essentially, is to make external resources available to the government and to the country. Therefore, it would seem to make no sense to take away resources by reducing official development assistance while resources are being provided through HIPC. Of course, the ultimate success of a growth-oriented strategy in SSA will be to bring an end to aid dependency. But that time has not come. Second, to pave the way for an end to aid-dependence and to avoid the need for another round of debt reduction in the future, policies will need to be aimed squarely at the objective of increasing growth by increasing the efficiency and reducing the risk of investing in SSA. Third, the idea of a link between debt reduction and poverty is obviously appropriate, but the direct link to social expenditure targets is somewhat less straightforward given the practical difficulties in translating increased spending into better delivery of services in areas such as health and education. In view of these difficulties, it would seem that the possibility of using the space provided by debt relief to improve the basis for growth and stability, for example by investing in infrastructure or reducing domestic debt, should not be ruled out.

V. Factors Reducing Productivity and Growth

In addition to the high level of risk, growth in SSA is affected by a variety of economic distortions and institutional deficiencies that lower the rates of return on capital and labor, as well as total factor productivity. The adverse impact of these factors can be reduced if public policies are set on the right course—although it should be recognized that

change will be politically difficult and will take time. The list of problems is familiar: lack of openness to international trade; poor infrastructure and insufficient education of the labor force; bad governance and corruption; insufficient competition and monopolistic structures in many sectors, notably in agriculture.

International Trade Restrictions: Domestic and Foreign

Of all the developing country regions, SSA is the least open to international trade, and this is widely recognized by students of the region as an obstacle to development. Rodrik (1998) found that, even though SSA's marginalization in world trade is due primarily to its slow growth, trade policies within the region are significantly correlated with the growth of trade. Coe and Hoffmaister (1998), on the basis of a much larger gravity model also find that relatively low level of bilateral trade with industrial countries results mainly from the relatively small size of the average African economy and their relatively low rates of economic growth since 1970. They also find that SSA's relative lack of openness contributes to explain its low level of trade with industrial countries. Both studies conclude that lowering trade restrictions should improve the region's trade performance significantly—SSA is not "different" in that respect. Using both time series and cross-section data in manufacturing, Jonsson and Subramanian (1999) find a significant positive correlation between openness to trade and total factor productivity in South Africa. These findings confirm that trade liberalization should help to spur growth, but Rodrik is right to emphasize that miracles should not be expected: trade policy alone will not be the solution to Africa's slow growth.

Progress toward trade liberalization has been made in several countries in sub-Saharan Africa over the past several years. But such progress must now be strengthened and extended to the entire region. There are two ways to do this: the first is through unilateral trade liberalization—Chile and Mexico adopted this approach and, as a result, their economies have become more efficient, more competitive, and more resilient. The second route is through regional trade agreements, *provided* that they seek trade creation, economies of scale, and greater competition—and not protection and isolation from the rest of the world.

There have been encouraging developments in this area. A notable example is the implementation of the common external tariff in the West African Economic and Monetary Union (WAEMU), which will contribute not only to intraregional trade liberalization but also to a considerable reduction and simplification of the region's external tariff structure. The IMF has played a role in this process—together with the World Bank and the European Union—by assisting the member countries of the WAEMU in estimating the impact on fiscal receipts of the planned reductions in import duties and by helping to identify alternative sources of revenue. Moreover, if despite a country's best efforts—and in the context of an otherwise strong program—the reduction in import duties leads to a temporary balance of payments gap, the Fund will take this into consideration in identifying the necessary financing for the program.

Trade liberalization in Africa should be accompanied by an improvement in the access of African producers to the markets of the advanced economies. Back in 1997, the Fund staff made a number of specific suggestions in this area to the governments of some of

the major industrial countries. These included: reducing tariff peaks and tariff escalation at all stages of production to lower effective protection on primary goods of actual or potential interest to SSA countries, such as clothing, fish, processed goods, and leather products; accelerating the phasing-in of Uruguay Round measures to improve access for textiles and garments; considering the announcement of a predetermined time schedule for the elimination of subsidies on products such as meat and sugar; and exempting SSA countries from antidumping and countervailing duties and from safeguard actions. So far, unfortunately, there has been relatively little progress in achieving these goals.

Overvalued Exchanges Rates

While selected industries occasionally have benefited from a protectionist trade policy, the production and exports of tradable goods in SSA has often been hurt by overvalued exchange rates. Sometimes, the motivation for this policy may have been the desire to provide cheap imported goods to the urban elite. But the resulting discrimination against tradable goods has been very costly in terms of output and employment forgone, particularly in the agricultural sector, but also, potentially, in the manufacturing sector. Fortunately, over the course of the 1990s, policy in this area has been evolving in the right direction. The most spectacular example was the devaluation of the CFA franc in 1994, which has provided a strong boost to growth, investment and exports in the region, following a lengthy period of stagnation.

Inadequate Infrastructure

Infrastructure is generally poor in most of SSA, and this increases the cost of investing in physical capital. Infrastructure is particularly poor in communications (ports, roads, railroads) and electric power generation. This imposes particularly heavy costs on producers of tradable goods, on top of the high cost resulting from SSA's low population density and the landlockedness of many of its countries. However, the reasons for inadequate investment in expansion and maintenance of infrastructure are policy related: insufficient budgetary appropriations; fraudulent diversion of budgetary funds; and inefficiencies resulting from corrupt management (e.g., ports) and cartelized structures.

Human Capital and Labor Force Productivity

Empirical evidence joins common sense in suggesting that human capital formation is an important determinant of growth. For this reason, the IMF and the World Bank have emphasized in their programs the importance of shifting the structure of government spending in favor of investment in human capital. A significant relation between growth and human capital formation, as measured by indicators such as schooling and life expectancy, does show up in statistical tests. Unfortunately, when the analysis is based on government expenditure in education and health, rather than on direct indicators, the evidence is unclear. Much of the evidence, both statistical and anecdotal, suggests that there is a large gap between budgetary appropriations and results in SSA. For example, measured in relation to GDP, spending on both education and health is higher in SSA than in Latin America even though performance indicators for both sectors are lower in SSA.

It is possible that outlays recorded as going to health and education are diverted to other sectors. For example, a study by Ablo and Reinikka (1998) concludes that less than 30 percent of the money allocated by Uganda's Ministry of Finance to primary schools in the period 1991-95 actually reached its destination. It may also be that the quality and the efficiency of social spending in SSA are relatively low. Gupta et al (1997) find that in the period 1984-85, government spending on health and education in Africa was less efficient than in the developing countries of Asia and the Western Hemisphere. This could reflect the fact that the ratio of wage costs to other factors essential to the delivery of education and health services (such as books or drugs) is very high in SSA in comparison with other developing countries.

Labor force growth has been rapid in SSA because of high population growth. In parts of SSA, however, (in South Africa, Namibia and Botswana, for example) employment growth has been hindered by labor market rigidities, including excessively high wages obtained by powerful labor unions, and the rate of unemployment has risen substantially. Unfortunately, in the years ahead employment and labor force growth in many parts of SSA will be dramatically affected by sharply increasing mortality resulting from current rates of HIV infection. The negative effects of HIV/AIDS are pervasive: it kills adults in their most productive years as workers, parents, educators and savers, it lowers productivity, and sharply increases health expenditures.

Governance

Growth and private investment are also hindered by bad governance and corruption. This works in at least three ways, that are often intertwined: by raising transaction costs and thus reducing profitability; by giving rise to distortions that hinder the operation of markets; and by preempting public resources from their intended uses.[9] Corruption and fraud have many sources, including poverty and, in many instances, inadequate salaries in the public sector. But they also feed on government policies that generate rents and allow a few members of society to acquire undeserved profits by bribing government officials. Thus, the Fund has consistently asked for the removal of import and export quotas, tax exemptions, subsidies, and other policies that grant special privileges to selected interest groups. It has done so not only because of the efficiency costs of these measures but also because, as long as they are in place, there will always be a temptation to bribe officials to obtain, and then to preserve, the privileges that these measures confer.

Of course, corruption can take a much simpler and direct form: the misappropriation of public funds in violation of the law and of budget procedures, sometimes in connivance with officials in the spending ministries or with potential taxpayers. This is an area where the Fund must play a role because of the importance of fiscal policy and budgetary management in its mandate. For this reason, the Fund staff has insisted on full accountability,

---

[9] Leite and Weidmann (1999) provide empirical evidence of the adverse effects of corruption on growth and of the connection between trade restrictions and corruption.

completeness, and clarity in the presentation and publication of fiscal data. In several countries in SSA–and elsewhere–the staff has insisted that there is no place for extrabudgetary accounts in the context of Fund-supported programs, and that all government transactions must be faithfully recorded in a single and publicly available budget. The Fund has required the investigation of tax and fraud cases and, together with the World Bank, has asked for external audits of major public sector entities in several African countries where fraud, financial improprieties or lack of transparency have been suspected. For example, external audits have been recently concluded, or are presently under way, at the national oil company (SNH) and the national water company (SNEC) in Cameroon; at the price stabilization fund for cocoa and coffee (Caistab) in Côte d'Ivoire; at the mining agency ANAIM and the aluminum company FRIGUIA in Guinea; at the National Petroleum Corporation (NNPC) and the Central Bank in Nigeria; and at the Petroleum Control Commission in Malawi.

Unfortunately, in a few cases the Fund has had to delay, to interrupt, or to refrain from extending a program because a major issue of corruption or fraud was unresolved. This has occurred recently in Kenya, in Côte d'Ivoire, and in Gabon. Unfortunately, because actions of this kind penalize those in the affected country who are trying hard to observe the program. Furthermore, the Fund staff finds it difficult to navigate these waters—where hard questions about sovereignty and equality of treatment are bound to come up--without clearly defined investigative and judicial functions. But in some cases the Fund must get involved because the integrity of the programs it supports is at stake, and because the international community's tolerance for corruption has diminished sharply since the fall of the Berlin wall.

Today a Fund program is unlikely to be approved by the Executive Board if a major problem of governance casts doubt on its chances of being implemented faithfully.

The Plundering of Agriculture[10]

There is an astonishing contrast between the protection provided to the agricultural sector in the industrial countries—where that sector employs a small minority of the population—and the exploitation of agriculture in much of the developing world—where farmers account for the bulk of the population. Africa is no exception. In many countries, the agricultural sector has been plundered by official price controls, low producer prices set by monopsonistic companies, and high costs of inputs, credit and transportation services stemming from high import duties, cartelized banking structures, and distribution networks that effectively prevent freedom of entry in the market. Ending the exploitation of agriculture in SSA would be a major achievement. It would reduce inefficiencies, increase growth, lower the inequality of income distribution, and diminish poverty. For those reasons, the IMF staff has called for the liberalization of agricultural sectors throughout SSA—including the cocoa sector in Côte d'Ivoire and Ghana, the cotton sector in many West African countries, and the cashew sector in Mozambique. At the same time, the Fund staff will continue to call for the end of the policies of agricultural subsidization and protection pursued by industrial countries, in some cases to the detriment of Africa's agriculture.

[10] From the title of an article by Schiff and Valdés (1995)

VI. What Can Be Done?

To conclude, raising growth is a necessary condition for social development and poverty reduction in sub-Saharan Africa. The "pessimistic" theories, which suggest that the region is condemned to low growth by geography and climate, are unconvincing. The relatively optimistic theories, which suggest that growth *can* be raised by improving policies, are much more persuasive. Raising growth will be a difficult task, but one that *can* be accomplished, provided policymakers in Africa and the international community—including the Fund—are ready to do their part. As part of that effort the Fund should continue to encourage countries:

- to maintain macroeconomic stability—no one will benefit from high inflation, particularly not the poor—by improving expenditure control; by strengthening tax administration, reducing tax evasion and launching a broad assault on exemptions; and by allowing the central bank to focus primarily on inflation control;

- to intensify efforts to improve efficiency by pushing trade liberalization (unilaterally or in the context of regional agreements), by removing the state from direct involvement in the production of marketable goods and services, by avoiding exchange rate overvaluation, and by enhancing competition in all sectors, including in particular the agricultural sector;

- to improve infrastructure, particularly in areas like ports and communications, where poor infrastructure discourages trade and investment;

- to continue raising the share of government spending directed to education and health while making sure that this is accompanied by an effective improvement in the delivery of services in those areas;

- to intensify efforts to root out corruption. This clearly is easier said than done, but eliminating rent-creating distortions and enforcing strict rules of fiscal discipline would do much to foster this objective;

- in a closely related area, to work toward reducing investors' risks by improving the quality and the integrity of the legal system.

In all these areas, the IMF, the World Bank, the African Development Bank, and other multilateral institutions can make substantial contributions. The Fund, for its part, can contribute through its financial programs, its policy advice, and its technical assistance. It can also contribute by helping reconstruction in the countries that have been ravaged by armed conflicts; by taking an active part in an extended process of debt reduction; and, last but not least, by pressing the advanced countries to open up their markets to the exports of sub-Saharan Africa.

References

Ablo, E. Y., and Ritva Reinikka, 1998, "Do Budgets Really Matter? Evidence from Public Spending on Education and Health in Uganda," World Bank Policy Research Working Paper No. 1926.

Barro, Robert J. and Jong-Wha Lee, 1994, "Losers and Winners in Economic Growth," in *Proceedings of the World Bank Annual Conference on Development Economics, 1993*, ed. By Michael Bruno and Boris Pleskovic, pp. 267-97.

Beddies, Christian, 1999, "Investment, Capital Accumulation, and Growth.: Some Evidence from The Gambia 1964-1998." IMF Working Paper 99/117 (August).

Bloom, David E., and Jeffrey D. Sachs, 1998, "Geography, Demography, and Economic Growth in Africa," Brookings Papers on Economic Activity: 2, Brookings Institution.

Coe, David T. and Alexander W. Hoffmaister, 1998, "North South Trade: Is Africa Unusual?," IMF Working Paper 98/94 (June).

Collins, Susan M. and Barry P. Bosworth, 1996. "Economic Growth in East Asia: Accumulation versus Assimilation," Brookings Papers on Economic Activity: 2, Brookings Institution, pp. 135-203.

Collier, Paul, 1998, "Ethnicity, Politics and Economic Performance." Unpublished, The World Bank (May).

———, 1999, "Comment on the Paper by Bloom and Sachs," Brookings Papers on Economic Activity: 2, Brookings Institution, Vol. 37 (March).

———and Jan Willem Gunning, 1999a, "Explaining African Economic Performance," Journal of Economic Literature, Vol. 37 (March), pp. 64-111.

———and Jan Willem Gunning, 1999b, "Why Has Africa Grown Slowly?", Journal of Economic Perspectives, Vol. 13, Number 3 (Summer).

———Anke Hoeffler and Catherine Patillo (1999), "Flight Capital as Portfolio Choice," IMF Working Paper 99/171 (December).

———and Catherine Patillo, editors, 2000, *Investment and Risk in Africa.* MacMillan.

Devarajan, Shantayanan, William Easterly and Howard Pack, 1999, "Is Investment in Africa Too High or Too Low? Macro and Micro Evidence," World Bank, (November).

Dollar, David and Aart Kraay, 2000, "Growth *Is* Good for the Poor," The World Bank, Development Research Center, (March).

Easterly, William, and Ross Levine, 1997, "Africa's Growth Tragedy: Policies and Ethnic Divisions," Quarterly Journal of Economics, Vol. 112 (November), pp. 1203-50.

———, 1998, "Troubles with the Neighbors: Africa's Problem, Africa's Opportunity," Journal of African Economies, Vol. 7 (March), pp. 120-42

Fischer, Stanley, Ernesto Hernández-Catá, and Mohsin S. Khan, 1998, "Africa: Is This the Turning Point?" IMF Paper on Policy Analysis and Assessment 98/6 (May).

Ghura, Daneshwar,1997, "Private Investment and Endogenous Growth: Evidence from Cameroon," IMF Working Paper 97/165 (December).

———and Thomas J. Grennes, 1993, "The Real Exchange Rate and Macroeconomic Performance in Sub-Saharan Africa," Journal of Economics, Vol. 42 (October).

———and Michael T. Hadjimichael, 1996, "Growth in Sub-Saharan Africa," Staff Papers, International Monetary Fund, Vol. 43 (September).

———, 1999, "Investment and Growth in Africa: Revisiting the Evidence," IMF, unpublished (December).

Gupta, Sanjeev, Keiko Honjo, and Marijn Verhoeven (1997), "The Efficiency of Government Expenditure: Experiences from Africa", IMF Working Paper 97/153 (November).

Hadjimichael, Michael, Dhaneshwar Ghura, Martin Mühleisen, R. Nord, and E. Murat Ucer. 1995, Sub-Saharan Africa: Growth, Savings and Investment, 1986-93, IMF Occasional Paper No. 118 (Washington: International Monetary Fund).

Jonsson, Gunnar and Arvind Subramanian, 1999, "Dynamic Gains from Trade: Evidence from South Africa." IMF Working Paper (forthcoming).

Leite, Carlos, and Jens Weidmann, 1999, "Does Mother Nature Corrupt? Natural Resources, Corruption and Economic Growth," IMF Working Paper 99/85 (July).

Rodrik, Dani, 1998, "Trade Policy and Economic Performance in Sub-Saharan Africa," NBER Working Paper 6562, National Bureau of Economic Research, Cambridge, MA (May).

Roemer, Michael and Mary Kay Gugerty, 1997, "Does Economic Growth Reduce Poverty?" Technical Paper, Harvard Institute for International Development (March).

Schiff, Maurice and Alberto Valdés, 1995, "The Plundering of Agriculture in Developing Countries," Finance & Development, Vol. 32 (March), pp.44-70.