ECONOMICS CRISIS IN AFRICA

Perspectives on Policy Responses

Edited by
MAGNUS BLOMSTRÖM
and MATS LUNDAHL

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ECONOMIC CRISIS IN AFRICA

All too often we are confronted with pitiful images of the victims of famine and drought which emanate from sub-Saharan Africa. While these images are normally drawn from the poorest countries, the entire region faces an intense economic crisis. Why is this area in a state of near-permanent crisis and perhaps, more importantly, what can be done about it?

E*conomic Crisis in Africa* presents an overview of the situation and examines the feasibility of current policies as well as presenting long-term objectives. The book is divided into four parts: Part I presents an overall view of the African crisis and crisis management. The authors focus on present economic and social conditions in the region. These are illustrated with cross-country studies, focusing particularly on Tanzania and Kenya. Part II examines problems of the external sector and, in particular, trade liberalization. Here, the relative success of Zimbabwe and Botswana is contrasted with the failure of Lesotho to implement an adjustment policy and the prevalence of 'Dutch Disease' in Zambia. Part III presents a micro-perspective on the African crisis and adjustment. This is illustrated by case studies from Uganda, Guinea-Bissau and the dismal failure of central state control over the Congolese economy. Finally, Part IV outlines the changes in economic systems which have taken place during the 1980s and the likely success of new policies. These analyses are presented in the context of Angola, Tanzania, the specific urgency for reform in Ethiopia and the magnitude of the task facing South Africa. However, the conclusion of *Economic Crisis in Africa* is that while most of the countries dealt with have embarked on far-reaching structural adjustment programmes it is still too early to say whether they will succeed or not – but historical experiences do not allow us to be optimistic.

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PREFACE

The essays collected in the present volume were originally presented at a conference on Responses to the Economic Crisis in Africa at the Stockholm School of Economics on 19–20 April 1991. However, the book has also a second origin. In the late 1980s, the Swedish International Development Authority (SIDA) began a programme of co-operation in macroeconomics and development with the Departments of Economics at the Universities of Lund and Gothenburg and the Department of International Economics and Geography at the Stockholm School of Economics. The majority of the authors represented in the book are involved in this programme, writing on such issues as stabilization, structural adjustment, growth, distribution and reforms.

We are greatly indebted to SIDA for financing the project and for taking an active part in the conference. Thanks are also due to Carin Blomkvist for shouldering a heavy burden in the organization of the conference and in the preparation of the manuscript for publication.

Stockholm, August 1992
Magnus Blomström
Mats Lundahl

1
INTRODUCTION

Magnus Blomström and Mats Lundahl

Sub-Saharan Africa is in a deep economic crisis. For instance, the World Bank (1989:2) reports that Africa, a region of 450 million people in 1987, had a total GDP of around 135 billion US dollars, about the same as that of Belgium, which has only 10 million inhabitants. A similar indicator of Africa's economic performance is the fact that Singapore, a small island of only 2.7 million inhabitants, exports some 50 per cent more manufacturing products than all of Sub-Saharan Africa together (Blomström 1990). These two observations indicate the seriousness of the problems dealt with in this book.

The situation in Africa has been bad for a long time, but during the 1980s it deteriorated much further. The continuing crisis has several dimensions. Stagnating or negative economic growth, serious balance of payments and fiscal problems and sluggish agricultural performance, coupled with rapid rates of population increases, are only some signs of the economic disaster. The social dimensions of the crisis include increasing unemployment, decreasing expenditure on social services and education, worsening nutrition and continuing high infant mortality. Environmental problems, such as desertification and deforestation, are accelerating. Moreover, the political systems are generally characterized by corruption, inefficiency and instability. And as if this was not enough, we are now hit by the news of another round of severe drought and famine in Africa.

Why this disaster? Unfortunately, there is no simple answer to that question. The background to the African crisis is complex and highly debated (see, for example, Milner and Rayner 1992; Rose 1985; Säve-Söderberg and Taxell 1988; World Bank 1989). The internal factors behind Africa's economic decline that are most frequently mentioned include misdirected macroeconomic policies, corruption and administrative inefficiency, lack of industrial tradition and low technological capability, poor health care and education and high population growth. Among the important external factors, fluctuations in terms of trade take a leading position. Although the country studies presented in this book stress different sources for the crisis, they generally conclude that internal factors have played a more crucial role than external ones.

Today, most African countries are facing the task of achieving important structural changes in their economies. The intermediate objectives of the ongoing adjustment programmes are generally to reduce inflation, to eliminate deficits in the balance of payments, in the government budget or in public enterprises, and to adjust to growing

debt services (Commander 1989). However, in the long run, the purpose is different. The long list of fundamental objectives reaches from the aim to accelerate economic growth, eliminate hunger and malnutrition and improve income distribution, to the need to lower the demographic pressure and solve environmental problems. However, as the chapters of this book show, the results of stabilization and adjustment programmes have been rather bleak so far.

The book is divided into four parts. Part I gives an overall perspective of the African crisis and crisis management. Part II addresses problems of the external sector. Part III discusses the crises and structural adjustment from a micro perspective. Finally, Part IV examines changes in economic systems which have taken place during the 1980s.

CRISIS AND CRISIS MANAGEMENT

The economic and social conditions in Sub-Saharan Africa have been gloomy most times since independence. After an initial period of growth, most African economies stagnated, and during the 1980s they began to decline. With only a few exceptions, per capita income has been falling during the last decade and most of the other development indicators have deteriorated in the same manner. There are few signs of improvements, despite the countries' own efforts and the inflows of aid resources.

Most countries have now introduced far-reaching structural adjustment programmes, but the projections for growth and development are still bleak. In fact, most projections for the first half of the 1990s suggest that scheduled debt service will continue to increase in the African countries and there are no signs of an upward trend in the inflow of new financial resources. Moreover, the manufacturing sector in most African countries is still far too small to allow significant import substitution. In this perspective, growth of export earnings is presumably the only means of obtaining the foreign exchange needed to import intermediates and investment goods.

In Chapter 2, 'Trade Compression and Economic Decline in Sub-Saharan Africa', Peter Svedberg presents a cross-country study of Africa's export performance and potential. He shows that very few African countries had sustained growth of real export earnings over the 1971–87 period. To some extent, this is explained by stagnating or deteriorating prices of primary commodities, but in most cases, it had more to do with the failure to expand export volumes. The reason for the poor export performance can be debated. Misdirected trade policies have obviously played an important role, but Svedberg also discusses alternative explanations.

Recently there has been a move towards more outward-oriented trade policies in Africa. Almost all countries that had significantly overvalued currencies earlier devalued considerably during the latter part of the 1980s. However, according to Svedberg, it is difficult to know how the present exchange rates are related to some 'fundamental equilibrium', since many of the countries still maintain tight government control of most capital and current account transactions. It is nevertheless noticeable that, during the past few years, no country in Africa had a currency that was as extremely overvalued as in the

late 1970s and the first half of the 1980s.

So far the impact on export volumes of the devaluations in the countries with high previous overvaluation seems to have been small. By the late 1980s export growth had picked up only in one country, Ghana. In countries like Sierra Leone, Tanzania and Uganda, there is yet no sign of a sustained improvement. This suggests that it may take time for new price signals to result in increasing production and that an equilibrium exchange rate may not be a guarantee for rapid export volume expansion. Svedberg claims that such a rate must be accompanied by other export-stimulating policies, such as improved producer prices, extension of credits and macroeconomic stability, to give the intended effects. Moreover, in the short term, export growth in most African countries can only be achieved through the rehabilitation of existing (mainly primary product) export sectors. In the somewhat longer term, diversification of both products and markets is necessary.

In Chapter 3, 'Understanding Structural Adjustment: Tanzania in Comparative Perspective', Göran Hydén and Bo Karlström argue for a broad approach to the analysis of structural adjustment policies, encompassing *political* as well as economic considerations. Analyses of structural adjustment in developing countries have traditionally focused on such macroeconomic issues as the effects of exchange rate changes and other policy shifts on domestic resource allocation, exports and the balance of payments. Over the past several years, however, research has broadened to cover longer periods of adjustment time and the interaction of economic and political variables.

Hydén and Karlström begin their chapter by surveying the structural adjustment literature and use the Tanzanian experience as an illustration. They review economic policies and attempts at policy reforms in Tanzania over the past ten to fifteen years, and construct a simple framework for analysing, in political terms, the scope for implementing structural adjustment policies in a developing country. In line with a growing number of studies of structural adjustment, they believe that a better understanding of the political dynamics of economic reforms is necessary.

Both in their literature review and their account of the Tanzanian case, Hydén and Karlström find that the adjustment process is filled with ambiguities and conflicts. Therefore, in order to understand structural adjustment policies and, particularly, to implement them successfully, they claim that it is necessary to incorporate these two concepts into the analysis. Their thesis is that ambiguity provides openings for effective policy action (room for manoeuvre), while conflict obstructs such action.

Arne Bigsten's contribution, 'Regulations Versus Price Reforms in Crisis Management: The Case of Kenya' (Chapter 4), discusses how policy-makers in Kenya met economic shocks. Focus is on the choices made by policy-makers between administrative regulations and the use of markets in bringing about the desired economic adjustment. According to Bigsten, a major constraint on policy reform in Kenya has been the influence of vested interests that stand to lose from the reforms.

In Kenya, political positions are often used as a base for successful economic activities. The core insiders in the Kenyan economy are individuals with political power and associated groups in the bureaucracy. One can also find economically-powerful individuals outside this group, but they are often well connected to the core group. The outsiders are those that have to act in the market without the benefit of political

connections. The state is used by insiders as a means of allocating the rents of the system. The outsiders have much fewer possibilities of reaping these rents. The demarcation line between insiders and outsiders thus, in the Kenyan case, has to be drawn on the basis of political connectedness.

Bigsten claims that one of the major constraints on growth in the African economies is the unwillingness to undertake reforms that threaten the entrenched élite. (Politicians and their associates have an interest in preserving the existing system of controls on imports and investment.) He reviews the macroeconomic trends in Kenya, and discusses the determinants of monetary policy, external sector policy, agricultural policy and employment policy.

In general, it seems as if Kenya has found it easier to implement price-related reforms than institutional reforms. There are yet no clear signs that the country will change to an export-oriented economy, where producers are faced with international competition. There is also a clear lack of enthusiasm for parastatal reform, since this encroaches on the scope for political action. The same reason can be given for the lack of enthusiasm for liberalization of import regulations and investment controls. Still, the distortions have not been so pervasive that macroeconomic management has been rendered ineffective. Although imbalances have at times been serious, it has always been possible to return to a sustainable position. Therefore, Kenya's economic record is still among the better ones in the region.

During the past decade it has become increasingly clear that the external debt situation is a severe obstacle to growth and development in Africa. In Chapter 5, 'Reducing the Debt Burden of Sub-Saharan Africa', the African debt crisis is discussed by Joakim Stymne. Africa's long-term debt has risen by almost twenty times during the last two decades and is now equal to the region's gross national product. This makes Africa the most heavily-indebted region in the world, with debt service obligations of almost half of its export revenues.

Stymne concentrates on one basic assumption of debt renegotiations in the context of Sub-Saharan Africa, namely, that a debt renegotiation is expected to make normalization possible between a debtor country and its creditors. Normalization means that debtors do not repeatedly find it necessary to take recourse to 'exceptional financing', of which the most important categories are the use of rescheduling and the accumulation of payments arrears. Normalization is desirable, because exceptional financing, for a variety of reasons, is very costly for the debtor. For example, a country which requests rescheduling may be seen as riskier than a country which avoids it, which increases the costs of using normal sources of finance.

Theory tells us that sovereign debtors only make debt payments if it is in their interest to do so, that is, if the costs of default do not exceed the costs of making the resources available for debt service. It is difficult to quantify the costs of default directly. Stymne, therefore, looks at the revealed behaviour of the countries of Sub-Saharan Africa. This indicates that when the scheduled debt service ratio exceeds about 25 per cent, the costs of using exceptional finance are perceived as lower than the costs of maintaining a normal relationship with the creditors. Such a debt service ratio corresponded to a debt ratio of more than double the actual one of Sub-Saharan Africa in 1989. This suggests that it will be very difficult for these countries to normalize the relationships barring

substantial debt relief.

Finally, Stymne employs a simple simulation model to get an idea of the magnitude of economic adjustment (on the debtor side) and debt relief (from the creditors) that would be necessary to reduce the debt burden sufficiently to normalize relationships. His simulation suggests that a rapid recovery of exports (an annual export growth of 7 per cent) is required to improve the ability of the debtors to get their economies in shape. Moreover, the payment situation of the debtors will not be normalized in a foreseeable future, unless debt relief is forthcoming which is significantly in excess of what is now being provided. A cancellation of about 50 billion US dollars of claims is necessary.

THE EXTERNAL SECTOR

The second part of this book is devoted to the external sector. There seems to be a general agreement today about the positive contribution of trade to economic growth and development (Little, Scitovsky and Scott 1970; Bhagwati 1978; Krueger 1978, 1983). The gradual demise of import-substitution development strategies, based on tariffs and other protective instruments, and the growing appeal of export-oriented strategies, are clear indications of this consensus. A wind of liberalization has swept across Africa during the 1980s, and today fewer countries strive for self-reliant industrialization and development behind high tariff barriers.

One interesting example of such a trade liberalization is Zimbabwe, discussed by Dick Durevall in Chapter 6, 'Trade Liberalization: The Zim-babwean Way'. At independence in 1980 the prospects for Zimbabwe looked quite good, but the high expectations were never met. Income per capita grew by only 1 per cent annually during the 1980s. Although this was respectable in comparison with most other Sub-Saharan countries, it was much lower than Zimbabwe's earlier growth performance, indicating that the economy had not recovered altogether from the deep recession of the last half of the 1970s.

According to Durevall, the most likely explanation for the stagnation of the Zimbabwean economy is that the import substitution policy has run its course. The share of manufacturing in GDP is close to 30 per cent, which means that most importables that can be substituted are already produced in the country.

In order to increase economic growth, the Zimbabwean government adopted a structural adjustment programme at the end of 1990. The programme consists of the five parts:

1. Macroeconomic stabilization (for example, by reducing the budget deficit, devaluing the currency and raising real interest rates).
2. Public sector reforms (privatization, rationalization, cost based or market pricing, and so on).
3. Trade liberalization.
4. Deregulation, which covers a number of markets.

5 A social programme (for example, the health and educational sectors will expand, and those who become unemployed as a result of the adjustment process will be compensated).

Durevall is optimistic about Zimbabwe's future and argues that the probability that the reform will become a success is higher than in most other African countries. Trade liberalization has been discussed in Zimbabwe for several years and many important groups are in favour of it – especially the organizations of the manufacturing industry. The country has a strong private sector, a large manufacturing industry, a well-developed capital market, a broad export base, a well-functioning infrastructure and a fairly well-educated labour force. Nevertheless, things could go wrong. Since the process of opening up the trade account is controlled, there is intensive lobbying from private companies that want to delay the reform. If the government starts to give in, credibility in the reform could be lost. This risk would be enhanced if Zimbabwe does not manage to raise the capital needed.

Another threat to the programme, according to Durevall, is the rate of inflation. This already amounts to 25 per cent, which is 10 percentage points more than forecasted. Rapidly rising prices will create public discontent which could persuade the government to abandon the programme or change the power structure within the government towards those who are against the reform.

Being a poor country, landlocked inside South Africa, creates special problems. In Chapter 7, 'Structural Adjustment and Economic Manage-ment in a Dependent Economy: The Case of Lesotho', Lennart Petersson deals with the difficulties of implementing a structural adjustment programme to reduce financial imbalances and to promote growth in the small, open and undiversified economy of Lesotho. Petersson points to the limited capacity of the government to shape and implement reform programmes, but also to the fact that the country faces severe constraints in pursuing economic policy, due to its close economic and institutional links with South Africa. Thus, monetary and fiscal policy are constrained by the country's membership of the Southern African Customs Union and the Common Monetary Area. The integration of factor and commodity markets reduces the ability to establish independent wage and interest rates, and to implement indirect taxes on traded goods which differ from those of South Africa. As a result, the liberalization of markets has largely meant an increased adaptation to the South African market.

The importance of structural measures has been emphasized in Lesotho's adjustment programme, but the success of those depends on the achievement of macroeconomic balance. Such a balance also seems to have been reached. Between 1988/89 and 1990/91, public savings increased substantially and the balance-of-payments position improved. However, Petersson shows that the main factors behind these improvements have been increasing customs union revenues and foreign aid, although restrained current expenditure and a tight monetary policy contributed as well. The impact of the introduced revenue-raising measures on government revenues that aim at reducing the external dependence by increased local (non-customs) revenue, has been almost insignificant, due to the small domestic tax base of the economy.

A large number of critical structural problems have been identified in Lesotho and

several measures to solve them have been introduced. For example, the tax structure and the expenditure policies have been improved, institutional changes of the land tenure system have taken place, and the Civil Service has been rationalized. However, the implementation of structural policy measures has been slow. It appears to be a long-run undertaking, due to political constraints, lack of popular support and insufficient administrative capacity.

In conclusion, the heavy external dependence remains in Lesotho, and Petersson suggests that the key factors to improvements are the development of domestic financial markets and the improvement of financial intermediations to agriculture and indigenous Basotho industry.

The last two chapters of this part of the book deal with two contrastingly different experiences of external shocks: Zambia and Botswana. Despite the fact that both countries have had large export revenues over the years, the evolution of their economies has followed very different paths. The sad case, Zambia, is discussed by Per-Åke Andersson and Steve Kayizzi-Mugerwa in Chapter 8, 'External Shocks and the Search for Diversification in Zambia'. At independence in 1964 Zambia had a world-class copper industry and the highest per capita income in Africa after South Africa and Nigeria. Today's reality is very different.

Since independence Zambia has gone through three different economic regimes. The first one was operative during the 1960s, which were relatively prosperous years. Thanks to favourable copper prices and high mineral production, the country registered impressive growth rates. With huge mineral incomes, the government also attempted to diversify the economy. It adopted an import-substituting policy and emphasized self-reliance. The mining companies were nationalized together with a number of other foreign firms.

In the 1970s, however, several economic shocks hit Zambia and put an end to the ambitious agenda. The weaknesses of the economy were then exposed: overdependence on mining, neglect of the rural sector and a capital-intensive, import-dependent manufacturing sector. The economic policy of the 1970s sought to maintain the *status quo*. Economic decline, however, continued into the 1980s (even in the African context, Zambia's economic decline has been rather extreme), and it was realized that tough measures had to be introduced in order to bring about long-term structural change. This third period witnessed increased conflicts with regard to the economic and political agenda. Groups that hitherto had benefited from the 'control regime', resisted the liberalization efforts, while businessmen outside these groups supported the changes. When trying to satisfy the contending views, the government failed to formulate a sustainable long-term strategy.

Thus, Zambia has learnt the lesson that a large supply of foreign exchange may lead to a number of negative effects, such as an appreciation of the Domestic currency, decline in exports of traditional products and increasing inflation and unemployment. These symptoms are generally referred to as 'Dutch disease', after the effects on the Dutch economy of the natural gas discoveries in The Netherlands in the 1960s. Andersson and Kayizzi-Mugerwa suggest that the disease that arose from the bonanza of Zambia's copper production, to a large extent, was a result of the government's use of windfall gains from copper to subsidize import-substituting manufacturing.

In their conclusion, Andersson and Kayizzi-Mugerwa discuss Zambia's structural adjustment efforts and claim that the mix of IMF/World Bank and 'own' policies has had few positive results so far. Zambia is currently struggling with a huge debt burden and high inflation, as well as with popular demands for multiparty democracy.

A very different experience of external shocks is discussed by Helene Norberg and Magnus Blomström in Chapter 9, 'Dutch Disease and Management of Windfall Gains in Botswana'. In Botswana, the discovery of diamonds in the early 1970s gave rise to a tremendous boom in export revenues, but the government seems to have managed to avoid the typical 'Dutch disease' effects and adjustment problems. In fact, Botswana, which was one of the poorest countries in the world when it became independent in 1966, with virtually no industry, has had one of the highest growth rates in the world during the past twenty-five years.

Norberg and Blomström suggest that the combination of various structural characteristics of the economy, and a competent government policy, to a large extent explains why Botswana's export boom never resulted in adverse effects on the rest of the economy. The two most important structural features that have limited the negative effects are that the booming sector has demanded relatively little labour, since it is extremely capital-intensive, and that labour mobility from the traditional to the modern sector has been limited because of huge differences in skill levels between the sectors.

Government policy has also reduced the negative effects of the boom. Since the diamond industry is state owned, the government controls the revenues. In Botswana these revenues have been used to promote national income, rather than to subsidize certain sectors (such as import-substituting manufacturing) or to support various interest groups. A large proportion of the diamond revenues have been invested in foreign banks and firms. By sterilizing revenues abroad and executing a non-expansive monetary policy at home, the inflationary pressure has diminished and the negative effects of the diamond boom have been reduced. Moreover, since most consumer goods are imported, the spread effects from spending have been reduced. Thus, the effects on prices, factor movements and output, which in the Dutch disease model lead to de-industrialization, have been limited in Botswana.

Although Botswana has avoided many of the pitfalls of windfall gains, Norberg and Blomström still find several features that limit future growth possibilities of the economy. For instance, the lack of good soil and water, skilled workers and industrial tradition, will reduce the potential for spreading the benefits of diamond production to other sectors of the economy. It will also limit the possibilities for the majority of the population to increase its income and welfare. Thus, Botswana is vulnerable to a disease of its own, where the main symptoms are an unequal distribution of income and an undiversified economy.

THE MICRO LEVEL

The third section of the book brings out a micro perspective on the African crisis and

adjustment. Such a perspective is important for several reasons. The micro level is where people feel the impact of policies. It is through the micro level incentives that the adjustment process has its main impact. An aggregate approach may serve to hide very different responses between sectors, and sectors may even ‘clash’ in the sense that their interests diverge widely (compare Mamalakis 1969, 1971; Lipton 1977). Many of the policies that were directly or indirectly responsible for the economic crisis in Africa neglected this. Planning often worked from a macro perspective, where too little attention was paid to the individual sectors of the economy, notably to agriculture, and the administrative measures were directed to supersede the normal incentive mechanism: the one working via the system of prices and markets on the individual agents.

In Chapter 10, ‘Urban Bustle/Rural Slumber: Dilemmas of Uneven Economic Recovery in Uganda’, Steve Kayizzi-Mugerwa examines the experience of Uganda, as manifested not only on the macro, but also on the household level. During the 1960s a dirigiste policy was pursued in Uganda. Although the government took the lead, emphasizing employment and investment creation, the economy remained a mixed one, where the rural sector, especially, retained its autonomy. These years were relatively prosperous. For example, between 1960 and 1970, growth of real GDP averaged 5.6 per cent per annum.

At the beginning of the 1970s, however, the incipient prosperity terminated. In 1971 Idi Amin came to power. During his rule, which ended in 1979, GDP fell most years, as did (very abruptly) investment. This was a result of several factors. Some were external: the oil shock of 1973–4, the ensuing international recession, and the wide fluctuations in the country’s terms of trade. At the same time, the public sector was expanded, while its quality, particularly in health and education, deteriorated. Military expenditure was up, and this, in combination with corruption, economic mismanagement and internal strife, contributed to the creation of an acute crisis by the end of the 1970s. Inflation was high, the balance of payments was under considerable stress and regular trade had been substituted for by smuggling. The modern sector was on the verge of a total collapse and the peasant sector, by and large, had opted out of the monetary economy.

After the fall of Amin, adjustment, both of the short-run and the structural kind, was urgently called for, and Uganda embarked on various recovery policies along the IMF/World Bank lines. On the macro level, the results of these packages have been mixed. On the positive side, the rate of inflation has dropped sharply, bank savings have increased and the economy is growing again. However, the government budget remains in deficit, and the prices received by the Ugandan coffee producers continue to be below world prices.

Kayizzi-Mugerwa also employs data from a 1990 socioeconomic survey in Kampala and rural Masaka, to find out how urban and rural households have responded to the economic decline and the recovery efforts. In both cases a diversification of income has been necessary. In Kampala, wage income alone has been insufficient when it comes to eking out a living. Activities such as petty trading and retailing, informal sector production, and even farming in the cities, have been necessary to supplement wages. Also rural areas have experienced a diversification of income, but to a lesser extent, since the wage component is much smaller there. In rural areas, subsistence farming still dominates the picture by far.

On the whole, urban areas appear to have fared far better than rural ones. (Kayizzi-Mugerwa even speaks of an urban 'bustle' in Kampala.) There seems to have been a net flow of cash and food remittances from country to town. Moreover, social services like education and health care continue to be concentrated in the cities, rural districts being constrained in this respect by their lack of cash.

The second micro-level study deals with Guinea-Bissau. In Chapter 11, 'Guinea-Bissau: Impact of the Structural Adjustment Programme on the Welfare of Smallholder Farmers', Magnus Alvesson and Mario Zejan examine the effects of the 1986 structural adjustment programme in Guinea-Bissau on the welfare and production incentives of a group of smallholder farmers in the southern part of the country.

When Guinea-Bissau gained its independence from Portugal in 1974, an economic policy was inaugurated which focused on import substitution in manufacturing, in combination with price controls. On the macroeconomic level, the resulting imbalances forced a recovery programme, beginning in 1983. This programme failed, however, due to lack of budgetary discipline in combination with unfavourable external developments. Inflation soon began to rise and foreign currency increasingly had to be obtained in the parallel market. Persistent lack of consumer goods had adverse effects on the welfare of the rural population and on farmer's incentives to produce. As a result, a structural adjustment programme had to be launched in 1986, with assistance from the World Bank. The basic aim of this programme was to turn relative prices in favour of traded goods, via a devaluation of the currency, price liberalization, budgetary discipline and a restrictive economic policy in general.

The core of Chapter 11 is devoted to an examination of how the Balanta tribe of southern Guinea-Bissau fared between 1986 and 1989. These farmers are by far the largest producers of rice – the most important staple – in the country, accounting for virtually all the domestic rice marketed. Alvesson and Zejan calculate the Balanta tribe's terms of trade with the rest of the economy and show that this measure was almost the same in 1989 as in 1986. The availability of consumer goods, on the other hand, had increased considerably during this period, and so had (although to a lesser extent) the availability of farm inputs. Thus, with constant relative prices, the Balanta tribe's welfare ought to have increased.

In their conclusion, Alvesson and Zejan claim that equilibrium prices have not yet been established in Guinea-Bissau, neither in consumer goods, nor in input markets, but when that happens, one can expect price measures and other policies affecting the profitability of agriculture to be more efficient in increasing the supply of rice.

Chapter 12, 'Afro-Marxism and its Disastrous Effects on the Economy: The Congolese Case', written by social anthropologist Kajsa Ekholm Friedman, paints a gloomy picture of the effects of central state control over the Congolese economy during the past two decades. At the root of the trouble is the implementation of a Marxist-Leninist ideology on a superficial level, by a state which essentially builds on the traditional Central African hierarchy. Ekholm Friedman argues that the Congolese are worse off in economic terms today than two decades ago because of state action.

By the time of independence from France in 1960, a number of light industries had been set up in the Congo and prospects for modernization appeared good. However, this process was interrupted by a wave of nationalizations around 1970, when the country had

adopted Marxism-Leninism as the official ideology, and the economy began to be modelled on the Soviet pattern. Moreover, the oil exports, which began in 1972, did not result in any trickle-down effects, because most of their fruits were reaped by the politicians and not by the citizens.

Congolese society is characterized by a separation of the state from the people. The ruling group forms an ‘enclave’ and the masses are essentially left to fend for themselves. The state is based on the military, who have ruled since 1968, and on the Marxist-Leninist ideology, but also on the traditional African hierarchy, with the president’s clan on top. The traditional structure is manipulated by a ruling group, employing the state essentially for its own, personal, purposes. In this setting, the economy has worked far from well.

Ekholm Friedman qualifies all state enterprises, such as the state farms, as failures. They have mainly served as vehicles for siphoning off money for the politicians, who have managed to strangle the entrepreneurial class that began to establish itself during the 1960s. The peasant sector, in turn, is facing a severe problem: that of disposing of its products. Those who can afford to pay prefer elaborated imported foodstuffs. The Congolese peasant cannot compete with foods imported from Zaïre and Cabinda. Moreover, when selling export products and crops that are meant for industrial processing, he must face an inefficient parastatal purchase and marketing organization. The only ‘assistance’ rendered to him by the state is via the network of co-operatives that also serves as a means of enrichment for the dominant class.

This situation has resulted in migration to urban districts at a rate which is very high in the African context – perhaps even the highest. In the cities, however, few salaried jobs are to be found, which in turn has put a heavy pressure on middle-aged males to support a large number of dependents. The situation was brought to an outright crisis when the government, in 1990, decided to lower the retirement age in an effort to cut public spending. Pressures arose for a multiparty system and part of the political structure began to turn against the president’s clan.

ECONOMIC REFORMS AND SYSTEM REFORMS

The policy measures that will be employed to steer an economy are ultimately determined by the economic system that prevails. Certain policies are simply not compatible with certain systems, and if these policies are to be implemented, the economic system must be reformed as well. Perhaps the best example of this is when a highly centralized system has to be decentralized before it is possible to go ahead with a market-oriented incentive policy.

As should be clear from the preceding, the economic systems in many African countries have been badly distorted. Either they have not generated the expected responses, or the responses have been too weak to achieve the intended goals. For

example, it is virtually impossible to do without markets where individuals can exchange goods, services and factors. When governments substitute these markets, parallel ones are certain to spring up – out of sheer necessity.

After a while, however, governments usually feel that the situation is getting out of hand – that the parallel economy is threatening the official one. Even stronger administrative measures are then employed to bring the situation under control. The state bureaucracy grows, the premia accruing to those who are able to beat the system increase vastly, and the already low efficiency of the economy declines even further. Sooner or later, however, the crisis becomes acute. The economic incentives generates a clash with the administrative measures undertaken by the bureaucracy. The whole system is due for change and repair.[1]

The first reform experience discussed in the present book is that of Angola. In Chapter 13, 'Angola on the Verge of Economic Reforms', Renato Aguilar and Mario Zejan examine whether the policy reform package that was launched in 1990 will be sufficient to put the country's badly distorted economy on the road to stabilization and growth. Economic reforms have been discussed for a long time in Angola, but little action has been taken.

The Angolan policy reform was a product of the dismal performance of the economy after independence in 1975, when a centrally planned socialist economy was introduced. Nationalizations, price and exchange rate controls and a state monopoly on foreign trade were important policy measures for the new government, but this strategy was not very successful. Real GDP per capita fell, food production per person went down, and so did industrial production. The only exception was the oil industry.

In their chapter, Aguilar and Zejan emphasize that the price system has been badly distorted in Angola. Price controls have favoured consumption and discouraged production. Rationing, shortages, parallel markets and barter transactions have carried the day. The price of foreign exchange has been set ridiculously low, creating an enormous premium in the black market and constraining non-oil exports. Wage controls have provided a strong disincentive to work. The fiscal deficit has reached some 15 to 20 per cent of GDP and has been financed by monetary expansion, which in turn has fuelled inflation in the parallel markets.

In 1990 the Angolan economy was completely out of joint. The confidence in money was severely undermined and the economy was increasingly demonetized. A devaluation was badly called for to make non-oil exports possible again. The internal price and wage structure needed to be corrected to provide the right signals to producers and consumers. The fiscal deficit had to be cut and the monetary supply needed control to bring inflation down and to restore the confidence in money.

A policy package that contained most of the above measures was presented in September 1990 but, according to Aguilar and Zejan, its implementation turned out to be a combination of half-hearted measures (including an announcement of a devaluation that was later postponed) and very drastic ones (like a forced 95 per cent reduction of liquidity). Rather than attempting to merge the official and parallel markets by correcting the price structure, the policy appears to have aimed at destroying the parallel market system. However, as long as the relative prices of traded and non-traded goods are not adjusted through a devaluation, the drastic reduction of private liquidity will simply serve

to reduce the overall price level in the parallel markets. In the meantime, this threatens the standard of living of a large number of people who lack access to the official markets and, hence, depend completely on the informal economy for their living. These are the people paying for the anti-market ideology in Angola, where the case for deep-going reform remains.

Policy reforms are closely intertwined with institutional reforms and may not be efficient unless they are undertaken simultaneously. This issue, in the context of Tanzania, is dealt with by Gun Eriksson and Mats Lundahl in Chapter 14, ‘Economic Recovery under Institutional Constraints: Tanzania Facing the Economic Crisis’.

After several years of extremely poor economic performance, caused by a mixture of external and internal factors, Tanzania embarked on an economic reform programme during the first half of the 1980s. By and large this programme failed, however, and it was not until the so-called Economic Recovery Programme (ERP) was launched in 1986 that more efficient steps were taken towards stabilization, structural adjustment and recovery. That programme envisaged price incentives for agriculture and a more efficient allocation of currency within the manufacturing sector. Restrictive fiscal and monetary policies were to be pursued, the currency was to be devalued and the economy was to become increasingly outward-oriented.

The ERP, which lasted until 1989, gave mixed results. The macroeconomic stabilization targets were never met. Despite that, important steps were taken in the right direction, and as a result GDP grew fast enough to allow for increasing per capita income. It is also likely that the poor never had to bear a disproportionately large share of the adjustment costs. Although the social infrastructure was left out of the ERP, income distribution was presumably improved as a result of the measures benefiting agriculture.

One of the most important features of Tanzania’s Economic Recovery Programme has been that of institutional reforms. Foreign trade has been liberalized and price controls removed. These measures have undoubtedly contributed to the strengthening of the private sector, but still a lot remains to be done, according to Eriksson and Lundahl. In their chapter they suggest several changes that are necessary in the near future in Tanzania. The size and the mode of operation of the grossly inefficient public sector has to be changed, better incentives must be introduced in the economy, the soft budget constraint of the parastatals has to be hardened and decentralization of decisions is necessary. Also, the financial system must be changed to serve not only the public, but also the private sector.

The ERP has now been replaced by the Economic and Social Adjustment Programme (ESAP), which attempts to combine market orientation with social considerations. However, it also emphasizes reforming the public sector, an extremely controversial matter in Tanzania today, because this sector extends privileges to a political class. Eriksson and Lundahl, therefore, conclude that it may be impossible to reform the public sector in Tanzania without first introducing political reforms.

After seventeen years of military rule, Marxism-Leninism and civil war, Ethiopia is the African country which most desperately needs reforms today. The prospects for such reforms are examined by Göte Hansson in Chapter 15, ‘Ethiopia: Away from Socialism’. The current Ethiopian economic system is characterized by extreme inflexibility as a result of the creation of a virtual command economy in the past. The state owns all the

essential productive assets. The market mechanism has been more or less destroyed, with the exception of parallel and illegal activities. There are no real incentives to production. International trade has been centralized and the currency is highly overvalued. As a result of all this, the performance of the Ethiopian economy has been dismal: falling per capita income, declining agricultural production and food availability per capita, exports at very low levels, depleted foreign exchange reserves, and trade and budget deficits.

In his essay, Hansson asks what will happen to Ethiopia in the post-Mengistu era. A Transitional Economic Policy programme was introduced in 1991, where several important system changes were envisaged. A mixed economy is to be created, reducing the importance of the state considerably. In agriculture, a mixture of peasant farms and modern large-scale operations is foreseen. Industry and services are to be left mainly in private hands and the remaining state enterprises are supposed to be run according to profitability criteria and market considerations. The domestic marketing system is expected to be increasingly privatized.

It is still far from clear how foreign trade will be influenced by the new policy. It has been stated that trade is to be left mainly to private initiatives, but the introduction of surrender requirements for foreign currency will curtail exports. Also, the transitional government appears reluctant to devalue the currency, since this will put strain on manufacturing enterprises using imported inputs. The government budget constitutes another problem. Although a balance is needed, the war damages call for expenditures and the soldiers have to be readapted to a civilian life. Therefore, the government hopes that foreign assistance will cover the deficit.

With a few exceptions, the Transitional Economic Policy thus resembles the standard structural adjustment package. Whether this package will succeed or not depends, according to Hansson, on what will happen in the political scene. While undertaking important structural changes in the economy, Ethiopia is also making a risky transition to a democratic government. In this context Hansson identifies three types of risk. First, the implementation of the economic transition programme may hurt certain politically active groups and lead to countervailing actions. The second risk is related to the ethnic and regional conflicts inherited from the former government. What will happen, for example, when Eritrea has broken loose? Will other regions claim similar demands? Finally, there is a risk of losing foreign support (financial assistance), conditional on the protection of human rights and the implementation of the economic reform package.

The African country facing the most difficult transition and reform process today is presumably South Africa, where both political and economic issues are at stake. This is discussed in the final chapter, Chapter 16, 'Macroeconomic Stagnation and Structural Weaknesses in the South African Economy', by Mats Lundahl and Lena Moritz. The South African economy went into a crisis in the 1980s, but to a large extent, for other reasons than elsewhere in the continent.

For almost a century the South African economy had been displaying one of the highest growth rates in the world. In the 1970s, however, the air began to go out of the South African growth balloon. External factors, like oil price increases and changing attitudes abroad towards apartheid, had an impact, but even more important were the domestic limitations to further expansion that had been built into the system for many decades. As manufacturing became the leading sector, an increasing number of skilled

workers were demanded, but the apartheid system systematically precluded the advancement of Africans, with the result that a skill bottleneck formed. Capital formation slowed down in the wake of the liberation of the Portuguese colonies and the Soweto riots. The manufacturing sector, which was producing inefficiently behind high tariff walls, was beginning to feel the saturation of the domestic market.

Since then the South African economy has performed poorly. GDP per capita fell during the latter half of the 1980s, capital formation was low and personal savings were close to zero. Gold-mining was squeezed between rising costs and low prices and other minerals faced demand problems as well. In addition, South Africa has had to cope with a foreign debt problem, which became acute in 1985 when foreign creditors decided to call in their loans. This forced a renegotiation of loans and a balance-of-payments surplus to allow for interest and amortization payments.

As majority rule is approaching, South Africa has to start thinking in terms of a post-apartheid economy. The most explosive problem in this context is the mass unemployment of Africans, unofficially estimated to 30–40 per cent, with the trend pointing upwards. This is clearly a long-run problem requiring not only the abolition of apartheid, but also a fast-growing economy.

Whether these conditions will materialize or not is discussed by Lundahl and Moritz. For the time being, they claim, South African economic policy is concentrating on short-run issues like combating inflation through tight monetary and fiscal policies, in combination with a defence of the currency. Thus, an inherent contradiction exists between the short and the long run in South Africa. What the future will look like depends to a large extent on what kind of government will rule the country in the post-apartheid situation.

The African National Congress (ANC) will undoubtedly have a major influence in tomorrow's South Africa. However, the ANC's economic strategy is still not clear. If the ANC does not begin to nationalize important parts of the economy and if no dead-end exercises in central planning are attempted, the dismantling of apartheid will, according to Lundahl and Moritz, presumably increase the efficiency of the economy. In this process, a redistribution of income will also take place – from whites to Africans – reducing the huge income gap between the races.

Most countries dealt with in this book have embarked on far-reaching structural adjustment programmes, but it is still too early to say whether they will succeed or not. Historical experiences, however, do not allow us to be very optimistic. As Anne Krueger has pointed out, countries that have undertaken structural reforms are typically beset by economic problems again, two or three years later (Krueger, forthcoming: Chapter 7). This may be due to technocratic mistakes or to unfavourable external circumstances, but it may also be a result of certain weaknesses in the reform process itself. For instance, the government may not be totally committed to the reforms. Implemented in an acute situation, once the situation seems to be improving, the reforms receive less attention. Another typical case is when a coalition government fails to design a politically-tenable reform package, which may threaten one or more of the coalition partners and, hence, the very existence of the government. In both cases, the reforms are unlikely to be perceived as credible by the citizens, thus delaying and weakening their response and possibly undermining the reform itself. To reduce the risk of this, it is essential that the underlying

economic system is reformed to establish long-run economic incentives.

NOTE

1 See Krueger (forthcoming): Chapter 7, for an analysis of this type of situation.

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Part I
CRISIS AND CRISIS MANAGEMENT

2
TRADE COMPRESSION AND ECONOMIC DECLINE IN SUB-SAHARAN AFRICA[1]

Peter Svedberg

INTRODUCTION

For more than a century, from the 1870s to the 1970s, African exports grew rapidly and their share of developing country exports increased. In the 1970s export growth in Sub-Saharan Africa (SSA) petered out; during the 1980s there was a huge decline. Export earnings in current dollars fell from US $50 billion in 1980 to about $36 billion at the beginning of the 1990s. The whole of Sub-Saharan Africa, forty-five countries with almost 500 million inhabitants, now has export revenues less than half of those of Hong Kong, a nation of 6 million people (IMF(a) 1991).

There are two main schools of thought when it comes to explain the decline. One stresses factors that are ‘external’ to the individual African country: deteriorating barter terms of trade for primary commodities being the main issue. The other line of thought emphasizes ‘internal’ factors, that is, overvalued exchange rates and high taxes on exports. There are also diverging opinions on how the line of causation runs, that is, whether export failure caused economic stagnation or vice versa. What is indisputable, however, is that the decrease of real export earnings went hand in hand with an overall decline in economic activity in most SSA countries during the 1980s. The annual per capita rate of growth of the real domestic product for the region as a whole declined from 2 per cent in the 1950s and 1960s to less than 1 per cent in the 1970s. During the 1980s, there was an annual decline of 2.3 per cent in the region (UNCTAD 1990(a): Table 6.2).[2]

The objective of this essay is threefold. The first is to assess the export performance of the SSA countries in the post-war era and the second is to analyse the causes of the export decline. The third is to investigate the possible links between the export decline, the consequential reduction of imports and the general decline in production and investment in the African economies.

AFRICA IN WORLD TRADE

In 1950 Sub-Saharan Africa had little more than 3 per cent of world exports (Table 2.1); this share declined somewhat over the next twenty years. However, between 1950 and 1970, Africa increased its share of all developing countries’ exports. During the 1970s the decline in the SSA share of world trade ceased, mainly as a result of the two consecutive real oil price increases; however, the share of all less-developed country

(LDC) exports fell. During the 1980s, after the collapse of the second oil boom of 1979–81, the SSA share of both world and LDC exports declined dramatically. By the beginning of the 1990s, the share of world exports was down to 1 per cent and that of LDC exports to 5 per cent. The sluggish export performance of African countries as a group since the early 1970s and, especially, in the 1980s, can thus not be seen as a 'typical' developing-country phenomenon. Moreover, the collapse of the oil boom was not the sole factor underlying the overall decline.

Table 2.1 Value of exports from world, less developed countries, and Sub-Saharan Africa, 1950–90

Region	*1950*	*1960*	*1970*	*1980*	*1990*
			Billions of current dollars		
(1) World	60.7	129.1	315.1	2,002.0	3,415.3
(2) LDCs	18.9	28.3	57.9	573.3	738.0
(3) SSA	2.0	3.8	8.0	49.4	36.8
			Share of LDCs – (%):		
(4) World exports	31.1	21.9	18.4	28.6	21.6
			Share of SSA – (%):		
(5) World exports	3.3	2.9	2.5	2.5	1.1
(6) LDC exports	10.6	13.4	13.8	8.6	5.0

Source: UNCTAD(a) 1979, 1989 and 1991, Table 1.1.

The African share of non-oil exports

In non-oil products, the SSA held its position in the world markets up to the mid-1970s. Subsequently, the share fell sharply; in 1988 it was down to 0.8 per cent, a decline by almost two-thirds since 1970 (Table 2.2). To some extent, this reflects the sluggish growth of world non-oil primary commodity markets; the share of such commodities in world exports fell from 26 per cent in 1970 to 16 per cent in 1988 (UNCTAD(a) 1990: Table 3.2.A). The declining SSA share also reflects a failure to boost alternative exports, that is, manufactures. However, the most noticeable phenomenon is that the African countries as a group failed to maintain their shares in the stagnating primary commodity world markets. Between 1970 and 1988 this share fell from 7.0 to 3.7 per cent (Table 2.2).

Over the 1970–85 period, the African countries lost their combined share in eight of the top ten primary commodity markets. Their share increased only in fishery products and tobacco. In the six most important markets, coffee,a Standard International Trade Classification (SITC) 0, 1, 2-(233, 244, 266, 267), 4, 68 and item 522.56.

Table 2.2 The share of Sub-Saharan Africa in world exports of major product categories (per cent)

Product category	*Share of product category in world exports*		*Sub-Saharan Africa's share of world exports*		*Share of product category in SSA exports*	
	1970	*1988*	*1970*	*1988*	*1970*	*1988*
Crude oil (SITC 331)	5.3	6.0	6.5	6.9	14.0	34.5
Non-oil products (SITC 0-9 less 331)	94.7	94.0	2.2	0.8	86.0	65.5
Primary commodities[a] (non-oil)	25.9	16.3	7.0	3.7	73.8	50.4
Agricultural commodities	7.0	2.8	6.3	3.6	12.3	8.2
Minerals & ores	7.5	3.8	9.7	4.2	30.0	14.6
18 IPC commodities[b]	9.1	4.3	16.1	10.0	59.1	35.6

Sources: Derived on the basis of data from UNCTAD(b) 1984, 1986, 1988 and 1989: various tables; UNCTAD(a) 1980: Tables 1.1 and 1.2.

Notes:

b What UNCTAD labels the Integrated Programme Commodities (IPC) (which supposedly are of greatest importance to developing countries): bananas, cocoa, coffee, cotton and cotton yarn, hard fibres and products, jute and jute manufactures, bovine meat, rubber, sugar, tea, tropical timber, vegetable oils and oilseeds, bauxite, copper, iron ore, manganese, phosphates and tin.

cocoa beans, refined copper, cotton, timber and sugar, the decline was in the 22 to 38 per cent range. In the market for iron ore, the decline was almost 50 per cent; and in the once large market for vegetable oils, an astonishing 84 per cent. It is also notable that the African countries at large have performed worse in the markets for semi-processed versions of the various commodities than for unprocessed ones (Svedberg 1988: Table 4; Svedberg 1991: Table 2). An update of the figures in these publications shows the shares to have declined further in the 1986–9 period.

Growth of real export earnings

The declining shares in the commodity markets reflect a dismal export performance in absolute terms, as measured by the exponential growth rate of real export earnings, which is another way of saying the change in the income terms of trade, or the import purchasing power of exports. Three-quarters of the thirty-three SSA countries for which there are data, had either no statistically-significant trend or an ascertained decline in real export earnings over the 1971–87 period (Table 2.3). Only nine of the countries had positive

Table 2.3 Exponential growth of real export earnings of individual African countries. 1954–70 and 1971–87

Country	*1954–70 Export growth rate*	*Barter terms of trade*[2]	*Country*	*1971–87 Export growth rate*	*Barter terms of trade*[2]
Mauritania	30.6	–	Congo	13.6	+
Rwanda	15.2	0	Mauritius	6.6	–
Burkina Faso	11.1	+	Gabon	6.0	+
Congo	10.9	+	Niger	5.9	–
Gabon	10.9	–	Rwanda	5.4	0
Liberia	9.9	–	Mali	5.0	–
Côte d'Ivoire	7.6	–			
Zambia	7.5	+			
Angola	7.4	–	Central Af. Rep.	3.4	0
Malawi	6.4	–	Burkina Faso	2.0	–
Sierra Leone	6.4	0	Malawi	0.9	–
Mozambique	6.3	–			
Togo	6.2	–			
Kenya	5.7	–	Angola	..[1]	+
Nigeria	5.6	–	Benin	..	–
Cameroon	5.5	–	Chad	..	0
Niger	5.4	0	Gambia	..	0
Somalia	5.2	0	Côte d'Ivoire	..	0
			Mauritania	..	–
Gambia	4.7	0	Nigeria	..	+
Central Af. Rep.	4.6	–	Réunion	..	–
Tanzania	4.0	–	Senegal	..	0
Ethiopia	3.6	–	Somalia	..	–
Uganda	3.6	–	Togo	..	0
Sudan	3.2	0			
Chad	2.2	–	Cameroon	–2.0	+
Senegal	2.1	–	Ethiopia	–2.7	–
Malagasy	1.5	–	Kenya	–3.9	0
Réunion	1.1	0	Ghana	–4.9	–
			Sudan	–5.1	–
			Liberia	–5.7	–
			Uganda	–5.7	0
			Malagasy	–5.9	–
Benin	..[1]	0	Zaïre	–7.0	–
Ghana	..	–	Sierra Leone	–7.4	–

Mali	..	0	Tanzania	–8.4	–
Mauritius	..	0	Zambia	–10.2	–
Zaïre	..	0	Mozambique	–14.0	–

Source: Svedberg 1988, App. Table 5 (updated), based on UNCTAD(a): various issues.
Notes:
1 A .. means no statistically significant real export earnings growth rate.
2 A + means a statistically significant improvement in the barter terms of trade; a – means a statistically significant deterioration in the barter terms of trade; a 0 means no statistically significant change in the barter terms of trade.

statistically-significant exponential annual growth of real export earnings over this period.

The export performance in absolute terms of most SSA countries over the 1971–87 period is also bleak when compared to earlier performance.[3] Over the years 1954–70, twenty-eight out of the thirty-three countries saw statistically-significant positive growth in real export earnings. For eighteen of these countries, the annual growth rate was above 5 per cent, something only six countries achieved over the later period. In the earlier period five countries had no trend in real export earnings, but not a single country saw them drop significantly.

TRADE POLICY AND EXPORT PERFORMANCE AFTER 1970

The analysis in the previous section showed that most African countries had an unfavourable export performance over the two recent decades in the three dimensions examined, namely, (a) relative to other countries, (b) in absolute terms and (c) compared to own performance in earlier periods. A first step, to be pursued in this section, in the long chain of analysis needed to understand the reasons for this and, thus, to get a grasp on what can be done to reverse the downward trends, is to estimate the extent to which factors that are unambiguously external to the African policy-makers, both on the demand and the supply side, are responsible for the failures.

Demand failures

Considering the relatively small shares accounted for by the individual African countries in the world markets for the products they export, it is justifiable to treat the barter terms of trade as an exogenous factor. The protection that African exporters face in the importing countries is also an external factor on the demand side, outside Africa. Delineating external and internal influences on the supply of exports is more difficult, as we shall see, both conceptually and empirically.

The barter terms of trade

Over both the 1954–70 and 1971–87 periods, half the countries (although partly different

ones) saw their barter terms of trade deteriorate significantly (Table 2.3). Eight countries, Ethiopia, Ghana, Liberia, Malagasy, Malawi, Mauritania, Mozambique and Tanzania, recorded significant declines in the barter terms of trade over both periods. Half a dozen (but different) countries experienced improved terms of trade in both periods. During the early period, it was mostly some copper- and oil-exporting countries; during the latter period it was the oil exporters only. It thus seems fair to conclude that the external impact in the form of world market price changes was unfavourable over the entire post-war period. Moreover, during the more recent period, the decline was larger for those countries that had a significant decline than in the earlier period (3.4 per cent per annum on the average as against 2.0 per cent). However, the difference between the decline in real export earnings during the 1971–87 period in many African countries, and the rapid export growth they experienced during the 1954–70 period is only marginally explained by different barter terms of trade developments (see below).

Protection in importing countries

A further possible adverse demand-side effect may have come from protection in the importing countries. A recent investigation of trade barriers against Sub-Saharan African exports concluded, however, that this is not the case (Erzan and Svedberg 1991). In the mid-1980s the SSA had a relatively better deal compared to other developing countries in terms of both tariff and non-tariff barriers (NTBs) in all the major markets: the European Community (EC), Japan and the United States. This was in part due to preferential treatment, especially in the EC, and in part a consequence of the concentration of African exports to primary products. Fuels, ores and metals face negligible duties and often only nominal NTBs. Also, most tropical products are relatively less protected. There is thus no compelling evidence suggesting that protection in the major markets has been a significant constraint on Africa’s growth of export.

Export volume determinants

The delineation of external and internal influences on export supply is empirically quite complicated. The export supply functions found in the literature usually include the overall production capacity of the economy (gross domestic product – GDP) and real export producer prices as the two independent variables. The net domestic real producer prices, in turn, are determined by world market prices, the real exchange rate and net taxes levied on the export sector. World market prices are external in the small country case, while the nominal exchange rate and net taxes are internal variables. The extent to which the real exchange rate is an internal policy variable is highly debated.

Impact of world market price on export supply

In countries where there is no interference in trade by governments through taxes, subsidies and disequilibrium exchange rates, relative producer prices correspond to world market prices. There would then be no difference between changes in domestic and international relative prices. High dimen-sion trade theory does not predict a positive

relationship between changes in price and quantities exported on a commodity-by-commodity basis in such a situation, but a 'correspondence' across commodities. In general, higher (lower) prices for a country's exports should lead to increased (decreased) export supply (Woodland 1982).

It is thus notable that there is no positive correlation between barter terms of trade developments and export volume expansion during the 1971–87 period across the thirty-three SSA countries (Svedberg 1988). This is an indication that domestic export producer prices have not moved in line with world market prices, suggesting that domestic prices may have been manipulated through the exchange rate, export taxes and/or government monopsonistic price setting.

Real exchange rate management

Data on nominal exchange rates and domestic price movements suggest that the African countries did not experience significant changes in their real exchange rates during the 1950s and the first half of the 1960s, when export volumes grew rapidly. During the later years of the 1960s, however, inflation picked up in Ghana, Somalia, Sudan, Tanzania, Uganda, Zaïre and Zambia. The increase in the rate of inflation was not matched by a lowering of the nominal exchange rate. On the contrary, some countries raised their nominal exchange rate when they choose not to follow the depreciation of the sterling (in 1967) and the French franc (in 1969). The real effective exchange rates thus started to appreciate notably in several countries. By 1973, the estimated real exchange rate index (1965 = 100) stood in the range 121 to 166 in Malawi, Sudan, Tanzania, Uganda and Zambia (Gulhati *et al.* 1985: Table 3). Inflation continued to run higher in many African countries than in the main trading partner countries in the 1970s. By 1982, the real exchange rate index (RERI) stood above 200 in about a dozen African countries. In a few countries, such as Ghana, Uganda and Sierra Leone, the nominal official exchange rate had ceased to have any meaning.

There is the expected correlation between overvalued exchange rates and export volume change during the past two decades across the African countries, but it is relatively weak. All the countries that stood out in terms of severely-overvalued exchange rates in the 1970–85 period (for example, Ghana, Sierra Leone, Tanzania and Uganda) had a statistically-ascertained decline in export volumes during the 1971–87 period (Table 2.3). It is also notable that all the eight countries that increased their volume of exports of non-oil/mineral products had little or no overvaluation of the exchange rate during this period. However, the correlation across all the African countries is far from perfect. A number of countries (for example, Ethiopia, Kenya, Cameroon and many within the Communanté Financière d'Afrique (CFA) countries) saw their recorded export volumes drop significantly despite no serious exchange rate overvaluation. That the correlation between real exchange rate appreciation and export volume change is relatively weak is not so surprising considering that export volumes are also influenced by such things as weather, sudden discoveries of natural resources and other price variables that have not been controlled.

Taxation of tradable versus non-tradable goods

Estimates from the International Monetary Fund (IMF) suggest that about one-third of total central government revenues around 1980 came from taxes on international trade and transactions in most African countries. However, the average masks very large variations across countries. The share is close to or above 50 per cent in Benin, Burkina Faso, The Gambia, Ghana, Guinea, Mauritius, Rwanda, Sierra Leone and Swaziland. It is below 15 per cent in Jibuti and Zimbabwe. However, most of the trade taxes are on imports; export duties account for less than 10 per cent of total government revenues in most SSA countries (UNDP/IBRD 1989: Table 4–16). On the average the shares are substantially higher mainly in the countries whose main export product is coffee and/or cocoa (Burundi, Ghana, Rwanda and Uganda), but there were large year-to-year fluctuations. Regrettably, as indicators of the relative tax burden on tradable versus non-tradable, these percentages are rather crude measures for three main reasons.

Openness

The first is that officially-recorded exports and imports correspond to varying shares of estimated total economic activity in the various African countries. Recorded exports as a ratio of GDP ranged from 4 to over 68 per cent across African countries in the mid-1980s. The share of government revenue from trade taxes normalized for the share of exports in GDP, defined as the Relative Trade Tax Index (RTTI), is a better indicator of the relative tax burden on the tradable goods sectors. Using this indicator, the relative tax burden on tradable varies from a low of 0.3 to above 10; there is thus an extreme variance across countries.

Tax rates

A second reason why the share of government revenue that comes from direct trade taxes is a crude indicator of the tax burden on the trade sector is that a low share can either reflect very low or very high (prohibitive) tax rates on exports and imports. One thus needs to consult data on export and import tax rates, as well as quantitative import barriers, to distinguish between these two possibilities. For instance, in the case of Zimbabwe, where the trade tax share is very low, this is mainly because many quantitative restrictions are used. In Jibuti, on the other hand, where the share is equally low, this is mainly a reflection of the free trade policy pursued by this small country.

Indirect trade taxes

The share of government income that comes from direct trade taxes is an incomplete indicator of the extent to which tradable goods are taxed in comparison with non-tradable because there are several other taxes that can be used to discriminate between the two types of goods. There is, for instance, a clear difference between how governments tax exports in countries where agricultural and oil/mineral products dominate exports,

respectively. In the former countries, direct border taxes are common. The reason is usually that it is more difficult and costly to tax individual small-holder producers directly. In the countries which rely on oil and mineral exports, profit taxes on the often few and large exporting companies dominate as a source of government revenue. In these cases, profit taxes are administratively less troublesome and costly.

Indirect taxation of agricultural exports through government marketing boards is also common in most African countries. In his assessment of African Marketing Boards, Bates found that in most cases, the farmers 'obtained less than two-thirds of the potential sales realization, and in many cases they received less than one-half' (Bates 1981:19, and Appendix B). This conclusion was based on several dozen studies from eight African countries for the 1940s to mid-1970 period. The same picture was revealed in the more recent investigations by Arhin *et al.* (1985).

In conclusion, without detailed time-series estimation of export supply functions for individual African countries, which is beyond the scope of the present paper, one cannot answer the question of the precise role of external and internal factors in explaining the export-volume growth/decline that has been observed at the individual country level. What we can say is that the external factor of prime interest, the barter terms of trade, has been unfavourable for the great majority of the countries in the region. Moreover, several countries have had a severely overvalued real exchange rate for many years in the 1971–87 period, an internal factor, and these countries' real export earnings have all declined.

It is notable, though, that many SSA countries with no or little over-valuation have also seen their export earnings fall. The impact of the second internal factor, the relative tax burden on exports, has not been possible to assess at the aggregate level of this paper. The direct taxation of export commodities is not very significant in all but a few coffee/cocoa producer countries. The indirect taxation of exports, through profit taxes in the oil-and mineral-exporting countries, and through state marketing boards and other arrangements in the agricultural raw material exporters, is much too intricate and country-specific to allow quantification without detailed country study.

CONSEQUENCES OF EXPORT EARNINGS STAGNATION

It is difficult, both conceptually and empirically, to distinguish between causes and consequences of poor export performance. It is by no means established that the problems in each and every African country started with discriminatory policies against the trade sectors. A comparatively high taxation of exports in Africa, mainly through indirect means (for example, marketing boards) has a tradition that goes back to the colonial days (Austin 1991). What is relatively new is the discrimination of the trade sectors through overvalued real exchange rates. In many cases it seems that the initial negative shock came from abroad in the form of a terms of trade deterioration (for example, the oil shocks in 1973 and 1979) and the unfortunate trade and exchange rate policies were applied as inferior substitutes for first-best fiscal and monetary interventions to restore macroeconomic balance.

Expected consequences and stylized facts

The unfortunate trade and exchange rate policies pursued by the majority of the African countries, whatever the initial reason, can be expected to influence overall production and growth in three main ways. The first is through the atemporal allocation of resources. The second is the impact on the growth of factor supplies and their productivity. The third is the effect on the degree of utilization of the productive resources.

Protection and resource allocation

Within the conventional static trade model, the only first-best reason for a country to impose a trade tax is if it is large enough to change the terms of trade in the international market to its own advantage and there is no retaliation. Very few of the African countries are sufficiently large in any single market to have this power.

In the conventional model, protection in small countries leads to a relative decline in the size of the traded sectors, allocation losses and decreasing real incomes. When it comes to the size of the traded goods sectors, the evidence is broadly consistent with the theory. In countries such as Ghana, Sierra Leone, Tanzania, and Uganda, with very high exchange rate over-valuation, exports as a ratio to total economic activity (GDP) was in the 0.17 to 0.30 range in the late 1960s; in the mid-1980s, the ratios had dropped to between 0.05 and 0.11 (see Helleiner 1989: Table 5, for more evidence from other countries).

All simulations of allocation losses from protection have yielded relatively small numbers, a once and for all decline in real income by a few per cent. If a decline in real incomes of this magnitude were the entire cost of the misguided trade and exchange rate policies during the past two decades in most of Africa, one would not have a very strong case for drastic policy change. However, what has actually happened is a stagnation of overall economic activity over the 1970s and an accumulated absolute decline of real per capita income in the 20–25 per cent range during the 1980s, which brought real incomes back to the 1960 level. The economic decline in the SSA as a whole over the past two decades is thus much larger than postulated by simple calculations of static allocation losses of protection. This suggests that if misguided trade policies are to blame for the drastic reduction in real incomes, the main link must be through the (non)expansion of productive resources, or their utilization, rather than atemporal allocation losses.

Trade policies and growth of productive resources

Although rigorous theory and modelling are still lacking, it is widely argued that a liberal trade regime has a favourable impact on the growth of factor endowments, their productivity and, thus, the rate of growth of the economy. The impact on the augmentation of productive resources (capital) is usually hypothesized to come through increased domestic savings. There is some (nowadays rather dated) evidence that the marginal savings ratio in the export sector is higher than in the non-export sectors in developing countries (Lee 1971). Higher savings are postulated to lead to higher

investments and – *ceteris paribus* – higher growth.

The favourable impact on growth through productivity increases is theorized to work through three main channels. The first is that (free) trade leads to specialization in economic activities that are characterized by economies of scale which cannot be exploited in small domestic markets, that is, to lower unit costs. The second is that trade reduces monopoly positions for firms in the domestic market which supposedly enhance competition and economic efficiency. The third is that involvement by domestic firms in international markets means a quicker and more inexpensive transfer of technology which increases productivity.

The rather eclectic, but highly suggestive, fragments of theory focused on 'dynamic' gains from trade, emphasizing economies of scale, product differentiation and improved human skills from international competition have so far withstood all attempts at rigorous testing. The estimated gains from trade in this context are usually simple 'calibrations' of different growth paths in response to changes in the underlying assumptions in the model. It has yet to be shown convincingly through what exact channels trade affects growth and that it actually works in practice.

Whatever the causality, the export decline in the African countries has gone hand in hand with declines in domestic savings and in gross investment. Gross domestic investment as a share of GDP went down from 20 to 15 per cent, and gross domestic savings from 22 to 13 per cent for the SSA as a whole between 1980 and 1989 (IBRD 1989: End Table 4, and IBRD(a) 1991: End Table 9). One would expect a decline in investments by one-quarter to lead to a proportional reduction in a positive growth rate, but not to a decline in real incomes, as has actually been the case in most of the SSA countries over the 1980s. Moreover, there is no correlation whatsoever between changes in either savings or investments, on the one hand, and export earnings growth on a cross-country basis during the 1980s. This suggests that if there is a strong link between trade performance and overall economic activity in these countries, it is likely to be mainly through other channels.

Trade and the utilization of productive resources

In 1980 Sub-Saharan Africa's total export earnings were US $50 billion: in 1990, they were down to US $36 billion, a decline in nominal value by 26 per cent. Over the 1980s the wholesale price index of industrial countries, which is a commonly-used index for the general price increase of the goods that the African countries import, went up by at least 40 per cent. In 1980 US dollars, Africa's export earnings in 1990 were only $26, half of that ten years earlier. Considering a compounded population increase by about 35 per cent over the 1980s (based on the 1970–86 average growth rate of 3.1 per cent), the per capita import purchasing power of exports thus declined by about two-thirds over these ten years.[4] Of course, it should be acknowledged that there is not a one-to-one correspondence between export earnings and import capacity. Other sources are used to finance imports, and not all export earnings are used to purchase import goods (see below).

On the average, three-quarters of Africa's recorded imports are made up of manufactured goods, about 15 per cent of food, and the rest of agricultural raw materials,

metals and ores, and fuels (IBRD(a) 1991: End Table 15). The import structure of most individual countries is relatively similar to that average, although there are some notable exceptions. Of course, the share of fuels varies depending on whether the country has its own oil resources or not, and also with the level of industrialization.

Most of the manufactured imports belong to Standard International Trade Classification (SITC) categories 5 and 7, that is, chemicals, machinery and transport equipment. Other manufactured imports (SITC 6 and 8 minus 67 and 68) comprise both consumption and production goods. Consequently, food, fuels, agricultural raw materials, ores and metals, and manufacturing goods SITC 5 and 7 make up the bulk of almost all African countries' imports. These are all goods that are used in production processes. It is thus unusual that consumption goods account for more than 20 per cent of total imports; typically the figure is far below that.

Consequences of export earnings decline

With imports totally dominated by goods that are used in domestic production, a drop in per capita real export earnings by as much as two-thirds over a ten-year period cannot pass unnoticed for the rest of the economy. The decline in export earnings has left the African countries with three main options. The first is to rely on foreign non-concessional borrowing and aid to finance imports when exports fail to generate the necessary foreign exchange. The second is to replace imports with domestic substitutes. The third is to do without some of the earlier imports of food, fuels, raw materials, chemicals, other intermediate products, machinery and transport equipment.

Alternative finance of imports

Like many countries in Latin America, African countries resorted to external borrowing to finance imports when export earnings faltered. Over the 1970–88 period, the African countries accumulated a debt of US $135 billion (Greene 1989). This sum is about equal to four years of imports in the early 1990s. For the SSA as a whole, accumulated debt, expressed as a ratio to GDP, increased from 0.15 in 1970 to 0.78 in 1988. The ratio of accumulated debt to exports of goods and services increased from 0.68 to 3.67 (Greene 1989: Table 2). In the 1970s, when the accumulated debt was still small or modest for most African countries, foreign loans helped to keep up imports. During the 1980s, when interest on and repayments of earlier loans became significant, the import capacity was reduced accordingly. For SSA as a whole, the ratio of debt service payments to exports of goods and services increased from 8 per cent in 1970 to 14 per cent in 1980; in 1988, it had climbed to 31 per cent (Greene 1989). However, 'debt service' reflects actual payments only, not scheduled obligations. Being relatively poor, small in absolute terms and owing debts mainly to governments (about 50 per cent) and international multilateral organizations (another 30 per cent), the African countries have not been forced to pay more than about half of their obligations in recent years. Their scheduled debt service obligations have been estimated at 50 per cent of export earnings in recent years (Greene 1989:841).

During the difficult years of the 1980s, Sub-Saharan Africa's share of total official

development assistance (ODA) from the Organization for Economic Co-operation and Development/Development Assistance Committee (OECD/DAC) countries, the principal source of foreign concessional assistance to developing countries, increased from one-quarter to one-third (OECD/DAC 1990: Table 14). The high and increased share of ODA going to African countries, together with considerable debt service relief, has meant that the aggregate net financial transfers to Sub-Saharan Africa have remained positive and relatively high, while they have become negative in all other major regions except South Asia (OECD/DAC 1990: Table 15).[5]

In conclusion, an inflow of foreign aid and other financial resources helped to pay for imports in the wake of faltering export earnings in the 1970s. However, increased debt service has reduced the import capacity during the 1980s, and on a net basis, imports are now slightly lower than export earnings.

Import substitution

The exact degree to which the drastic decline in imports has been offset by increases in the domestic production of import substitutes cannot be assessed accurately owing to the lack of sufficiently detailed data. However, the small initial manufacturing industrial base (11 per cent of gross domestic product) and the negative per capita growth in the manufacturing industries (–2.9 per cent annually 1980–8 according to IBRD(a) 1990: End Table 2) suggest that very little import substitution has actually taken place in most SSA countries (see also note 2).

In a great majority of the SSA countries, including such populous countries as Nigeria, Sudan and Zaïre, the manufacturing sector was less than 10 per cent of GDP at the beginning of the 1980s. Only in five countries, Malagasy, Rwanda, Senegal, Zambia and Zimbabwe, was the manufacturing sector above 15 per cent of GDP. Moreover, around 1980 most of the manufacturing industry in the various African countries produced consumer goods for the domestic market, mostly processed food, textiles and clothing (IBRD(a) 1982: End Tables 3 and 6). Machinery, transport equipment and chemicals accounted for only a few per cent of manufacturing output almost everywhere. Only in Kenya, Nigeria and Zimbabwe was the share of producer goods above 20 per cent (ibid). The capacity for import substitution of industrial intermediate goods, machinery and transport equipment was thus exceedingly small in almost all the countries.

Second, although the statistics are not very reliable, it seems that there has been very little, if any, growth of production in import-substituting manufacturing industries over the 1980s. IBRD estimates suggest that there has been notable per capita growth rates, above 2 per cent per annum in manufacturing production in seven African countries over the 1980–9 period: Burundi, Benin, Lesotho, Congo, Côte d'Ivoire, Cameroon and Mauritius. In the first four countries, with 2 per cent of the African population, the growth was from a very low base (4–7 per cent of GDP). Moreover, Congo, Mauritius and Lesotho were among the rare African countries with rapidly increasing export earnings, signifying that import compression was not a major problem.

All this suggests that there may have been import substitution of manufactured producer goods in the wake of stagnating or declining export earnings and ensuing import compression in two of the SSA countries: Côte d'Ivoire and Cameroon. Côte d'Ivoire had

no statistically-significant change in recorded real export earnings over the 1971–87 period and Cameroon had a significant, although modest, decline (Table 2). The latter country, especially, poses a challenge to further investigation, since, based on World Bank and United Nations Conference on Trade and Development (UNCTAD) estimates, Cameroon had very rapid growth, not only of manufactures, but also in total GDP, for the 1971–87 period. A per capita GDP growth rate of 3–4 per cent per annum over this period during which there was a statistically significant decline in real export earnings seems to contradict the import compression thesis, unless there has been significant import substitution and foreign borrowing.

The IBRD estimates do not suggest any change in the relative size of the manufacturing sector (13 per cent of GDP) in Cameroon. Moreover, processing of food and agriculture products, textiles and clothing continued to account for two-thirds of total manufacturing output between 1970 and 1986 (IBRD(a) 1989: End Table 6), the latest year for which IBRD gives data on the composition of the manufactured output. Neither is there any evidence that Cameroon has been able to run a significant current account deficit, that is, to pay for imports in excess of export earnings through increased financial inflows (UNCTAD(a) 1990: Table 5.1.A). The explanation to the Cameroon puzzle may be that recorded exports grossly understate true exports. Trade partner data on imports from Cameroon for 1982–3 are about 40 per cent higher (one of the highest figures for Africa) than officially recorded exports (Yeats 1990: Table 3). There are also indications of large quantities of trade with neighbouring countries that have escaped recording altogether (Club du Sahel 1988).

Import compression

In the absence of any evidence of (1) imports financed through foreign aid and other financial resources net of debt service and (2) of increased import substitution in producer good sectors, the 'availability' of such goods in the African countries must have decreased more or less in proportion with declining export earnings. This simply must have resulted in a lowering of the capacity utilization and reduced investments. In the rest of this section, the empirical support of the import compression hypothesis and the various links between export earnings and the overall economic performance will be scrutinized.

Import compression and import composition

The data on import structure for developing Africa as a whole provided by the IBRD(a) (1982: End Table 11, and 1991: End Table 15) suggest that the share of manufactures in imports increased between 1980 and 1989 in fifteen of the seventeen SSA countries for which data are presented. However, the import 'structure' as estimated by the IBRD is measured by the share of various import categories in value terms. This may mask relatively large changes in the import structure in volume terms. Between 1980 and 1989 the price of most primary products and fuels declined significantly relative to the price of manufactured goods. FAO estimates (FAO(a) 1989: Tables 133–150) suggest that food (cereals) imports in terms of absolute quantities have been maintained relatively

unaltered in most countries up to 1989 and this is also the picture revealed by the UNCTAD data. In volume terms, imports of crude petroleum to the net-importing SSA countries declined from 12 to 10 million tons between 1980 and 1989 (UNCTAD(b) 1988: Table 3.11.5; UNCTAD(b) 1991: Table 3.11.3). This tentatively suggests that the import compression in quantitative terms has fallen mainly on the manufactured goods that make up the bulk of total imports throughout Africa.

Import compression and capacity utilization

No rigorous quantitative study on the capacity utilization in various sectors of the African economies during the 1980s has been undertaken. To measure utilization is inherently difficult even under the best of circumstances; in the SSA, the unreliability and lack of the most basic data add to the problem. All we have is an OECD report that provides a myriad of 'anecdotes' of scarcities and severely underutilized capacity in almost every sector of ten countries in Eastern and Western Africa (Berthèlemy and Morrisson 1989: Chapter 1). How representative these accounts are is difficult to say. They are at least consistent with the a priori hypothesis that a decline by two-thirds in per capita imports over a ten-year period, when imports comprise predominantly producer and investment goods, simply does not permit a high level of capacity utilization in the economy.

Import compression and growth

In recent years, half a dozen studies have examined the role of exports in affecting growth in the African countries. The typical approach is to set up a GDP production function with labour, capital and exports as the (exogenously determined) factors of production. Exports have been taken as a proxy for imports. The tests show a positive, almost invariably significant, correlation between growth of exports and growth of total income (Ram 1987; Khan and Knight 1988; Rosen and Shapouri 1989; Fosu 1990; Gyimah-Brempong 1991).[6]

There are a few caveats to the results that merit comment. First, the models tested are relatively simple and do not allow us to untangle the different ways in which exports may affect overall growth, that is, through the allocation of existing resources, factor growth and productivity, or utilization of production capacity. There is one econometric model which is specified in a way that permits broad separation of the different influences (Esfahani 1991), but it has not yet been tested on data from African countries. Second, most of the evidence from Africa is for the pre-1982 period; the most pronounced import compression has taken place since then. Third, all the evidence is based on cross-country observations, with all the well-known shortcomings of that approach, including that of establishing causality.

CONCLUDING REMARKS

Very few African countries had sustained growth of real export earnings over the 1971–87 period. This is to some extent explained by stagnating or deteriorating primary

commodity prices, but in most cases a failure to expand export volume is the most important factor. It would be an over-simplification to claim that the poor export performance and the present economic crisis in Africa are the consequences of misdirected trade policies only. It would be equally simplistic to ignore this aspect. Some African countries have pursued foreign exchange rate policies that meant incredible overvaluation in real terms. All these countries have seen their export volume decline significantly, as one would expect. A severely overvalued real exchange rate is simply not consistent with export volume growth in economies where private agents make production decisions on the basis of expected economic returns. In addition, many governments have taxed export producers also indirectly through parastatals and state marketing boards.

However, whatever the exact reason for the poor performance,[7] the consequences of stagnating or declining real export earnings are apt to be similar in most African countries. The great majority of countries do not engage in domestic production of items like fertilizers, oil, intermediate and capital goods. Such goods made up the great bulk of total imports in almost all African countries in the 1980s, as before.

Projections for the first half of the 1990s suggest that scheduled debt service will continue to increase in the African countries and there are no signs of an upward trend in the inflow of new financial resources. Moreover, the manufacturing industry base in most countries is still far too small to allow significant import substitution in the early 1990s. In this perspective, export earnings growth is the only means of obtaining the foreign exchange needed to import intermediate and production goods. In the short term, export growth in many countries can only be achieved through the rehabilitation of existing (mainly primary product) export sectors. In the somewhat longer term, diversification in terms of products and markets are critical.

To some extent there is already a move towards more outward-oriented trade policies. Almost all African countries that had significantly overvalued exchange rates earlier, have devalued considerably during the latter part of the 1980s. The real exchange rate remained lower two or three years after the devaluations, signifying that domestic price increases have been contained reasonably well. The World Bank (IBRD 1989: Figure 1.10) estimates suggest that the average real exchange rate index (1973 = 100) for a group of thirty Sub-Saharan African countries had a peak of 200 in 1984: in 1988, it was down to 100 again. It is difficult to say, however, how the present rates relate to ‘fundamental equilibrium’, as most of the countries still maintain tight government control of most capital and current account transactions (see IMF(c) 1990). It is nevertheless noticeable that, in the past few years, no country in Africa had an overvalued exchange rate of the order of magnitude that prevailed in the late 1970s and first half of the 1980s.

The impact on export growth in volume terms of the devaluations in the countries with extreme previous overvaluation seems to have been small so far. Only in Ghana has export growth picked up in the late 1980s; in countries like Sierra Leone, Tanzania and Uganda, there is yet no sign of a sustained improvement. This suggests that it may take time for new price signals to result in increased production and that an equilibrium exchange rate (if yet achieved) is not a guarantee for rapid export volume expansion. It must be paired with other policies that stimulate export growth, such as reasonable

producer prices, the extension of credit, macroeconomic stability, and so on.[8] Many African countries probably have a long way to go before this is achieved.

NOTES

1 This paper reports on findings of the project 'The Export performance of Sub-Saharan Africa: Causes, Consequences and Policy Options', financed by the Swedish Agency for Research Co-operation with Developing Countries (SAREC).
2 This is also the figure reported by OECD/DAC (1990: Table 3) and IBRD(a) (1990: End Tables 2 and 26); however, in the 1991 World Development Report, the Bank has revised the figure to minus 1.1 per cent annually in the 1980–9 period (IBRD(a) 1991: End Tables 2 and 26), without any comment on the reason for this substantial revision. Also growth of manufacturing output was substantially revised.
3 It is also notable that there was no general deconcentration of exports in the SSA during the 1970–88 period; some countries' exports became less concentrated, others' more so. Neither is there a correlation between change in concentration and in real export earnings growth (see Svedberg 1988: Appendix Table 1 and Svedberg 1991).
4 A very large part of the decline is accounted for by a fall in Nigerian oil exports: from $23 billion in 1980 to $6 billion in 1989 in current US dollars; a decline of 80 per cent in real terms. Many other countries export proceeds also declined significantly (see Table 2.3), although less drastically, especially when calculated on a per capita basis. When describing the export performance of the SSA, the World Bank often present the change in export volume only. By this indicator, performance does not look good, but for many questions, not the least import capacity, the declining barter terms of trade should also be considered. Moreover, to assess performance in a continent without considering a population growth above 35 per cent per decade is often misleading.
5 Private export credits and private bank lending have never accounted for substantial additions to the inflow of foreign exchange to most of the African countries. The same applies to foreign direct investment; and the little there has been of finance from these sources had dried up almost completely in the 1980s (IMF(b) 1989: Table A41).
6 For reviews of the pre-1987 empirical literature on links between export performance and overall economic growth, see Lal and Rajapatirana (1987) and Svedberg(1990).
7 The exact reasons for the poor export performance, of course, vary from country to country and detailed analysis has to be undertaken before precise diagnosis of the individual country can be provided. This type of study will be part of the future work in the project from which the present paper reports.
8 Also see Faini *et al.* (1991).

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3
UNDERSTANDING STRUCTURAL ADJUSTMENT: TANZANIA IN COMPARATIVE PERSPECTIVE

Göran Hydén and *Bo Karlström**

INTRODUCTION

Now that the 1980s are over, it stands out as a decade of major economic adjustments in the world economy as well as in many individual economies. Not since the 1930s has the world economy undergone such dramatic changes. What is more, the adjustments of the 1980s affected not only capitalist but also socialist economies. Two main forces were driving the economic changes in the 1980s. First, the adjustment back to 'normality' after the two oil shocks in the 1970s and the exceptionally high inflation and interest rates which these shocks generated. Second, a shift in political and economic ideology away from state control and interventionism towards 'neo-liberal' ideas. In short, this *global* adjustment has meant major public policy shifts: from equity to growth; from state to market; and from 'self-sufficiency' to outward-looking development strategies.

Needless to say, these shifts have caused a great deal of political tension and, in many countries, major political realignments. Paradoxically, the latter have been most far reaching where, at the beginning of the decade, they were least expected: in the Soviet Union and Eastern Europe. In the liberal democracies of Western Europe and North America the process has been gradual but steady. Even in societies where the Keynesian macroeconomic legacy and the notion of the welfare state weighed heavily, adjustments in economic policies have taken place, although sometimes grudgingly. In Scandinavia, for example, it has either forced the Social Democrats – the guardians of Keynesianism – out of office, as in Denmark and Norway or, as in Sweden, prompted the ruling Social Democrats to adopt more market-oriented economic policies, thereby triggering off a crisis of legitimacy within the Swedish labour movement.

Structural adjustment has proved particularly painful and difficult for the countries in Sub-Saharan Africa and Latin America for three major reasons: first, the prevalence of 'statism', often rationalized through socialist arguments; second, the narrow 'limits of tolerance' in economies where large parts of the populations live in, or close, to absolute poverty; and third, the limited institutional and technical capacity to cope with the challenges of structural adjustment.

This paper uses the example of Tanzania to analyse the political and economic problems of structural adjustment for a poor Third World country. Tanzania has been chosen because it illustrates well the three problems just mentioned. It also illustrates the international aspects of structural adjustment – pressures from lenders for such

adjustments, as well as ideological resistance to it by ‘friends abroad’. The paper is divided into three parts: (a) a review of the emerging literature on structural adjustment in the Third World in general, and Africa in particular; (b) an account of the political and economic context of structural adjustment in Tanzania; and (c) a discussion of the lessons learnt, with implications for future research.

STRUCTURAL ADJUSTMENT: CONFLICTS AND AMBIGUITIES

Growth among industrial countries was exceptionally high and stable during the 1980s, even in comparison with the boom periods in the 1960s and early 1970s. It is in the light of this success in the western economies, and the continued stagnation in Eastern Europe and the Soviet Union, that the latter group of countries have engaged in a dramatic form of structural adjustment – ‘perestroika’ – on their own volition. These events have left the Third World countries with few options but to consider the same medicine. Yet, its application there has been much more controversial than in either the east or the west.

Two important actors on the economic scene in the Third World – in addition, of course, to national governments – have been the International Monetary Fund (IMF) and the World Bank. Both institutions figure prominently in the discussion of structural adjustment, and for good reasons: the lending conditions of the two institutions have influenced policies in a large number of countries, and through their research and publications they have in many ways set the agenda for the public discussion of economic reforms.

IMF policies have been of a short-term, stabilizing character, aimed at reducing inflation and restoring balance in a country’s external transactions. World Bank policies, on the other hand, have been aimed at longer-term, structural policy issues, intended to stimulate growth through a better use of a country’s resources (Feinberg and Kallab 1984; Corbo *et al.* 1987). To be sure, these distinctions have not always been maintained in practice, and over the past several years, the roles of the IMF and the World Bank have become increasingly blurred.

The Bank’s macroeconomic lending began in a systematic fashion around 1980. A ‘blueprint’ of what the World Bank expects of its clients is spelled out, as far as Africa is concerned, in the report entitled *Accelerated Development in Sub-Saharan Africa* (World Bank 1981). This document, sometimes referred to as the ‘Berg Report’ after its principal author, Elliot Berg, was edited in order to anticipate African reactions and expectations. For instance, on the opening page it says ‘the Report builds on the Lagos Plan of Action, the statement of development strategy adopted by the Heads of State at the meeting of the Organization of African Unity held in April 1980’ (World Bank 1981:1). Still, it caused great controversy in African political circles when it first appeared. The early official response asserted that the report was not only unnecessary but also antagonistic to the Lagos Plan of Action. Some independent observers have come to similar conclusions. Like the representatives of African governments, they have expressed doubts that the prescriptions in the World Bank’s report provide the necessary short-run policy foundation for achieving the medium- and long-term goals of the Lagos Plan of Action (Browne and Cummings 1984; Shaw 1986). However, reservations have also been

expressed over the Lagos Plan and its underlying philosophy. Ravenhill (1986), for instance, concludes that it is too vague in its reference to 'collective self-reliance'. It appears to display faith in a crude 'Third Worldism', for instance, the belief that international trade will be qualitatively different if conducted between developing – or African – countries, rather than on a North-South basis.

In the latter part of the 1980s, the divergence of opinion between the World Bank/IMF and African governments has shrunk. The latter have gradually come to accept the need for structural adjustment, although it may still be regarded as a necessary evil rather than a preferred strategy. The major reason for the African 'conversion' appears to be less intellectual than political. In the light of a continuing stagnation or decline in per capita incomes in the 1980s, the African countries have lost much of their bargaining strength. However, the ambivalent attitude to structural adjustment policies does linger on in some official circles, for example, in the UN Economic Commission for Africa – the principal official 'think tank' in Africa, responsible for the preparation of the Lagos Plan of Action and several subsequent documents dealing with the economic crisis in Africa.

The literature from, or inspired by, the World Bank/IMF in the past several years is less assertive and more searching than the more prescriptive documents of the early 1980s. This reflects to some extent the lack of success with structural adjustment in Africa up to the mid-1980s, but also a growing recognition that the task is much more complex and difficult than was originally thought (World Bank 1988). The conflicts over structural adjustment in the early 1980s have been replaced by the ambiguities of structural adjustment in the late 1980s.

At the official level this is perhaps best illustrated in the World Bank report on Africa entitled *From Crisis to Sustainable Growth: A Long-Term Per-spective Study* (World Bank 1989). The report begins by asking a number of searching questions. Its main recommendations, centred on the twin notions of 'enabling environment' and 'capacity building', are less technical, or 'economistic', than most previous official documents. Furthermore, the report has been 'cleared' with a group of senior African advisers, assisting the Bank in their private capacity. While structural adjustment in the early 1980s meant something very specific – exchange rate adjustments, changes in trade regimes, and so on – in the late 1980s it had come to incorporate almost anything relating to 'development'. The increasing complexity of the concept of structural adjustment has also inspired much research within the IMF and the Bank[1], as well as several conferences (Helleiner 1986; Corbo, Goldstein and Khan 1987). The elasticity of the concept of 'structural adjustment' is also evident in publications from other international organizations, for example, *Structural Adjustment with a Human Face*, issued by UNICEF (Cornea, Jolly and Stewart 1987).

The academic literature on structural adjustment in recent years has also become more multifaceted and concerned with increasingly broader dimensions of the process. There are at least three different directions in which this literature has moved. One is a further development of the economic theories of adjustment and structural reform and their applicability to Third World countries (Berg and Batchelder 1985; Fischer 1986; Edwards and Ahmed 1986; Gylfason 1987; Bleijer and Cheasty 1988). This category of research includes also new work on specific components of structural adjustment policies, such as price elasticities in international trade and thus the effectiveness of

devaluations (Goldstein and Kahn 1984), and agricultural pricing policies (Mellor and Ahmed 1988).

A second direction of research is toward a greater concern with the effects of structural adjustment on the weaker groups in society. Cornea *et al.* (1987) discusses this issue in some detail, and so does Berg (1988), Seragelding (1989), and World Bank (1990). A recent conference at the University of Florida examined the same set of issues as they affect women.[2] Much of the recent writing in this area tends to stress that there is less conflict between 'growth' and 'equity' than commonly believed and that these, in fact, can be blended so as to spread the benefits of growth more widely (World Hunger Program 1989; Bhagwati 1988; Lal and Myint 1993). A consensus is emerging, arguing that growth is a *necessary, although not sufficient prerequisite* for a reduction in absolute poverty.[3]

A third orientation has been spurred by a growing interest in the political aspects of structural adjustment – and of economic policy-making in general. Joan Nelson at the Overseas Development Council has played a major role in developing this literature. It stresses the need to link what Callaghy (1989) calls the *economic* logic – measures needed to strengthen fiscal policies, to curb inflation, and to raise economic efficiency and growth – with the *political* logic – actions to assure a reasonable degree of consensus and political stability. In short, structural adjustment is unlikely to be successful unless it makes both economic and political sense (Cohen *et al.* 1985; Haggard and Kaufman 1989; Nelson 1988, 1990; Herbst 1990; Gulhati 1986, 1990; Rodrik 1990; Whitehead 1990).

This review leaves us with the distinct impression that 'structural adjustment' has become an increasingly diffuse concept. Providing policy prescriptions is no longer as easy as it appeared in the early 1980s. But what are the implications of this growing ambiguity? Is it only a source of frustration, or is it possibly also a ground for optimism? With these questions in mind we now turn to an examination of the Tanzanian case.

TANZANIA: FROM SOCIAL ENGINEERING TO STRUCTURAL ADJUSTMENT

The political and ideological setting

There are few countries, at least in Africa, where the notion of development as a form of social engineering was more deeply entrenched in public policy circles than in Tanzania in the first two decades after independence. This confidence in what is sometimes referred to as the 'top-down' approach to development reflected in part the prevalent belief in positivism in the 1960s, in part the optimism that the victory of independence had generated. For the country's first president, Julius Nyerere, this belief was based largely on his exposure to Fabian socialism in Britain and, later, reinforced by his contacts with the centrally-planned economies of both China and the Soviet Union. His visions at the time of Tanzania's independence are contained in the Arusha Declaration which Tanganyika African National Union[4] – *de facto*, by voters' choice, the only party after the independence election – adopted as its policy blueprint in 1967. His various

speeches on the subject are contained in volumes published by Oxford University Press in the late 1960s (Nyerere 1966, 1968).

The overriding political objective of the Arusha Declaration was to create a nation in which equality among citizens was the hallmark. This strong belief in an egalitarian society and a 'new socialist personality' was to be realized through direct guidance from the top. A strong political party, built with highly-motivated leaders, was necessary to get the central bureaucracy to move in the desired direction. To prevent the accumulation of private wealth, privately-owned enterprises were either taken over by the state or strongly discouraged through laws and regulations. Party and government leaders, including employees in the rapidly-growing public enterprises, were prevented from having any second source of income. Everybody was expected to live on the official salary received, and that salary was not meant to permit any luxurious living. In 1973 the discrepancy between the highest and the lowest paid was only 1 to 9, making Tanzania's income distribution at that time one of the least skewed among developing countries.[5] The majority of the population, however, remained agricultural and largely outside the monetary economy. Here, the principal target in the government's economic policies was the entrepreneurial small farmer – derogatorily referred to as 'kulak'. Not only should rural income differentiation be discouraged. Farmers should also move together into villages and produce collectively or co-operatively. The evolution of these policies has been the subject of several books, of which Pratt (1976) is the most informed.

Behind the vision of an egalitarian society lay a very distinct anti-market philosophy. It went beyond the superficial anti-capitalism that was so common in the world in the late 1960s and early 1970s and which manifested itself in Tanzania, for example, in the form of daily news commentaries aimed at discrediting anything capitalist in Tanzania (or neighbouring Kenya). Without being a Marxist, Nyerere also held the view that prices have little or no role to play in allocating economic resources. For instance, he and his colleagues in key decision-making positions saw an intrinsic value in fixed nominal prices, including unchangeable nominal exchange rates and nominal interest rates. Changes in nominal prices were seen as a symptom of profit-making and thus of a capitalistic mentality. Allocative decisions were to be made on social and political grounds, using the rapidly-growing central bureaucracy as an instrument. The strong anti-market philosophy permeated official thinking in Tanzania from top to bottom of the official hierarchy in the 1960s and 1970s. As we shall demonstrate below, it has not disappeared to this day.

It is important to remember that these beliefs were shared with many other countries during this period. It met with support and sympathy in Communist countries, not least in Mao's China. In countries such as Canada, The Netherlands, and in Scandinavia, Nyerere's development strategy was viewed as enlightened, not only because it avoided copying capitalist strategies, but also because there was a genuine belief in those countries that state intervention in an egalitarian direction was ethically right and economically efficient. The 'social engineering' dimension and the poverty orientation of Nyerere's policies also met with support for a number of years from the World Bank, notably its then President, Robert McNamara. Throughout the 1970s Tanzania enjoyed wide support from the donor community. With his eloquence, Nyerere carefully nurtured this support in various international fora.

Growing economic problems and external shocks

As early as in the mid-1970s, Tanzania's economy was beginning to suffer from the ambitious and increasingly unrealistic development policies (see Table 3.1). Public sector revenue, even with high and rising foreign aid, did not keep pace with the growth of public expenditures. Exports began to decline, thus constraining the room for imports. Distribution of goods within the country, including vital inputs for agriculture, was stifled by bureaucratic red tape incurred through the massive nationalization of trade. Peasant farmers were unable to produce as well collectively as they had done individually. Agricultural production declined, particularly after the enforced villagization that was initiated in 1973 and carried out over the following three years. This distressing experience has been analysed from different vantage points by authors like von Freyhold (1979), Hydén (1980), Ellis (1982) and Lofchie (1989).

Table 3.1 Tanzania: selected economic indicators (average annual changes in per cent)

	1967–73	*1974–8*	*1979–81*	*1982–4*	*1985–7*
GDP per capita[1]	2.5	–0.9	–1.1	–2.9	0.7
Inflation (CPI)[1]	8.5	15.1	23.2	30.6	33.1
Exports[1]	3.6	–6.8	7.1	–16.7	6.0
Imports[1]	3.6	2.8	14.3	–8.4	13.8
Ratio of net exports to GDP [2,3]	–2.6	–9.6	–11.4	–7.1	–12.4
Ratio of debt to exports[2]	120.6	187.1	261.1	513.1	902.4

Source: Lele (1988), based on World Bank Database.

Notes:

1 Constant prices.

2 Average *level* for period.

3 Same as the deficit in the current account of the balance of payments.

The government was unaware of, or unwilling to recognize, these imbalances and problems at the time. Instead, it continued to promote an ambitious development programme including, after 1975, a foreign exchange intensive industrialization strategy. Two factors, in particular, may have contributed to conceal the underlying imbalances in the economy. The first was a sharp increase in coffee prices, the second a boom in foreign aid.[6]

Reflecting a severe frost in Brazil, the world's largest coffee producer, international coffee prices shot up in 1975. Tanzania's coffee prices more than doubled in 1975 and 1976. This unexpected windfall raised the value of exports, improved temporarily the balance of payments, and raised incomes. Tanzania's terms of trade improved by about one-third between 1975 and 1977. During these boom years real GDP grew at a rate close to 3 per cent per annum. In the absence of the stimulus triggered by the rise in coffee prices, the growth rate would have been close to zero (Bevan *et al.* 1990). Superimposed

on the coffee boom was another positive 'shock', namely, a sharp acceleration in the inflow of foreign aid. Tanzania had already in the first part of the 1970s been a major recipient of foreign assistance. Between 1974 and 1980, the nominal value of such assistance, counted per capita, increased nearly four-fold, from US $149 to US $547. In real (inflation-adjusted) terms, per capita aid more than doubled (Table 3.2), and during a few years around 1980, net official development assistance exceeded Tanzania's own export receipts.

Table 3.2 Aid to Tanzania

Year	*Per capita* net receipts *(constant, 1983 US$, prices)*
1973	18.1
1974	18.5
1975	30.2
1976	29.7
1977	33.2
1978	33.5
1979	42.0
1980	42.9
1981	44.7
1982	37.5
1983	29.1
1984	25.4
1985	21.0
1986	27.6
1987	33.5
1988	34.9
1989	30.9
1990	28.4

Sources: World Bank, *World Development Report*; IMF, *International Financial Statistics.*

A major explanation for this 'aid boom' was, no doubt, Nyerere's skill in articulating his poor country's predicament in international discussions. His success was enhanced by the fact that he generalized his own country's problems and spoke of the Third World as a whole. For instance, he had a major role in the establishment of the Brandt Commission, charged with the grand task of suggesting a new international economic order. Throughout the 1970s most donors continued their generous aid flows to Tanzania. This was true not only for those that found themselves ideologically close to Nyerere's position. Even the United States, during the Carter Administration, remained supportive of Nyerere's politics. Table 3.3 gives the distribution by main donors to Tanzania and, as a comparison, the corresponding set of data for Kenya.

This was the time – more specifically, in 1978 and 1979 – that the IMF and the World Bank began detailed discussions with the Tanzanian Government about the need to

modify the rigid domestic price system and exchange rate policy, the marketing policy in the agricultural sector and related issues. Against the background of the coffee boom, the generous aid flows and the fact that Tanzania had many friends in the international community, it is not surprising that the Tanzanian government showed little interest in these approaches by the Fund and the Bank – especially since the advice of those institutions was based on a belief in the price mechanism as an allocative device, which was alien to the Tanzanian development philosophy.

Table 3.3 Top six donors of official assistance to Tanzania and Kenya[1]

Tanzania		*Kenya*	
Sweden	14.8	United Kingdom	15.5
World Bank	9.6	United States	10.2
West Germany	9.4	World Bank	9.7
Netherlands	9.1	West Germany	9.2
Denmark	6.9	Netherlands	8.6
Norway	6.8	Sweden	6.9
Others	43.5	Others	39.9
TOTAL	100.0	TOTAL	100.0

Source: Lele 1988.
Note:
1 Distribution based on cumulative aid flows 1970–84.

Starting already in 1979, however, a series of *negative* external shocks unravelled the weaknesses of the Tanzanian economy. Coffee prices fell sharply just as the second oil shock occurred. The result was a dramatic decline in Tanzania's terms of trade, by 40 per cent between 1978 and 1982. The upsurge in international interest rates – and thus in Tanzania's external debt burden – added further to the strain. In addition, aid flows reached a peak around 1980 and fell sharply in real per capita terms from 1981 (Table 3.2). On top of all these external jolts, Tanzania was dragged into a war with Uganda which ended with Tanzanian troops marching on the Ugandan capital and overthrowing dictator Idi Amin.

Lack of policy response to the crisis

In spite of this dramatic reversal of economic fortunes, the government did not react by adjusting its economic policies. The only 'adjustment' for several years was a dramatic compression of imports through the licensing system which had disastrous effects on domestic production. From 1980 to 1985 the volume of imports, that is, imports calculated in constant prices, declined by more than half. Despite the imbalance in Tanzania's external accounts, government spending continued to rise rapidly. Since the widening fiscal deficit was financed primarily from the Central Bank, money supply shot up, and inflation continued to accelerate (Table 3.1). Bevan *et al.*, in discussing the coffee boom in the latter part of the 1970s, comment that

> the boom became a brief respite in a gathering macro-economic debacle of tragic proportions. The origin of this debacle was an overriding political commitment to an unsustainable public expenditure programme. The political decision process was unable to respond to evidence of failure.
>
> (Bevan *et al.* 1990:66)

The rapid inflation, together with the unwillingness of the authorities to adjust the nominal exchange rate, led to a rapid increase in the real effective exchange rate.[7] The black market exchange rate soared and reached a peak of 10:1 to the official rate in 1984–5 (Lofchie 1989:135). Interest rates were not adjusted for inflation, nor were agricultural producer prices. The result was continued and large negative real interest rates and sharp declines in most real producer prices.[8]

The economic effects of this policy was an implicit taxation of the agricultural sector and a subsidization of urban residents. The policies also led to an 'interest wedge' between farmers and those employed by the state. As Lofchie notes in his recent comparative review of Kenya and Tanzania: 'The divorce between those who held land and made their living by farming it, and those who controlled the Tanzanian state and formulated its agricultural policies, could not have been more complete' (Lofchie 1989:191).

Many missions were sent from Washington to communicate these messages to officials in the Tanzania government, including the President himself. Nyerere, however, looked at the matter quite differently. First of all, for the Fund and the Bank to set conditions for future financial support was seen as an infringement on Tanzania's national sovereignty. In response to the specific calls for a major devaluation of the Tanzanian currency, Nyerere argued that it would be political suicide; on several occasions he insisted that a major devaluation would lead to riots in the streets. In his obstinacy, Nyerere took advantage of the divided opinions among advisers and donors. Thus, the Tanzanian government called upon academic advisers who were ready to take a position contrary to that of the Fund, especially on the sensitive question of the exchange rate. Reginald Green from Sussex University played a very important role as adviser to the government and as defender of its policies (Green 1983). Together with Professor Ajit Singh (Singh 1983) from Cambridge, he argued sternly for not giving in to the Fund's pressures for devaluation.[9] Furthermore, several donor countries, for example, the Scandinavian countries, and some international agencies, particularly the International Labour Organization (ILO), took Tanzania's side against the Fund and the Bank in the early 1980s (Collier 1991). The so-called 'like-minded' donor countries also responded to Tanzania's requests for increased financial assistance.

For Nyerere, then, structural adjustment was entirely a question of politics and ideology, and it became increasingly a political game, with the Washington institutions as the main opponent. Much of it came to focus on the exchange rate issue, where the political prestige aspect was most obvious. Nyerere built his principal line of defence by mobilizing individuals, institutions and foreign governments ready to argue against the neo-classical – in some official speeches called 'capitalistic' – views of the Fund and the Bank. The battle lines were very clearly drawn, and because of the almost theo-logical

nature of the discourse there was little, if any, scope for compromise. Nor was there much scope for technical discussions between Fund/Bank officials and Tanzanian civil servants; the political and ideological overtones were too loud to allow civil servants in Dar es Salaam to engage in serious and factual discussions. Nyerere continued, as long as he remained head of state, to insist that Tanzania's economic woes were not of its own making but caused by an unfair international economic system. Its main actors, therefore had a moral responsibility to help Tanzania – as well as other countries in a similar predicament – out of its crisis, without first insisting on conditions that were viewed as politically impossible to fulfil.

As the agony over the appropriate policy reactions went on, the economic decline continued and worsened. Official statistics, based on national accounts, show an average annual decline in real GDP per capita of 0.5 per cent between 1965 and 1985. The national account statistics, however, do not capture the full extent of the contraction since producers withdrew from the market and increased their barter trade (Hydén 1980). Analysis based on a series of household surveys – where non-pecuniary transactions, barter trade, and so on, are taken into account – suggests a much worse scenario. The bottom line is almost incredible. Over the fifteen-year period to 1984, real income per household fell by roughly 50 per cent. The urban population suffered most, with an estimated decline in living standards of the order of 65 per cent (Bevan, Collier and Gunning 1988). It may well be unique in economic history that an already poor country, without suffering from prolonged drought, war or climatic deterioration, becomes twice as poor in the relatively short span of fifteen years. And this happened during the rule of an enlightened and gifted president who received exceptionally large amounts of foreign financial assistance throughout this period of economic collapse.

The political irony of the 'holding operation' by Nyerere is that those whom he claimed he wished to protect from a fall in living standards through devaluation – the urban population – became the prime victims of his policies. With little or nothing to buy in the stores and with horrendous prices in the parallel markets, they were worse off than the peasants who more easily could withdraw into subsistence production and local markets. Beginning in 1983, and following the ill-conceived campaign to lock up 'economic saboteurs' – literally anybody with above-average private capital – opposition to Nyerere emerged first in Zanzibar and later on the mainland. At this time, even the friendly donor governments were beginning to reconsider their positions. For instance, Sweden started to put its weight behind the IMF in discussions with the Tanzanian government around the middle of the 1980s (Lundström 1988).[10] Also within the Tanzanian Civil Service, a small number of economists in the Treasury and the Central Bank began to consider a 'home-made' strategy of stabilization and structural adjustment.

Reluctant search for new policies

It was only after Nyerere's resignation as President, however, that new options were discussed in earnest and, even then, not without controversy; as chairman of the ruling party, Nyerere was able to continue to influence public policy. In 1986 the Tanzanian Government (1986) launched its three-year Economic Recovery Programme (ERP), and at about the same time an agreement was signed with the IMF.

By stressing 'recovery', the government indicated its desire to treat the new programme as different from the 'austerity' programmes often associated with IMF agreements. The ERP contained a mixture of short-term stabilization measures, such as restoring internal and external economic balance through prudent fiscal and monetary policies; and measures directly aimed at stimulating growth, such as export incentives, stronger incentives for agricultural production, public expenditures (financed largely by foreign aid) to rehabilitate physical infrastructure in support of directly productive activities. Both domestic and foreign trade policies were to be liberalized. The policy initiatives in the ERP signified a change of direction in economic policy. Gradual adjustments in the exchange rate took some of the political stigma out of depreciations; adjustments in agricultural producer prices began to reverse the urban-rural terms of trade; the liberalization of import policy started to unlock one important bottle-neck to production.

In terms of macroeconomic statistics, the new policies show on the whole encouraging results. Total production has begun to recover, with gross domestic product (GDP) in real terms rising by some 4 per cent per annum during the four years to 1990, implying an increase in per capita incomes for the first time in a decade. The turnaround in agricultural production is particularly significant. As always in a period of major economic adjustment, there are segments of the population that suffer in terms of real incomes – at least temporarily. For the average Tanzanian citizen living in urban areas, making ends meet has become more difficult as the rate of inflation has continued at a high rate – some 30 per cent per annum in the latter part of the 1980s. At the same time, however, consumer goods – both domestic and imported – have become available in the markets.

ERP officially came to an end in mid-1989, but the government has since negotiated a new Economic and Social Adjustment Programme (ESAP), based on much the same conditionality as its predecessor. The reform process has accelerated in 1990 and 1991. Key sectors of the economy are being privatized; a private banking system will be established; decisions have been taken to allow foreign private ownership of Tanzanian enterprises, and so on. In the purely political realm similarly dramatic decisions have been taken, most importantly, to allow more than one party.

The threats to a successful realization of these policies come primarily from three sources. The first, over which the government has little control in the short run, is a continued decline in world market prices for Tanzania's primary export commodities. The second is the policy legacy of the past. Although Nyerere now has resigned also as chairman of the ruling party, its policies of the past twenty years have left behind an institutional infrastructure that often stands in the way of reform. Agricultural policy is a case in point. The inefficiency of monopsonistic marketing boards and government-controlled co-operative organizations has led to enormous overhead costs and thefts, preventing higher food prices to be passed on to the growers. The third threat comes from the declining capacity of the public sector to serve the economy. Large numbers of qualified civil servants have left government jobs for the private sector or for jobs in other countries. Those who remain cannot make ends meet on the basis of their regular salaries. They have to engage in private activities on the side. Because these side 'projects' are so much more remunerative – often ten times as much as the official

salaries (Tripp 1989) – they understandably get more attention.

In sum, it must be acknowledged that in the midst of ambiguities concerning both objectives and consequences of the reform policies, the Tanzanian Government has taken a number of significant steps towards reversing the economic decline. The question today is whether it has the political will and the social energy to carry the reform programme through. Structural adjustment for a low income country is always difficult. It may be particularly hard in a country which has to engage in an ideological somersault in order to complete the reform process. On the basis of the experience to date (end 1991), what can be said about the chances of success? Second, what are the implications for future studies of structural adjustment that this study tells us? It is to these two questions that we now turn.

POLICY REFORM: CONSTRAINTS AND OPPORTUNITIES

In line with a growing number of studies of structural adjustment, we also believe that a better understanding of the political dynamics of economic reforms is necessary. We suggest that in the future it would be helpful, both to lending institutions and for academics analysing the cases, to use the growing literature on policy implementation. Beginning seriously in the 1970s with the contribution by Pressman and Wildawsky (1973), the concept of implementation has become important in policy studies. In recent years, this field of research has been enriched by a number of studies (for example, Haggard and Kaufman 1989; Nelson 1989, 1990; Thomas and Grindle 1990).

There are three dimensions of policy development that the literature on implementation has identified as particularly important. The first is that it always takes place in conditions of uncertainty. By focusing on implementation as opposed to only the policy decision it becomes clearer that what happens is often an almost fortuitous result of loosely connected processes. In the well-known ‘garbage can’ theory of decision-making (March and Olsen 1976), these processes consist of ‘streams’ of problems, solutions, participants and choice opportunities. These streams are channelled by organizational and social structures. The latter influence the policy process (a) by affecting the time pattern of the arrival of problems, choices, solutions or policy-makers, (b) by determining the allocation of energy by potential participants in the decision, and (c) by establishing linkages among the various streams.[11]

The second dimension is that implementation is inevitably a battle over the realization of ideas. It is not only a matter of adhering to a given policy design, but of engaging in coalition-making with a view to strengthening the chances that the policy will be successfully implemented (Majone and Wildawsky 1978; Nelson 1990; Thomas and Grindle 1990). Implementation is evolutionary; it is successful, not only in terms of carrying out a given objective, but also in terms of how the policy is reformulated in the light of changing circumstances.

The third dimension is that policy-makers learn from their experience, even when that experience is ambiguous. Policy-makers impose order, attribute meaning, and provide explanations as a way of ‘getting on top’ of uncertain decision situations. Korten (1980) has provided a prescriptive model of how learning may take place in a policy situation

characterized by ambiguity. His model can also be used to analyse the full cycle of policy-making and of the consequences that accrue from breaking the cycle in different ways under different circumstances.

Returning now to the specifics of structural adjustment, we have seen both in the literature review and in the account of the Tanzanian case that the adjustment process is filled with ambiguities and conflicts. If we wish to become better at understanding this process, we need to incorporate these two concepts into our analysis. As a first step in this direction we suggest it might be helpful to think of policy situations as different in terms of (a) ambiguity and (b) conflict. At the same time, it is important to consider what the means are that allow a policy to be successfully implemented under any of these conditions. This analytical schema is summarized in Figure 3.1.[12]

		CONFLICT	
		low	**high**
AMBIGUITY	**low**	*technical* resources	*political* power
	high	*institutional* capacity-building	*ideological* coalition strength

Figure 3.1 Different policy situations as defined by ambiguity and conflict

Thus, an issue defined as 'technical' is characterized by low levels of both ambiguity and conflict and is viewed as requiring primarily technical and intellectual 'resources' for successful implementation. A 'political' issue, on the other hand, is low in ambiguity (the parties know where the battle lines are drawn) but highly conflictual. It can only be implemented through the application of power to resolve the conflict. When an issue is high in both ambiguity and conflict, it tends to be 'ideological'. It can only be resolved by coalition-making: the evolution of majority support for one particular set of ideas. When, finally, the issue is low in conflict but high in ambiguity, it is often portrayed as 'institutional'. A given policy requires enhanced institutional capacity for implementation.

We suggest that the Tanzanian experience with structural adjustment involves a gradual move from one policy situation to another as streams of problems, solutions, choice opportunities and participants became inter-linked in different ways as a result of changes in both domestic and external circumstances. Each of these scenarios also marks a phase in the development of Tanzania's structural adjustment policies.

The first phase – roughly 1975–9 – was technical. In these years, discussions were confined to a rather narrow circle of economists. Their policy prescriptions, however, could not be treated merely as technical as the economy continued to weaken. Thus, in late 1979–early 1980, the issue of economic reform entered a second, political phase as Nyerere grabbed hold of it by making devaluation of the currency a matter of prestige

and sovereignty. The battle lines were now drawn quite clearly and the Tanzanian authorities were consequently locked into a set of fixed positions from which they could not move until after Nyerere had resigned as head of state in 1985.

The third period, stretching from 1985 to 1989, is predominantly ideological. Nyerere's resignation paved the way for 'pro-reform' groups both inside and outside the country to strengthen their positions. New coalitions were formed, but the old opposition did not disappear. Entrenched in the ruling party and in certain quarters of the government, it continued to block, or at least slow down, the proposed reforms. At the same time, the actual costs of failing to adjust the country's economic policies became increasingly apparent to a growing number of officials as the 1980s drew to a close. Time became a factor supporting the pro-reform coalitions.

We suggest that since late 1989, Tanzania has gradually moved into a fourth phase, characterized by the emphasis on institutional reform. The political establishment has now accepted the need for reform, indicated by an increasing number of policy and institutional changes in 1990. Recent economic reforms in Eastern Europe and the Soviet Union have, no doubt, helped those in Tanzania who argued for market-oriented changes in economic policy. Somewhat unexpectedly, these pro-reform groups have also been supported by Nyerere who, after his resignation as chairman in 1990, has continued to call on his countrymen to encourage an open debate about Tanzania's future. As these debates continue, it is clear that there is very little interest in state socialist policies. Furthermore, the pro-reform groups have learned a good deal about how to conduct adjustment policies. The scope for substantive reforms is therefore far greater than in the past. It is not surprising that, like the World Bank in its long-term perspective study on Africa (World Bank 1989), the government of Tanzania is now stressing the need for capacity-building. In this situation, the greatest threats to the reform process come, as we have indicated above, from the adverse trends in the global economy and – somewhat ironically – from the weakening of the state apparatus as it fails to sustain needed public services and infrastructure. Thus, although the political space has grown wider for the resolution of many outstanding policy ambiguities, the economic conditions pose a serious challenge to the political will and energy of those Tanzanians who wish to push the reform further.

Finally, what are the implications from this for the future study of economic adjustment and related development policy issues? We believe that this field needs further intellectual development beyond the boundaries of methodological individualism (implicit in leading economic paradigms) and dogmatic structuralism (implicit in various sociological paradigms). The perceived economic rationality of a given policy and the presumed interests of various interest groups provide us only with crude ideas of what determines preference formation and, eventually, policy outcomes.

The striking thing about economic adjustments in both Eastern Europe and the Third World is the extent to which people have endured the hardships associated with these reforms and leaders have been ready to change positions so as to promote such reforms. To be sure, in some countries, such as Tanzania and the Soviet Union, it has taken a physical change in leadership to bring about such reforms. Yet, the presumed economic interests of the 'new class' in Eastern Europe and the Soviet Union and the 'bureaucratic bourgeoisie' in Africa have proved to be much more brittle than analysts believed only a

few years ago.

We believe that in order to capture better the constraints and opportunities associated with structural reforms, we must take into account, explicitly, that institutions and processes matter, and that they influence policy outcomes in ways that current models of analysis often fail to capture. Institutions, whether viewed as conventions or as entitlements, provide an interpretative order within which both policies and political behaviour can be understood. The waxing and waning of key institutions need to be examined, particularly as it affects given policy situations. We have suggested in this article that one way of doing this is to differentiate such policy situations in terms of their levels of ambiguity and conflict.

Our study of Tanzania indicates the significance of timing and thus the need for an analysis of how problems, solutions, choice opportunities and participants in these processes come together in various configurations. Policies do not evolve in rationally neat packages. The actors sort out ambiguities by learning from experience. The conclusion we draw from the Tanzanian case is that such learning is enhanced when ambiguity rather than conflict dominates the political scene.

NOTES

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1 This research is mostly published in *IMF Staff Papers, The World Bank Economic Review* and *The World Bank Research Observer.*

2 The proceedings of this conference, titled 'Structural Adjustment and Transformation: Impact on African Women Farmers' is due to be published by the University of Florida Press in 1992.

3 The relationship, and the possible conflict, between economic growth and equity has a long tradition in the literature on economic developmnent. See, for instance, Adelman and Morris (1973), Chenery *et al.* (1974) and Ahluwalia (1976).

4 TANU was renamed Chama cha Mapinduzi (CMM) – the Revolutionary Party – in 1977.

5 It should be stressed that this measure of income inequality measures only persons in the monetary economy with officially registered salaries. Tanzania was, and is, a dual economy. Taking this fact into account, the income gap of 1 to 9 is relatively large.

6 The following analysis owes much to Paul Collier, especially Collier (1987).

7 Changes in the effective exchange rate are changes in the home country's currency value against a group (often called a 'basket') of currencies, usually those of the home country's main trading partners. Changes in the real effective exchange rate (REER) are computed by adjusting each currency value in the effective exchange rate calculation by the inflation rate in the respective countries – the home country as well as the trading partners. Thus, for instance, a more rapid inflation rate in the home country than in the trading partners will, in itself, lead to an increase in the REER. Changes in the REER of a country are commonly regarded as realistic measurements of changes in that country's competitive position; an increase in the REER means a loss of competitiveness, a decline means a gain.

8 A detailed discussion of the imbalances and distortions in the economy is contained in Ndulu 1987.

9 Writing in 1983, when the Tanzanian economy had gone through five years of severe

compression and the real effective exchange rate had appreciated by over 100 per cent since 1979, Professor Singh argued that 'the economy has not actually collapsed; it continues to function' . . . 'As a professional economist, I think that there are powerful and legitimate arguments against a Tanzanian devaluation of the kind being proposed by the IMF and the World Bank' (Singh 1983:1).

10 In a symposium in Dar es Salaam in November 1984, arranged by the four Nordic development agencies, the Tanzanian Government was strongly advised to come to terms with the IMF. Some of the Nordic delegates present were still worried about offending the Tanzanian Government.

11 For a recent discussion of issues relating to policy implementation, see Thomas and Grindle (1990).

12 This is a modification of a similar model used by Richard Matland of the University of Michigan to study budgetary reform in Norway.

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4
REGULATIONS VERSUS PRICE REFORMS IN CRISIS MANAGEMENT: THE CASE OF KENYA

Arne Bigsten

INTRODUCTION

Since independence the Kenyan economy has been exposed to a series of shocks starting with the first oil crisis of 1973–4, followed by a coffee boom in 1975–8. The second oil shock of 1979 was accompanied by a serious drought. The coup attempt in 1982 was followed by yet another drought in 1983–4, and a second, but smaller, coffee boom in 1986. Since then economic conditions have been somewhat more stable, although there has in the last few years been a slump in the coffee market.

I will discuss how policy-makers in Kenya have chosen to meet the shocks listed above, concentrating on the period after the coffee boom. The paper takes a political economy perspective and tries to show why certain policy changes have been easier to undertake than others. Focus will be on the choices made by policy-makers between administrative regulations and the use of markets in bringing about the desired economic adjustment. The constraints on policy reform in Kenya have not primarily been ideological hang-ups, as in Tanzania, but rather the influence of vested interests that stand to lose from the reforms.

INSIDERS AND OUTSIDERS IN THE POLITICAL ARENA

During the colonial period the white settlers formed the political élite and controlled large-scale farming and part of modern industry. A major share of equity was owned by a small Asian minority. After independence President Kenyatta and other members of the emerging African (particularly Kikuyu) élite acquired large areas of land as part of the Africanization of the settler economy. In the largely Asian-controlled urban economy there were also moves towards Africanization. Under the Trade Licensing Act of 1968 firms had to have African equity participation. The ruling political élite used this opportunity to get a stake in business. The transition thus saw the African political élite obtaining extensive business interests.

Since independence much political power in Kenya has been concentrated in the hands of the President. Since the late 1960s there has been only one party in Kenya, which with time has become less and less important in the policy debate. The democracy movement has in the last year had some impact, and one consequence has been attempts at reviving

the party machinery. There is still strong opposition in official circles to the introduction of a multiparty state, though.

In western economies it is seldom that individuals need to be involved in politics to become economically successful. In Kenya, however, it is commonplace that political positions are used as a base for successful economic activities. I would argue that the core insiders in the Kenyan economy are individuals with political power and associated groups in the bureaucracy. One can also find economically-powerful individuals outside this group, but they would often be well connected to the core group. One could call the latter group insider associates. Finally, the outsiders are those that have to act in the market without the benefit of political connections.

When a government uses selective policy instruments such as quotas, rents are created. Agents trying to capture these are involved in what Bhagwati (1982) calls directly unproductive profit-seeking (DUP), that is, they seek profits in ways that do not contribute to production of goods or services. In the case of Kenya the state is used by insiders as a means of allocating the rents of the system. The outsiders have much less of a chance of reaping this rent. The insider-outsider demarcation in the Kenyan case is thus drawn on the basis of political connectedness.

One of the major constraints on growth in the African economies is the unwillingness to undertake reforms that threaten the entrenched élite. An indigenous business class as well as multinational firms have prospered behind high import barriers, making it possible to earn high profits by selling on the home market. Business interests and politicians are often linked. Therefore the politicians have a stake in this sector of the economy. Due to the limitations of the small domestic market, growth of the business sector is hampered, but it provides a good and secure income for the group in control.

Politicians and their associates have another interest in preserving the existing system of controls on imports and investment. These systems make it possible for decision-makers to collect part of the rent either directly or by proxy in the process of allocating licences and permits. Thus, from the point of view of the insiders, this system may be preferable to an alternative one where a larger cake would be shared by a larger number of people and where the shares going to the current insiders might be smaller. The rents associated with licences, and so on, would decline or disappear altogether. Monopoly power would be reduced or eliminated by the opening up of the economy. The pressure of competition would increase and this would reduce profit margins.

It could, of course, be argued that the resistance of insiders to letting outsiders in is short sighted since they, in the long run, might still be better off if the growth rate increases sufficiently to compensate for declines in their income share. Still, the time taken for this to happen may be so long that, given reasonable time preferences, insiders might still be rational to resist. One may assume that the skills required to succeed economically along the road of politics will have less economic value in the future, where the market determines resource allocation to a higher degree.

In this context political democracy would have an economic value apart from a political one. It would open up the insider arena to the outsiders. This would make certain types of behaviour impossible to sustain, at the same time as it would lead to a wider dispersion of influence and an increase in the size of the insider group. This would be good for growth, since some growth obstacles would disappear, as well as equity.

STABLE 1960s AND TURBULENT 1970s

Kenya is often pictured as a free market economy. This is not altogether true, although it has been more pro-market than some of its neighbours. At independence Kenya inherited many institutions set up to protect settler interests, and these were largely retained. After independence Kenya continued to encourage the private sector and foreign investment, while at the same time rapidly expanding the public sector. Fiscal and monetary policies were cautious during the 1960s, and the government budget was balanced. Expenditures on education, health and roads were increased, but there were also investments in a number of enterprises. The profitability of many of these was low. Still, the 1960s was a period of successful economic development, with a growth rate of over 6 per cent per annum, fiscal balance, low inflation, and a stable exchange rate.

Expansionary budgets and falling terms of trade led to a balance-of-payments crisis in 1971. The policy-makers chose to meet this with selective restrictions on bank lending, a higher liquidity ratio, licenses on all foreign exchange transactions, and direct price controls on retail sales (see Kenya Association of Manufacturers 1988). The measures were seen as temporary, but they were subsequently retained.

There was some concern about efficiency losses due to protection, and in the middle of 1973 the system of import controls was liberalized. However, the first oil crisis led to a new balance-of-payments crisis and the liberalization was reversed. To improve the external balance the shilling was devalued in 1975 and an export subsidy was instituted. There was recognition of the need for stabilization. However, real coffee prices more than doubled between 1975 and 1976, and Kenya's trade balance improved dramatically (Bevan *et al.* 1990). Because of the boom, plans for restructuring the economy were abandoned. Since coffee-growers were well represented in the Cabinet, the increased prices were passed on to the farmers while, for example, in Tanzania the extra money went directly to the government. Given the fixed exchange rate and a liquidity ratio that was slack during the boom, money supply increased dramatically. The rediscount rate was as low as 1.5 per cent in 1977, and there was a large increase in bank lending. Temporarily there was thus an unplanned liberalization from the regime of financial repression, through a large reduction in the market clearing interest rate. There was also a temporary import liberalization, since the quotas were less binding. Government revenue grew rapidly due to sales and trade taxes. It then turned out to be politically impossible to hold back expenditure demands from the different ministries, when the Treasury was flush with money.

Due to the boom, real gross domestic product (GDP) growth resumed (6.8 per cent p.a. 1976–8), but during 1978 the terms of trade fell by 20 per cent. It was obvious that the boom was over and that this had to be met by policy changes. The liquidity ratio was increased from 15 to 20 per cent, the interest rates were increased, and a cash ratio was imposed. These measures could, however, not halt the bank lending to the private sector since the banks were extremely liquid. Investments therefore reached record levels. The budget for 1978/79 was more restrictive than the previous one, but although the balance-of-payments problem was extensively discussed, no serious policy measures to redress it

were proposed. By 1979 the economy was in serious disequilibrium as a result of the public sector deficit, even before the second oil shock.

MACROECONOMIC TRENDS 1979–89

At the end of the 1970s Kenya faced falling coffee prices and increasing oil prices. In addition, 1979 and 1980 were drought years and large quantities of food had to be imported. The budget and balance-of-payments deficits soared and inflation accelerated. Once again the government chose to postpone adjustment and to rely on foreign borrowing. The economy was borrowing money as if the negative shock had been temporary. The current account deficit surged to 12 per cent of GDP in 1980. Major macroeconomic indicators for the period 1979–89 are shown in Table 4.1.

To meet World Bank demands import controls were liberalized and interest rates increased in 1980. It was, however, extremely difficult to contain government spending, due to the erosion of the budgetary procedures during the coffee boom. The budget deficit was partly due to falling government revenue, but more so to the large increase in the government expenditure level.

In the second half of 1981 the external reserves were more or less depleted and had to be replenished by borrowing from the Eurocurrency market. Belatedly, the government conceded a measure of liberalization under pressure from both the International Monetary Fund (IMF) and the World Bank and

Table 4.1 Kenya: some important economic indicators (per cent)

	Real GDP growth (%)	*Domestic savings (%/GDP)*	*Gross invest. (%/GDP)*	*Exhaust Pub. sec. deficit (%/GDP)*	*External deficit (%/GDP)*	*Inflation rate (%/year)*
1979	5.0	13.9	22.7	1.9	7.2	8.4
1980	3.9	16.7	30.0	6.2	12.5	12.8
1981	6.0	16.8	20.3	2.1	10.1	12.3
1982	4.8	14.3	21.6	0.0	6.9	22.3
1983	2.3	16.5	20.9	–2.4	1.8	14.5
1984	0.8	15.0	20.9	2.1	2.5	9.1
1985	5.1	21.8	25.6	0.1	1.6	10.7
1986	5.6	19.2	21.8	1.6	0.6	5.7
1987	4.9	16.2	24.4	3.0	6.2	7.1
1988	5.2	17.2	25.3	2.2	5.1	10.7
1989	5.0	16.7	25.5	0.8	5.4	10.5

Sources: Kenya, *Statistical Abstracts*; Kenya, *Economic Surveys*.
Notes:
Definitions: Exhaustive public sector deficit = exhaustive government spending – exhaustive government revenue.
External deficit = Exports minus imports of goods and services + net factor incomes from abroad + net transfers from abroad.

devalued. In January 1982 a stand-by agreement with tough conditions was reached with the IMF, but it was suspended soon afterwards.

Though the coup attempt in August 1982 failed, it led to capital flight, and considerable policy changes were brought about. Technocrats within the domestic financial institutions gained increased influence, due to the economic and political crisis. This group managed to bring about a number of reforms, and one lasting achievement was the reduced politicization of the exchange rate and the interest rate. With regard to the ambitions to liberalize the economy extensively, there was less success due to political resistance.

Interest rates became positive in real terms after 1982. In monetary policy, Kenya has since then tried to maintain real interest rates positive, but the nominal interest rates have continued to be rigid and other monetary instruments were not changed much. As before, one has tried to control banks through liquidity ratios and used other asset requirements for 'non-banks'. By 1983 revenue increasing measures and expenditure controls had brought the budget deficit under some control.

In 1983 a new IMF stand-by agreement of Special Drawing Right (SDR) 179.5 million was signed. The conditions attached were devaluation, increased agricultural prices, reductions in bank lending and reforms in credit policy. This was the first programme in several years that was actually implemented. The exchange rate regime was switched from one with the shilling pegged against the dollar to a more flexible rate with the shilling pegged to the SDR. Since 1983 Kenyan policy-makers have pursued a fairly cautious economic policy, which has meant that the macroeconomic aggregates have been kept under a measure of control.

From 1982 the ambition was to liberalize imports, but it was not until 1985 that some (modest) progress was made in this field. Kenya has a system of tariff schedules for different commodities. In June 1985 a number of items were shifted to less restrictive schedules, and in 1986 the schedules themselves were administered in a more liberal manner. A drought in Brazil in 1985 caused coffee prices to rise by about 40 per cent between 1985 and 1986. This, together with falling oil prices, led to an improvement in the balance of payments and faster economic growth. The boom, however, was short lived. Real coffee and tea prices fell to very low levels and there was again increased restrictiveness in the administration of imports. In 1988 the system was reorganized in such a manner that one can say that the changes represent a certain liberalization, but the import control system is still one of the main creators of bottle-necks. It is also a system for allocation of rents, and this makes it politically difficult to change.

Important indicators of the impact of liberalization and devaluation policies are changes in relative prices. This policy would tend to benefit export producers and it should be possible to observe the effects on the relative prices of exportables versus importables. The domestic price of exportables, P_x, is determined by world market prices, the exchange rate and export subsidies or taxes. The domestic importables price, P_m, is determined by the world market price, import controls and tariffs. The relative price P_x/P_m is thus determined by international terms of trade and trade restrictions. Estimates of relative price changes for the period since 1979 is shown in Table 4.2, which also shows the development of the external terms of trade of Kenya.

We find that since 1982 the domestic price of exportables relative to importables has

been increasing due to devaluations and trade liberalization. However, at the same time economic policies were expansive after 1983. This increased the balance-of-payments deficit again. There has therefore been a need for further policy changes in the trade or fiscal and monetary fields to restore a sustainable equilibrium. We see that external terms of trade (TOT) have fallen drastically since 1986. This has held back the improvement in relative exportable prices. In 1989 there was a strong decline. The relative price shift in favour of agricultural exportables, achieved since 1982, was undone in one year. The positive impact of policy changes was thus counter-acted by adverse external influences.

This is also reflected in data on the agricultural terms of trade. They deteriorated rapidly from 1979 to 1982. After this, they have been stabilized due to changes in exchange rate policy, resulting in higher prices for agricultural producers. The relatively poorer development after 1986 is mainly the result of falling coffee prices on the world market. The burden of this decline has primarily been borne by the cash crop producers. Prices for other crops increased at a relatively satisfactory rate.

Table 4.2 Kenya: price indices (1979 = 100)

	P_{xt}	P_{mt}	*TOT*	P_{ms}	$P_a = P_x$	P_x/P_{ms}
1979	100.0	100.0	100.0	100.0	100.0	100.0
1980	120.4	131.1	91.8	112.1	107.5	95.9
1981	132.8	166.6	79.7	124.3	116.4	93.6
1982	145.9	191.5	76.2	138.3	127.5	92.2
1983	175.1	245.1	71.4	145.0	138.5	95.5
1984	210.4	250.8	83.9	157.2	151.2	96.2
1985	207.3	296.8	69.8	168.9	168.5	99.8
1986	221.9	281.5	78.8	177.3	181.3	102.3
1987	183.9	285.3	64.5	190.3	219.3	115.2
1988	211.6	314.1	67.4	207.5	239.4	115.4
1989	227.7	379.2	60.5	269.7	252.9	93.8

Sources: Kenya, *Statistical Abstracts*; Kenya, *Economic Surveys.*

Notes: Import and export prices are for products, while the remaining ones are GDP deflators and thus for value added. Non-tradables include building and construction, wholesale and retail trade, restaurants, and hotels, transport, storage and communication.

Prices:

P_{xt} – total exports

P_{mt} – total imports

TOT – international terms of trade

P_{ms} – domestic manufacturing, taken here to be the proxy for import substitutes

P_a – agriculture, here considered the proxy for exportables, is a very imperfect one since some products in the sector are obviously import-substitutes.

Since 1985 the GDP growth rate in fixed domestic prices has been around 5 per cent per

year, which means that per capita incomes have increased. It is not possible to say whether income inequality has increased or decreased. There are some positive changes with regard to the urban-rural and informal-formal sector gaps, but these may be counteracted by increases in capital incomes. Inequality is still very high in Kenya, but probably not getting worse.

DETERMINANTS OF ECONOMIC POLICY

To show some of the constraints on policy-making in Kenya, we will in this section take a closer look at some specific policy areas.

Monetary Policy

Until 1966 Kenya was in the East African Currency Union. After its breakdown Kenya was faced with the choice between letting the interest rate rise and abandoning the convertibility of the currency, and they chose the latter option. This initiated the policy of cheap credit which lasted well into the 1980s. It also implied a system of foreign exchange rationing. One reason for this policy choice was that the African élite benefited from cheap money, which was needed to buy out Asian and European property. The beneficiaries of convertibility, on the other hand, was the Asian community, who wished to hold part of its wealth abroad as an insurance against political risks.

The new government introduced liquidity and minimum cash-to-deposits ratios with which to control the banking system. There were ceilings on nominal interest rates which were below the rate of inflation. Real interest rates were thus negative. These measures led to financial repression. The sectoral lending targets were not seriously enforced, though. Since a credit squeeze hurts the African élite, it was only seriously tried once, in 1971. Subsequently credit had to be rationed by the banks. Between 1976 and 1980 the maximum lending rate temporarily ceased to be binding and credit was readily available at the low nominal interest rates. There was thus a temporary financial liberalization, which was independent of economic policies. The potential gains from financial liberalization are the increased incentives to save from higher real interest rates and more efficient allocation of investment resources. During the coffee boom, however, real interest rates fell and savings were not stimulated. Moreover, there was an investment boom, which meant that care in the selection of projects decreased. During the period of repression the banks had not learnt how to identify good borrowers. A second, but planned, liberalization in the mid-1980s included a conscious increase in real interest rates. At this time, however, bank lending was curtailed and played a limited role in investment finance.

Monetary policy has changed towards a more market-oriented direction in the last few years. One can point to the widening of bank spreads, establishment of a discount window at the Central bank and a variety of government debt instruments, establishment of an auction system for government debt instruments, and strengthened regulation and supervision of NBFIs (Non-Bank Financial Institutions). Kenya has in recent years introduced Treasury bonds with a maturity of one to five years, sold to institutions and

the public. These are steps from a segmented and controlled financial system towards one where interest rates and credit allocation are determined by market forces, and monetary growth is controlled through the more generalized monetary instruments of open market operations.

Ceilings on bank credit to the private sector, to accommodate the financial needs of the government, has been the major mechanism by which private investment has been crowded out. The large budget deficits call for a strict monetary policy. Decision-makers in the Central bank have realized this, but political support has proven difficult to get. Increased financing of the deficit outside the banking system is necessary, and this in turn requires high interest rates. The Central bank has in recent years managed to get acceptance for monthly issues (a fixed amount per month) of treasury bonds, and the effective rate of interest has risen, but it is still too low to attract enough money to check money supply. On the grey market the rate of interest is higher than in the official market. The Central bank has been able to bring about changes in the direction of the equilibrium rate, but the process is slow and cumbersome.

The balance of payments has deteriorated, which is another reason why interest rates should be increased. The interest rate has an impact on capital flows in Kenya. The political uncertainty following the murder of an influential politician and clashes between demonstrators and the authorities, have raised the risk premium for foreign investors. The capital account of the balance of payments is legally controlled, but firms and individuals have a variety of methods for transferring money, such as over-invoicing, exporting without bringing the money back to Kenya, and so on.

External policy

With the foreign exchange crisis in the early 1970s, extensive control of imports in the form of quantitative restrictions was introduced. Effective tariff protection was in many cases high. Producers lobbied successfully for protection, and it was normally provided in the form of quantitative restrictions. The number of commodities requiring special import licences increased from 69 in 1964 to 228 in 1972. Originally the aim was to protect domestic industry, but from the foreign exchange crisis in 1971 they were also used to conserve foreign exchange. Exchange controls were also applied to capital movements, but this control could be bypassed via the black market at a premium. The level of the quantitative controls have been endogenous to the macroeconomic environment accommodating monetary and exchange rate changes. Instead of allowing foreign exchange holdings to change, the restrictiveness of the quota system has been changed.

Although the government has now and then taken small steps on the road to liberalization, they have not been done willingly. The reluctance to reform trade policy might seem difficult to explain, since liberalization would mainly hurt groups such as Asian Kenyans and multinationals. However, the government also has an ownership interest in industry, as has the political élite. It may, therefore, be reluctant to dispose of the most efficient machine for the allocation rents.

To be successful a trade liberalization has to be accompanied by either devaluation or a more restrictive fiscal and monetary policy. This was not the case in 1980. The experiment was financed by running down the foreign exchange acquired by the

government during the coffee boom, and this was obviously not sustainable. Since agents realized that quotas were temporarily removed, there was an import scramble and a substitution out of investment into imported consumer durables. Between 1982 and 1985 there was a more substantial trade liberalization than the one of 1980, yet this time it was sustained. This was possible because there was a compatible co-ordination with other policy instruments so that the trade liberalization did not cause an unsustainable balance-of-payments deficit. It was co-ordinated with currency devaluations.

Although agriculture will remain the mainstay of the Kenyan economy for a considerable time to come, the long-term aim is to convert the country into an industrial nation. To do this Kenya has to be successful in export markets, and export policies were heralded as the 'centrepiece' of the budget of 1990/91 (Kenya 1990:10–12). The basis for the drive is a competitive exchange rate. This is now gradually adjusted. The replacement of import quotas with tariffs has been quite extensive in the last two years. It is estimated that at present tariffs are used on more than 70 per cent of all items, making up about 95 per cent of all imports. Initially quotas are replaced by the equivalent tariffs, which are then reduced gradually. In spite of the continuing real depreciation of the Kenya shilling, the export diversification drive has so far had relatively little success. There are, though, encouraging signs with regard to some non-traditional exports, notably horticultural products.

Agricultural policies

Kenya has, in an African perspective, had a successful development of the agricultural sector. It has pursued a more liberal policy with less urban bias than, for example, Tanzania. Lofchie (1989) proposes that the critical variables for success in agriculture are land policy and the tolerance for or encouragement of private investment in agriculture by the political élite. The latter group's investment in Kenyan agriculture has, according to Lofchie, contributed to the evolution of a policy environment favouring agricultural producers. In Tanzania the élite cut itself off from land ownership, and this meant that the welfare of agricultural producers became a peripheral goal in spite of the officially proclaimed ideology. Barkan (1983) notes that in Kenya

> rural communities and especially rural elites have a means to pressure the state to provide a measure of services to the local community. Political careers rise and fall on the ability of elected officials to extract services from the centre. In this context, urban based central planners may not always allocate a 'fair share' of state resources to the rural areas . . . but their freedom to pursue urban based policies is sharply curtailed.

Since the colonial days there has been marketing boards for export crops in Kenya but, in contrast with several other African countries, these have not been used much as revenue generators. Still, some producer prices were held back in the 1970s. In 1980 the weighted producer prices (except for sugar) were 24 per cent below import parity prices. This meant that the farmer's incomes were 7 per cent below what they would have been with import parity prices (Cleaver and Westlake 1987:26). This income loss accrued to the

urban consumer in the form of lower prices and to the government in the form of reductions in subsidies to parastatals. However, by 1986 the weighted producer prices (with the exception of sugar) were only 7 per cent below import parity prices, which means that there really was a shift in policy to the benefit of the farmers.

In agriculture the pricing procedures are now on the whole satisfactory, but the efficiency of parastatals in disbursing payments to farmers still leaves a lot to be desired. For coffee, tea, maize, milk, cotton and sugar, producers in recent years have had to wait up to fifteen months for their payment. This is just one example of the inefficiency in the marketing parastatals. The preservation of the system is partly due to some lingering distrust of market solutions in this area, but parastatals are also used as instruments of political control and patronage. To dismantle them would mean reduced security of the position of the political élite. There would be less positions and less money to control and allocate, and therefore a reduction of its scope of influence.

One of the reasons for the inefficiency in marketing parastatals is the lack of competition. The government has recently agreed therefore, under pressure from international institutions, to allow competition in the marketing of some commodities. There is to be a gradual liberalization over the next five years. For example, the function of the National Cereals and Produce Board (NCPB) will be confined to the maintenance of strategic reserves and as a buyer of last resort, which means that 75 per cent of the market will be left to private traders, millers and co-operatives. This will be accompanied by the removal of interdistrict movement permits and the operation of buying centres.

One way of privatizing the parastatals would be to sell them off to co-operatives and this is being considered for cotton ginneries. Ruotsi (1989) has studied the efficiency of co-operative ginneries in Kenya. He finds that co-operative ginneries have so far functioned very poorly and are even worse than the Board ginneries. Ruotsi lists a number of reasons for this. Management is poor with cases of misappropriation. There has been little attention to financial control. Performance of the unions in administrating the Farm Input Loan scheme has been disastrous.

Are these problems intrinsic, or are there reforms that would make co-operative ginneries function efficiently? There is, of course, scope for improvement, but the question is whether the system of incentives and behaviour is conducive to efficiency. There are some indications in Ruotsi's study that this is the case. He relates, for example, the story of the Malakisi Union, where in 1978 the whole governing committee was forced out of office because of incompetence and dishonesty. The farmers, that is, the owners of the ginnery, were informed at the general meeting about the details. In spite of this the meeting returned most of the committee members in the next election. Although this seems absurd, it reflects the power structures and loyalties that govern behaviour at the grassroot level in Kenya. In a face-to-face confrontation, the members are not willing to demand responsibility from the local élite. Thus, the system of ownership control is not working and is, therefore, not a deterrent against incompetence and fraud. The farmers would probably be less forgiving towards a private producer. When dissatisfied they would vote with their feet and drive the firm out of business.

Thus, farmers have not received any dividend from the co-operative ginneries, the level of services has deteriorated and there has been an almost complete breakdown of the seasonal credit system. It seems quite likely that the joy of being a joint owner of the

ginnery would not compensate for this. What is required is a system where incentives are effective and incompetence and inefficiency are punished by the market. The risk of bankruptcy must be real. A transfer to private ownership would achieve this.

Employment policy

The formal labour market covers only about a fifth of the Kenyan labour force. The rest of labour is either self-employed, mainly in agriculture, or in some form of informal employment. Wages in the informal market are not regulated in any way, but are determined by supply and demand. Policy-makers have attempted to control wages in the formal labour market in both directions: with minimum wage laws they have attempted to hold wages above the supply price of labour for unskilled recruits, and annual wage guidelines attempted to reduce wages in real terms. The minimum wages may have distorted the wage structure, but the incomes policy became largely irrelevant in the 1970s. The fall in real wages which occurred in the modern sector from this time was due to competitive pressures.

There is now a need to pursue a broadly-based policy to generate new employment opportunities for the rapidly-increasing labour force. In agriculture there is a whole range of policies which would be desirable. First, there is a case for subdividing large mixed farms to increase agricultural employment. Second, measures such as a land tax and capital gains tax on land could be introduced to discourage the low intensity of land cultivation by the large farms and the holding of idle land for speculative purposes. Third, one could ensure that there are no policy-induced distortions that discourage the growing of labour intensive crops. Fourth, one might try to influence the choice of technique in agriculture. Fifth, one should take advantage of seasonal slacks to embark on rural works. Whether these policies are politically feasible is, of course, another matter. Land tax proposals, for example, have been around for at least two decades, and since they run counter to the interest of the ruling élite, they are not likely to be introduced irrespective of the degree of external pressure.

Government employment has for many years increased at a rate faster than the need for manpower, and this is having a negative effect on the long-term growth prospects of the economy. It is counter-productive to try to solve the employment problem of Kenya by artificially inflating public sector employment. To change government employment policies is politically very difficult. The spectre of increasing skilled unemployment is feared by the politicians, since this may be a hotbed for anti-government agitation. Reduced government employment also reduces the scope for its influence, which may undermine its all-pervasive power. To allocate jobs is an important way of building support.

THE POLITICAL ECONOMY OF POLICY REFORM IN KENYA

In general it seems as if Kenya has found it easier to implement price-related reforms than institutional reforms. Since independence the government has directed large sums of money into investments in parastatals and public sector firms. In 1986 there were over

100 state corporations in manufacturing and commercial sectors. Experience shows that 'some of these entities are inefficient, poorly managed, unprofitable and a burden on the tax payer on account of the heavy subsidies made to them in recent years' (Kenya, *Development Plan*: 152–3). Several investigations have shown the parastatals to be mismanaged, and inefficient in repaying their debt. They are a heavy budgetary burden. The government has started a process of privatization, but the sales of publicly-owned corporations has been slow to start.

One could also wonder to what extent the pressure from the Bretton Woods institutions have contributed to the change in policy. Mosley's (1990) evaluation of the impact of the Structural Adjustment Loans (SALs) in the 1980s suggests that the policy changes brought about were those that were domestically supported anyway or where the pressure from the IMF was very strong, such as the exchange and interest rates. During the second half of the 1980s the picture is less clear. Mosley finds that the World Bank has been able to exert some leverage on issues such as fertilizer imports and the reform of development finance institutions

Kenya is a country that is capable of breaking out of the state of stagnation and develop. However, there is reluctance among decision-makers to change the system that has functioned for a long time and which provides the insiders with a good life. Producers for the domestic markets are still making good profits, and they do not necessarily have to worry about the slow growth of the industrial sector as a whole. There are as yet no clear signs that the country will change to an export-oriented economy, where producers are faced with international competition. There is also a clear lack of enthusiasm for parastatal reform, since this encroaches on the economic scope of politicians. The same reason can be given for the lack of enthusiasm for liberalization of import regulation and investment controls. Still, the distortions have not been so pervasive that macroeconomic management has been rendered ineffective. Thus, although imbalances have at times been serious, it has always been possible to return to a sustainable position. Therefore the country's economic record is among the better ones in the region.

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5
REDUCING THE DEBT BURDEN OF SUB-SAHARAN AFRICA

Joakim Stymne

INTRODUCTION

Since the early 1980s it has become increasingly clear that the external debt situation of the countries of Sub-Saharan Africa is one of the more severe of the many obstacles to growth and development in the region. Since the mid-1980s a variety of measures have been introduced – or at least proposed – with the purpose of reducing the debt burden and improving access to external financing, mostly in the context of economic reform programmes.

One of the options that have long been available to countries that experience acute balance-of-payments problems is to request a rescheduling of external debt obligations. The process of rescheduling of claims held by bilateral official creditors takes place in the Paris Club, where a large number of countries in Sub-Saharan Africa have reached agreements with their creditors since the late 1970s. At least initially, these reschedulings were carried out under the assumption that the debtors would be able to restore balance-of-payments viability in the medium term. In the long term they were expected to be able to fulfil all their debt obligations. The main component of a rescheduling agreement was therefore a decision to postpone a proportion of the repayment of principal that would fall due during a given time period, usually twelve to eighteen months. The purpose of this postponement was to ease temporarily the strain on the debtor's balance of payments while necessary adjustment measures were being implemented. Principal falling due was only postponed, and was subject to market interest. Hence, debtors received no debt reduction in present value terms.

However, it soon became apparent that such temporary relief in many cases was insufficient. Debtors often faced new crises not long after a rescheduling exercise was concluded. Creditors have come to accept that, in many cases, it is unlikely that their claims will be honoured in full. Nevertheless, there is less than full agreement between creditors about the best way of translating this insight into specific policy toward countries with a large overhang of external debt.

The starting point for this paper is the assumption that it is desirable to normalize the relationships between the individual African debtors and their creditors. A normal relationship is defined here as one where the debtors have restored balance-of-payments viability in the long term. This means that debtors do not repeatedly find it necessary to take recourse to 'exceptional financing' – of which the most important categories are the accumulation of payments arrears and the use of rescheduling. It follows that

postponement of debt obligations to a date in the near future when the debtor country will almost certainly remain unable to service its debts does not constitute a normalized relationship.

Normalization is desirable since the use of exceptional finance in the long run is costly for the debtor. It is a signal that the debtor is not creditworthy. A country which requests rescheduling may be seen as riskier than a country which avoids it, which increases the cost of using normal sources of finance such as trade credits. More importantly, the costs of being forced to use exceptional finance are to a significant degree dead weight losses. A large sovereign debt overhang may cause a country to choose a level of investment which is lower than that which would be socially optimal (Krugman 1987; Froot 1990). Some of the gains from improved economic policies in the debtor country are in effect taxed away through a reduction of future debt relief. An additional efficiency cost that may be substantial in the small, resource-constrained economies of Sub-Saharan Africa arises from the extended process of negotiations, first with the IMF and then with bilateral creditors. This ties up scarce resources in the form of key personnel within government administration and the Central Bank for months on end. The protracted negotiation periods furthermore increase uncertainty about the consequences of all the economic decisions in the debtor country, which may be expected to lead to a reduction in investment.

What is required to achieve normalization? Normalization would imply that the debtor country's ability or willingness to service its debts is sufficiently large, relative to scheduled debt service payments (interest and payments of principal). Hence, it would not be in the debtor's interest to request a renegotiation of these payments, nor to default outright. Clearly, this means that any discussion of the likelihood of achieving a normalized relationship requires the operationalization of concepts such as 'ability to pay' (for a theoretical discussion of ability versus willingness to pay, see Eaton *et al.* 1986).

It will be argued below that the growth of a debtor country's export earnings relative to debt obligations is a good indicator of ability or willingness to pay. As long as debt service requirements are sufficiently small relative to export earnings, the cost of requesting a debt rescheduling exceeds the benefits of relieving the strain on the balance of payments. If debt service requirements are large in relation to export earnings, the benefits of not paying may exceed the costs of going through repeated debt reschedulings.

One purpose of this paper is to examine the concept of the 'pain threshold' in the Sub-Saharan Africa context: the level of debt service requirements above which it is not likely that a debtor will be able or willing to achieve a normalized relationship with its creditors. A second aim is to give an indication of the amounts of debt relief that would be justified if the creditors want to support debtors, that are already beyond this pain threshold, to achieve normalization.

With this in mind, the organization of the paper is as follows. The next section gives a brief background to the debt crisis in Sub-Saharan Africa, with special emphasis on the sources of financing and the growing importance of reschedulings, as well as a brief discussion of various initiatives to reduce the debt burden. The section following studies the development of certain measures of debt burden for different analytical categories of

African debtors, and suggests a rough estimate for the maximum sustainable debt service (the ‘pain threshold’) and the last but one section explores several aspects of debt relief. With the help of a simple simulation it raises issues concerning the feasibility of normalizing external payments relationships. It concludes that both outright debt reduction and a rapid recovery of exports are prerequisites for reducing the debt burden to a sustainable level. Finally, in the last section a number of concluding remarks are presented.

BACKGROUND

The background to the accumulation of large debt burdens in Sub-Saharan Africa has been analysed in several studies (see, for example, Krumm 1985; Lancaster and Williamson 1987; Greene 1989; Humphreys and Underwood 1989; World Bank 1989). The following picture emerges from these studies. External borrowing on a significant scale began only in the early 1970s. After the oil shock of 1973, the oil importers of Sub-Saharan Africa undertook external borrowing to compensate for oil price increases, while oil exporters borrowed to finance highly ambitious investment programmes. By the second half of the decade, African countries of all types had embarked on these types of extensive programmes. Imports of oil and goods demanded by urban consumers were subsidized by the governments, sometimes directly, sometimes by means of extremely overvalued currencies. In addition, external borrowing to some extent paid for imports for private investment – over-valued currencies making this very attractive – either directly through private borrowing or indirectly through the foreign exchange made available from public balance-of-payments related borrowing.[1] During years of falling export prices, countries borrowed to maintain consumption. On the other hand, creditworthiness improved during years of rising prices and countries tended to borrow even more in order to expand development programmes (Krumm 1985).

Gross capital formation as a share of gross domestic product (GDP) was well over 20 per cent throughout most of the 1970s, but the returns to the investments were poor. It can be noted that, while import volume grew by on average almost 3 per cent per year during the 1970s, export volume rose by an annual rate of less than 1 per cent, and that the share of Sub-Saharan Africa in the value of exports from all less-developed countries fell from 13.8 per cent in 1970 to 8.6 per cent in 1980 (Svedberg 1991). This indicates that these investments offered limited returns in terms of potential earnings or savings of foreign exchange. In retrospect, it would seem that an unsustainable policy environment was maintained and deepened during the 1970s with the help of foreign credits. The continent has fared very poorly on the most important outcome variable: per capita GDP. In 1990 income per capita had fallen almost 8 per cent from the already low level of 1980 (IMF 1991).

External financing during the 1980s

A confluence of external and internal developments has exerted a double pressure on the balance-of-payments position of the countries of Sub-Saharan Africa since the early

1980s. They entered the decade with a large debt overhang and a legacy of unsustainable policies. Their economies were jolted by several external shocks which exposed their vulnerability: falling terms of trade and sharply increasing real interest rates (for figures, see Stymne 1989). In addition, the droughts of the early 1980s exacerbated the troubles further.

There was only gradual adaptation to these difficult circumstances as countries attempted to lower overvalued exchange rates, reduce fiscal deficits, improve incentives for farmers and raise domestic interest rates. The results were mixed. Export volume followed a positive trend while import volume fell. Fiscal deficits remained large throughout the 1980s and have only recently been curtailed on average.

During this period the access to external finance became extremely tight, especially in the first half of the 1980s. Hence, on the one hand there has been a greater demand for external resources as the terms of trade fell, old debts needed to be serviced and domestic savings improved only slowly; on the other hand less external resources became available, as the scope for borrowing dried up and real aid flows were slow in picking up.

The creditors

A significant development during the 1980s was that commercial creditors became even less willing to provide flows to the region than previously. When Latin America's debt crisis broke out in the early 1980s, the initial creditor response was to increase lending with the aim of making it possible for the debtors to implement economic policies that in the long run would make it possible to service their debts. However, in the case of Sub-Saharan Africa, hardly any such concerted lending was forthcoming.

The relative importance of the three main categories of creditors (private lenders, such as banks and suppliers, bilateral official lenders, such as export credit agencies and bilateral aid organizations, and multilateral official lenders, such as the World Bank, the African Development Bank and the International Monetary Fund (IMF)), in providing new flows has clearly shifted toward higher concessionality of loans and the increasing involvement of official creditors. According to the World Bank (1990), the average grant element of new loans increased from 21.3 per cent in 1980 to 47.3 per cent in 1989.

Table 5.1 Sub-Saharan Africa: composition of debt by creditor (in billions of US dollars)

Creditor group	*1980*	*1989*
Private creditors	19.5	37.1
Bilateral official creditors	16.5	56.1
Multilateral official creditors (including IMF)	10.5	37.7
Total	46.5	131.0

Source: World Bank 1990.
Notes: Short-term debt is excluded. Sub-Saharan Africa includes Nigeria, excludes Angola, Namibia, South Africa.

The claims held by each of these three creditor groups is indicated in Table 5.1. The table

shows that, both absolutely and relatively, the claims of private creditors have exhibited the least growth. This reflects that different creditor types have different rationales for their actions, and that the commercial viability of external creditor activity has waned overall. Much of the new lending has come through official institutions. Such lending has also become more co-ordinated, for example, in the context of the World Bank's Special Program for Africa (SPA), which makes concessional external assistance available to twenty-three countries that 'make efforts to reform their economies'.

The largest share of debt service paid by African countries has been received by private creditors. Approximately half of all debt service paid in the years 1980–9 was received by private creditors. About one-third was received by multilateral creditors, including the IMF, and the rest by bilateral official creditors. Unless reform programmes contribute to making the African economies more viable, there is no reason to believe that the interest of commercial creditors in Sub-Saharan Africa would increase substantially.

The importance of exceptional financing

During the 1970s most of the current account deficits (after the inclusion of grant aid) were financed on capital account, that is, through foreign borrowing. There were only a few reschedulings and the countries did not generally run up arrears. All this changed by the early 1980s. The squeeze on external financing manifested itself in the increasing use of exceptional finance. Recall that this refers to the rescheduling of claims and to the accumulation of arrears as a result of an inability to finance current account deficits on capital account. (The use of foreign exchange reserves and, in IMF terminology, purchases from the Fund, are also referred to as exceptional finance.) An indication of the importance of exceptional finance is provided by Table 5.2, which is an attempt to sum up the financing situation of Sub-Saharan Africa during the 1980s.

Table 5.2 Sub-Saharan Africa: external financing during the 1980s (in billions of US dollars)

	1980–3	*1984–7*	*1988–9*
Current account deficit	58.7	39.1	27.0
Non-debt creating flows	14.4	19.2	12.8
To finance	44.3	19.9	14.2
New long-term borrowing minus scheduled repayment of principal	23.1	–1.0	–5.6
Impact of rescheduling	10.6	27.7	16.5
Other (including other exceptional finance)	10.6	–1.8	3.3

Sources: See text.

Notes: Figures are period totals. Sub-Saharan Africa includes Nigeria, excludes Angola, Namibia, South Africa.

The figures in Table 5.2 should be interpreted with great caution. Attention should be paid to the pattern of finance rather than the specific numbers. The data for individual

years have been added together partly for this reason, partly in order to highlight the increasing dependence of Africa on exceptional finance. The current account deficit is expressed exclusive of official transfers, that is, aid. Current account deficits have in total remained large throughout the decade, although individual countries have made some progress in reducing them. Aid constitutes the largest share of 'non-debt-creating flows', which also include direct foreign investment (the net amount rarely exceeds one billion US dollars annually for the continent) and various transactions of minor importance such as gold monetization.

'New long-term borrowing minus scheduled repayment of principal' constitutes what could be seen as 'normal' transactions. The table shows that such flows fell drastically. The reason is that the growth in payments falling due has been far from matched by increased new lending from the creditors. Instead, the debtors have taken recourse to exceptional finance. The most important aspect of this development is the large share of payments falling due that are currently being rescheduled. In the period 1980–3, half the current account deficits were still financed through long-term lending. Since 1984, more than the entire cumulative current account deficits (after non-debtcreating flows) have in fact been financed through reschedulings! There has been no net financing on capital account.

The 'other' categories of external financing consist of payments arrears, use of reserves, and several other, smaller, categories. The large figure for the 1980–3 period is explained by the substantial accumulation of arrears during position of many countries.[2]

Debt rescheduling

Between January 1980 and September 1990, twenty-eight countries in Sub-Saharan Africa (as defined elsewhere in this paper) went through as many as 135 debt reschedulings with official and commercial creditors. The record is held by Zaïre, with thirteen reschedulings during the period. The amounts rescheduled are from a creditor perspective often small, with amounts between US $10 and 20 million not being uncommon. The opposite is sometimes true, however: on four occasions Nigeria has reached agreements about postponing payment of altogether more than US $20 billion.

As has already been mentioned, the debt renegotiations were originally carried out under the assumption that the debtors would be able to restore balance-of-payments viability within the consolidation period, that is, the time period during which the country's obligations were reduced. The assumption soon turned into fiction, something the creditors have slowly come to recognize. This recognition has led to gradually changing practices in the Paris Club, where the claims of bilateral creditors are renegotiated. Originally, only repayment of principal falling due under a brief period (twelve to eighteen months) could be considered for negotiation. Later, when it became increasingly common that this would be insufficient to create even short-run financial viability, the Paris Club also began to consider interest payments and previously rescheduled principal payments. The maturities of the rescheduled claims were lengthened from an average of nine years at the beginning of the decade to fifteen years toward the end. 'Multi-year rescheduling arrangements' (MYRAs) were introduced in order to extend the period during which creditors accepted to postpone claims in cases

when the restoration of balance-of-payments viability within twelve to eighteen months was particularly unlikely.

Finally, in 1988 the bilateral creditors gave up their firm resistance to the idea of outright debt reductions, and accepted the menu approach agreed by the leaders of the seven richest developed countries at their meeting in Toronto. This implied that, in the case of the poorer debtors, creditors were committed to providing relief under one of three options: cancellation of one-third of the amount consolidated, twenty-five-year maturities on rescheduled amounts, or a reduction in interest on rescheduled amounts. The first and third of these options led to debt reduction in present value terms.

Some two dozen debt reschedulings had been carried out on the basis of the Toronto agreement by the end of 1991. However, the effects on the cash flow of the debtors have been limited: the World Bank calculates that the total cash flow savings generated by these terms are only about US $100 million annually

The so-called Trinidad initiative, a proposal formulated by the UK in 1990, implied that, in the case of the very poor, heavily-indebted countries, the creditors would choose from a menu of options that included more significant outright debt reductions. So far, however, this initiative has not yet received sufficient support from all creditors to be possible to implement.

It should be emphasized that only bilateral official creditors reschedule claims as a result of the Paris Club agreements. The international creditor community has accepted the multilateral creditors' claim of seniority, which in practice means that such creditors never reschedule any claims. This is particularly problematic in the case of Sub-Saharan Africa, where certain debtors have very large obligations to multilateral organizations. These creditors have responded partly by making more resources available to such debtors. In principle this could have the same net effect as agreeing to reschedule claims. However, the multilateral organizations do not have satisfactory mechanisms in place for reaching agreements with countries that need assistance, and which have in addition accumulated substantial arrears to the multilateral creditors. As arrears make the debtors ineligible for new lending from these organizations, such payments problems can create an intractable situation which tends to continue until the organization is prepared to bend its rules and provide new assistance in spite of the arrears. Zambia's relationship with the IMF is a case in point.[3]

Unlike multilateral official creditors, commercial creditors are willing to accept the rescheduling of obligations. Such negotiations are sometimes referred to as the London Club. These agreements are of the more traditional type; the simple postponement of repayment of principal at market interest. No provision is generally made for outright debt reduction. There are said to be instances, however, of debtors clearing obligations with individual creditors below par.

To sum up, the increasing reliance on reschedulings is very troubling. In 1980–3, approximately 50 per cent of the current account deficits were still financed through 'normal' borrowing, that is, on capital account. Since 1984, however, they have in net terms been entirely financed through reschedulings. It occurs all too frequently that before long the rescheduling debtor requests a new debt renegotiation. As the role of reschedulings has become more important, their purpose has become less well defined. There is an inconsistency between the assumption that a debt rescheduling is a unique

event, allowing relief in a particularly tight situation, and the reality that almost all African countries which reschedule repeat the exercise within a few years. A rescheduling agreement now seems less a means to resolve a short-term liquidity crisis than a temporary postponement of the manifestation of a permanent, structural problem. Given the importance of official creditors, both in terms of being the dominant group of creditors and in terms of leadership in debt renegotiation practices, it appears that any reversal of the trend of falling net transfers is going to be the result of political will on the part of the official creditors rather than voluntary action by the commercial creditors. Such political will has, for instance, been expressed by changes in the rules of the Paris Club reschedulings, in response to changes in circumstances. Moreover, new kinds of facilities to enable adjustment have been developed both at the World Bank and at the IMF. Nevertheless, it seems that such changes are insufficient to make possible a rapid turnaround of the economies, or even normalization of debtor-creditor relationships.

The question obviously arises whether it is really beyond the ability of the African debtors to reverse the situation on their own. After all, countries that have managed to implement strong reform programmes have done considerably better than those that have not (World Bank and UNDP 1989). The next section will therefore examine the following question: When is a debt burden excessive?

AFRICA'S EXCESSIVE DEBT BURDEN

The external long-term debt of Sub-Saharan Africa almost tripled during the period 1980–9. In Africa the decade was characterized by economic decline. Meanwhile (to take an example), Korea's debt almost doubled from US $18.2 billion in 1980 to 35.9 billion in 1986 without long-term external payments disturbances and without raising serious questions about the fundamental viability of the economy. After 1986 Korea chose to reduce its external obligations. The main difference lies in the fact that Korea's ability to service its debts has improved at the same pace as debt has been growing, whereas the ability to pay of the African debtors has not. In Korea's case a sound economic base and skilful macroeconomic management made it possible to avoid a deterioration of the external position in the early 1980s (Collins and Park 1987). The African debtors have had less luck and skill during the decade.

A country's stock of debt is a summary measure for a set of future obligations that the country has undertaken to fulfil. A country's debt burden refers to the 'weight' of these obligations. An excessive debt burden would refer to a situation when the costs of fulfilling this profile of obligations exceeds the benefits of doing so. In the Korean example it would appear that the debt obligations were sufficiently low relative to the benefits of not paying, which was clearly not the case for many African countries that had much lower debt stocks.

Eaton *et al.* (1986) point out that international commitments are non-enforceable, since there are no mechanisms available that can force a sovereign country to pay its debts in full unless it chooses to do so. Therefore, the correct indicator of a debtor's 'willingness to pay' is the punishment that a creditor can credibly threaten to impose on the debtor. Only if the potential punishment exceeds the obligations would it be in the debtor's

interest to pay.

Attempts to quantify these punishments have shown that they appear to be limited. Kaletsky (1985) argues that creditor governments are extremely unlikely to support individual commercial creditors to collect their claims by force, unless there is also serious conflict at the political level between the two governments. According to Kaletsky's calculations, the most important likely 'cost of default' is that default may make it necessary for the debtor to carry out trade on *a* cash basis rather than financed through trade credits. However, for most developing countries, such costs would be much less than the cost of fulfilling debt obligations. This indicates that there are costs of default that are less tangible, for example, the loss of reputation. In Korea's case, fulfilling obligations may be a way of maintaining its reputation on international credit markets, ensuring future access to loans and attracting investors. This seems less probable in the case of most Sub-Saharan African debtors, who are unlikely to be net recipients of external credits from commercial lenders for a long time.

Given the difficulty in pinning down the cost of default conceptually, it is obviously even more difficult to quantify it. In the absence of an accepted measure of the cost of default, it may therefore be preferable to arrive at a conclusion about it by reversing the logic. This would be based on the assumption that it is possible to infer that *the costs of fulfilling obligations exceed the costs of default when sovereign default is observed.* In the terms of this paper, this would refer to the situation when the debtor country requests a rescheduling. In order to characterize the point at which this happens, some standard measures of debt burden will be used. These measures relate debt obligations to income. The assumption is that, all else equal, the cost of fulfilling debt obligations are smaller, the smaller the obligations are relative to income. The benefits of default may be expected to exceed the costs of default if obligations are large in relation to income.[4]

Future obligations are in principle discounted in the figure for the debt stock. A proxy for future income is also required. One possible such proxy is simply current national income (GDP), although it is a flow variable while outstanding debt is a stock variable. Debt to GDP ratios are often provided as indicators of debt burden. However, there are drawbacks in using the debt to GDP ratio. The most important is that since debts have to be serviced with foreign currency, the value of exports of goods and services gives a more accurate impression of income as it relates to debt-servicing ability. If the production of non-tradables increases but not that of tradables, there is a rise in GDP without necessarily any corresponding increase in the ability to service debts. Furthermore, there is in Africa a low degree of substitutability of exported commodities for domestic consumption goods. Therefore, the measure of debt burden to be used in the following analysis is the ratio of total outstanding external debt to exports of goods and non-factor services, or, in other words, the debt ratio.

The function of the debt ratio here is thus to provide an indication of the long-term debt burden. It can be understood as a measure of solvency. However, debt service problems manifest themselves in the short term, as cash flow problems. Once these cash flow, or liquidity, problems become so frequent and sizeable as to be permanent features, making it unlikely that the debtor will be able to reach external balance, it is clear that the long-term debt burden is excessive.

One commonly used indicator of the cash flow burden of the debt obligations is the

ratio of actual payments of interest and principal on external debt to exports of goods and non-factor services, or, in other words, the debt service ratio. It is impossible to determine unambiguously a specific debt ratio as a 'point of insolvency', nor is there a debt service ratio which is a 'point of illiquidity'. However, it can be expected that there is cause for concern if any of the measures deteriorate substantially over time. Furthermore, experiences from other countries may provide a rule of thumb for determining the level at, respectively, which a debt ratio or a debt service ratio predict long-term and imminent payments problems for a debtor. A rising debt burden is evidence that adjustment of economic policies is necessary, a high burden that debt relief may be essential for making adjustment possible.

The present section will discuss the development of the measures of debt burden for various categories of countries in Sub-Saharan Africa, in order to arrive at a specific conclusion about when a debt burden may become excessive.

The growth of debt burden

The increasing African debt burden as expressed through the debt ratios and debt service ratios are shown in Figure 5.1. The story told by the numbers is clear: after slow deterioration in the 1970s, the magnitude of the burden has grown rapidly since 1981. Export prices stagnated that year, which resulted in a larger share of export earnings being required for debt service payments. Moreover, the share of debt to be amortized had started to rise for many debtors. The subsequent unfavourable trend of export prices in conjunction with further debt accumulation and only small gains in export volumes have caused an accelerated deterioration of liquidity and solvency status.[5]

For the group of forty-four countries in Sub-Saharan Africa as a whole, debt and exports grew at the same rate throughout the 1970s, leading to a more or less constant debt ratio. The annual growth of export volume was just 0.9 per cent during the period, but with export prices growing at 13.1 per cent per annum there was little increase in the debt burden in spite of the large amount of borrowing. Outstanding debt increased by a factor of nine, exports by a factor of seven, and thus the debt ratio only rose from 66 per cent in 1970 to 85 per cent in 1980. In an inflationary period, such active borrowing did not appear extravagant – the value of the stock of debt would appear to have gradually been inflated away.

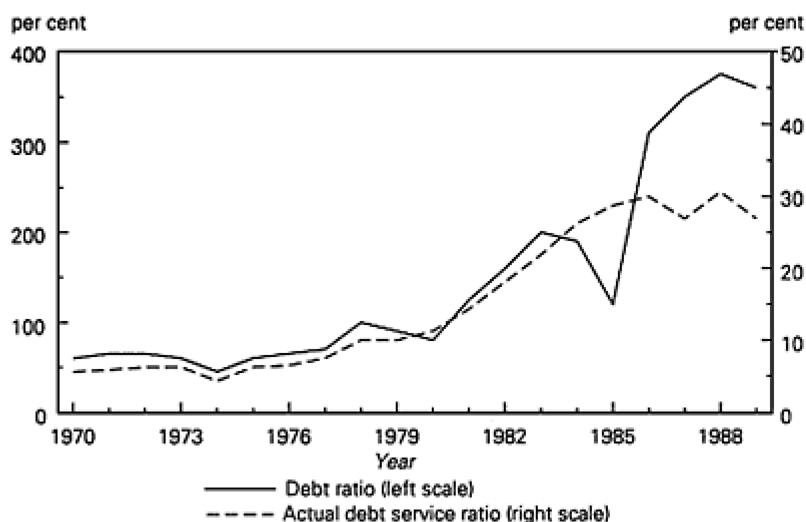

Figure 5.1 Debt burden of Sub-Saharan Africa, 1970–89
Sources and definitions: See text.

However, by the end of the decade, the boom had fizzled out for most commodities, and the 1980s brought deflation from the point of view of African exporters: up until 1987 export unit values declined on average by 3.5 per cent annually for Sub-Saharan Africa excluding Nigeria. There are many examples throughout history of firms or individuals amassing debt during an inflationary period and then going bankrupt in the following deflation. In 1989, as export earnings grew faster than the stock of debt for only the second time in the decade, there was some indication of a break in the trend toward what would in practice be bankruptcy for a whole continent.

The debt service ratio rose somewhat during the 1970s, from approximately 6 per cent at the beginning of the decade to over 10 per cent towards the end. The main reason for the faster growth of the debt service ratio than of the debt ratio during the 1970s was the increase in bank borrowing and non-concessional official borrowing. Such credits tended to carry higher interest and have shorter amortization periods than the softer loans of the period preceding the first oil shock. The share of concessional loans of outstanding debt fell from around 50 per cent in 1975 to around 40 per cent in 1979 (World Bank 1988).

After 1980, the rate of increase in debt service payments fell – but by then the level of payments was already high, and with stagnating exports the rate of increase in the debt service ratio until 1986 was as rapid as that of the debt ratio. Both ratios rose approximately by a factor of three between 1980 and 1986: the debt ratio from 85 per cent to 304 per cent, and the actual debt service ratio from 11 per cent to 30 per cent.

Toward the end of this period, the growth of the actual debt service ratio flattened out. It fell from the 1986 high to 22 per cent in 1989. This is entirely a result of the increasing importance of exceptional finance. The scheduled payments continued to grow at a pace similar to growth of the stock of long-term debt.

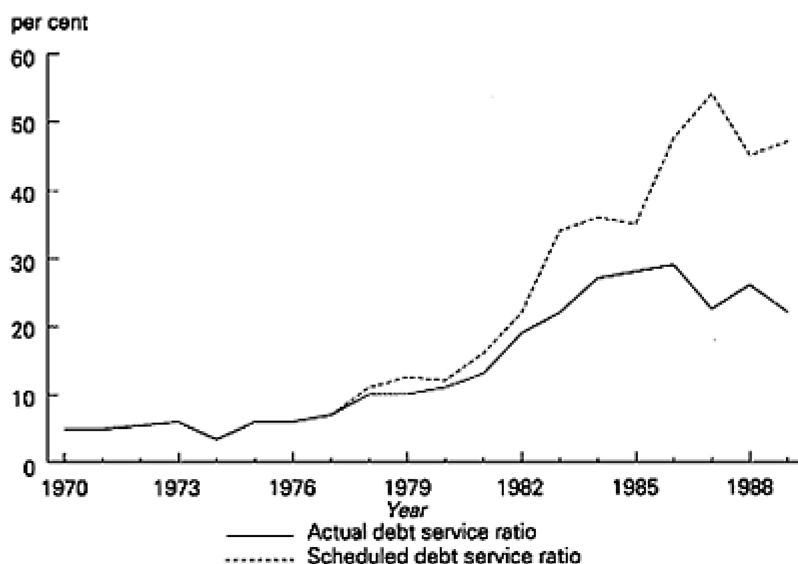

Figure 5.2 Debt service ratios of Sub-Saharan Africa, 1970–89
Sources and definitions: See text.

The difference between scheduled and actual debt service ratios for Sub-Saharan Africa as a whole are displayed in Figure 5.2.[6] It can be seen that the trend of the scheduled debt service ratio is the same as the trend of the debt ratio. The large, and generally growing, difference between actual and scheduled payments indicates that normalization between debtors and creditors is not likely. The debt service obligations associated with a debt ratio of over 300 per cent imply a debt burden which is perceived as too heavy by the debtors. Judging from Figure 5.2, the maximum sustainable debt burden seems to lie between 20 and 30 per cent of export earnings. If scheduled debt service exceeds this, it seems that the costs of requesting a rescheduling are exceeded by the cost of making resources available for full payment.

Countries with and without payments problems

There is a noteworthy difference between the patterns of debt burden growth of countries that have experienced payments problems and those that have not. The former category is defined as the thirty-two countries (currently owing 85 per cent of outstanding African debt) that accumulated payments arrears and/ or have gone through rescheduling of external debt at least once in the period 1980-8. The latter category consists of a rather disparate set of twelve countries: a few poor agricultural exporters such as Burundi, Kenya and Rwanda; middle-income countries such as Botswana and Cameroon, and some very small countries with special circumstances such as Jibuti and the Seychelles.[7]

The median income of the group of countries without payments problems somewhat exceeds that of the countries with payments problems. Nevertheless, both groups contain

a variety of debtor types, from the poorest to the (comparatively) most well off. The structure of debt is not dissimilar between the two categories: they both owe around three-quarters of their long-term debt to official creditors and the rest to private creditors. The factor that distinguishes the two groups is the growth of their debt burdens after 1980, as displayed in Figure 5.3.

Up to 1980 the debt ratio grew almost identically for countries with and without payments problems. After 1980, however, things changed. Between 1980 and 1989, the debt stock of the former category tripled, while it

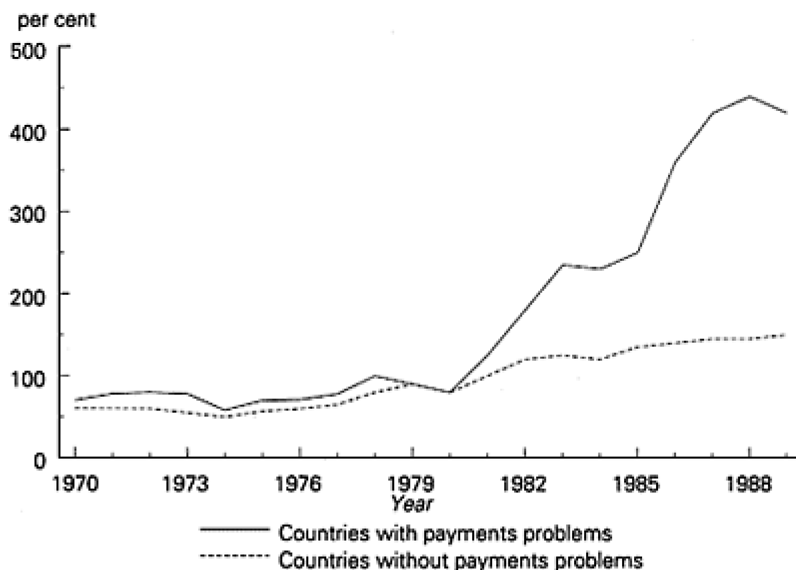

Figure 5.3 Debt ratios by country category, 1970–89
Sources and definitions: See text.

increased by around 150 per cent for the latter category. Nominal export earnings fell by a quarter for the former category – and increased by a quarter for the latter.

This manifests itself in the development of scheduled debt service ratios for the two categories of countries. Until the early 1980s, the scheduled ratios were very similar for the two categories. A few years later, poor export earnings and growing debt stocks implied obligations that were rising very rapidly for the countries that have experienced payments problems. As can be seen from Figure 5.4, scheduled debt service ratios for the problem countries are between two and three times those of the countries without payments problems.

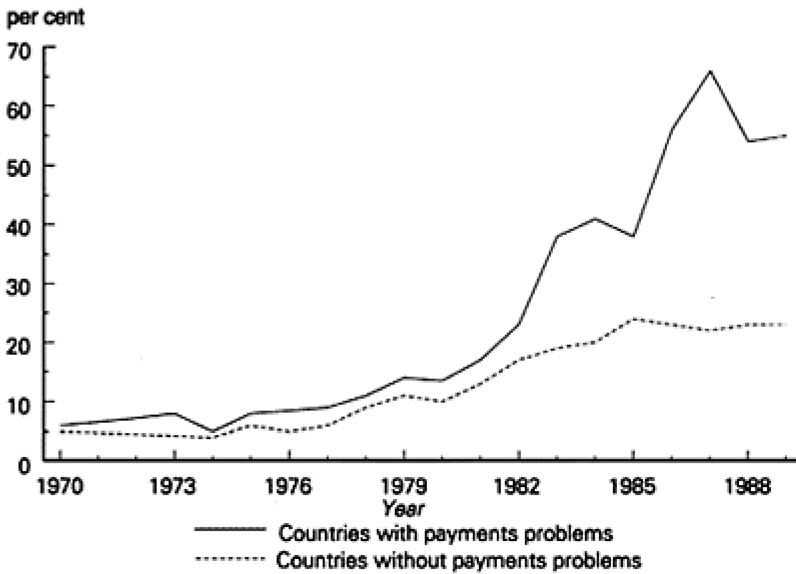

Figure 5.4 Scheduled debt service ratios by country category, 1970–89

Sources and definitions: See text.

Figure 5.5 compares actual debt service ratios for the two categories of debtors. These ratios are very similar for the two groups. At most, the actual debt service ratios of the problem countries are higher by a few per centage points. Reschedulings (and arrears, which are not incorporated in the graph) have reduced actual debt service payments – sometimes by being capitalized and consequently showing up in the debt ratio.

What debt service obligations are caused by a given stock of debt? For the group of countries without payments problems, the average interest paid on outstanding debt has been close to 6 per cent throughout the period.

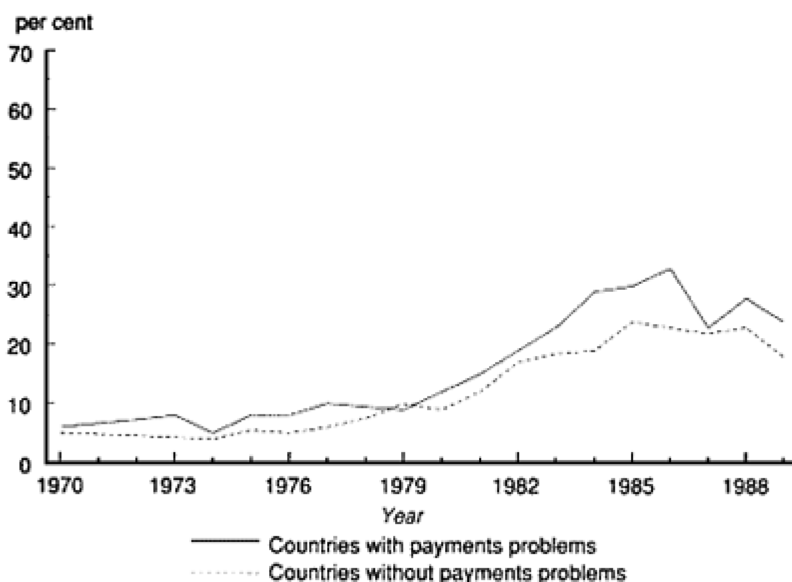

Figure 5.5 Actual debt service ratios by country category, 1970–89

Sources and definitions: See text.

However, the share of outstanding principal repaid grew from 6 per cent in 1981 to 9 per cent annually toward the end of the decade. The reason behind this growth lies in the maturity structure of the loans taken in the 1970s and the early 1980s. Thereby, debt service payments on outstanding debt increased from 12 to, on average, 15 per cent toward the end of the 1980s.

For the group of countries with payments problems, the ratio of debt service payments to debt stock fell from around 11 per cent in the early part of the 1980s to less than 6 per cent in 1989. Contracted obligations, however, were similar to those of countries without payments problems.

The result of all this is that actual debt service payments as a share of exports have remained at the same level in the two categories of countries, in spite of the significantly higher debt ratios of the countries with payments problems. In 1987–9 the actual debt service ratios of the problem countries were on average close to 25 per cent. In the countries without payments problems, the scheduled debt service ratios were on average around 22 per cent for this period, while they were a staggering 59 per cent for the problem countries. Each time the payments of problem countries are rescheduled (or when a previously diligent debt servicer enters the category of reschedulers), they are in effect added to the principal. This has a snowballing effect on future obligations. Ostensibly, the creditors and debtors expect that future developments will make the fulfilment of these increased obligations possible.[8]

The pain threshold

A central issue here is the sustainable level of debt service, that is, the level over which a sovereign debtor through its actions reveals that it is costlier to pay than to (partially) default. By inference, the feasible ceiling on the debt ratio is given, if the terms of repayment of the debt stock are known.

The unweighted mean debt service ratio in the year of each country's first rescheduling is 24.3 per cent for twenty-nine of the African countries that have rescheduled at least once. The mean debt service ratio in the year prior to the first rescheduling is 23.8 per cent. (Median debt service ratios are in each case about 1 percentage point less than the mean.) However, it should also be noted that there are large individual variations: the mean debt service ratio in the year of the first rescheduling has a standard deviation of 13; in the year prior to first rescheduling, the standard deviation is 14. Thus, the debt service ratio has little predictive power for the payments willingness of a given country; it is necessary to approach each country in a case by case fashion. But the measure can be used to generalize the experience of a group of countries. It supports the conclusion above about the maximum size of debt service obligations at which the debtors find it worthwhile to maintain a normal relationship with their creditors.

As a thought experiment, the following question may be asked: What amount of adjustment would be required for the problem countries to normalize payments – that is, at what volume of debt would their current debt service payments be 'legal?' Assuming that the maturity structure of the debt of the two categories of debtors is roughly equal (in the sense that the percentage of outstanding debt to be amortized per year is the same, as well as average interest paid – in this case adding up to about 15 per cent of total debt), and assuming that 25 per cent is a feasible debt service ratio, then the maximum debt ratio is slightly less than 170 per cent. If feasible debt service were 30 per cent, the debt ratio should not be allowed to exceed 200 per cent. In the case of the countries with payments problems, the actual debt service ratios are squeezed to their feasible levels through rescheduling exercises. Of course, the intention is that these debtors will normalize their payments eventually. But what kind of adjustment would this require?

In 1989 the group of debtors with payments problems had a debt ratio of 429 per cent. If this group were somehow able to reduce its total outstanding debt from US $120 billion to 47 billion, its debt ratio would be pushed down to 170 per cent. Equivalently, if export earnings were to instantly jump from US $28 billion to 71 billion, the same objective would be reached. In either case, the debt service ratio would remain at 25 per cent – but, since actual debt service would be equal to contractual, it would eliminate the need to take recourse to the painful process of rescheduling.

Of course, reality is more complicated. The feasibility of the adjustment process will be pursued in a slightly more developed fashion in the next section. But this example does show that even a very large adjustment would lead to little apparent alleviation of the actual debt burden, as expressed through the share of export earnings paid as debt service. This is likely to be a powerful incentive against adjustment in these economies.

Furthermore, it underlines that the size of the effort required to normalize external relations increases with the debt ratio. As the gap between the actual debt ratio and the

sustainable debt ratio grows, the probability that the problem debtors are going to be able or willing to achieve such a turnaround on their own accord can be expected to fall.

THE EFFECTS OF DEBT RELIEF

All proposals for debt relief are based on some notion of relief being conditional on reform of the debtor economy. Initially, Paris Club agreements were conditional on the debtor's commitment to introducing policies to improve debt service capacity reasonably quickly, with little attention paid to growth prospects. However, the focus has shifted somewhat toward the long-term growth prospects of the debtor economies as a larger share of new resources are being provided on soft terms by multilateral and bilateral institutions.

In the context of the present paper, it would be interesting to arrive at some idea of the magnitude of economic adjustment (on the debtor side) and debt relief (from the creditors) that would be necessary to reduce the debt burden sufficiently to normalize relationships. In the following this question is pursued through an exceedingly simple simulation of the Sub-Saharan economy, where all diversity between countries is disregarded. The simulation underlines the importance of adjustment (here manifested in export growth) in reducing debt burden. This discussion disregards such problematic aspects of debt relief as the free-rider issue among creditors (even if it is in the creditor's collective interest to forgive debt, the individual creditor wants to press his claims in full) and various incentive effects on the debtor (is expected future debt relief an incentive for bad economic policies today? Does relief provided to one debtor raise the bargaining power of other debtors?).

The effect on debt burden of debt relief over a five-year period is simulated, given different assumptions about export growth. The simulation is based on the development over a five-year period of the economy of an entity very much like Sub-Saharan Africa. A number of scenarios are explored with different assumptions about export growth and about debt relief provided. In line with the discussion in the last section, normalization requires that the debt ratio falls to 170 per cent by the end of the simulated period.

Obviously, a reduction in the debt ratio can come about both as a result of export growth and of reduction of claims, through repayment of principal or through debt forgiveness. One important aspect of this is that, for a given change in the debt ratio, higher export growth makes it possible to accumulate more debt. If export growth is rapid enough, a sufficient drop in the debt ratio may come about accompanied by only limited reduction of the debt stock.

The starting point of the simulation is the balance of payments of 'Sub-Saharan Africa'. Current account deficits need to be financed through foreign borrowing, which adds to the stock of debt. Current account surpluses are used to reduce the outstanding stock of debt. The change in the debt stock is equal to the current account deficit (increased stock) or surplus (reduced stock). This means that outstanding debt is always rolled over, and that principal is only repaid when the debtor runs a current account surplus.

The current account consists of four components. These are exports of goods and non-

factor services, imports of goods and non-factor services, official transfers (grant aid) and interest payments on foreign debt.

The basic assumptions of the simulation are as follows. In year zero exports of goods and non-factor services are US $38 billion, and imports of goods and non-factor services US $43 billion. Official transfers are US $5 billion. Outstanding debt is US $133 billion, which gives a debt ratio of 350 per cent. Average interest on outstanding debt is 6 per cent, as is the interest on new loans. All this roughly corresponds to the figures for Sub-Saharan Africa at the end of the 1980s.[9]

The simulation has been made for a large number of scenarios, of which the results of four are presented in Table 5.3. Four different rates of annual export growth have been assumed in the various scenarios: 0, 3, 7 and 11 per cent. This gives the first component of the current account. The second component of the current account is given by assuming (in all scenarios) that official transfers grow by 10 per cent annually. The third component of the current account deficit, interest payments on external debt, is estimated to be 6 per cent of the previous year's debt stock. The fourth component of the current account, import expenditures, is inferred in the following fashion.

Each scenario assumes a 'target' debt ratio by year 5. Since the export growth is known by assumption, the value of exports at the end of the period is predetermined, and thus, by inference from the debt ratio, the stock of debt is also given. This in turn, makes it possible to calculate the cumulative current account, which is allocated over the five-year period. With the current account deficit (or surplus) known in each year, as well as three of the four components of the current account (exports, aid and interest payments), imports can now be calculated. Four different 'target' debt ratios were explored in the simulations: 80, 170, 260 and 350 per cent.

For example, assuming 3 per cent export growth and no debt relief, exports in year five are US $44.1 billion. If the debt ratio is to be 170 per cent by that year, outstanding debt needs to be reduced from US $133 billion to US $74.9 billion. Thus, the cumulative current account surplus required is US $58.1 billion. Allocated over five years, and given the development of the other current account items, this means that cumulative imports are US $145.2 billion. This corresponds to a reduction of annual import expenditures by almost 30 per cent.

Table 5.3 Sub-Saharan Africa: projections of debt burden. Results of a simulation

	Scenario 1	*Scenario 2*	*Scenario 3*	*Scenario 4*
Scenario assumptions				
Annual export growth	3%	11%	7%	11%
Annual debt forgiveness (bn US $)	0	0	10	5
Debt ratio, year 5	170%	170%	170%	170%
Scenario outcomes (bn US $)				
Cumulative exports	207.8	262.7	233.8	262.7
Cumulative imports	145.2	229.3	234.6	254.3
Cumulative int. payments	32.1	36.9	34.4	36.9
Cum. current account	58.1	24.1	–7.6	–0.9

Debt stock by year 5	74.9	108.9	90.6	108.9
Int./exports, year 5	11.4%	10.6%	11.0%	10.6%

Note: Five-year projections of external variables under different assumptions about export growth, debt relief and the debt ratio. See text for further explanation.

The second scenario presented in Table 5.3 assumes export growth of 11 per cent per year. In order to achieve a debt ratio of 170 per cent by year 5, a cumulative current account surplus of US $24.1 billion would be required.

The performance required in each of these two scenarios seems highly improbable in the case of Sub-Saharan Africa. It would require an extremely rapid and successful export growth while imports are actually squeezed. The reforming countries would reap little benefit themselves of such performance – most of the benefits would accrue to the creditors in the form of debt service payments.

This leads to the following question: How much can imports be squeezed and still enable a given level of export growth to be attained? Much more sophisticated methods than those used here are required to answer this question properly. In particular, it makes little sense to study the continent as a whole rather than individual countries. The domestic economy is not specified in the simulation, so there is no way of making it determine the relationship between export growth and import requirements.

A simple assumption is therefore made here. It can be noted that in no year during the past decade has Sub-Saharan Africa produced a surplus on its trade in goods and non-factor services. Imports tend to exceed exports by some 10 per cent. Even when the production of tradables has been markedly expanded, and an improvement in the terms of trade has taken place, it would be hard to trust the feasibility of scenarios that require import strangulation while exports grow rapidly. Therefore, the highly *ad hoc* assumption is made that the only acceptable scenarios are those where the cumulative value of imports does not significantly exceed the value of exports. This clearly rules out the feasibility of the two scenarios discussed so far. In fact, it rules out any scenario which does not include debt relief.

With this in mind, a number of scenarios assuming various levels of debt relief, given combinations of assumptions about export growth and the target debt ratio, have been explored. The debt relief is assumed to consist of the gradual cancellation of part of the principal. The reduction is annual; thus, four versions of debt relief, billion US dollars 0, 2, 5 and 10 annually, imply a total write-off during five years of billion US dollars 0, 10, 25 and 50, respectively. The effect on the cash flow is much less, since each US dollar cancelled implies US dollar 0.06 less in yearly debt service payments, as interest paid is 6 per cent. But since debts are cancelled, this reduction is permanent.

This scheme for debt relief is unlike those that in practice are being considered, in that it only provides cancellation of principal, and does not address the issue of interest on outstanding debt. This mechanism is preferred here since it makes it possible to retain the comparability of the debt ratios, pre- and post-relief. Conversely, if interest on outstanding debt was reduced, a given debt ratio would imply a lower debt burden. However, there is no conceptual difference between the two types of relief, since it would

be possible to choose some concessional refinancing of non-concessional debt that would have the same effects on the cash flow as in this model. Finally, the reason for the gradual cancellation of principal is to allow a slower impact on the payments position of the creditors than if the cancelled debt was struck out all at once.

Few scenarios achieve a debt ratio of at most 170 per cent by year 5 without violating the assumption that cumulative exports may not exceed imports. If the debt relief amounts to US $10 billion per year, export growth of 7 or 11 per cent makes it possible to achieve a debt ratio of 170 per cent by year five. If debt relief is US $5 billion per year, annual export growth of 11 per cent is required. Two of these examples appear as scenarios 3 and 4 in Table 5.3.

How does this compare with current debt relief available? As already mentioned, the Toronto terms provide extra relief of perhaps US $100 million annually. In the scenario above with 7 per cent export growth, altogether US $50 billion would need to be completely forgiven by year five. The annual cash flow effect of this would be around US $3 billion – forever.

Programmes such as the Special Program for Africa do provide additional resources for the poorest countries. For 1988–90, altogether US $6.7 billion were made available as 'new funds' (World Bank 1990). If amounts of this magnitude were made available without any substitution for the official transfers that would be provided anyway, it could come close to the amounts necessary for normalization.

To sum up, this simulation suggests two things. First, the payments situation of the debtors will not be normalized in the foreseeable future, unless debt relief is forthcoming which is significantly in excess of what is now being provided. Second, any attempt to improve the ability of the debtors to get their economies in shape will require a rapid recovery of exports in order to succeed.

CONCLUDING REMARKS

A troubling aspect of the increasing reliance on financing through rescheduling is the inconsistency between this practice and the theory that reschedulings are exceptional events. Their recurrence is antithetical to the maintenance of orderly trade and payments relationships between debtors and creditors. As long as the need for future reschedulings is not abolished, reschedulings only postpone the manifestations of structural problems.

This paper has not considered the various incentive problems involved in providing debt relief. Neither has it discussed the kind of adjustment efforts that are necessary to achieve rates of export growth that are indicated as necessary by the simulation exercise. On the other hand, it has pointed to an issue which is mostly not explicitly addressed in discussions of debt relief: how much relief is necessary if relationships between debtors and creditors are really to be normalized? It is clear to everyone involved that repeated debt renegotiations under the fiction that the payments problems are temporary are very costly to the debtors. Although a programme such as the proposed Trinidad terms expects markedly-reduced payments requirements from the debtors, it is still necessary to consider more explicitly (preferably on a case by case basis rather than, as in this paper, on a continent-wide basis) what the requirements are for true long-term normalization

rather than for short to medium-term relief.

Since many African debtors will never be able to service their debts properly there is a strong argument for increased permanent debt relief. By being the basis for normalization, such relief could be a catalyst for an increased flow of resources to the poor debtors, in support of efforts to achieve positive income growth rates. A combination of debt relief from the creditors and efforts by the African debtors to raise the production of tradables significantly could have a strong impact in restoring the viability of the debtors' economies.

NOTES

1 The accumulation of foreign assets by domestic citizens or, in other words, capital flight, has played a smaller role in Sub-Saharan Africa than in Latin America (except probably in some of the larger debtor countries, such as Nigeria and Zaïre). This is largely because of the predominance of public borrowing over private, and since most foreign transactions are controlled by state-run organizations.

2 The recommendation to treat all these figures with caution should be taken seriously. Table 5.1 is a condensation of data from several different sources, namely, data provided by the IMF Research Department and figures found in World Bank (1988), World Bank (1990) and IMF (1991). The data from these sources are not always consistent. The processing of the data has included a fair amount of personal judgement. The timing of the impact of rescheduling is one category where this has been especially important. Again, the general magnitudes should be reasonably correct, give and take a few billion US dollars. For a further discussion of this, see Stymne (1989).

3 Creative approaches to get around the problem of multilateral creditors' unwillingness to reschedule claims include the 'fifth dimension', supplemental International Development Association (IDA) adjustment credits to countries with interest due on International Bank for Reconstruction and Development (IBRD) debt.

4 Obviously, lenders and export credit guarantee agencies attempt to develop sophisticated systems for estimating the probability of default (see, for example, Solberg 1988). They have an interest in finding mechanisms to forecast both the timing and the extent of default of individual countries. However, the purpose of the discussion in this section of the paper is to make a basic analysis of the level of the debt burden which in the Sub-Saharan case seems to be unsustainable in the long run, and not to refine methods to assess individual country risks.

5 The data in these and the following figures are based on data made available by the IMF research department and the World Bank (1990). The caution concerning the interpretation of the data expressed in note 2 above are valid here as well. The debt ratio and the debt service ratio are as defined in the text. Actual debt service ratio refers to the amounts actually paid, rather than the obligations to pay. Sub-Saharan Africa includes Nigeria, excludes Angola, Namibia and South Africa.

6 Data on 'scheduled debt service' are not directly available. The figures have been inferred by taking actual debt service payments and adding impact of rescheduling. To arrive at actual scheduled debt service, arrears would also need to be added. One important effect of this would probably be to increase the gap between scheduled and actual payments in the early 1980s. However, the uncertainties involved in estimating arrears have led to their exclusion from the present estimates of scheduled debt payments. Another potential source of error

concerns the timing of the impact of rescheduling. The largest share of the consolidation period may fall in another period than the date of the rescheduling agreement. Attempts have been made at a proper timing of the impact of each individual agreement. Errors in this process, however, may mean that the shape of the curve in Figure 5.2 is different from the 'true' curve. In any case, the general impression should be correct.

7 The additional five countries of the group are Ethiopia, Lesotho, Mauritius, Swaziland and Zimbabwe. Some of the twelve countries have recently shown signs of 'falling over the edge'; Cameroon rescheduled for the first time in 1989. The whole set of countries are included here among the countries without payments problems, however, so as not to reduce the size of the group too far.

8 The exception is when terms are chosen from the Toronto menu so that certain debt obligations are reduced in present value terms.

9 Since the principal is continuously rolled over, the size of the debt service ratio does not have any significance in this simulation. Instead, one indicator of the burden of debt service payments is the ratio of interest payments to exports. With an outstanding debt in the base case of US $133 billion, 6 per cent interest and US $38 billion of exports, the interest ratio would be 21 per cent.

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Part II
PROBLEMS OF THE EXTERNAL SECTOR

6
TRADE LIBERALIZATION: THE ZIMBABWEAN WAY

Dick Durevall

INTRODUCTION

At independence in 1980 the prospects for Zimbabwe looked bright and initially economic growth was exceptionally high. However, in 1982 drought and other shocks caused gross national product (GDP) to decline and the euphoria soon vanished. For the whole decade the average per capita growth of real GDP was approximately 1 per cent, which was better than that of most other Sub-Saharan countries. In spite of this, at the end of the decade real income per capita was lower than in the mid-1970s and poverty was still widespread.

After several years of deliberation the government concluded that the import-substitution policy inherited from Rhodesia was inhibiting growth and had to be abandoned. Hence, in October 1990 a structural adjustment programme was launched, and in the beginning of 1991 a document called 'Zimbabwe: A Framework for Economic Reform (1991–95)' (Goz 1991a) was released, stating what steps had to be taken.

This chapter is structured in the following way. The second section deals with the economic performance since independence and the arguments for implementing a trade liberalization programme. In the third section the policy framework paper is outlined. Some of the consequences of the reform are analysed in the next section. Finally, the last section provides some concluding remarks.

THE ZIMBABWEAN ECONOMY SINCE INDEPENDENCE

In 1965 the white settler government declared the unilateral independence of Rhodesia. The UN-imposed sanctions forced the regime to follow a policy of import substitution. The Zimbabwean government, which came to power in 1980, continued with the same development strategy.

During the period 1980 to 1989 the average annual rate of growth of real GDP was 4.0 per cent (see Figure 6.1).[1] As already noted this is about 1 per cent per year in per capita terms.

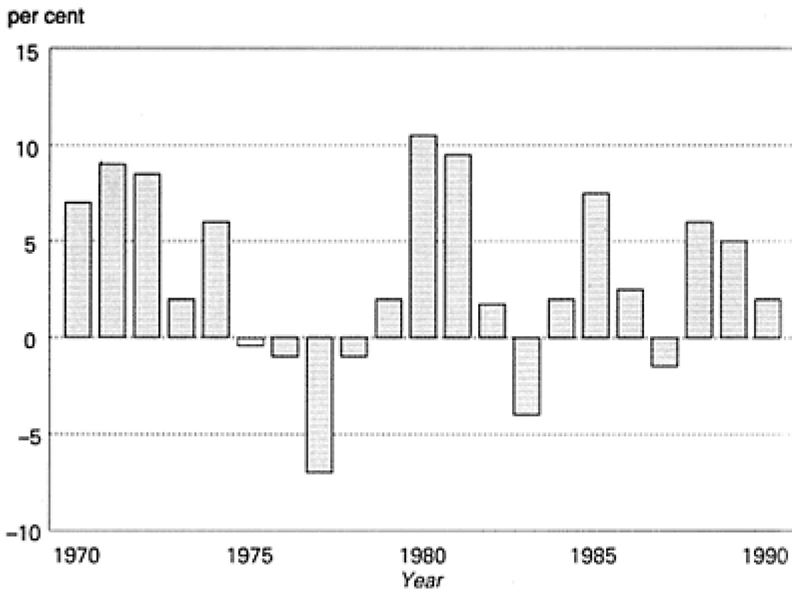

Figure 6.1 Zimbabwe: growth of real GDP, 1970–90 (1980 prices)
Sources: CSO (1989); IMF (1990).

However, if we instead were to compare *levels* of real GDP *per capita* for different periods, it is easy to show that on the whole the performance of the Zimbabwean economy has not been satisfactory. As shown by Figure 6.2, real GDP per capita in 1989 was lower than at the beginning of the 1980s when, in turn, it was lower than in any of the years 1972–5. In fact, ten years after independence real GDP per capita was about 10 per cent less than fifteen years earlier. This indicates that the Zimbabwean economy could probably have grown faster.

More evidence of economic stagnation can be found by looking at the development of investments. The share of real gross fixed capital formation in GDP declined from 22 per cent in 1983 to 13 per cent in 1985, and was at the end of the decade 12.5 per cent (see Figure 6.3). Such a low investment to GDP ratio is hardly enough even to maintain the existing capital stock. Not surprisingly, large portions of Zimbabwe's machine park are quite old. In order to have high and stable growth rates over several years, the ratio should be at least 20 per cent.

Yet another indicator of economic stagnation is the number of people employed in the formal sector as a share of the total population. It decreased from 16.7 per cent in 1975 to 12.9 per cent in 1988 as shown in Table 6.1. The manufacturing sector employed 2.5 per cent of the population in 1975, while

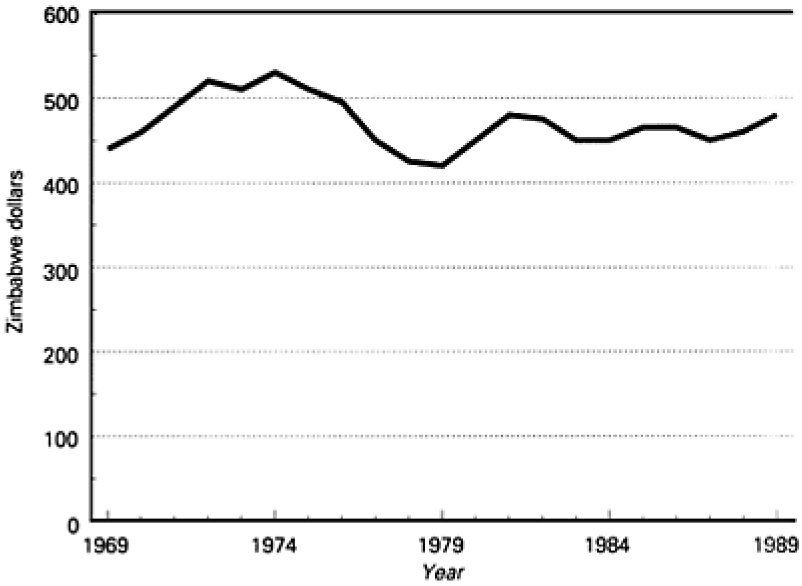

Figure 6.2 Zimbabwe: real GDP per capita, 1969–89 (1980 prices)
Sources: CSO (1989); IMF (1990).

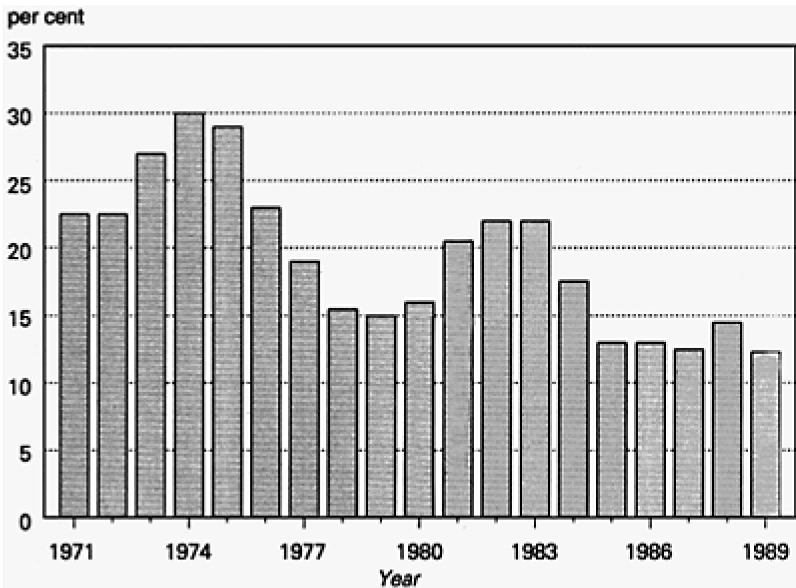

Figure 6.3 Zimbabwe: fixed capital formation, 1971–89 (share of GDP, 1980 prices)

Sources: CSO (1991); *Quarterly Digest of Statistics*, September.

in 1987 this figure had declined to 2.0 per cent. Moreover, the net increase of total employment in the formal sector has been low in comparison to the number of people entering the labour force. Although the term unemployed is not a well-defined concept in Zimbabwe, a sign of the seriousness of the situation is that while 268,000 were estimated to be unemployed in 1980, today the figure is between 1.2 and 1.5 million (GOZ 1989, 1991a).

Table 6.1 Zimbabwe: formal employment in per cent of population

Year	*1975*	*1976*	*1977*	*1978*	*1979*	*1980*	*1981*
Employment (%) population	16.7	15.9	15.1	14.3	13.8	13.7	13.7
Manufacturing emp. (%) population	2.4	2.4	2.2	2.1	2.2	2.4	2.4
Year	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*
Employment (%) population	13.7	13.4	13.0	12.9	12.8	12.3	12.9
Manufacturing emp. (%) population	2.2	2.1	2.1	2.1	2.1	2.0	–

Source: CSO, *Quarterly Digest of Statistics.*

The reason for the economic stagnation is, according to Davies and Rattsø (1990), that the import-substitution strategy lost its dynamics in the mid-1970s, when the easy substitution phase was over (see also World Bank 1987). The economy has since then fluctuated around a basically stagnant trend due to external shocks.

In order for import substitution to work it must be possible to substitute imports at reasonable cost. With time this becomes more and more difficult as there are less goods than can be produced and sold with a profit on the domestic market without heavy investments. Today the bulk of consumer and many intermediate goods are already produced in Zimbabwe. At the end of the 1980s only 2 to 3 per cent of all imports were consumer goods (Davies 1989).[2]

Some economists have, however, argued that external shocks are the main culprits for the poor performance, and that the government should continue with the import-substitution policy although in a streamlined and revised form (Green and Khadani 1986, Robinson 1987; Pakkiri *et al.* 1988). That Zimbabwe has been afflicted by a number of negative shocks is evident from Figure 6.1. The first oil shock coincided with an escalation of the liberation war in the mid-1970s. There was a second oil shock in 1979, followed by a world recession and rising international interest rates. In addition there have been several droughts, most notably during 1982–4, 1987 and 1990.

There are thus basically two views with regard to the causes of the slow economic growth and they suggest different development strategies for Zimbabwe in the 1990s – continuing with the same policy or, deregulating the economy and switching to export orientation. Unfortunately no in-depth study has been made to resolve the issue.

In the following section we describe the market interventions that have been necessary to undertake in pursuing the import-substitution strategy in Zimbabwe and some of their

consequences. There are several indications that with time these became damaging to growth (see also Durevall 1989).

The foreign exchange allocation system

The policy of import substitution implies an overvalued effective exchange rate. Overvaluation makes it more profitable for a firm to sell on the domestic market than to export, that is, it creates a bias against exports. Unless there are large compensating capital inflows the result is a lack of foreign currency. Moreover, since imported goods are relatively cheap, the demand is large. Hence, there is a need for import controls. In Zimbabwe this is carried out with an exchange allocation system, which is a way of regulating the supply of foreign currency and directing it to activities preferred by the government. In principle it is a system of import quotas, although the quotas may change each time an allocation is made.

In 1980 over 90 per cent of the imports passed through this allocation system. The introduction of export incentive schemes reduced this figure and in 1986 it was 56 per cent (GOZ 1987). Foreign currency is allocated to the private sector after bids every six months. In addition, there are several socalled *ad hoc* allocations. To enter the system, a new firm must have existed for more than a year and should establish that its activities render the country a net gain of foreign exchange. Investment projects must be net foreign exchange savers within a period of twelve months (Robinson 1987).

The positive aspect of the allocation system is that domestic industries are protected from competition during a building-up phase when they cannot compete internationally. The system has, however, several negative effects. One is that although the allocations are made after bids from the importers, the priorities of the government often determine the outcome. It is uncertain that these will correspond to the allocation outcome of a deregulated foreign-exchange market. In this sense the resulting distribution is not efficient since foreign exchange does not go to the activities that can make the most profitable use of it.

A feature of the allocation system is the need for continuity. Once a firm has been accepted into the system it will receive foreign exchange on a regular basis because otherwise it would go bankrupt. Adding this to the requirements for eligibility it is obvious that new firms have difficulties entering the allocation system while old ones lead a fairly easy life.

In addition, there is the problem of actually administering the allocations. The process is complicated, and a number of people, committees and ministries are involved. The administrative routines also make it necessary for managers to spend a great deal of their time processing applications. Small firms find it especially costly to have people dealing with foreign exchange issues, and firms with only a couple of employees may even find it prohibitively expensive.

Finally, those in charge of the distribution of foreign exchange can sell allocations, or give them to companies controlled by themselves or by friends. Corruption was generally thought to be limited in Zimbabwe. Nevertheless, several ministers resigned recently after the publication of the findings of the Sandura Commission which showed that there had been corruption on a large scale.

Monopolies and price control

The shortage of foreign exchange caused by the anti-export bias, together with the policy of replacing imports with domestic production, have tended to create monopolies. The reason is that the government has allocated foreign currency for investments to producers of different goods. There is thus heavy concentration in many sectors of the Zimbabwean economy. According to *a* study by UNIDO (1986) approximately 50 per cent out of the 6,000 products made in Zimbabwe were produced by one firm, 80 per cent by three companies or less, and only 50 products were manufactured by twenty firms or more. The allocation system thus provides protection not only from foreign competition but from domestic competitors as well.

The lack of competition makes it profitable for companies to produce small quantities and charge high prices. In order to prevent firms from making excessive profits, and to protect the consumers, the authorities in Zimbabwe have had to control the prices of practically all goods. The reaction of a producer facing price control is to alter the product slightly and market it as new, or to decrease the production cost by reducing its size. This is, however, only easily done for certain products such as clothes, but difficult for others such as cement and toothpaste. As a result some companies have been severely hit by the price controls while others have prospered.

A company has to apply for permission before raising the price of a product. Processing these applications has sometimes taken such a long time that the cost of producing the product has become higher than the price (Riddell 1988; Humphrey 1989). As a consequence the production of certain goods has ceased. For instance, Bulawayo Steel Products produced axes and picks for mainly low-income rural households. When the cost exceeded the price for a long period of time the company stopped producing the goods even though they could have been sold domestically for much higher prices (Riddell 1988). Another negative effect is that companies do not invest in production of goods with low official prices. One such example is cement, the scarcity of which is partly due to price control (Humphrey 1989).

STRUCTURAL ADJUSTMENT IN ZIMBABWE

On 1 October 1990 the structural adjustment programme was officially launched, but it started in earnest in March 1991 after the meeting with the foreign aid agencies and the World Bank in Paris. The reform programme is wide-ranging and, if everything goes according to plan, most sectors of the Zimbabwean economy should be thoroughly liberalized by 1995.

In many respects Zimbabwe is the ideal country for implementing an adjustment programme. Its import-substitution strategy has been successful, contributing to the growth of a mainly privately-owned manufacturing sector which makes up close to 30 per cent of GDP and produces a variety of goods. There is a developed capital market, several private banks, a stock market, insurance companies, building societies, and so on. Moreover, the infrastructure is very good by African standards. The importance of having

profit maximizing companies and capitalist institutions when opening up the economy cannot be overestimated.

It is also important that Zimbabwe has not been forced to implement the programme due to a severe economic crisis. When this is the case the adjustment programme often leads to social upheavals and political instability which make new investments risky. In these circumstances economic growth does not rise and sometimes the programme is scrapped. Zimbabwe appears to have chosen to launch the programme on its own volition. It is therefore easier to persuade the public that it is a necessary step to take and not just another colonial imposition from the World Bank.

In reality the World Bank has been pressing the Zimbabwean government to abandon its inward-looking policy for quite some time. One of the Bank's strategies has been to internalize the idea that trade liberalization is the solution to the current problems. This has partly been done by sending World Bank staff to many of the seminars held in the country. In conjuncture with the breakdown of a number of socialist economies the strategy has been effective in convincing the political leadership, as well as the organizations of the manufacturing sector. In addition, some politicians have been in favour of reform all along, and they have undoubtedly been vital in bringing the process as far as it has got.

The fairly widespread acceptance of trade liberalization is a great strength which helps facilitate a successful implementation. None the less, not all organizations, let alone politicians, are in favour of the adjustment programme, and there will probably be resistance from labour unions and manufacturing companies.

Yet another advantage is that Zimbabwe has a diversified export sector where about one-third constitutes manufactured goods. The implementation of several export promotion schemes since 1982 has contributed to this situation. Entering a foreign market is quite difficult, but once you are in it is not too hard to stay there. In this sense the export promotion programmes have been preparing the way for a more general outward-oriented development strategy.

The external sector

There are various approaches that can be used to open up the trade account and they have both advantages and disadvantages (for a discussion, see Tanacs 1990). Three fundamental choices have to be made; the length of the time period, whether to immediately switch to a system of tariffs or work with existing quotas, and in what order different industries should be deprotected and goods imported freely.

According to the plan, Zimbabwe will move to an open economy during a period of five years (1991–5). The five-year period makes it possible to implement the reform between elections which is good for credibility in the reform. Furthermore, the period is considered sufficiently long for the domestic industry to upgrade or replace its often old machine park. Though five years is not a long time in an international perspective, the World Bank would have preferred three years (World Bank 1987).

The opening up is done by sequentially putting import goods on the Open General Import Licence (OGIL) scheme, and decreasing import taxes slowly from an average of 29 per cent to 23 per cent (see Table 6.2). By August 1991 about 25 per cent of all

imports had been put on OGIL. The advantage of not moving from quotas directly to tariffs is that the risk of setting them too high or too low is reduced. There are, however, drawbacks with the approach chosen. The fact that the opening up of the economy is controlled means that it can be halted, and as a consequence there will be intensive lobbying by domestic producers claiming that they will have to close down if exposed to competition. Since some companies will go bankrupt, and jobs will be lost, the government will have a difficult time resisting the pressure to reimpose controls. If it starts to give in, confidence in the programme may be lost.

The third important question is whether all sectors of the economy should

Table 6.2 Zimbabwe: import liberalization goods on OGIL and import taxes

Year	*1989*	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*
Goods on OGIL, (%) of imports	20	24	50	70	75	85	85
Average tax on imports			29.0	27.5	26.0	24.5	23.0
Sales tax							
– general			15	15	15	15	15
– capital			10	10	10	10	10

Source: GOZ (1991a).

be liberalized at the same time or each subsector individually. The case for treating each subsector by itself is quite strong since competitiveness varies greatly between them. The government has settled for a mix of the two approaches where first raw materials and intermediates will be liberalized. After a couple of years capital goods will also be placed on OGIL, and in 1994 and 1995 imports of consumer goods will be decontrolled. In that way the pressure for imports is spread out over time and the tradable sector can augment productivity and production before capital goods are imported on a large scale. Nevertheless, there is one serious drawback with sequential deprotection. The improved availability of imported inputs and the continued lack of competition will raise profits on the domestic market for consumer goods, that is, the anti-export bias increases. It is therefore absolutely necessary for the success of the reform that no doubts arise as to its full implementation.

Exchange rate policy

At the end of 1982 Zimbabwe adopted a crawling peg exchange rate policy which means that the dollar is regularly devalued by a tiny fraction. Since 1982 the devaluations have normally exceeded the rate of inflation, causing the real exchange rate to depreciate. Even so, there are still indications of considerable overvaluation. There is a widespread shortage of foreign exchange evidenced by the low supply of imported inputs and capital goods (see *CZI Review*, March 1990). Moreover, the difference is almost 100 per cent between the black and the official exchange rates. Another indication is that a great deal of the exports of manufactured goods resulting from the export promotion programmes are sold at a loss with the purpose of giving the exporter access to foreign exchange. The

foreign currency is then used in the production for the domestic market where the actual profits are made (Humphrey, in conversation). On the other hand, as more inputs and capital become available productivity increases, and this will give rise to an upwards pressure on the exchange rate. Yet on balance, considering the available information and that it is the government's explicit intention to maintain the export sector competitive through an active exchange rate policy, it should be safe to conclude that the real exchange rate will continue to fall (GOZ 1991a).

Deregulations

Several other sectors can also be deregulated when foreign trade is liberalized. The widespread price control is already being removed from a substantial number of products. Strict controls only remain on ten products including basic food stuffs and a few other items (GOZ 1991b).

The investment controls will be relaxed as imports on capital goods are placed on OGIL. During the period of transition investments will, however, require the approval of the newly-created Zimbabwe Investment Centre which guarantees an answer within three months. After 1995 only large investment projects will require approval.

Capital flows are strictly controlled in Zimbabwe and will not be abolished altogether because of the fear of capital flight. Recently though, selected new investments and export-oriented projects have been allowed to repatriate 100 per cent of net after tax profits instead of the previous 50 per cent. In 1995 this will be extended to all companies.

Monetary policy has relied on direct controls like administered interest rate and moral suasion. It is believed that these methods become less efficient when various sectors of the economy are deregulated. Hence, by 1993 open market operations will be introduced to regulate monetary aggregates and interest rates. The goal of the monetary policy is to control the money supply so it does not generate inflation and to ensure that domestic savings are generated for investments.

Regulations in the labour market have for some time been regarded as an obstacle to employment creation. Firing workers has been rather complicated and time-consuming even in cases of obvious misconduct. In order to facilitate structural change a mechanism for quick retrenchment has recently been implemented. Moreover, intervention in the wage-setting has been replaced by collective bargaining in almost all sectors.

A number of regulations exist which impede the establishment of new companies and sales of products, especially in the small-scale and informal sector. These are, in many cases, part of the colonial heritage and often do not serve any specific purpose at all, except limiting competition and giving power to bureaucrats. A commission has been set up to review some of the regulations and others will be abolished right away.

In the agricultural sector the Grain Marketing Board has a monopoly on a number of the crops. Private sale of maize is only permitted within the communal area in which it is cultivated. The intention is to deregulate the agricultural sector during the next five years. With greater participation of private traders costs of transporting and storing crops are expected to decline.

The budget deficit

During the 1980s the deficit of central government was around 10 per cent of GDP per annum. The plan is to reduce the deficit to 5 per cent of GDP in 1991–5, and this will be done by cutting public expenditure. In the fiscal year 1991/92 it is estimated to decline to 8.5 per cent (GOZ 1991b).

The parastatals receive an amount equal to almost 4 per cent of GDP per annum in subsidies. By introducing competition, replacing administered prices with market-cost-based prices, privatizing some of the public enterprises, giving the management more responsibility, and setting up comprehensive programmes for improving efficiency, the subsidies of all parastatals will be eliminated by 1995, except for Zimbabwe Steel Company Ltd (ZISCO) where it will be reduced by 60 per cent in nominal terms.

The Civil Service wage bill is planned to decline from 16.5 per cent of GDP in 1990/91 to 12.7 per cent in 1994/95. This will be accomplished by reducing the number of civil workers from 104,000 to 78,000. Moreover, real wages will not be permitted to increase except in cases where it is necessary to keep or attract personnel with specific skills.

CONSEQUENCES OF THE ADJUSTMENT PROGRAMME

In 'Zimbabwe: A Framework for Economic Reform (1991–95)' (GOZ 1991a) the reform is predicted to increase growth of real GDP from 4.2 per cent in 1990 to 5 per cent in 1995. Considering past average growth rates this is not too optimistic. Since droughts that bring down growth with 3 to 4 percentage points are common, the actual rate of growth will probably have to be around 8 per cent in certain years in order for the forecasts to correct on average.

Inflation was expected to be around 16 per cent in 1990 and 1991, and then fall to 10 per cent by 1994. It is already clear that this will not be attained. In 1990 inflation was about 20 per cent, and in mid-1991 it was running at 25 per cent (GOZ 1991b, *Financial Times*, 30 August 1991). A number of factors will push inflation upwards during the coming years. There will be increases in prices set by public enterprises on such vital goods as petrol, electricity, maize, wheat, and so on. The abolition of price controls will probably lead to increases even if foreign competition is permitted. Moreover, decontrolling prices means that goods sold on parallel markets, where the rate of inflation is high, will enter the consumer price index.

It can be argued that most of these factors are once and for all increases in the price level and thus really not inflationary. However, the goal of the exchange rate policy is to maintain the competitiveness of the tradable sector by not letting the real exchange rate appreciate. In practice this implies indexing the domestic price level to the exchange rate which introduces inflationary inertia. A one-time jump in the price level may therefore raise inflation for a considerable amount of time.

In addition, there will also be a direct inflationary impact from real devaluations via import prices. Since the Zimbabwe dollar is still overvalued, the authorities will have to speed up the rate of mini-devaluations to well above the rate of inflation.

The private savings rate as a share of GDP is expected to increase from 15.4 per cent in 1989 to 18.0 per cent in 1995. This forecast is uncertain, however. Since the main reason for the high private savings is limited access to consumer goods, due to import compression, relaxing import restriction might create a consumption boom. This would put pressure on prices and, if followed by compensatory wage increases, could lead to a vicious cycle with rising inflation (Davies and Rattsø 1990). It is thus important that the budget deficit is reduced as planned, and monetary growth is controlled in order to limit the risk of high inflation.

During the period of transition gross investments as a share of GDP are projected to rise from 21.0 to 25.3 per cent per annum. Since public investments are planned to decline, private investments will account for 6 percentage points of the increase.

Imports will grow faster than exports initially because it takes time for resources to move to the export sector. The current account deficit is planned to grow from an estimated 2.8 per cent of GDP in 1990 to 6.4 per cent in 1992, and then a decline to 4.0 per cent in 1995. Hence, during the liberalization there will be an increased need for capital inflows. The additional financing required for the period 1991–5 is forecasted to be US $2.44 billion. At the donor conference in March 1991 Zimbabwe was promised US $700 million for two years.

Implications of the land reform

In GOZ (1991a) the government states its intention of redistributing 5 million hectares of commercial farm land to 110,000 communal farmers. About 6 million hectares will continue in the hands of predominantly white large-scale commercial farmers. The reason for announcing a speeding up of the land reform at the same time as the structural adjustment programme is probably political. The Lancaster House constitution, which stated that land could only change hands on a ‘willing-seller, willing-buyer’ basis, expired in 1990, and consequently a bill was passed in Parliament making expropriation legal. Since the slow advancement of the resettlement programme so far has been blamed on the constitutional constraint, it would seem disagreeable in the eyes of the public that government did not use its new right to speed up resettlement.

From an economic point of view the timing of the land reform is not very good. The change in the constitution does not include the right to go to the courts if compensation for expropriated land is considered low, and this seems to be creating anxiety in both the domestic as well as the international business community. Officials, on the other hand, argue that the land question is a special issue. This is true in the sense that the authorities hardly plan to nationalize private companies during the adjustment programme. However, the land reform will have real effects on agricultural production. First, it runs counter to the purpose of structural adjustment because the largescale commercial sector belongs to the tradable sector which should expand, while communal and resettled farmers mainly produce for their own consumption and the domestic market. Second, the planned reform has a negative impact on investment in commercial farming since it is not known which farms will be expropriated. Third, the productivity of the already resettled farmers appears on average to be lower than for large-scale commercial farms (Cusworth 1990). Thus, agricultural production will decrease unless the government carries out the

programme in such a way that newly-resettled farmers have higher productivity, and/or only inefficient commercial farms are bought.

A significant decline in agricultural production would have widespread effects on the Zimbabwean economy since the agricultural sector earns one-third of all foreign exchange, supplies a considerable share of the domestic industries inputs (44 per cent in 1981/82 according to Riddell 1988) and is a large buyer of domestically-produced manufacturing goods.

None the less, it certainly seems possible to increase agricultural production by resettling a large number of families. There is quite naturally no consensus on how much underutilized land that remains in the large-scale commercial sector – a great deal of it has been bought by the government already. According to a recent World Bank study there is about 3.5 million hectares of land that could be resettled without negatively affecting productivity, if cattle grazing is considered less productive than peasant farming (Roth 1990).

In the budget 1991/92 a total of Z $37 million was set aside for the land reform. This is about 3 per cent of the estimated cost of settling 110,000 families.[3] Thus, the government does not seem to be in a hurry with the implementation. Needless to say, the situation is not satisfactory since, if a core of commercial farms is going to be left intact, the authorities should as soon as possible make official which farms they intend to buy so that the rest could expand production during the coming years.

The impact on incomes and social welfare

The liberalization programme will cause relative prices to change. As a consequence, in the short run some people will be worse off and some better off. To predict the immediate impact on different income groups is, however, rather difficult because changes in income, prices and employment all interact to determine the outcome. Since a decline in real income can have dramatic consequences for the poor, it is important that the latter are identified and given help. In GOZ (1991a) it is thus stressed that the programme is designed to reduce the negative impact on vulnerable groups. Public employees will receive compensation in the form of commuted pensions, and for the private sector guidelines on compensation and assistance are being worked out. A social development fund is also being set up that will provide financial support for retraining and employment promotion. The government also intends to set aside money for a fund that will be used for targeting aid if the impact on the poor is too severe, and the nutritional status and the developments of income will be monitored. Hence, the social dimension is taken into consideration before the programme is launched and forms an integrated part of it. In this sense the Zimbabwean trade liberalization is different from most others where at best *ad hoc* measures have had to be implemented to alleviate increased poverty (one example is Tanzania).

Considering that probably up to two-thirds of Zimbabwe's rural population (GOZ 1991a), that is, about 3.5 million people, live in extreme poverty, the social dimension of the programme will obviously have a marginal effect. It would therefore be wiser to continue subsidizing the least-refined sort of maize until the impact of the adjustment programme is assessed. The planned government support might, however, lessen the

hardship for those who lose their jobs and reduce the risk for demonstrations against the reform.

Unemployment

Roughly 20,000 jobs in the manufacturing sector, and 28,000 in the public sector including the public enterprises are believed to disappear. In gross terms between 30,000 and 45,000 new jobs will be created per year according to GOZ (1991a). Thus, in the most optimistic scenario the net increase in number of jobs until 1995 is going to be 225,000–48,000 = 177,000. This figure is highly uncertain because forecasting the future of the manufacturing sector is difficult and little is known about the informal sector. In any case, the increase will not be enough even to maintain the present level of unemployment since about 200,000 school-leavers are added to the labour force each year. Nevertheless, without the reform the number of unemployed would most likely have grown much faster.

Miners and farmworkers

About 1.5 million people live on commercial farms, and 300,000 to 400,000 are directly dependent on the incomes of the miners. Hence, a large share of Zimbabwe's inhabitants will be affected by changes in mining and commercial farming. A direct consequence of the reform should be an increase in production and profits in both sectors, unless the land reform wipes out the positive effects on farming. As a result, real wages and income ought to rise. It should also be remembered that more job opportunities are probably as important for family income as higher wages.

The communal areas

Between 50 and 60 per cent of Zimbabwe's nine million inhabitants live in the communal areas. Most of these are subsistence farmers but about 15 to 20 per cent market a large share of their produce and can be considered relatively wealthy, while 6 per cent of the households are landless (Davies 1987). Communal farmers produce mainly for the domestic market so export orientation will not directly benefit them. Large devaluations could, of course, make exports of, for example, maize profitable, or there could be a change in the pattern of production. But this is not very likely in the short term. Indirectly there may be gains to those who supply exporters with raw materials, like cotton to the ginning industry.

When subsidies to the Agricultural Marketing Board are removed consumer prices will increase – affecting the landless who usually are poor – and producer prices will decrease, primarily hitting the wealthier peasants. There are, however, linkages between households that make it difficult to draw any firm conclusions about the final impact. For example, seasonal labour and the extended family system transmit income losses from the well-off farmers to poor households.

On average 25 per cent of total available consumption for a household is made up of gifts and transfers (CSO 1988). In many cases the husband and some of the children have

wage employment outside the communal area and the wife does the farming.[4] Declining real wages in urban areas, where many work in the service sector, will therefore have a negative impact on incomes in the rural areas. On the other hand, many also work in mines and on large-scale commercial farms, and should therefore receive higher income. The traditional division between urban and rural populations often made in the literature on structural adjustment is therefore not entirely correct for Zimbabwe.

It should not be forgotten that there are shortages of many goods in the rural areas. Deregulation will augment the supply and most likely prices will be lower than in the unofficial markets. Also, by breaking up the monopoly of the Grain Marketing Board and allowing competition in the transport sector price increases will be kept down.

Health and education

Reductions of the budget deficit and devaluations usually affect the social sectors negatively, limiting the access to health services and education. In Zimbabwe though, real expenditure on health is planned to grow at the same rate as GDP, and on education at a slightly lower rate. This implies a real growth per capita between 1 and 2 per cent per year for the social sector until 1995. These figures merit a few comments.

Cost recovery is going to be employed extensively so users will have to pay more for social services. For the educational sector, fees at the primary level will be introduced and set to Z $12 per year in rural areas, Z $60 in high density urban areas, and Z $210 in low density urban areas. At the secondary level the tariffs will be made more progressive, ranging from Z $150 in rural areas, Z $210 in high density urban areas, and Z $450 in low density urban areas (Ministry of Education and Culture 1991). In the health sector a new schedule was implemented in 1985 requiring everybody earning more than Z $150 to pay for medical care. Due to the staffs' reluctance to demand, or even accept, payment from patients few people have been charged. From January 1991, however, all government-run hospitals and clinics have charged fees according to the 1985 schedule. With an average rate of inflation of about 12 per cent the maximum income of Z $150 has declined in real terms to Z $80, thus including many more people in the tariff-paying group than in 1985. Of course, the real value of the fees has also been reduced by the same percentage. A well-devised system of progressive fees should benefit the poor. Even so, currently a number of poor people have to pay for treatment, and according to anecdotal evidence there have been large drops in the number of patients going to some clinics. This may partly be due to initial problems of issuing certificates of income and partly reflect previous abuse of medical services. Nevertheless, it is also possible that the costs simply are too high.

It should not be forgotten that reports indicate that between 20 and 30 per cent of the adult population are HIV-positive.[5] This suggests that AIDS patients will account for a growing share of health expenditure since they tend to be hospitalized for longer periods (Davies 1990). Furthermore, if a cure is found it will most certainly be very expensive. The health care system will thus be put under great pressure during the 1990s and the future may not be so bright as the growth figures on health expenditures imply.

CONCLUDING REMARKS

Implementing the structural adjustment programme is not easy nor is it painless since it concerns a very complicated transformation of the economy. Moreover, there is no prescribed way of going about it – every approach has both advantages and weaknesses.

The Zimbabwean programme appears to be well designed and has every reason to be successful when implemented. Although it has already started, there is still a long way to go and several obstacles remain. It is quite likely that some politicians and bureaucrats will cause delays since they risk losing power and income. In spite of this, the prospects are good and if trade liberalization does not succeed in Zimbabwe it is unlikely to succeed anywhere else in Sub-Saharan Africa.

NOTES

1 In GOZ (1991a) the average rate of growth of real GDP for 1980–9 is claimed to be 2.7 per cent. This figure is not based on published statistics and seems unlikely even if some recent GDP statistics have been revised downwards.
2 These figures also reflect a considerable shortage of especially consumer durables. Recently private imports have been allowed to increase a great deal which probably makes their share of total imports higher.
3 In the Second Five-Year National Development Plan currently under preparation by the Ministry of Finance, the cost per household is estimated to be Z $10,000.
4 Over 40 per cent of the rural households have a women as the head of the family.
5 At the meeting in Paris with the donors and the World Bank in March 1991, the Minister of Finance, B. Chidzero, said that these figures were obtained testing people who sought help for venereal disease.

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7
STRUCTURAL ADJUSTMENT AND ECONOMIC MANAGEMENT IN A DEPENDENT ECONOMY: THE CASE OF LESOTHO

Lennart Petersson

INTRODUCTION

After a period of financial stability and high growth rates of real production and income during the 1970s, the performance of Lesotho's economy was until 1987–8 characterized by low growth, rapidly-rising fiscal deficits and substantial deterioration in the external current account and the overall balance of payments. The economic boom and the good financial performance of the 1970s had its origin in rapidly-increasing remittances from Basotho miners in South Africa and in customs union receipts, the latter due to a new customs union agreement with South Africa in 1969. When these external sources of income stagnated in the 1980s, the country found itself in a few years time in a situation where the economic and financial outlook was very bleak. In the medium term this was due to uncertainties arising from political and economic instability in South Africa, in particular with respect to future migrant remittances. Furthermore, since 1984 South Africa has brought up the issue of changes in the customs union arrangement to reduce the burden on its budget, which would effectively reduce Lesotho's revenue. The situation forced the government to cope with the internal problem and the long-term structural weakness of the economy, which has made the country heavily dependent on exports of labour.

The country's natural resources are limited, and technical and managerial skills needed for industrial development are scarce. As a result, the production and export base is very small. In addition, the institutional infrastructure is deficient in many respects. One major problem is the lack of incentives for the private sector, particularly for improvements in the agricultural sector. The traditional land tenure system has led to inefficient land utilization, which has encouraged overgrazing and continued soil erosion impedes growth in productivity. In the public sector, including the parastatals, the government is facing problems in administration, the planning process and budgetary control. Finally, the monetary system, developed since the late 1970s, must be deepened and the range of financial instruments available extended.

To address these issues and to improve the economic and financial prospects of the country, in 1988 the government adopted a mediumterm macroeconomic and structural adjustment programme (SAP) for 1988/89–1990/91. The programme was supported by a

structural adjustment facility by the International Monetary Fund (IMF). When this programme came to an end the government decided to participate in an enhanced structural adjustment programme (ESAP) for the following three years. In the present chapter the main macroeconomic and structural policies implemented under the SAP period will be analysed and related to the improvements in economic performance since 1987–8, and the priorities made in the enhanced structural adjustment programme will be discussed in the context of the remaining problem of the economy. The constraints on pursuing an independent economic policy and the measures introduced to overcome and reduce the country's heavy external dependence will be a main theme in the analysis.

THE STRUCTURAL ADJUSTMENT PROGRAMMES

The broad objectives of the SAP were to strengthen the country's fiscal and external payments position, and to restore and maintain a high growth rate of real GDP. The living standards of the people should be improved by expansion of productive employment in the domestic economy and a more equitable income distribution. In order to promote growth, a major objective of the programme was to reform the system of incentives and to introduce macroeconomic and sectorial policies aimed at improving resource allocation. This has largely meant policies aimed at institutional changes and removal of structural impediments.

A major problem in performing economic policy in Lesotho is the constraints imposed by the country's membership in the Common Monetary Area (CMA) and the Southern African Customs Union (SACU) and by other close economic and institutional links with South Africa. Lesotho's currency, the loti (plural: maloti), is pegged at par to the South African rand, the exchange system is free of restrictions on payments and transfers for current transactions within the common monetary area, and maloti issues are required to have a 100 per cent backing by holdings of South African rand, rand assets or, since 1989, other convertible foreign currencies (Lundahl and Petersson 1991: Chapter 9). This limits the use of monetary policy instruments, and makes fiscal policy the major instrument of economic management. The customs union agreement and the close economic integration with South Africa, however, imposes constraints on the pursuit of an independent fiscal policy as well. Since the mid-1980s about half the government revenue has been derived from duties and excise taxes collected and distributed by South Africa on behalf of the member countries. In terms of the agreement, South Africa sets customs and excise policy and duty rates. Moreover, approximately one half of the country's total factor income is in the form of workers' remittances from South Africa, which cover most of a trade deficit of about the size of the gross domestic product (GDP). Consequently, commodity and factor prices are closely tied to those of South Africa. Retail prices in Lesotho are more or less equivalent to those of South Africa and the rate of inflation is predominantly influenced by the South African rate of inflation (Bourne 1989:19).

An important goal was to reduce most of the fiscal and current account deficit during the programme period by means of tight fiscal and monetary policy. In the short run, the policy had to resort largely to cuts in the government's current spending, thereby

increasing public savings. A main objective of this policy was to free domestic resources for private sector investments. The proportion of capital expenditure in gross national product (GNP) was to be maintained and used to provide more favourable conditions for the private sector. An important goal was to gradually increase local revenue in order to reduce the dependence on customs union receipts, and to create financial resources for increased expenditure in the social sectors.

In spite of a rapidly-growing public debt during the 1980s, there is no external debt service problem in Lesotho. In 1988 the debt service ratio as a percentage of exports of goods and factor service was around 4 per cent, which is low compared to several other African countries (IMF 1991:19). The debt service should, however, be considered in the context of the weakness and vulnerability of Lesotho's balance of payments, and its heavy reliance on foreign currency earnings from migrant workers. This heavy external dependence was, in addition to rapidly growing financial imbalances, the main factor which made a structural adjustment programme an urgent necessity.

In the short run, the current account deficit would be reduced by expenditure-reducing policies, such as cuts in government spending, tax increases, reduced subsidies and transfers to domestic residents, and by restrictions on the credit created by the banking system. The large share of imports in Lesotho, amounting to about 70–80 per cent of GNP, means that this policy can be expected to be an efficient means of reducing imports and thus improving the current account of the balance of payments.

The strategies to ensure balance-of-payments viability in the long run are intended to restrict non-concessional foreign borrowing, to contain the rate of growth in consumer imports and to increase the relative importance of merchandize exports in total external receipts by an export-oriented expansion and diversification of the productive base, largely through the promotion of foreign investments.

The programme can be categorized into macroeconomic and structural policies. To facilitate the monitoring of progress in the implementation of the programme, targets and quantitative and structural bench-marks are specified for each annual arrangement of the programme. Thus, targets for increased growth rate of real GDP, annual limits on the overall budget and current account deficits and for the net external reserves are specified. In the monetary sector, the main quantitative bench-marks established are quarterly ceilings on aggregate domestic credit and on net claims on the government, and an annual ceiling on non-concessional loans contracted or guaranteed by the public sector.

The structural policies are intended to enhance the productive potential of the economy by improving the allocation of resources and by stimulating domestic savings and investments. The policy measures are directed towards an elimination of structural impediments in a wide range of areas, such as fiscal reforms through improved tax stucture and expenditure policies, financial reforms to mobilize private domestic savings, changes in the structure of incentives in the private and public sectors, land reforms, improvements in the management of public enterprises and parastatals to promote efficiency and reduce government interventions and subsidies. A number of structural benchmarks are introduced, such as the completion of a national livestock inventory, amendments of the Land Tenure Act, introduction of use of ranger fees on livestock, reduction of subsidies to parastatals, introduction and maintenance of an appropriate interest structure and introduction of new financial instruments. In many cases the time-

frame is, however, not specified.

In the ESAP, the gains made under the SAP would be consolidated, and adjustment measures would be revised and improved in areas where performance had fallen short of the target. The basic structure with respect to adjustment policy objectives, targets and policy measures remains. However, the number of policy measures have been increased and specified in greater detail. Moreover, further improvements and modifications have been made within individual policy areas which, in particular, include financial sector reform, public sector management and parastatal reform, and existing measures to protect the poorest segment of the society should be revised and improved. Finally, compared to the programme, presented in the policy framework paper in 1988, new policy areas have been included, namely, social sector policies, labour policies, environmental and population policies.

FISCAL POLICY AND PUBLIC SECTOR REFORMS

The main part of the fiscal deficit was targeted to be reduced during the SAP period by restrained current expenditure and the introduction of measures aimed at raising local (non-customs) revenue, and thereby reducing the external dependence. The main structural targets under both the adopted programmes were to improve the weak fiscal management, which made it difficult to control government expenditure, to rationalize public employment and to improve the efficiency of the public sector. A main issue to be assessed is whether introduced measures have been implemented and administered in practice during the programme period and contributed to the substantially reduced fiscal deficit.

Macroeconomic targets and performance

The fiscal deficit has improved significantly during the programme period (IMF 1991:19; World Bank 1992:12). As a proportion of GNP, the deficit has decreased from about 10.5 per cent in 1987/88 to 0.6 per cent in 1990/91. A major target of the programme was increased public savings, that is, to increase the difference between revenue, including grants, and current expenditure. This target has been achieved and, as a proportion of GNP, a deficit of 3.6 per cent has been converted into a surplus, which is projected at 6 per cent in 1990/91 (IMF 1991:19; World Bank 1992:12). Current expenditure has been restrained, while scarce public financial resources have been allocated to public investment, which has been allowed to increase slightly in real terms. This means that the overall objectives of the fiscal policy have been achieved.

However, the experience of the programme period would suggest that it is difficult to implement measures which significantly reduce the level of public expenditure. The major achievement was that the long-run trend of an increasing public expenditure share in GNP was brought to a standstill around 34 per cent during the first two years of the programme period and a slight decrease in 1990/91. The reduction was targeted at about 28–29 per cent at the end of the period (Matekane 1990:19). The large reduction of the fiscal deficit is largely the result of increased customs union revenue and grants, outside

the direct control of the government. Thus, the share of customs union revenue in GNP increased from 10.2 to 13.2 per cent, and budgeted grants from 4.1 to 7.7 per cent (Lesotho 1991: Appendix 1).

Progress in implementing new revenue-raising measures, aimed at increasing local revenue, was generally disappointing, and apart from customs union receipts, revenue items stagnated or fell in real terms. Most of the intended reforms of the taxation system and the introduction of revenueraising measures have been abolished, delayed or have not yet resulted in increased revenue. As a result, the proportion of local revenue in GNP was almost unchanged around 9–10 per cent at the end of the SAP period.

Most new taxes or increased tax rates would strike hard at low-income earners, or be of minor importance. Thus, in the present system, exemption from indirect taxes are made on certain goods and services, such as basic food and other items, that weigh heavily in the budget of the poor. The improved cost recovery in the health sector during the programme period include exemptions for the lowest income consumers.

Certain changes were, however, introduced. The general sales tax rate was increased from 12 to 13 per cent, parallel to an increase in the tax rate in South Africa, and the tax was extended to parastatals in the electricity and telecommunications sector. The general sales tax, introduced in 1982, has for subsequent years been the second most important source of tax revenue after customs receipts (IMF 1984:17–24). The implementation of the tax and the tax rates were an adaption to the prevailing system of indirect taxation in South Africa. In addition, the somewhat higher rates prevailing on certain 'luxury' items, namely tobacco, beer, liquor and motor vehicles was increased substantially in 1989–90, but reduced in the following year. The reason for the return to lower tax rates on these commodities was that, due to the open border, the increased tax rates encouraged people to shop across the border. It becomes obvious that the tax rates on commodities cannot generally be much higher than those in South Africa. Thus, in 1990 a slowdown in the growth rate of production and employment in the beer industry, with an associated increase in smuggling, was reported (World Bank 1990a:7).

At present the migrant workers outside Lesotho, whose incomes represent almost half the factor incomes in Lesotho, are not included in the income tax system. These relatively well-paid Basotho are the largest potential for an enlarged taxation and increased income tax revenue, and a main target for increased government revenue in the SAP. They may also be relatively easy to tax as they are well recorded by the mining companies. The implementation is, however, problematic because of political and other constraints. Negotiations with South Africa is required, as the migrants are taxable in South Africa. However, only a few migrants with incomes above a minimum threshold actually pay taxes. Thus, to avoid income tax, the migrants may prefer to be taxed in South Africa, where they are treated as low-wage earners, and the government may have to negotiate with the miners as well. The 1973 labour agreement between Lesotho and South Africa needs to be revised to ensure that employers deduct any relevant taxes from migrants' wages on behalf of the Lesotho government (Bardill and Cobbe 1985:74). The negotiation with South Africa, initiated by the structural adjustment programme, has been unsuccessful.

In 1991, when a new labour agreement was completed between the two countries, it became clear that South Africa would not be co-operative in the near future and place

responsibility for withholding such taxes on the mining companies. As a result, in 1991, the government introduced a levy of 100 maloti (M) per contract from Basotho miners, which represented about 1 per cent of an annual average wage earned by black workers in the mines (Lesotho 1991:22, Central Bank of Lesotho 1991:64). The revenue from this levy can be estimated at about 0.2 per cent of GNP. This is a very small amount of revenue, compared to the expectations and the estimated potential revenue from this source of revenue, which have been predicted under the SAP (see, for example, World Bank 1988:9).

Due to administrative weaknesses, the focus of tax reforms in the SAP has concentrated on simplification of the existing system. During the third year of the programme the income tax system was simplified through the reduction of the number of tax brackets, and the administrative burden associated with the system of tax holidays for companies was removed. At the end of the 1980s most medium- and large-scale enterprises benefited from tax holidays. The companies, largely foreign-owned, could also transfer the main part of their profits abroad, due to the free movements of capital.[1] The tax holidays were replaced by a single tax rate of 15 per cent on profits with no special allowance – only interest reductions and economic depreciation will be allowed.[2] Another change introduced was that the system of assessing and collecting tax on the preceding year's profit would be replaced by a current basis of assessment, and companies will have to pay tax on estimated profits. The background to this measure may be that quite a large number of enterprises did not survive the first year and could not be taxed in the previous system (Baffoe 1989:75). Finally, the tax system will also include the public enterprises.

The changes implies a clear improvement in the former tax system, where many medium- and large-scale enterprises could avoid taxes, and where public enterprises until 1989–90 were exempted from taxes. By abolishing various tax incentives to the private sector, the tax system has been simplified for industry, and the tax base enlarged. The incentives to tax-induced movements between different types of activities and incomes will be reduced by the implementation of a more unified corporate tax system and the removal of exemptions, and by the reduction in tax rates between personal and corporate taxes.

The next step to be implemented under the ESAP period is to improve actual tax collection and to enlarge the tax base, thus gradually increasing local revenue in relation to GNP. The enforcement of existing taxes envisaged in the ESAP will mainly concentrate upon income tax applicable to self-employed persons, non-corporate business entities and companies (IMF 1991:7–9). These tax reforms will increase the burden of tax administration, which will be strengthened. The government intend to engage experienced and high-quality staff in the tax authority to improve the collection and processing of required information, and to audit, assess and enforce the taxes.

The enlargement of the tax base will, however, comprise a rather limited amount of total income available for taxation. The exceptions are business income and certain small enterprises which are, however, hard to tax by comparison with large formal sector firms. Thus, in addition to improved collection for the self-employed, the government will increase traders' licence fees, which in the future will be renewed only in cases where tax clearance can be proved. The incomes of a large group of self-employed are low. The

administrative cost can be expected to be high, and it will be difficult to increase the efficiency by which the taxes are in fact collected. On the other hand, it is socially desirable to include all sources of incomes in the taxation system, and to increase compliance and reduce evasion by a more efficient and equitable structure (Newbery 1987). This will also reduce the distortions of the price structure, because some of the small, informal and often transient firms in business activities produce untaxed substitutes for taxed goods and services. These activities may also reduce the revenue from other taxed activities and from the general sales tax. The informal sector and commercial agriculture may also be relatively fast-growing activities in the future.

Structural policies

The programmes for reform of the fiscal management and the Civil Service suffer from a severe shortage of appropriately skilled labour. The close integration of the labour market in the region, which imposes severe constraints on the establishment of independent wage and salary structure in Lesotho, and the governments' wage policy, has further increased this problem. The low wages and salaries paid to highly-educated and skilled manual workers, compared to those prevailing in South Africa, have made it difficult to attract, educate and retain sufficiently competent workers within the country. This is particularly the case in the public sector, where the wage policy is largely followed. Low wages, relative to the opportunities outside the country, are largely explained in terms of income distribution considerations, and the tight budgetary position under which the government usually operates. The wage adjustment, in particular for the civil servants, seems mainly to be a compenstion for inflation, which is the policy adopted in the SAP (Lesotho 1988:20). Consequently, skilled and educated workers take up employment in South Africa, resulting in serious problems for the government to recruit and hold personnel of good quality.

In April 1988, when the SAP was adopted, wages and salaries of civil servants were increased substantially. Compared to the previous salary review in January 1985, the increase was largely an adjustment to inflation. In the subsequent two years, wages were more or less frozen in nominal terms. In the programme, annual adjustments of wages and salaries were recommended as a means of avoiding the need for large adjustments, which has in the past been an important cause of large fluctuations in the proportion of government expenditure in GNP. The growth of the Civil Service was restrained by various measures of rationalization. Staff levels were to be maintained in technical, professional and managerial areas, while a retrenchment process for contract and daily paid employed was put in force. At the same time, a Civil Service programme was introduced aimed at increasing the capacity of the Civil Service to implement government policy. An important rationale for these reforms would be to increase the quality and efficiency of the Civil Service, while reversing a former trend for largely politically-motivated increases in the number of civil servants (Matlosa 1990:35–6). According to criticism of the former policy, affiliation to Basotho National Party (which ruled the country from its political independence in 1966 to 1986), rather than merit was, particularly since 1985, the main criteria of employment.

The implementation of reforms and improvements in the system of economic and

financial management and in the efficiency of the Civil Service has been delayed, but is under way with the assistance of various donor countries and international development organizations. The time-frame for the comprehensive programme has been moved forward to the beginning of the 1990s, and it has been clear that the impact of the programme on the governments' capacity to monitor and control public expenditure will not be felt in the medium term. In the meantime, short-term measures and an interim expenditure control system has been introduced. This has contributed to restraints in current expenditure.

PUBLIC SECTOR PRIORITIES AND REFORMS IN THE EARLY 1990s

In the ESAP, the high priority given to improving the quality and the efficiency of the Civil Service, while at the same time restraining its size, is continued. A key factor in the achievement of these objectives is a new wage and salary structure designed to facilitate the filling of key posts. The implementation of the policy will involve restraints on wage increases and the employment of unskilled people, while the salaries of increasing numbers of skilled labour will be increased in order to be more competitive with the private sector and with those of South Africa. The introduction of more market-oriented wages will result in increased wage differentials, because of scarcity of skilled labour on the one hand, and the abundance of unskilled labour on the other. Taken together, the programme designed to improve the Civil Service represents an important change in government policy, compared to the former resistance of the government to restrict the employment of relatively unskilled labour, and to allow large income differentials between unskilled and various types of skilled labour.

The average pay increase for the civil servants in 1991–2 is budgeted at 22 per cent, while wage differentials are increased by providing pay increases ranging from 17 to 45 per cent for the least-skilled and highest skilled employees (IMF 1991:9, Lesotho 1991:14–15). Subsequently, during the last two years of the ESAP, the increases will be restricted to the rate of inflation. Based on annual Civil Service pay reviews, depending on labour market conditions, job reclassifications and the merit of individuals, pay structure may be revised and the percentage increases for individuals may vary significantly.

The budget provides for increased expenditure of 41 per cent on salaries and wages, which includes an average pay increase of about 67 per cent for teachers. This pay increase is part of a number of priorities within the present level of expenditure which are made under the ESAP. A shift will be made in the intersectoral resource allocation as well as within various sector programmes. A greater development orientation for expenditure is suggested by targeting priorities towards human resources (education and health), to productive sectors and infrastructure, and in particular the maintenance of physical infrastructure. A reform process of the parastatal sector is initiated, with a view to increase the market orientation of production and price-setting of goods and services produced by public enterprises. The government may also consider privatization, sales of shares and liquidation of certain parastatals.

MONETARY AND CREDIT POLICIES

Since the introduction of a national currency, and the creation of the Lesotho Monetary Authority in January 1980 (in 1982 renamed the Central Bank of Lesotho (CBL)), the growth of domestic credit has been very expansive. This monetary expansion was generated by fiscal deficits, financed through the banking system, including the Central Bank, and by external borrowing. In 1987–8, the government's share of total domestic credit was almost two-thirds. The objective of the Central Bank in increasing the share of domestic savings channelled to investments within Lesotho, in particular to increase the proportion going to agriculture and industry, was, however, not achieved. The main part of credit to the private sector went largely to households, which resulted in increased consumption, and to the distributive services of the business sector, such as wholesale and retail outlets which rely on imports (Central Bank of Lesotho 1989:22–3).

Objectives and measures under the structural adjustment programme

The objectives and targets of monetary and credit policies during the structural adjustment have been to increase credit to the private sector, while reducing net government borrowing from the banking system, discouraging short-term capital outflow, and to mobilize domestic savings.

The main instruments of monetary policy under the IMF-supported structural adjustment programme have been credit ceilings and interest rates. The credit ceilings have been applied separately to government and non-government credit, and applied bank-by-bank (World Bank 1990b:36–42). The ceilings are specified from time to time, determined by the monetary authorities with the assistance of the IMF. Throughout the programme period, strict limits have been imposed on new external non-concessional borrowing contracted by the government and public agencies.

The quantitative benchmarks on domestic credit have largely been observed as a result of the reduced fiscal deficit of the public sector and low productive sector demand for credit. At the end of the SAP period in March 1991, domestic credit was M126 million (or 24.6 per cent) below the overall credit ceiling (Central Bank of Lesotho 1991:10). Credits (net) to government, which increased by about 70 per cent during 1988–9 were subsequently about halved until the end of March 1991. This suggests that the government successfully managed to contain its expenditure. However, also increased external borrowing on concessional terms, exceeding the fiscal deficit, was used to replace domestic borrowing.

Credit to business sectors grew rapidly while credits to households stagnated, a development which reflects the emphasis on the productive sectors of the economy. Lesotho citizens may, however, have borrowed in South Africa, thus avoiding the restrictions. The targeted increase of lending to certain business sectors was not achieved. Moreover, the lending to business enterprises contained largely limited overdraft facilities to large firms, and until recently the banks were not involved in any term lending (World Bank 1990b:90–1).

The use of credit ceilings imposed a restraint on government expenditure and on the expenditure of households and certain other private sectors. The ceilings may also be regarded as a second-best response to an unsustainable current account deficit. After 1988 the current account of the balance of payments has improved significantly (World Bank 1992:12). This improvement is, however, largely explained by external factors, namely increases in customs union revenue, foreign aid and labour remittances. As a result, and due to large external borrowing, the net foreign assets of the banking system increased significantly during 1990, and by the end of the year were able to cover 5.8 weeks of imports compared with 4.0 weeks of imports a year earlier (Central Bank of Lesotho 1990:16).

The CBL officially sets the prime lending rate, the minimum savings deposit rate, the Treasury bill rate and the rates on banks' deposits at the CBL. The interest movements in Lesotho are constrained by the monetary integration, although the prime rate has generally been held just below the South African prime rate to encourage investments. The deposit rates, excluding the savings rates, have been considerably lower than those in South Africa (World Bank 1990b:44–8). This may have reduced savings and resulted in an outflow of deposits, for example, among the mineworkers. Since 1988 the growth rate of bank deposits, excluding government, has been below the inflation rate.

The deferred pay scheme represents an artificial form of forced savings with interest rates kept low over a long period. Under the scheme, South African mining houses are obliged to transfer 60 per cent of the basic pay of Basotho miners to a special fund at the Lesotho Bank, but it has become relatively easy to evade part of the stipulated savings. The mineworkers are dissatisfied with the scheme, and have requested a reduced transfer of their income to the deferred pay fund, along with a number of other changes to make savings more attractive.[3] The fund has recently experienced tough competition from the banks in South Africa, which are allowed to exploit the computerized payroll arrangements in the mining industry. As a response to this competition, in 1990 the interest paid to miners on their deferred pay was more than doubled to about 13 per cent, which is almost as good as the interest paid on savings deposits in Lesotho or the competing savings deposits in South Africa (Central Bank of Lesotho 1991:7–9).

During the SAP period, the interest rates were gradually adapted to South African rates. The interest paid on savings deposits has been increased substantially to about the level of or slightly above the rate of inflation (Central Bank of Lesotho 1991). The strategy under the ESAP is to maintain deposits and prime lending rates in line with those in South Africa, and to ensure that rates are positive in real terms (IMF 1991:22). The intention is that the interest rates on government bonds for subsequent years will be held in line with the yield curve prevailing in South Africa. Consequently, the South African rates are accepted as a true opportunity cost for capital. However, a certain distortion of the structure of deposit and lending rates in Lesotho remains.

Distortions in the credit market

On the negative side, the policy of credit ceilings implies a regulation of the credit market, which in addition to being an administrative interference in the credit process and the allocation of credits, results in a distortion of the structure of interest rates. Moreover,

in spite of the common monetary area, there are also a few restrictions on capital outflow through the banking system from Lesotho to South Africa, to ensure the employment of local savings domestically and to centralize foreign exchange reserves. The most important is the Minimum Local Asset Requirement, which specifies a minimum 85 per cent local use (or transfer of assets to the CBL) for local liabilities to the public in Lesotho. Thus, the financial resources of the banking system may be diverted to domestic investments with lower returns than could be achieved elsewhere in the common monetary area, and thus lower the interest which can be paid to depositors. The restrictions may result in less competition between the banks in Lesotho and South Africa, and between the three banks operating in Lesotho, as their credit quotas are not based on their efficiency but on the size of their past operations. Moreover, demand for credit of the productive sectors is low, due to a lack of absorptive capacity, while credit ceilings are binding constraints in other sectors. This reduces the motivation to mobilize more resources, and may contribute to the prevailing gap between deposit rates in Lesotho and South Africa. There is also, compared to South Africa, a wide differential margin between the average lending rate and all categories of deposit interest rates (World Bank 1990b:47). This is an indication of inefficiency, limited competition in the banking system, or the result of local high-risk lending. With three dominant banks, the concentration is high in Lesotho, and the domestic competition is very limited.

Another distortion of the interest rates in Lesotho is the diversity of prevailing lending rates which result from the fragmentation of the system. This is the result of the establishment of specialized financial institutions that are created to serve specific purposes, and because interest rates in certain cases are subsidized. Until 1990 there was also a tax advantage in lending to government, such as tax exemptions on interest on government bonds (World Bank 1990a:10,24; 1990b:13,35). In addition, the government-owned Lesotho Bank is exempted from all taxes. Combined with a relatively high interest yield on treasury bills, this meant that such bills were a safe, and the most profitable, investment for the two commercial banks subject to corporation tax, which may have crowded out private investments. In 1990, however, all tax exemptions on earnings from lending to the government was removed.

The fragmentation of the credit market has resulted in a wide divergence in interest rates. This distorts the allocation of resources, because the profitability of projects will be affected by the access to credit at the more favourable rates, it opens the possibility for rent-seeking and the total amount of subsidized credits is dependent on foreign aid flows or government support. To reduce these distortions all credit should be priced at market interest rates, while support may be given in the form of capital grants, technical assistance or direct grants to the government.

Financial reforms in the 1990s

In the 1990s the objective seems to be a liberalization of the internal financial markets and a continuation of the gradual adaption of interest rates to South African rates. The few existing restrictions on capital movements between Lesotho and South Africa will, however, remain. The reasons are that it reduces the volatility flows arranged through the banking system, and – to the extent that banks cannot find outlets for local productive

investments – it contributes to a concentration of the external assets of the system in the hands of the CBL. The intention of the financial reforms under the ESAP is to deepen the financial system and extend the range of financial instrument available. The treasury bill market will be extended to the non-bank public, and the government will encourage transfer of such bills from the banks to the public. The strategy is designed to prevent short-term outflow of capital (where restrictions on capital movement within the common monetary area apply to the banking sector but not to citizens), and to make it possible in the future to develop market-oriented instruments for controlling bank credit and domestic liquidity.[4] The government also intends to introduce measures to make provision for project and venture capital finance available to indigenous Basotho industry. With regard to the promotion of manufacturing enterprises, the major problem is, however, not financial resources, but the weak entrepreneurial basis and the lack of qualified and experienced staff in the banking system, which can help to prepare and make assessments of projects. Finally, the government may also consider measures which aim to expand contractual savings through the life assurance sector and investigate other ways of mobilizing non-bank financial resources.

ADJUSTMENT AND GROWTH SINCE 1987–8

A primary objective of structural adjustment is to promote growth within the context of a sustainable balance-of-payments position. The strategy is to increase the share of private sector investment and to provide market-oriented incentives to increase output. Emphasis is placed on increasing productivity in the agricultural and livestock sector, and to reform the land tenure system. The implementation of structural policy measures appears, however, to be a long-run undertaking, due to political and other constraints. The government lacks control of adjustment target variables and the administrative capacity has been insufficient. As a result, few structural bench-marks were attained. The development of production has continued to be largely a reflection of external factors. Lesotho is currently embarking on a large undertaking, the Lesotho Highlands Water Project (LHWP), the purpose of which is to export large quantities of its surplus water resources to South Africa, and to generate hydropower for local use. LHWP-related activities and increased exports of manufacturing products have recently been the main source of growth in the economy.

The Lesotho Highlands Water Project and related investments

The water transfer component of the project started its engineering and preliminary construction phase in 1988, and has recently begun its core component.[5] This has meant a dramatic increase in gross investments in Lesotho. From 1988/89 to 1990/91, LHWP investments are estimated to have increased from 2.8 to 21.6 per cent of GNP (IMF 1991:19). During the period, almost the entire cost of these investments has been financed by South Africa.

The overall aggregate demand and production in Lesotho has increased, primarily in the construction sector, but also in certain other sectors, such as manufacturing and

service sectors. The LHWP has, like the rapidly-rising amount of migrant remittances in the 1970s, made building and construction a driving force in the growth of the domestic economy. Since 1988/89 when the first stages of construction of the LHWP started, the building and construction sector has grown rapidly and can be expected to continue to experience a high growth rate for the coming years. From 1987 to 1989, real value added in the sector increased by 50 per cent at 1980 prices (Lesotho Bureau of Statistics 1990). It is, however, difficult to predict the duration of the building and construction boom. The direct effect of the development in infrastructure will continue at least until the mid-1990s, although the indirect effect may be short-lived.

The LHWP, as well as the foreign investment, results in an inflow of a large number of foreign citizens into Maseru and to some extent other commercial and industrial areas of the country. These people are largely professionals, such as manufacturers, consultants, contractors and skilled labour employed in the new enterprises or in the LHWP. The combined effects of rising foreign investments and the LHWP have created a large growth demand for houses, office and residental accommodation and other types of services (*Financial Mail* 1988:30–1). This has meant sharply-rising property rentals, particularly for medium and high standard accommodation. This must be met by an increased supply which creates a commercial building boom, competing with the construction of infrastructure. To make the most of the opportunity created by the growth in demand both by the LHWP and the growing industry, a number of severe problems have to be solved and bottle-necks have to be removed in Lesotho's economy. These include areas such as the finance of residential development, property legislation, shortage of serviced land, the restricted Land Act, shortage of skilled labour and bureaucratic inefficiency. Furthermore, increasing employment opportunities for unskilled labour in urban centres in Lesotho, in combination with reduced demands for migrants in South Africa, will result in internal migration within Lesotho, which requires serviced land and cheap accommodation. There is a clear risk that, due to delay in producing offices and accommodations, the demand will decline before development costs have been written off, and the boom is turned into a recession. Second, attractive housing and leisure facilities may be developed in South African towns close to Lesotho, which will be favoured by, in particular, well-paid workers and their families, thus reducing Lesotho's long-run benefit of the project.

Finally, there is a skilled labour shortage in Lesotho, which has grown worse and reduced the increase in domestic employment, due to the project. Skilled workers are attracted away from government employment and donor-aided projects, which had to be replaced by appointments of expatriate appointments in the ministries. This has forced the government to implement a more market-oriented wage structure.

Industry

For almost a decade after the mid-1970s, the government adapted an inward-looking policy through import substitution. Production in export-oriented industries remained relatively small. Thereafter, and especially since the adaption of the SAP, the main strategy to expand manufacturing production was to encourage foreign investment in export-oriented industries. The policy was based on the free enterprise system, where

success through the development of an indigenous manufacturing sector was limited, due to shortage of investment capital, labour skills, technology, managerial, technical and marketing expertise. Thus, an investment promotion unit was established in the late 1980s with the purpose to promote private investments and to perform targeted investment promotion campaigns in South Africa and elsewhere. An export finance scheme which was introduced in 1987 and began to operate in 1988 was given increased resources.

During the late 1980s, sanctions against South Africa made Lesotho an attractive base for manufacturing for exports to both the European and North American markets while maintaining access to the South African market. The increase in manufacturing production and exports has been significant. From 1986 to 1989, in current prices, the average annnual growth rate of exports of manufactured products was around 60 per cent (Lesotho Bureau of Statistics 1990).[6] The main part of these exports, largely textiles, apparel, clothing and footwear, was produced in foreign-owned companies for exports to overseas countries. The rapid deterioration of the loti, which is pegged at par to the rand, contributed to the development by increasing the country's competitiveness on these markets.[7]

Exports have increasingly gone to the USA market. Thus, between 1987 and 1989, Lesotho exports to USA increased from US $5 to US $19 million (LNDC 1990). The US generalized system of preferences scheme provides considerable benefits for Lesotho exports. As a result, companies from Hong Kong, China and Taiwan have established production in Lesotho to avoid the quota which under the present Multifibre Agreement[8] applies to exports from production located in their home countries. Lesotho also provides a location with political access and preferential entry to other overseas export markets, and duty-free access to the consumers of the EEC and the Southern African Customs Union markets (LNDC 1987).

Production was heavily dependent on South African goods (Petersson 1990). Savings (import substitution) or earnings (exports) of foreign currency, due to the expanding domestic production was small. Thus, exports of dividends and profits exceeded the inflow of private capital. Investment goods and the main share of material inputs were imported, and expatriate salaries have resulted in further leakage through their contribution to imports of goods and services. In the SAP, new policy instruments were introduced to reduce this leakage and to expand production based on domestic resources. Thus, at the end of the SAP period, the system of tax holidays was abolished, and the policies to encourage investments have increasingly included domestic investors and the stimulation of domestic activities in connection with the LHWP.

Consequently, during the SAP period, Lesotho has achieved a significant success in promoting export-orientated production, based on a relatively small number of foreign-owned enterprises. The dependence on raw materials, semi-manufactured products and foreign technology and management has, however, remained. The future development of production and exports of manufactures is dependent on political and economic development in South Africa, and a potential liberalization of world trade in textile and textile products and changes in the Multifibre Agreement.

Certain measures introduced under the SAP will be maintained and improved during the next three years. These measures include streamlined procedures for granting work

permits to key expatriate staff of foreignowned enterprises, and to make more land available for industrial development. Finally, minimum wage levels will be reviewed on an annual basis in the light of prevailing labour market conditions. In the ESAP, an increased emphasis is placed on the promotion of indigenous investments and the provision of training for industrial employees and small-scale entrepreneurs. Basotho industrial entrepreneurship is confined to the small-scale unit. Training to generate business- and industrial-related skills will increasingly be supported and the provision of training for industrial and small-scale entrepreneurs will be expanded.

Agriculture and land policy

Agriculture is the predominant sector (66 per cent) among the currently employed population (Fyhrlund 1988:33). The contribution of the sector in terms of GDP has, however, gradually declined since independence from about 40 to around 20 per cent during the 1980s. As a result of dramatic wage increases for mine migrants during the 1970s, most rural households utilize their land resources primarily for purposes of security and as a supplementary source of income.

The land tenure system, where private ownership of land is absent, and communal grazing are identified as the key problems of the sector. It fails to provide incentives for individuals to restore land fertility and to improve their land, and results in overgrazing, which contributes greatly to soil erosion and land degradation (ILO/JASPA 1979: Chapter 4). Consequently, a main target of the land policy in the SAP is to improve the system of land allocation and to increase the efficiency of its utilization (Lesotho 1988:14–17). The proposed improvements in the land tenure system may be regarded as an implementation of, and an extension of, the 1979 Land Act. The Act provides for the distribution of land to a single heir and, thus, no further subdivision of land would be allowed (Eckerdt 1982:13–14). The right to permanently-cultivated land may also facilitate the development of a rural credit market. One important extension of the Land Act is to give legal title to land-leasing arrangements, which require the surveying of fields. The capacity to survey plots is, however, inadequate even in relation to the preferential urban areas (Matekane 1990:25). As a result, in 1990 the government decided to amend the law to enable legal recognition of informal land-leasing, which will be implemented under the ESAP (Lesotho 1991:8; World Bank 1990a:10).

In general, the implementation of the land reform and the measures introduced to reduce grazing on arable land have been delayed because of political and social resistance, and a lack of administrative capacity (Bardill and Cobbe 1985:80,94,99; Mapetla and Rembe 1989). It seems that most population segments oppose at least some part of the reform package. Any change in the system of land allocation affects the economic and political relations in the rural areas, and political power and the wealth of affluent people rests largely on traditional institutions. The traditional system remains fairly popular, which makes it difficult to implement modern institutions, and to bring the chiefs into the mainstream of development planning as their main source of power is based on the allocation of use rights of land.

The effect of the land reform will be a concentration of arable land resources among fewer, more ‘progressive’ farmers on economically-viable holdings, and a transformation

from largely subsistence to more commercial farming. This will create a large landless class whose living standards and social security will be drastically reduced unless a massive investment in rural development is undertaken. The reform was introduced in the late 1970s after a period of increased migration and dramatic increases in real wages in the South African mines. This made intensive farming less attractive and contributed to extensive livestock development through the increased capacity of migrant workers to buy livestock. In turn, this has made transformation of agriculture both more socially acceptable and an urgent necessity. Thereafter, however, the demand for migrant labour in South Africa has been declining, and the intake of apprentices from abroad has been almost entirely eliminated.

Since the 1970s there has also been a tendency for income sources (and influence in the society) to have co-existent distributions, such as the size of landholdings, livestock herds and wage earnings, where non-farm incomes increase the capacity for purchase of livestock and other investments (Eckert 1982:25–6). Unregulated grazings – as well as the rights to use arable land for grazing after the growing season – lead to a skewed ownership of livestock which, mainly benefits the more affluent members of the community. In practice there is no control of cattle numbers. This causes resistance towards grazing reforms which has its origin in a conflict over income distribution.

The government aims to reduce overgrazing through a reduction in livestock numbers and an increase in the carrying capacity of rangeland. Under the SAP, the government prepared legislation to authorize the village development councils to institute range user (grazing) fees. The revenue will be used to finance improvements on the range. Due to political and social constraints, and a lack of local capacity to implement grazing fees, the introduction of the fees has been postponed, but will gradually be implemented sequentially among rural areas during the ESAP. At the outset these fees will, however, be low relative to earlier proposals. The intention is to provide increased resources for local administration to allow them to execute certain measures of the development programme. The government will also introduce new measures and maintain and strengthen existing programmes, which aim to increase the quality of livestock, and to make livestock holding a commercial venture rather than a means of savings. Few measures are, however, introduced to encourage rural people and associations to play a greater role in decision-making. Thus, the government seems to rely on being able to raise the income levels of participants to achieve social acceptance for the transformation of agriculture.

The objective of crop agriculture is to expand and diversify production. Thus, the government will continue to promote the production of vegetables and food crops in order to replace imports, and to export high-value horticultural crops. This requires that the tradition that fields should be opened to grazing after harvest must be changed. This extension of individual rights of arable land, which was introduced during the 1980s, is a precondition for production of certain high-value crops, such as fruit and vegetables. However, the weakness of modern institutions has prevented the implementation of such changes througout the country. Fencing is still rare.

SOCIAL ASPECTS OF STRUCTURAL ADJUSTMENTS

On the United Nations Development Programme (UNDP) Human Development Index, where human development is indicated by an aggregate measure of life expectancy at birth, literacy rate and income per capita, Lesotho does better (number 53 from bottom) than in its income ranking (number 35) (UNDP 1990:128). Lesotho is the only country of 130 countries, included in the report, in which the Human Development Index is substantially larger for females than for males. It has, however, not been possible to differentiate incomes between men and women. These differentials are large in Lesotho, due to limited opportunities for wage employment within the country and the labour migration system in which, especially, a large number of men have the opportunity of temporary migration to relatively well-paid employment in South Africa. The women are left behind to take care of the family and the farming, largely producing subsistence crops. Furthermore, migrant incomes give opportunities for investments in livestock production and business activities, which increase income differentials between men and women and between those households which have and those which do not have a migrant worker. The index of human development represents an average of the population, and does not accurately reflect conditions for the poor. Income distribution is very skewed in Lesotho. Half the population of low-income households receive only around 10 per cent of total cash income, and half the population lives, according to the estimates presented by UNDP, below the poverty line (Eklöf and Molapo n.d.:5; UNDP 1990:158). In health and education, the poor may be expected to be at substantially lower levels than the average for the entire population.

In order to avoid adverse effects on the poor, vulnerable groups may be protected during the adjustment process. Adjustment may also be designed to include measures that aim to enhance the ability of the poor to participate in the growth process. Then, investments in improved health and education are identified as the key to the long-term reduction of poverty (Seragelding 1989:50–1).

Social impact of structural adjustment

In the fiscal policy of Lesotho's structural adjustment programme, measures have been introduced to broaden the domestic tax base, reduce tax evasion, and reduce government spending. The revenue-raising measures introduced are oriented towards increased taxes on incomes and consumption of primarily relatively well-to-do people, who largely live in urban areas. Goods identified to represent basic needs are exempted from taxation. Cost recovery in the health services includes exemptions for low-income groups, while cost recovery in infrastructure will fall mainly upon urban communities. Hence, it seems that the government has tried to protect the poor from increased charges on service and taxes, which have been implemented under structural adjustment. The open border imposes, however, a severe constraint on the governments' ability to implement differentiated indirect taxes on goods, which are designed to increase taxation of 'luxury' consumption. Deviations from South African tax rates encouraged people to shop across

the border and resulted in smuggling.

Current expenditure, excluding interest payments, has been reduced only slightly in real terms during the SAP period, and much less than targeted. The wage bill was, however, targeted to grow by the rate of inflation, but after a large increase in 1988,[9] the real wages and salaries of civil servants decreased substantially until 1991. The budgeted increase that year did not make up for the losses in purchasing power during the SAP period. Moreover, the number of contract and daily-paid employees, who belong to the lowest paid groups of the society, has been reduced (Matlosa 1990:32–4). No safety net for retrenched civil servants has been implemented. At the same time, the number of skilled labour has been allowed to increase slightly, and gradually, especially since 1991, a more market-oriented wage structure was implemented which favours skilled labour. Consequently, the employment and wage policy has resulted in a reduction in the number of, and a decline in the purchasing power of, unskilled civil servants, and increased wage and salary differentials between skilled and unskilled labour have increased among the civil servants.

Social sector policies

One major problem with poverty-related initiatives in sectors such as health and education is that it will require a high level of current expenditure, which was to be restrained during the SAP period. Thus first, after the reduction of the fiscal deficit, initiative was taken to direct increased revenues towards human development. Consequently, before 1990/91, no objectives for the social sector were included in the structural adjustment programme. This has been changed in the enhanced structural adjustment programme. The intention is that, in particular, the share of education in total government expenditure will be increased. In the health sector, real current expenditure will not be allowed to fall, and it may be increased modestly.

According to several of the UNDP's indicators of human development, there is much that is positive about education in Lesotho. The adult literacy rate is high compared to an average of developing countries, and in particular compared to the countries of Sub-Saharan Africa. The gross primary enrolment ratio is also high. It is, however, not difficult to find problems with the Lesotho educational system. The average presented by UNDP does not accurately reflect the conditions of the poor. Families with low incomes cannot afford the fees, books and uniforms of primary school, or to send their children to secondary school, and many boys are assigned by their parents to take care of cattle. There are also problems of poor school facilities, lack of qualified teachers, a declining standard of education and regional inequalities. The low wages of qualified teachers, compared to the wages in South Africa, have resulted in an ongoing loss of experienced teachers from Lesotho. The drop-out rate from school is very high compared to most developing countries. In the labour force survey 1985/86, it is estimated that among the currently-employed population in Lesotho, excluding migrant workers, 21.6 per cent have no formal education and another 59.7 per cent have not completed primary school or informal training (Fyhrlund 1988:47).

Education, especially in primary, technical and vocational education is given a high priority in the enhanced structural adjustment programme. The main aim is to increase

the quality of education, and the main measure is specified as a substantial teachers' pay increase. The target during the programme period is to raise wage levels to those of other civil servants with similar qualifications and experience. The share of education in total government expenditure will be increased. The programme focuses in the medium term on the objective of providing an increased number of semi-skilled and skilled labour to the modern sector rather than providing education for all children. This may increase the inequality in education standards, and thus incomes among the population. Income inequalities may also increase by the gradual introduction of more market-oriented wages, which means the adaption to the South African wage level for skilled labour and increased wage differentials. The country may otherwise increasingly lose skilled labour to other countries, in particular, in the event of a dismantling of apartheid, in South Africa.

In the long run, the measures to increase the quality of education must be supplemented by measures directed towards the poor. In order to expand the development opportunities for a growing number of people, education must be made more accessible for an increasing number of people and measures introduced to assist children to complete their education. This is a long-run undertaking, which requires an increased level of expenditure on education, and will result in an increased demand for skilled labour in the education sector.

CONCLUDING REMARKS

The policy of liberalization of the factor markets under structural adjustment has largely meant an adaptation to the regional, that is, the South African market. Thus, the first steps towards a more market-oriented wage structure have been introduced, which means increased wage differentials. The policy is designed to reduce the loss of experienced and skilled labour to South Africa, which are scarce in the region and a major bottle-neck of development in Lesotho. It is also a principal measure to improve the quality and efficiency of the Civil Service and the educational sector. This policy may in the future result in an adaptation to the South African wage level for skilled labour, while the abundance of unskilled labour in Lesotho means that their wages can be kept low and below the wage level in South Africa. The government also intends to increase the share of education in the total government expenditure in a programme which, at least in the medium term, seems to focus on the objective of providing the modern sector with an increasing amount of skilled labour.

The strategy in the monetary and credit sector is mixed. The restrictions introduced on capital movements between Lesotho and South Africa to ensure the employment of local savings domestically will remain, while the interest rates gradually have been adapted to those of South Africa. In the internal financial market, credit ceilings and the fragmentation of the credit market system will largely remain, aimed at increasing credit facilities to the productive sectors. The objective seems, however, to be a strengthening and a gradual liberalization of the internal financial system, and to develop market-oriented instruments for controlling bank credit. This may in the long run pave the way for a liberalization of the external financial market.

The experience under the SAP emphasizes the country's severe external dependence on customs union revenue and grants and on the constraints in setting indirect tax rates on traded goods, due to its economic integration with South Africa. Furthermore, almost half of the country's total factor incomes are excluded from the income tax system. This refers to the remittances of the relatively well-paid migrant mineworkers, where South Africa will not co-operate and place responsibility for withholding such taxes on the mining companies. The possibility of substantially increased revenue from other sources is small. The impact on government revenue of the introduced revenue-raising measures, aimed at increasing local (non-customs) revenue, has been almost insignificant. Consequently, fiscal policy had to resort largely to expenditure levels.

The heavy external dependence also remains in the real sector. Generally, the structural benchmarks of supply-side policy instruments were not attained, and the progress was slow. The Lesotho Highlands Water Project is the completely predominant source of growth in the economy, followed by the export-oriented manufacturing industry. In the agricultural sector, the introduction of a number of institutional changes of the land tenure system has been supported under the SAP, but the implementation has been delayed because of political constraints and lack of administrative capacity. The full implementation would mean a fundamental change in the Basotho society, where new opportunities for income from farming would gradually be eliminated for an increasing part of the population at a time when new opportunities for migration are almost eliminated as well. Traditionally the Basotho society has rested on the combined income possibilities from these two sources.

NOTES

1 The only restriction is the amount of transfer, where profits are subject to 15 per cent withholding tax (LNDC 1987:3).
2 Companies currently enjoying a tax holiday will have the option of moving immediately to the new tax rate or continuing the tax holiday and paying tax at the current rate of 37.5 per cent when it expires (World Bank 1990a:6).
3 In 1991, after negotiation with the mineworkers, the government decided to reduce the deferred pay percentage to 30 per cent (Lesotho 1991:23).
4 There exist, however, at present no secondary market in government bonds, which can be used for these purposes.
5 The construction of the hydropower component is scheduled to start at the beginning of the 1990s.
6 The average annual inflation has been around 15 per cent.
7 In US dollars per loti, this decline was from 0.899 in 1983 to 0.382 in 1989.
8 The agreement is an arrangement regarding international trade in textiles, and consists of a series of bilateral agreements under which import quotas are fixed by source.
9 The previous salary review was granted in January 1985, and compared to that year, the wage increase of 45 per cent was largely an adjustment to inflation.

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8
EXTERNAL SHOCKS AND THE SEARCH FOR DIVERSIFICATION IN ZAMBIA

Per-Åke Andersson and *Steve Kayizzi-Mugerwa*

INTRODUCTION

At independence in 1964 Zambia inherited an economy which was heavily dependent on the mining sector for employment, foreign exchange earnings and government revenue. Nevertheless, during the first decade the country enjoyed one of the highest rates of growth in Sub-Saharan Africa. Prices for its major export, copper, had an upward trend and the state was poised to take over the main commercial and industrial undertakings.

When the world-wide recession of the 1970s hit Zambia, mineral dependence proved to be a two-edged sword, however. Both foreign exchange reserves and government revenue fell drastically. To sustain the economic structures built in the affluent 1960s, mining, the main generator of foreign exchange, had to continue to receive the lion's share of domestic resources.

This chapter analyses Zambia's macroeconomic responses to economic crisis. The presentation is chronological and follows the sequence of measures taken in an effort to contain the economic decline. The next section presents a theoretical overview of the economic implications of mineral dependence. To put Zambia's experience in perspective, the third section looks at the country's colonial legacy and its social, political and economic impact. Subsequent developments are discussed in the following three sections under three headings: ten years of relative prosperity, 1964–74; shocks and decline, 1975–80; and a lost decade, the 1980s; respectively. In the seventh section we summarize Zambia's experience and the last section concludes the chapter.

MINERAL DEPENDENCE IN THEORY

In retrospect, mineral affluence has not been the blessing that most developing countries had hoped it would be, that is a remover of the external sector's constraint on economic growth. Experiences from countries as far apart as Mexico (Sterner 1985), Nigeria (Schatz 1977) and Namibia (Södersten 1985) show that sudden surges in mineral prices undermine the implementation of well-thought-out policies in favour of hurried but incomplete schemes – a 'stylized fact' which Schatz (1977) has amply documented for the Nigerian case and equates with 'euphoric planning'.

It has also been suggested that in poor countries politicians, and other leading groups, have a 'high rate of time preference' (Seibert 1984). Booms thus lead to extraction rates

which are beyond the absorption capacity of a semi-industrialized economy and the amassing of projects takes precedence over relevance and quality. Hence a number of 'white elephants' are left behind in the post-boom period – monuments to the unfulfilled ambitions for fast development.

Increases in mineral incomes alter domestic consumption patterns, first, as a result of 'habit' formation arising from the newly-acquired capacity to import what is not available at home, and second, due to the impact of the 'international demonstration effect' (Nurkse 1953), via the consumption habits of the affluent classes in both government and industry.

On the side of economic management, booms lower the marginal costs of raising revenue. Government receipts increase without a parallel decrease in private disposable income. Expenditure thus expands as the standard excuse in lean times 'we have no more money' ceases to be valid (Lewis 1984). In mineral-rich countries, public sectors tend to dominate economic activity. Thus most of the increase in domestic expenditure that follows a boom will be within the realm of 'general' government, including subsidies to both parastatals and urban consumption.

In the search for economic diversification, mineral-dependent countries are very amenable to arguments for industrialization, mainly via import sub-stitution. This is often at the expense of the traditional sectors of the economy, notably peasant agriculture. Further, as capital goods industries are often rudimentary, rapid industrialization tends to boost the importation of both intermediate and capital goods. Part of the difficulty, during periods of falling mineral incomes, is that in the short run imports cannot be substituted for by goods produced domestically. In fact this might still be difficult even in the long run. Mineral affluence thus implies a dependence on imports that could persist long after the means to sustain it had dissipated.

The adverse side-effects mentioned above could probably be tolerated if, as is often assumed, the imported technology and advanced management techniques in mining help improve domestic productivity via intra-sectoral resource and skill transfers – spillover effects which could have positive impacts on industrialization. But even this view is questionable. For apart from its high cost, both in absolute and foreign exchange terms, the technology used in mining is often too advanced to provide technological leadership to the rest of the economy. Being rigidly capital intensive, the sector can only alleviate a small portion of the acute unemployment problems of most mineral-dependent economies. However, several forces seem to be working simultaneously to ensure that the mineral sector, in spite of the disadvantageous side-effects, gets all it needs in terms of factors and other resources. The rest of the economy competes for the residue.

Although the mineral sector's direct linkages with the rest of the economy are assumed to be weak (Hirschman 1957), mining has, mainly via its higher wages, a powerful 'demonstration effect' on the rest of the economy. It is capital intensive and employs, relative to its output, a small labour force. The presumed higher productivity, coupled with the low share of labour in value added, encourages the push for higher wage claims. Together with the sector's wage leadership, this complicates adjustment efforts during a period of weak mineral prices.

Finally, the structural and income distributional impacts of the mineral sector on the rest of the economy can be discussed under two headings: dualism and Dutch disease.

Dualism comes about when the 'retained value' of mineral exploitation goes, overwhelmingly, to the modern or urban sectors of the economy, either as the intended result of domestic policy or as the outcome of domestic power struggles, with urban classes using their influence to turn economic policy in their favour. Reference is made to two dualisms resulting from mineral affluence. As we saw above, miners are able to extract wages far exceeding those in other sectors of the economy – this has been called wage dualism. Mining sectors also use highly-advanced technologies which are partly manned by foreign nationals earning high wages. The implication of this is that the other type of dualism – technological dualism – is bound to reinforce wage dualism.

The Dutch disease describes the impacts of a mineral boom on the relative prices in an economy which produces both traded and non-traded goods. It is a trend of events describing a process of de-industrialization (Corden and Neary 1982). When traded goods comprise both a booming (minerals) and non-booming (manufactures) sector, the shift in prices brings about a reallocation of resources from the non-booming to the booming sector causing a decline in the former. Roemer (1985) believes, however, that de-agriculturalization is the most likely outcome. Not unlike dualism, the Dutch disease is associated with a skewed income distribution (Cassing and Warr 1985).

COLONIAL BACKGROUND

The British South Africa Company handed over the administration of Northern Rhodesia to the British Government in 1924 and copper-mining was embarked on in earnest a few years later. Its development was largely left to transnational interests, involving South African, British and North American companies. It was, however, not to take firm roots until the boom years that followed the Second World War.

In relation to her southern neighbour, Northern Rhodesia was regarded as something of a marginal colony. To ensure a cheap and plentiful supply of labour to the mining industry, the colony's traditional sectors were left undeveloped. The social and economic infrastructure, the mining industry apart, received low priority.

The years preceding the Second World War marked the beginning of what would be called, by students of the Zambian economy, dualistic development. Mining was undergoing a boom while the peasant sector tried to make ends meet under a lop-sided agricultural legislation which favoured the small, but capital intensive, settler-farmer enclave (Fry 1979). Migration from rural areas to mining and commercial agriculture was actively encouraged, while alternative income-generating opportunities in traditional agriculture and craftsmanship were restricted by laws and other regulations.

Probably the most important socio-economic impact of the mining sector was the role it played in the evolution of an urban working class (Gertzel and Szeftel 1984). Miners are 'a labour aristocracy' with considerable influence on the economy at large, most notably via their impact on modern sector wages.

The colonial legacy can be summarized in five points:

1 Development of a technologically-advanced mining sector into the mainstay of the economy, thereby laying the ground for an almost irreversible external dependence. And since mining uses capital-intensive techniques, the sector would not be relied

on to generate the employment that the country yearned for.

2 Traditional agriculture was marginalized by a combination of taxation and agricultural policies which were tilted in favour of expatriate farmers and the mining industry (Lucembe 1974).
3 Economic activity was concentrated in the 'line-of-rail' provinces, laying the ground for vast regional inequalities after independence.
4 At independence, the wage structures were characterized by huge differentials, their piecemeal adoption meant that income disparities were to continue to flourish.
5 African education and other social infrastructure were largely neglected.

TEN YEARS OF RELATIVE PROSPERITY, 1964–74

From the vantage point of the crises-ridden 1980s, the period 1964–74 was Zambia's golden age. Thanks to favourable copper prices and high mineral production, the country registered impressive growth rates. Table 8.1 shows that the growth of gross domestic product (GDP), while showing considerable variation between the years, reached 7 per cent in real terms. During this period the contribution of mining to GDP ranged from 23 to 48 per cent. Copper accounted for up to 94 per cent of total exports and around 50 per cent of government revenue. The mineral incomes to the government (GRZ)

Table 8.1 Zambia: gross domestic product (million kwacha) and copper dependence

Year	*GDP*	*(%)*	*GDPC*	*(%)*	*CU*	*C/GDP*	*C/G*	*C/X*
1964	1,618	–	449	–	644	45	53	91
1965	1,915	18	518	15	686	40	71	91
1966	2,172	13	572	10	588	44	64	94
1967	2,449	13	628	10	619	39	60	93
1968	2,632	7	650	4	660	38	58	95
1969	3,123	19	758	17	755	48	59	96
1970	2,695	–14	634	–16	686	36	58	96
1971	2,697	0	614	–3	636	23	36	94
1972	2,962	10	656	7	701	24	19	92
1973	2,934	–1	627	–4	683	32	29	95
1974	3,132	7	648	3	709	32	93	53
1975	3,056	–2	614	–5	648	13	13	91
1976	3,187	4	620	1	712	17	3	92
1977	3,035	–5	573	–8	659	11	–	91
1978	3,067	2	573	0	654	12	–	88
1979	2,973	–8	529	–8	584	18	–	90
1980	3,063	4	551	4	609	16	5	94
1981	3,352	6	554	1	560	14	1	94
1982	3,155	–3	523	–6	592	11	–	93

1983	3,108	–2	498	–5	576	15	4	92
1984	3,084	–1	479	–4	551	14	6	88
1985	3,279	6	487	2	480	16	8	85
1986	3,346	2	434	–11	460	18	13	83
1987	3,503	6	465	7	483	14	7	85
1988	4,216	5	470	1	422	10	2	85
1989	4,210	0	–	–	451	12	11	88
1990	–	–	–	–	441	–	17	–

Sources: Republic of Zambia (a); Republic of Zambia (b); Republic of Zambia 1986; IMF, *International Financial Statistics*, various issues.

Definitions: GDPC = GDP per capita.

CU = Copper production in thousands of tonnes.

C/GDP = Contribution of copper to GDP (per cent).

C/G = Contribution of copper to government revenue (per cent).

C/X = Contribution of copper to exports (per cent).

varied considerably from a high of 71 per cent in 1965 to a low of 19 per cent in 1972. This created a number of planning difficulties.

Variations in overall economic growth were not wholly to blame on the impacts of the mining sector, however. The strategy of import substitution bears much of the blame. During the first years of independence, industrial policy proceeded along lines laid down in the colonial period and would, according to the White Paper on Industrial Policy of 1964, be capitalist oriented. All this was to change four years later, in 1968, with the Mulungushi Reforms. Rejecting the capitalist approach and emphasizing self-reliance, the government nationalized the mining companies together with a number of foreign-owned firms.

Table 8.2 shows that while capital investments from the private sector actually decreased in the late 1960s, public sector investments increased threefold. The public sector's share of capital investments rose from 42 to 67 per cent. Suckling (1985) has estimated that the growth of the real capital stock increased from around 6 per cent in the mid-1960s to over 10 per cent in the late 1960s. The rate levelled off at 7 per cent in the early 1970s.

Table 8.2 Capital investment in Zambia (millions of pounds sterling), 1954–70

	1954–64		*1966–70*	
	million £	%	*million* £	%
Public sector	180.4	42.3	281.8	67.7
Private sector	245.7	57.7	147.5	34.4
Total	426.1	100.0	429.3	100.0
Annual average	42.6	–	107.3	–

Source: Republic of Zambia (1966).

In spite of this impressive increase in public sector investments, the nationalization policy has had a number of critics. Fundanga (1986) suggests that instead of spending financial resources on acquiring existing companies, the government should have used the money to undertake new investments. The industrial capacity of the country would have expanded instead of merely bringing about a change of ownership. Furthermore, nationalizations have not reduced, as had been hoped, the capital outflows, rather these have been substituted for increased interest payments to abroad. Makgetla (1986) has calculated that during 1970–4 the total capital outflows, including factor incomes, was around 2.5 times higher than the capital inflows (Table 8.3).

Table 8.3 Capital flows to and from Zambia, 1970–84 (million-kwacha period averages)

	1970–4	*1975–9*	*1980–2*	*1983–4*
Total inflow	45	115	295	130
of which medium- and long-term loans	32%	48%	77%	92%
Factor incomes paid abroad	110	140	240	330
of which investment income	64%	66%	81%	89%
Net capital flow	–61	–24	45	–200

Sources: Makgetla (1986); World Bank (1984).
Note: Total inflow equals private investments, grants, and long- and medium-term borrowing by GRZ.

The Second National Development Plan of 1971 saw a re-emphasis of the theme of self-reliance. The role of import substitution was extended to areas such as meat-processing, dairy products and textiles. The period of 'easy' import substitution, 1963–73, saw a remarkable growth of the manufacturing sector. Total manufacturing value added increased on average by 12.7 per cent per year (growth for low income countries was 5.4 per cent and that for Africa 7.3 per cent (Table 8.4)). Gulhati and Sekhar (1981) have estimated that during 1965–72 around 55 per cent of the growth of manufacturing was due to import substitution, while 44 per cent was due to increases in domestic demand and only 1 per cent was due to increases in exports. Import substitution continued to be important well into the 1970s (Andersson 1988).

Table 8.4 Growth of manufacturing value added at constant 1975 prices (per cent)

Years	*1963–73*	*1974–81*
Zambia	12.7	–0.7
Low income developing countries	5.4	6.2
Africa	7.3	5.9

Source: UNIDO (1985).

Using the Dutch disease model to study this time period, Kayizzi-Mugerwa (1988, 1991)

has argued that the expected reduction in industrial activity, owing to the resource and macroeconomic effects of the mining boom, was offset by the massive investment programmes of the government. Instead, the burden of adjustment fell on agriculture which was indirectly taxed and drained of resources. Both agriculture's shares in formal employment and in non-mineral GDP fell from 1960 to the mid-1970s, while both ratios indicated a positive trend for manufacturing. Thus since the mineral boom had increased the cost of production in the country, import substitution became the only viable alternative for the development of manufacturing in Zambia.

But even in the prosperous post-independence days, agriculture was seen by policy-makers as an important alternative to mineral extraction. However, the country's agricultural policies were never clear cut. According to Keppler (1979), three contradictions complicated the agricultural and, by implication, rural development policies:

1 The need to appease urban dwellers by assuring them low food prices as opposed to the necessity for improving incentives to farmers through higher prices for their produce.
2 The choice between concentrating government efforts and programmes on commercial and emergent farmers or on the majority composed of peasant farmers.
3 The conflict that arises between pursuing a capitalist or socialist approach to agriculture.

The first-mentioned contradiction was partly resolved by the introduction of production and consumer subsidies at the beginning of the 1970s. To keep costs in mineral production as low as possible, it was necessary to keep the miners' wage demands down by maintaining low prices for agricultural goods as well as for manufactured 'wage goods'.

Commercial farmers, with their powerful lobby, have had much influence on agricultural policy. It has been difficult to respond to the needs of the small farmers. Fertilizer subsidies, which account for the bulk of agricultural support, are mostly to the benefit of the large-scale farmers. This also applies to the credit schemes that have been used from time to time.

These conflicts reflected the broader dilemma of choosing 'the' path to development. Having taken over 'the commanding heights' of the economy, the state had assumed the main thrust in the area of industrialization. It was, however, difficult to transfer this to agriculture. Problems ranged from the sheer size of the country to the atomization of peasant holdings. The government's demonstration farms planned for each district would have little impact.

In comparison to the economic decline of subsequent years, the period 1964–74 was prosperous. However, the features of a dependent economy, such as massive imports, expansive government and consumer subsidies, were consolidated in the course of the decade. Instead of strengthening the country's ability to control its resources, the nationalizations at the end of the 1960s and beginning of the 1970s led to a net outflow of foreign exchange resources. Failure to rejuvenate the agricultural and traditional sectors of the economy left few options for the country when the economic shocks set in. The seeds of future vulnerability were thus sown in the affluent 1960s.

SHOCKS AND DECLINE, 1975–80

The mid-1970s marked a sharp discontinuity in the development of Zambia. The country's terms of trade fell sharply following the first oil crisis and the subsequent world economic recession. The country's structural shortcomings were suddenly exposed: extreme dependence on copper, a fragile manufacturing base and neglected peasant agriculture. The relative openness of the economy ensured that the effects of the world recession would be transmitted to all sectors.

The nature of the shocks was as follows: oil prices increased threefold in 1973/74, while the international recession reduced the demand for copper and its price fell by 40 per cent in 1975. Using copper/oil prices as an illustration of Zambia's purchasing power (Table 8.5), the two had seen a similar development after 1975. However, the second oil crisis of 1979/80 resulted in a sharp decline of the copper-petroleum terms of trade. The shocks had a debilitating impact on the balance of payments. In 1975 the trade balance turned negative for the first time following the halving of the value of exports. This should be compared to the trade surplus of around kwacha 400 million in both 1973 and 1974. Better copper prices and a reduction of imports turned the trade balance positive in 1976. The increase in the share of oil in total imports indicates the magnitude of the reduction in other imports. Oil's share was 9.6 per cent in 1973, it rose to 13.6 per cent in 1975 and was close to 20 per cent in 1979.

Table 8.5 Zambia: copper–petroleum terms of trade, 1973–80

Year	*Copper price*	*Petroleum price*	*Barter t-o-t*	*Index (1972 = 100)*
1973	1,156	19	61	190
1974	1,326	57	23	71
1975	794	58	14	44
1976	1,007	70	14	44
1977	1,016	87	12	38
1978	1,089	87	13	39
1979	1,571	139	11	34
1980	1,719	202	8	27

Source: Kayizzi-Mugerwa (1988).

Notes: Prices (in kwacha) are, respectively, for metric tonne of copper and petroleum. t-o-t = terms of trade.

Over the years Zambia had used its positive trade balance to finance its services account (that is, freight and insurance), investment incomes and transfers to abroad. The crises led to a current account deficit which reached 30 per cent of GDP in 1975. It has remained negative ever since.

How did the government react to the setbacks in the mid-1970s? Its initial reaction was to treat the crisis as temporary. It thus increased its borrowing from bilateral and multilateral sources and ran down foreign reserves. Although reserves were reduced to

less than kwacha 100 million, just sufficient to cover eight weeks of imports, the government only managed to reduce its deficit by 10 per cent.

As real export revenues continued to fall, while import prices went up, the government embarked on a number of strategies. With the objective of reducing imports, an elaborate system of import licencing and foreign exchange allocation was embarked on in conjunction with a highly-differentiated tariff structure. In practice the system soon grew too complex and unwieldy (Colclough 1988) to run smoothly. To improve the cash-flow situation in the mining companies, reducing imports and improving the competitiveness of Zambian exporters, an exchange rate adjustment was undertaken in 1976. This was followed by a 20 per cent devaluation in 1978. The continued administrative management of the exchange rate implied that, in between adjustments, the currency would become overvalued, leading to parallel markets for foreign currency.

The years of revenue surpluses had helped sustain the expansionary stance of the government. The large fiscal deficit of 1975 put an end to this, however. The mining sector's contribution to the budget fell to only 13 per cent from a high of 71 per cent in 1965. Its contribution fell further in the course of the subsequent years (Table 8.1). In a bid to increase revenue, the government raised customs levies and excise duties. This did not stop the revenue contraction. To maintain recurrent expenditure on basic administration, security and social and economic services, there was increased borrowing from the banking system. This left little room for capital investments and their share of total government expenditure fell from 28 per cent in 1974 to 17 in 1980. As a percentage of GDP, gross fixed capital formation showed similar trends.

The financing of the fiscal deficit, by borrowing from the banking system, together with the rise in import prices, increased the rate of inflation (Suckling 1985). The Bank of Zambia's claims on the government increased fourfold between 1975 and 1978. Inflation rose from around 8 per cent in 1974 to 16 per cent in the years that followed.

Though Zambia was considered a high-wage economy in the 1960s and early 1970s, the level of real wages started to decline during the crises. To combat the effects of the inflationary spiral, the government increased its regulation of consumer prices and expanded its subsidies on basic commodities. The volume of subsidies reached 12 per cent of total government expenditure in 1975, but declined to around 10 per cent for the rest of the decade. In 1980 subsidies claimed 25 per cent of the government budget. The control of prices for basic commodities also implied that many state-owned companies could not make profits, their losses being covered via the budget. Altogether, consumer subsidies and net lending to parastatals claimed 80 per cent of government revenues in 1980 (Table 8.6).

As the backbone of the economy, the mining industry was not directly

Table 8.6 Zambia: government expenditures on subsidies, 1980–9 (million kwacha)

Year	*Nominal*	*1980 prices*	*Index*	*Sub/rev*	*SL/rev*
1980	196.8	196.8	100	25	80
1981	110.2	103.0	52	13	14
1982	156.9	138.0	70	18	31

1983	82.2	60.9	31	8	12
1984	91.6	56.8	29	8	11
1985	188.4	85.1	43	14	27
1986	569.9	141.2	72	18	29
1987	677.4	112.9	57	15	23
1988	1,462.2	184.8	94	26	30
1989	1,502.8	82.6	42	19	–
1990	3,915.0	–	–	19	–

Sources: Institute For African Studies (1989); Katongo (1988); Republic of Zambia (a); Republic of Zambia (1989).

Note: The figures for 1990 are budget estimates.

Definitions: Sub/rev = subsidies as a percentage of government revenue.
SL/rev = subsidies and net lending as a percentage of government revenue.

affected by the reduction of imports, but increases in the cost of machinery and other inputs affected the profitability of copper extraction. The mining sector's contribution to GDP decreased to 15 per cent and that to government revenue to zero.

The extremely good performance of the manufacturing sector in the 1960s was reversed after the oil crises. For the rest of the 1970s the sector had an average growth rate of –0.7 per cent per year. In spite of this and reflecting the overall economic decline, the sector's share of GDP rose from 12 per cent in 1974 to around 19 per cent in 1980. The recession and increase in import prices had an adverse impact on the import-substitution effort. Though the 'second stage' of import-substitution had been embarked on, the escalating cost of capital and intermediate goods inhibited further progress. As a percentage of total inputs in manufacturing, imports reached an average of 55 per cent in 1975. This ranged from 12 per cent in non-metallic mineral production to 85 per cent in basic metal production (Andersson 1988).

In 1978 Zambia received financial assistance from the International Monetary Fund (IMF). What would turn out to be a long, and not recrimination-free, relationship had begun. The Action Programme was to cover two years and the main objectives were to restore balance-of-payments equilibrium and to reduce the rate of inflation (see Ndulo and Sakala 1987). In the area of fiscal policy, emphasis was put on the reduction of aggregate demand. A brief increase in copper prices enabled the country to meet most of the IMF's performance criteria by the end of the agreement in 1980. When the programme expired in April 1980 subsidies to maize consumption, including handling and administration, shot to unprecedented levels. The budgetary difficulties were further accentuated by food imports as a result of two years of drought. What prevented the situation from getting out of hand was the ability of the mining sector to contribute to government revenue for the first time since 1977.

A LOST DECADE, THE 1980s

With the country's fading fortunes and increasing friction with regard to the economic

agenda, the 1980s saw a number of policy reorientations, three of which were distinct. First, the government sought to take back the political initiative, seemingly lost to the IMF-supported Action Programme. With the ambition of self-sufficience in agriculture the government embarked on the Operation Food Production Programme. Second, the continued economic decline dissuaded the government from further experiments and forced it to embark on a multifaceted structural adjustment programme which culminated in the auctioning of foreign currency. Third, the discontinuities of the rapid economic changes and the continued lack of visible progress caused much disaffection. In 1987 the government broke away from the IMF programme in favour of efforts based on 'own resources'.

Through all this, the government's main difficulty lay in preparing members of the ruling élite for the often drastic shifts in policies. The switch of administrative controls for market forces directly threatened groups which had hitherto been in charge of the control apparatus and to whom the rents had accrued. On the other hand, some influential businessmen advocated for market solutions. Though the need for economic diversification was never in doubt, instruments for its implementation were to shift with the policy moods of the country (Andersson and Kayizzi-Mugerwa 1989).

After failure to keep the momentum of the rather successful Action Programme of 1978, a comprehensive structural adjustment programme was embarked on in 1983 (within the framework of the economic reform package of 1982). Its objectives were to strengthen incentives for production, diversify exports and promote economic growth. Price distortions were to be corrected, while market forces would determine prices. Further, the government would decontrol interest rates, deregulate prices and reduce tariffs. Furthermore, the parastatals and the trade and tax systems would be reformed. Finally, agricultural producer prices would be increased to encourage production.

In practice, the government embarked on policies that focused on the reduction of aggregate demand. A freeze was imposed on wages as well as on government employment. The fiscal deficit was reduced during the first years of the programme, but had risen to 13 per cent of GDP by 1987 (Table 8.7). The reason for the earlier success was that the government had managed to keep its consumption low. For instance, subsidies were only 8 per cent of government expenditure in 1983 and 1984 (Table 8.6). Maize and fertilizer

Table 8.7 Zambia: indicators of macroeconomic performance, 1978–89

Year	*Exchange rate*	*M1 growth*	*P1*	*P2*	*Copper price*	*Fiscal deficit*
1978	0.97	1.3	11.5	16.0	61.92	–
1979	0.97	31.0	11.3	9.6	89.49	–
1980	0.97	–0.7	11.5	11.7	99.12	5.3
1981	0.97	10.5	10.4	14.0	79.05	8.8
1982	0.97	21.2	13.0	12.5	67.21	9.2
1983	0.78	15.3	18.0	20.0	72.23	3.8
1984	0.55	39.0	21.0	20.0	62.46	6.6
1985	0.25	11.0	33.0	37.5	64.29	11.1
1986	0.11	41.7	58.0	52.0	62.70	12.1

1987	0.12	87.3	54.0	43.0	81.50	13.3
1988	0.12	40.0	46.0	59.0	110.80	4.4
1989	0.07	65.0	106.2	124.7	130.00	6.6

Sources: Republic of Zambia (a); Bank of Zambia, various issues. *Definitions*:
Exchange rate = average nominal level of exchange rate, SDR to kwacha.
M1 growth = growth in money supply (per cent).
P1 = changes in prices for urban high income groups (per cent).
P2 = changes in prices for urban low income groups (per cent).
Copper prices (US cents/pound) at London Metal Exchange.

subsidies increased during the maize production booms of 1986 and 1987. Foreign interest payments also increased during this period. The government deficit was 24 per cent of GDP in 1986 alone. The kwacha was devalued by 20 per cent in July 1983 and was pegged to a basket of currencies dominated by the US dollar.

Both the inflation rate and the growth of money supply had been modest during the Action Programme. The streamlined expenditure helped improve the fiscal balance and reduced the government's need to borrow from the banks. By 1983, however, the inflationary pressures were being felt once again. Consumer prices rose from 13 per cent in 1982 to 33 per cent in 1985 (Table 8.7). Much of the blame for this escalation is often put on the rapid depreciation of the exchange rate. The latter had become a key instrument in the power struggle between those in favour of continued economic control and those who sought liberalization. In trying to meet these conflicting demands, the government was to embark on a crawling-peg system. Eventually the government began a full-fledged auctioning of foreign currency.

The dynamics around the auction seem to have taken over from fiscal imbalances as the immediate generators of inflationary pressures in the economy. The companies and businesses bidding for foreign exchange needed credit to raise the kwacha cover for their purchases. Also substantial amounts of working capital were needed to cater for the increased degree of uncertainty and the rather entangled planning horizon.

By mid-1986, actors on the auction market seem to have detected that the system was not sustainable in the long run. Speculation and excessive borrowing from commercial banks to purchase local currency cover implied a rapid depreciation of the kwacha. In the first half of 1986 it depreciated by about 30 per cent while the stock of money grew by over 20 per cent in the same period. The government tried to put breaks on the depreciation by reintroducing a measure of control, but when auction-related donor assistance began to dry up, the kwacha nose-dived against the dollar. However, what finally made the auctioning system unworkable was the rampant inflation that it seemed to generate and the loss of purchasing power that was experienced by fixed-wage-earners. The food riots in the copperbelt showed how explosive the situation was becoming and the pressures to abandon the liberalization experiments increased.

In May 1987 Zambia abandoned the IMF-supported adjustment programme and introduced the New Economic Recovery Programme (NERP). This implied a complete departure from the earlier liberalization attempts. It indicated a partial return to the 'command economy' approach of the 1960s and early 1970s. Henceforth, adjustment and

growth were to be through ‘own resources’. Among the policies advocated were:

1 A fixed exchange rate, which would be determined by a foreign exchange allocation committee (FEMAC);
2 Price control of ‘strategic’ commodities;
3 Fixed interest rates; and
4 A ceiling on debt servicing to 10 per cent of export earnings.

The NERP resulted in a reduction of the fiscal deficit, thanks to reduced government spending and the moratorium on debt servicing. However, the need to finance the bumper maize harvest of 1988 put pressure on public expenditure once again. Thus the new confidence was shortlived. Though the government had anticipated little foreign assistance for its new programme, the massive investments to be undertaken presupposed access to substantial financial resources. In the event, development assistance fell from US dollars 500 to 350 million. The IMF, World Bank and other donor agencies put a halt on their programmes.

The new system of foreign exchange allocation was biased in favour of the traditional businesses (de Vylder 1988). Few newcomers managed to enter the system. This implied that, though generally inefficient the parastatals would be kept going by the system.

By early 1989 the government was preparing the people for another major policy shift. In January food coupons were introduced in a bid to eliminate food subsidies altogether in the long run. In July of the same year the government decontrolled prices for all goods except maize. The liberalization package of the early 1980s was reintroduced. Government bonds would now be used in financing the government deficit.

Once again the exchange rate policy was drastically changed. In July 1989 the kwacha was devalued by 63 per cent. This was followed by a crawling-peg system with monthly adjustments which would soon become weekly. In February 1990 a dual exchange rate system was introduced. It comprised two windows, the official rate and the ‘market rate’. The latter was set at 40 kwacha to the US dollar. Initially the official rate would cater for metal exports, transactions of the international organizations, donor project support and for all imports that came via the FEMAC system. The second window would service non-traditional exports, foreign private investments, donor balance-of-payments support and some non-FEMAC imports of industrial inputs and spares. During 1990 more and more items were transferred to the second window and FEMAC was cancelled.

The combined effect of the large devaluation and the decontrol of prices led to a high rate of inflation. This was fuelled by the huge public sector wage compensations (30–50 per cent) and their impacts on wages in the rest of the economy. For the first six months of 1989 the rate of inflation was around 70 per cent, jumped to 140 in July but seemed to stabilize at 175 per cent by the end of the year.

In a bid to reduce directly money supply, a currency reform involving the replacement of old notes for new ones was embarked on. The minimum reserve requirement for commercial banks was raised to reduce the sector’s loanable funds. The parastatals were advised to deposit the kwacha equivalent of their external debt obligations at the Bank of Zambia. All this had the effect of reducing domestic credit expansion and the growth of money supply. The positive inflationary implications of this contraction were negated when ZCCM, the mining conglomerate, placed its windfall profits from both the

devaluation and the good copper prices in commercial banks. A stricter supervision of commercial banks and a mineral resource levy on ZCCM were introduced in the budget for 1990.

A SUMMARY OF EXPERIENCES

Even in the context of the Sub-Saharan African performance, Zambia's economic decline has been rather extreme. Real GDP per capita is estimated to have declined by 15 per cent between 1980 and 1988, that is, in spite of the relatively impressive growth rates of the years 1987–8.

The need to restructure and diversify the economy was an early concern in Zambia. During the twenty-six years of independence a number of attempts have been made to reduce the dependence on copper. First, import substitution was vigorously supported. Today, the over-sized industries from the import-substitution era produce way below installed capacities and are now seen as hinderances to the development of a viable manufacturing sector based on small-scale firms and using a technology in keeping with Zambia's meagre resources. However, due to 'cheap' foreign exchange capacity, utilization in the key parastatals showed some increase in the 1980s.

With the failure of the industrialization drive, emphasis has reverted to the agricultural sector. It is said to have high multiplier effects via its linkages with the rest of the economy. It is also seen as a potential source of non-traditional exports. The Operation Food Production Programme, presented by the government in 1980, was to be the blueprint for Zambia's transformation from a mineral to an agricultural economy. Based on large-scale solutions including mechanized state farms, it proved an ineffective means of improving agricultural output. With regard to price incentives and the government's apparent determination to increase them, real agricultural producer prices never quite reached the levels of 1974 (Andersson 1990).

As a fairly urbanized country, Zambia's agricultural policies have also sought to satisfy the food requirements of urban dwellers. There has thus been an entanglement of policies to both create real incentives for agricultural producers and to ensure 'reasonable' food prices for urban dwellers. Food subsidies have been at the centre of the adjustment debate. Given Zambia's fiscal problems, a real increase in producer prices cannot be countered by an equal increase in consumer subsidies without bursting the budget. Food coupons have been one way of introducing an 'ability-to-pay' element, though the long run demands the removal of controls on the production and marketing of food.

With both agriculture and manufacturing failing to deliver, the country has had to fall back on its mining sector. In the face of increased uncertainties in the mining industry, the sector has had to rationalize production, investments, financial, marketing and administrative routines. To maintain production levels in the face of declining ore quality, a number of new and expensive techniques were introduced. This has not stopped copper production from falling from 610,000 metric tonnes in 1980 to 420,000 metric tonnes in 1988. The mining industry still contributes 10–15 per cent of GDP and the bulk of the foreign exchange.

During the crises of the 1980s, the country accumulated an enormous external debt.

Servicing it has long been problematical and arrears have piled. The external debt problem threatens to undo all progress. Bank of Zambia officials estimated the total foreign debt at US dollars 7,200 million in 1989. This amounts to more than twice the country's GDP and eight times the value of its exports. In June 1989 arrears were estimated at US dollars 850 million to the World Bank and 175 million to the IMF, respectively. Furthermore, Zambian debt is considered to be relatively expensive and its structure being more that of a middle-income developing country than of the low-income one that Zambia is today.

In terms of social well-being, the drastic economic developments, since 1974, have put a heavy burden on the ordinary citizens of Zambia. First, the modern sector has failed to create employment opportunities for the many newcomers to the labour market. While wage employment declined between 1974 and 1988, the labour force grew rapidly. Consequently, the ratio of the wage employed decreased from 27 per cent in 1974 to 16 per cent in 1985. An increasing share of the work-force, and especially the newcomers, has had to make a living in the informal sector or in traditional agriculture. Real wages have been declining since 1974. The impact has been harsh on the urban-based skilled and semi-skilled groups. During the 1980s a middle-level employee lost up to 60 per cent in purchasing power. A deterioration in health and education services has worsened the situation. As an illustration of the relative decline of the urban attraction, rural-urban migration figures show that while in the 1970s the rate of migration was 5 per cent, it fell to only 2 per cent in the 1980s. This should be compared to the 12 per cent of the 1960s.

Two important structural changes have taken place in the formal sector labour market. First of all there has been a shift from employment in the 'productive' sectors (the primary and secondary sectors) to employment in the tertiary sector (the service sector). While 56 per cent of the formal employment was in agriculture, mining, manufacturing and construction in 1974, this fell to 49 per cent in 1985. Second, there has been a shift in employment from the private to the government sector. There has been a conscious policy of increasing public sector employment, especially in central administration where it has risen from around 87,000 in 1974 to 108,000 in 1985. In construction, where the private sector dominates, employment decreased from 70,000 in 1974 to 30,000 in 1985.

CONCLUSION

Zambia is still as dependent on minerals today as at independence. Unfortunately the sector has shrunk since the 1960s and its real contribution has fallen. The question is whether the magnitude of the economic decline could have been contained at some stage during the past decades. Bell (1983) has, for instance, argued that a mineral revenue stabilization fund could have alleviated some of the adverse impacts of mineral price fluctuations on the government budget.

In retrospect, all parties associated with Zambia's adjustment effort could be blamed for underestimating the structural difficulties involved in shedding copper dependence. On close inspection the encashment of mineral incomes, especially foreign exchange, gave mining a central and overwhelming influence which might not be apparent from its 10–15 per cent share of GDP. In trying to protect mining and related industry the

government embarked on price and foreign exchange controls. Preserving a competitive cost structure in mining was also one of the main causes of the subsidy policies in which the government is still embroiled. In terms of economic management it has always been difficult to pursue cautious policies in the face of a windfall. On the other hand, sudden mineral price declines have forced the government to borrow from the banking system, leading to inflation.

In terms of the development and diversification ambitions of the country, the 1980s were a lost decade. The mix of IMF/World Bank and 'own' policies has had little to show in terms of results. A combination of external shocks and domestic policy failures has made it difficult to sustain policies. Today the country is groping its way through the debt burden, high inflation and the challenges that have come with the switch to multiparty democracy. Although the mining sector has perhaps less than twenty years of economic life left, any real results on the diversification issue will have to wait for the future.

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9
DUTCH DISEASE AND MANAGEMENT OF WINDFALL GAINS IN BOTSWANA

Helene Norberg and *Magnus Blomström*

INTRODUCTION

Many countries have learnt the lesson that a resource discovery or a boom in export prices does not guarantee economic development. More often, a rapid increase in export revenues gives rise to adverse effects and adjustment problems throughout the rest of the economy. These problems are often referred to as Dutch disease, after the effects on the Dutch economy of the natural gas discoveries in The Netherlands in the 1960s.

In Botswana substantial diamond resources were discovered in the Kalahari desert after the country's independence in 1966. Large-scale diamond operations started in the early 1970s and ten years later Botswana had emerged as one of the world's top three diamond producers. However, despite a tremendous increase in export earnings, Botswana seems to have managed to avoid serious adjustment problems and the typical Dutch disease effects. Botswana, which was one of the poorest countries in the world when it became independent, has shown impressive growth levels during the past twenty-five years. Real gross domestic product (GDP) growth between the mid-1960s and mid-1980s averaged at 8.8 per cent per year, an achievement which was not only the highest growth rate in Africa during this period, but one of the highest growth rates in the world (World Bank 1988:222).

The purpose of this paper is to study Botswana's economic development during the last decade within the framework of a Dutch disease model. The next section shortly describes the theory of Dutch disease and the following section provides a brief overview of Botswana's recent economic development, and discusses Botswana's monetary policy, sectorial growth, fiscal development, and the development of the economy in relation to the Dutch disease model. The final section concludes the study by discussing the policies that have been pursued in Botswana.

THE THEORY OF DUTCH DISEASE

The theory of Dutch disease applies to situations where one sector of an economy is booming, either because of an exogenous price increase in an export product, a discovery of new resources, or a once-for-all exogenous technical improvement (see, for example, Corden and Neary 1982; van Long 1983; Corden 1984; Eastwood and Venables 1982; and Neary and van Wijnbergen 1984, 1986). In the traditional Dutch disease model the

economy consists of three sectors: the booming sector, the lagging sector, and the non-tradable sector. The booming and lagging sectors face given world prices. Output is produced by labour and a sector-specific factor. Labour moves between the three sectors so that wages are equalized.

According to the theory of Dutch disease, a boom in one sector of the economy draws labour out of the other sectors and increases wages in the whole economy. This results in price increases for domestic goods and lower returns and output in the lagging sector which faces world prices. There are two effects in the Dutch disease process, namely, the resource movement effect and the spending effect. The resource movement effect arises when labour moves to the booming sector. This increases wages and prices in the non-tradable sector, which, in turn, creates an additional movement of labour from the lagging to the non-tradable sector. The spending effect arises when the extra income is spent. That increases prices on domestic goods, which now will be more attractive to produce. Resources will be attracted from the rest of the economy and, as a result, the lagging sector will fall even further behind.

Thus, the most common symptoms of Dutch disease are an increase in the relative price of non-traded goods, that is, an appreciation of the real exchange rate, a possible increase in output of non-traded goods, and a decrease in both output and exports of non-booming tradable goods (Kamas 1986). There are various policies that can reduce the negative effects of the boom (see, for example, Balassa 1983; Davis 1983; Scherr 1989; van Wijnbergen 1984b). A non-expansive macroeconomic management reduces real appreciation and inflationary pressures in the economy. In addition, the lagging sector can be protected by microeconomic policies such as increases in tariffs and import quotas, as well as subsidies to output. If the boom is temporary, it might be worthwhile to avoid short-run signals that redirect resources away from their long-run optimal allocation. A permanent boom weakens the arguments for protection, although some kind of protection may be justified in the short run to avoid unemployment and negative effects on income distribution (Cassing and Warr 1985; van Wijnbergen 1984a).

BOTSWANA AND DUTCH DISEASE

Before discussing whether Botswana shows any of the symptoms of Dutch disease, a short description of the country's recent macroeconomic development is warranted. We then look at changes in money, prices, and exchange rates and, finally, at the sectoral growth and fiscal policy. Unless otherwise mentioned, the data used in this section are from official sources, as reported in Norberg and Blomström (1991).

Macroeconomic development

Between 1985 and 1989 Botswana's annual real GDP growth was never below 8 per cent (Table 9.1). Most of this growth was accounted for by the mining sector (diamonds). No less than 45 per cent of the country's GDP is currently generated within that sector. In contrast, the agricultural sector, which contributed around 40 per cent of GDP prior to independence, now accounts for only 3.5 per cent. It is also worth noting the relative

insignificance of manufacturing, construction and communications. Their combined contribution to GDP accounts for only some 8 per cent. In other words, Botswana has developed into a mineral-based economy, where other sectors are insignificant.

Table 9.1 Botswana: gross domestic product by sector of origin (millions of pula at 1979/80 prices)

	79/80	*84/85*	*85/86*	*86/87*	*87/88*	*88/89*
Agriculture	83	47	53	51	60	60
Mining	211	560	573	662	692	807
Manufacturing	29	36	45	50	52	55
Water, electricity	15	23	31	35	37	39
Construction	36	36	30	34	40	52
Trade, hotels	157	206	237	252	273	319
Communications	14	29	39	37	41	44
Finance	58	82	97	100	116	129
Government	122	173	186	202	238	261
Other	6	21	16	18	21	17
TOTAL GDP	731	1,212	1,308	1,441	1,570	1,783
ANNUAL GROWTH		8.1	8.0	10.2	9.0	13.5

Sources: Bank of Botswana, *Annual Report 1989*; CSO 1989.

Botswana's trade balance has shown a surplus since the mid-1980s (see Blomström and Norberg 1990 for details). This surplus is due to diamonds, which currently account for 75 per cent of Botswana's exports. Meat, which had been the most important export commodity before Botswana became a mineral-based economy, currently accounts for less than 4 per cent of the export earnings.

Since Botswana is a small and open economy, dominated by the mining industry, imports play an important role. Food, fuel, machines and vehicles are amongst the most important import categories. The Southern Africa Customs Union (SACU) supplies over 75 per cent of the imports – of which almost all is supplied by South Africa. Europe is the main destination for Botswana's exports, which reflects that diamonds are exported via Switzerland.

The trade surplus has allowed Botswana to build up significant international reserves over the years and the country's financial position is currently very strong. Botswana's assets abroad amounted to 6.2 billion pula (US $3.3 billion) in 1990 (or approximately US $2,500 per Batswan). This corresponded to no less than 24 months' imports (Bank of Botswana, *Annual Report 1990*:33). Thus, relative to the size of the economy, Botswana benefits from one of the highest levels of foreign exchange reserves in the world today.

Although the Botswana economy has grown rapidly and is financially very strong, most of its inhabitants can still not benefit from this development and there are serious problems with the diversification of the economy (see Picard 1987). One symptom of this is the situation on the labour market. Formal employment, which totalled 180,000 as of March 1989, provides opportunities only for some 25 per cent of the population aged 15

and over (EIU 1990/91:13). Compared to most developing countries, Botswana has shown a rapid growth in formal sector employment over the past two decades (annual employment growth has averaged around 9 per cent), but the increase in the number of jobs has been insufficient to keep up with the rapid population growth. Botswana has one of the highest rates of population growth in the world for the moment (3.4 per cent in 1989), and approximately 25,000 people enter the labour market every year (EIU 1990/91:15). Unemployment and underemployment, therefore, are presumably the greatest challenges facing the current government.

Furthermore, incomes are very unequally distributed in Botswana (see Colclough and McCarthy 1980). According to the latest income and expenditure survey (CSO 1988), the poorest 40 per cent of the population earned 11 per cent of total national income, while the richest 20 per cent accounted for 62 per cent of the income. There are big income differences between urban and rural areas, and the income distribution is more skewed in rural than in urban areas.

Money, prices and exchange rates

Money supply in Botswana has increased substantially during the 1980s. The main stimulus for this increase has been the growing surplus in the balance of payments that has arisen as a result of higher diamond prices and expanding volumes during the 1980s (with 1990 as the only exception, reflecting a relatively poor performance of the export sector that year). The expansionary influence of this growth in money supply has, to a large extent, been offset by increases in government deposits at the Bank of Botswana, which acts as 'deposit taker of last resort'. Table 9.2 shows changes in money supply and the factors that have caused these changes.

Table 9.2 Botswana: monetary survey (millions of pula)

End of	*Domestic credit*	*Credit to government*	*Credit to priv. sector*	*External assets*	*Other*[1]	*M3*[2]
1985	–357	–614	257	1,606	–728	521
1986	–962	–1,236	273	2,207	–649	596
1987	–1,504	–1,789	285	3,160	–668	988
1988	–1,959	–2,328	369	4,387	–1,237	1,191
1989	–2,486	–3,016	530	5,233	–1,013	1,756
1990	–3,214	–3,971	757	6,319	–1,596	1,510

Source: Bank of Botswana, *Annual Report 1990.*

Notes:

1 Changes in 'other' mainly reflect gains and losses arising from the valuation of foreign exchange reserves in terms of the domestic currency.

2 M3 consists of currency outside banks, demand deposits, savings deposits and time deposits.

In December 1990, Botswana's government had deposits with the Bank of Botswana of nearly 4 billion pula (approximately 2.1 billion US dollars). The increase in government

deposits is the main explanation for the growth of the Bank of Botswana's assets. Total assets of the Bank have increased at an average rate of over 50 per cent per annum during the past decade. This increase was almost totally recorded in the form of foreign exchange. Bank of Botswana had international reserves of 6,234 million pula and total assets of 6,251 million pula in December 1990. In other words, almost all assets were held outside the country. Around half of these international reserves were balances at foreign banks and half were treasury bills and securities.

A policy package to reduce the excess liquidity in the banking system was introduced in 1986. This package led to increased commercial bank credits, although deposit levels continued to grow even faster. During 1988–90 the increase in deposits, together with rising inflation, led to negative real deposit rates and, in some instances, to negative real lending rates as well. This occurred in spite of attempts to gradually move towards positive rates.

The large increase in money supply has not, however, resulted in an equivalent increase in prices. Between 1985 and 1990 the supply of money increased by over 200 per cent (Table 9.2), while the cost of living rose by only 66 per cent (Bank of Botswana, *Annual Report 1990*). Inflation peaked at 15 per cent in the early 1980s, but was then subsequently moderated. However, during 1989–90, it rose again to 12 per cent per annum. A breakdown of consumer price index shows that average inflation for non-tradables in 1990 was 11 per cent. Domestically-produced tradables (that is, goods for export) had an inflation rate of 15.5 per cent, while imported goods increased by an average rate of 11.6 per cent. Imported goods account for 52 per cent of all items, which implies that the inflation rate on imported goods, that is, the inflation in South Africa together with the pula/rand exchange rate, has a considerable impact on the inflation rate in Botswana. Although the pula appreciated against the rand by over 35 per cent during the 1980s, inflation was imported, since the inflation in South Africa was even higher.

While the pula appreciated against the rand, it depreciated against the US dollar by 60 per cent during the 1980s. This has made diamond incomes worth more in pula terms, since diamond exports are priced in US dollars.

Exchange rate management in Botswana has so far been guided by the conflicting objectives of mitigating the impact of imported inflation and, at the same time, maintaining the competetiveness of exports and the domestic industry. The pula is pegged to a trade-weighted basket of currencies. It was devalued three times between 1982 and 1985 to boost exports that were hit by commodity price falls, and to reduce the pula's strength against the depreciating rand. In 1985 and 1989 there were two revaluations, by 3 and 5 per cent, respectively, to offset inflationary pressures. In September 1990 the pula was once again devalued by 10 per cent to offset a sharp decline in export earnings.

To conclude, by executing a non-expansive monetary policy, and by sterilizing revenues abroad, the inflationary pressure in the Botswanan economy has been diminished and the negative effects of the diamond boom on the rest of the economy reduced.

Sectorial growth

According to the theory of Dutch disease, the resource movement effect draws resources from non-booming sectors, and decreases output in these sectors, while the spending effect draws resources from the lagging sector to the non-tradable and booming sectors. In analysing the sectorial development in Botswana, we divide the economy into five sectors: the booming mining sector, agriculture, manufacturing, services (trade, hotels, transport, and finance) and the public sector (education, central government, public government). The service and public sectors are assumed to correspond to the non-tradable sector in the Dutch disease model. Manufacturing is supposed to be a lagging sector, although manufacturing is also produced for the domestic market. We also consider agriculture as a lagging sector, because livestock, which dominates Botswana's agriculture is, to a large extent, exported. Figure 9.1 shows the developments of the different sectors.

In absolute terms, agriculture has decreased, while all other sectors have grown. It is worth noting that both services and manufacturing show approximately the same growth rates although services have grown from a much higher absolute level than manufacturing. In looking for explanatory factors for these developments, it is necessary to examine each sector separately.

Mining

As already shown, Botswana has made steady progress towards becoming a mineral-based economy, where diamond extraction is predominant.

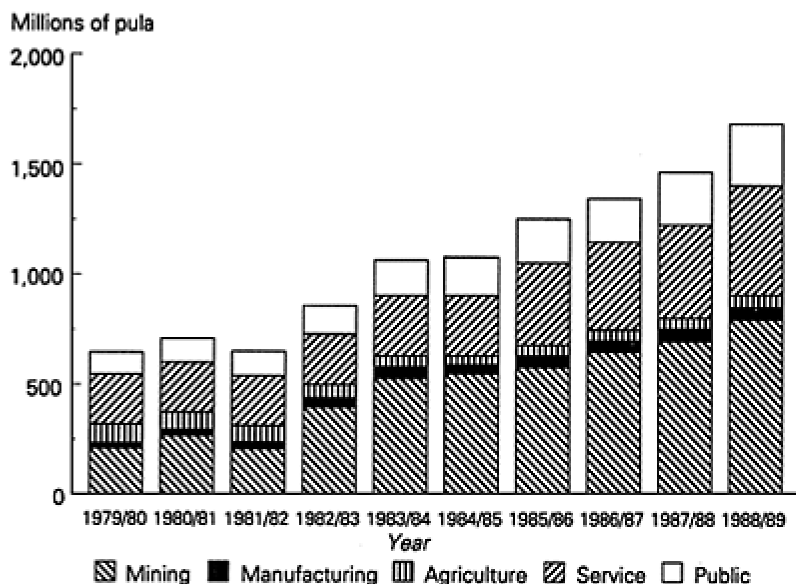

Figure 9.1 Botswana: sectorial development (GDP per sector in 1979/80 prices)

During the 1980s diamond production has increased substantially and in 1990 the country produced 17.4 m carats of diamonds. The Botswanan diamond mines are owned by Debswana, a joint venture divided evenly between South African de Beers and the Botswanan government. In 1987 Debswana represented 14 per cent of the world market (Barclays Bank 1989:33) and more than 50 per cent of total production within de Beers (Granberg and Parkinson 1988:21). Diamond reserves in Botswana are thought to be large enough to maintain production at present rates for many years (ibid.:20). The possibility of extending the diamond industry further, however, appears limited.

Other natural resources such as coal, copper, nickel and caustic soda are also exploited in Botswana. Copper and nickel production commenced in 1974 in Selebi-Pikwe and recent findings make it possible to exploit these resources over the next decade or so. However, copper and nickel production has proved to be more problematic than diamond extraction. Technical problems in the 1970s, and low prices in the 1980s, resulted in serious losses for BCL – the company responsible for Botswana's copper and nickel operations (EIU 1990/91). The efforts made to maintain the mining operation reflect BCL's importance in the local economy. The company employs more than 4,000 workers.

Coal production has also been affected by low world market prices during the 1980s. The recent discovery of large coal reserves in Botswana provides for export possibilities, but a prerequisite for such a development is higher world market prices (Granberg and Parkinson 1988:22). Currently, Botswana produces coal mainly for domestic production of electricity, in order to lessen its dependence on imported oil.

To produce caustic soda and salt, Botswana's government signed an agreement in 1989 with the South African chemical corporation AECI (African Explosive and Chemical Industries) concerning the so-called Sua Pan project. In terms of investment, Sua Pan is the largest commercial project that has ever been undertaken in Botswana. The project will require investments equivalent to some US $490 million, in addition to major infrastructural investments (EIU 1990/91:20).

The complete mineral potential of Botswana is far from being fully exploited or even ascertained. This depends, to some extent, on the thick sand deposits in the Kalahari Desert, which make prospecting expensive and difficult. Exploration has, however, been very active during the latter half of the 1980s.

Agriculture

Despite increasing urbanization, 80 per cent of Botswana's population remain residents of rural areas. However, because the soil is fairly poor, most areas are relatively better suited for rearing livestock than growing crops. Livestock, which presently account for about 80 per cent of the income from agriculture, is very unevenly distributed. Five per cent of the households own half of all livestock, with the country's 360 large-scale, commercial farmers owning one-fifth (EIU 1989/90:17). Half of all rural households do

not own or have access to livestock.

In the mid-1960s, cattle herds in Botswana totalled 1.4 million animals. By 1981, they had increased to 3 million. The rapid increase was mainly due to government policies which provided new waterholes, fencing and free vaccine. This expansion of herds led to overgrazing. However, six years of drought during the 1980s led to a persistent decline in cattle population, which was not reversed until 1988. By 1990 cattle stocks totalled 2.6 million head (Bank of Botswana, *Annual Report 1990*). Moreover, the relative importance of livestock in Botswana's economy has fallen steadily over the years. Until 1977 meat was the chief export product. Today, however, livestock accounts for less than 4 per cent of total exports.

The drought in the 1980s also led to problems for crop production. The annual production of crops fell from 60,000 tons in 1981 to only 10,000 tons in 1985. In 1989/90, crop production totalled 77,000 tons, which represents only 35 per cent of domestic consumption.

To counteract the negative effects of the droughts, a Drought Relief Programme was set up by Botswana's government. Among other forms of assistance, the programme has subsidized sowing and arranged for farming equipment to be rented out. Direct food distribution was also implemented on a large scale during the worst years during the 1980s. A majority of the population (about 60 per cent) has been dependent on such food distribution since it was introduced, and during the crisis year of 1987, four out of five Batswan could not manage without this form of assistance.

In 1990 the emphasis on 'self-sufficiency' in food production was replaced by 'food security' as a policy objective in Botswana (Ministry of Agriculture 1989). The government is supposed to provide infrastructure, research and extension services, whilst production, marketing and prices should be generated by market forces. It has been stated that agricultural subsidies have not encouraged productivity in the sector. On the contrary, it has tended to perpetuate dependency, and a system of targeting subsidies to specific areas is instead proposed in the new programme.

Manufacturing

Manufacturing production almost doubled during the 1980s and non-traditional exports of manufactured goods increased annually by some 20 per cent in the late 1980s. This increase was, however, from a very small base. By 1990 manufacturing, which consists mainly of food, textiles, metals and chemical production, still accounted for only 5 per cent of GDP.

The principal manufacturing investor is Botswana Development Corporation (BDC), in partnership with foreign companies and local firms. BDC is involved in ninety companies, but its income base is narrow, and only five firms contribute to 99 per cent of the BDC's profits (EIU 1990/91:23). Lack of industrial tradition, skilled labour, and serviced land are factors which contribute to this mediocre performance. Despite that, the government seems to be optimistic about Botswana's future industrialization possibilities. Manufacturing is considered to have the greatest potential to diversify the Botswana economy and absorb the growing labour force. Current government plans assume an annual growth rate of over 7 per cent in this sector over the next five years (MFDP

1990:6). This growth is expected to stem from private initiatives.

The growth in manufacturing production does not seem compatible with Dutch disease symptoms. This will be examined below when we analyse the growth of wages and employment.

Services

The service sector shows the fastest growth of all sectors in Botswana during the 1980s. This development reflects increases in transport, wholesale and retail trade, and financial services. The financial system has shown a remarkable performance, although many shortcomings remain which hinder it from becoming more sophisticated. The tourist industry, which is still insignificant in terms of the national economy, has also increased steadily throughout the 1980s. Thus, neither the growth in the service industry seems to suggest Dutch disease in Botswana.

Wages and sectorial employment

Despite an almost 40 per cent increase in mineral production and an almost eightfold increase in mineral revenues (in current pulas) between 1983 and 1988, employment in the mining sector increased only modestly (see Figure 9.2). Employment in services, on the other hand, shows a remarkable growth both in absolute and percentage terms. Employment in agriculture and manufacturing grew at about the same rate in percentage terms, but manufacturing employment increased more in absolute terms. It is worth noting that, when comparing growth in employment and output for manufacturing, it is clear that labour productivity in manufacturing has declined markedly over the years. While manufacturing output grew by some 90 per cent during the 1980s, employment growth has exceeded 190 per cent.

Hence, we do not find any extensive labour movements from the lagging and non-tradable sectors to the booming sector in Botswana in the 1980s. This suggests that employment has not been influenced by the ‘resource movement effect’, discussed above. However, employment may still have

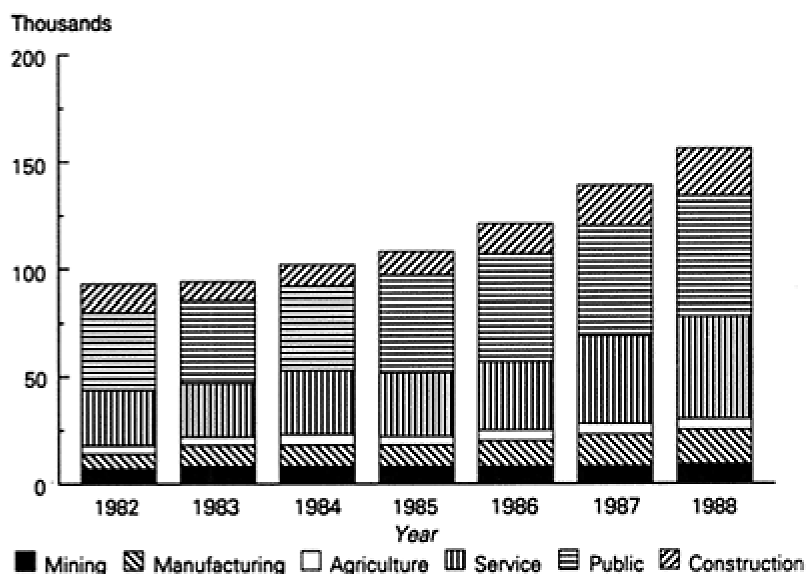

Figure 9.2 Botswana: estimated numbers of paid employees

been influenced by the 'spending effect', since there has been an employment increase in the non-tradable sector during the period. In order to see that, we will examine changes in wages.

Table 9.3 shows monthly cash earnings by sector. Despite the rapid growth of the Botswanan economy, wages have increased in line with inflation in most years (around 8–12 per cent). This is a result of the government's labour policy, where wages in the mining and public sectors are controlled by the National Employment, Manpower and Income Council. Strikes have been rare since independence, although there were unofficial strikes by bank employees and teachers in 1989. There is a free trade union movement, and collective bargaining takes place through a system of wage councils for each sector of the economy, although the ability to organize official strikes is limited in practice (EIU 1990/91:15).

Table 9.3 Botswana: employee estimated monthly cash earnings by sector (pula)

	1981	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*
Agriculture	57	45	75	66	64	87	92	99
Mining	223	29	308	315	351	465	488	525
Manufacturing	140	159	168	213	264	282	278	331
Construction	126	145	168	198	200	214	250	270
Commerce	110	128	161	169	186	200	233	262
Finance	237	244	281	318	369	457	451	515
Central gov.	NA	NA	NA	NA	299	388	372	442

Source: CSO 1989.
Note:
NA = not available.

When the economy was at an early stage of development, the government argued that it had to intervene in the labour market to avoid monopsonistic pricing (Bank of Botswana, *Annual Report* 1990:13). This policy was revised in 1990, based on the argument that the economy had now grown enough and that the areas where market failure may cause problems had diminished. Thus, salaries in general are no longer tied to Civil Service salary levels. The government has, however, reserved the right to intervene where wage increases conflict with overall economic objectives.

Government policy and weak labour unions, thus, seem to explain the low wage increases and the relatively small effects of the diamond boom on other sectors in Botswana. This development is neither in accordance with the Dutch disease theory, nor with the experience of other African countries that have had export booms. Zambia, for example, experienced windfall gains from the boom in copper prices in the 1960s and early 1970s. These price increases had a direct positive impact on wages in manufacturing, mining and construction because, in contrast to Botswana, the workers in Zambia were more unionized (Mugerwa 1988:71). Hence, they have been able to take advantage of the situation.

We conclude that the sectoral growth and allocation of employment in Botswana have not been a result of wages reflecting a higher value of marginal product of labour in the booming sector. Some resources went to the mining sector in the 1970s and early 1980s, but the resource movement effect has thereafter been almost non-existent.

On the other hand, some effects from spending appear to be present. The service sector has increased in importance. Although this would be expected in a growing economy, such a growth is also consistent with the Dutch disease model. However, 'services' consist of trade, hotels, transports and finance, some of which are 'tradable goods'. Domestic production of domestically consumed goods is very limited, but 'services' are more difficult to import than consumer goods, which may explain part of this sector's growth.

Neither seem agriculture, nor manufacturing to be hardly hit by Dutch disease. The decline in agriculture is probably due to the prolonged droughts during the 1980s, as well as to government policy, rather than to the diamond boom. When it comes to manufacturing, the spending effect might have caused some indirect de-industrialization. On the other hand, if this is the case, it is not because labour in general has gone to other sectors (manufacturing output had increased by less than manufacturing employment). It is more likely that manufacturing has suffered from a resource drain, where skilled labour, credit and private capital have gone to the service sector, because of the difficulties in a country like Botswana to compete in manufacturing on the world market, or with imports in the domestic market.

Fiscal policy

Since the booming sector in Botswana is mainly state-owned, it is important to study how the government has used the revenues from the boom. The revenues can be spent on public bureaucracy, but may also be used to increase wages, imports of consumer goods, investment in infrastructure, or to subsidize domestic private industry. Thus, the benefits of the boom may go to wage-earners, capital owners, foreign investors, local entrepreneurs, the leading élite, or to some other group. The policy outcome can be assumed to reflect the governments weighting of different priorities, as well as the strength of political agents and pressure groups.

There have been large differences between countries in Africa regarding these matters. For example, in Kenya, windfall gains from coffee exports were mainly used to build a public bureaucracy (Bevan, Collier and Gunning 1990), while in Zambia, windfall gains from copper were used to subsidize an import-substituting manufacturing sector (Mugerwa 1988). We shall now analyse how the revenues from diamonds in Botswana have been used.

Table 9.4 shows annual 'spending' (between 1970 and 1987) as a function of GDP for some African countries. 'Spending' is defined as the part of GDP that is not saved. Using ordinary least squares (OLS), we regress the following simple equation:

$$\text{Spending}_t = a + b(GDP_t) \qquad t = 1970, 1971,...1987$$

An increase in GDP by 1 per cent makes Botswana spend 0.67 per cent and save the rest. Compared to other African countries, Botswana has obviously a very low propensity to 'spend'.

Table 9.4 Botswana: spending as a function of GDP[1]

Country	*Coefficient*	*T-statistic*	*R2*
Botswana	0.67	14.12	0.93
Angola	0.78	13.68	0.93
Mozambique	0.75	3.64	0.64
Tanzania	2.11	11.56	0.95
Lesotho	2.12	14.60	0.93
Malawi	0.88	18.61	0.95
Zambia	3.05	4.02	0.69

Note:
1 Data are from UNDP/World Bank 1989.

Savings ratios were high in Botswana both during the 1970s and 1980s, slightly above 20 per cent of GDP, but they fluctuated a lot over the years. For example, in 1982 the saving ratio fell to 8 per cent due to a fall in revenue. Since then, however, there has been a steady increase, and in 1986 savings were over 40 per cent of GDP. Compared to other

countries, particularly in Africa, this is remarkably high.

Botswana's investments are also at high levels (see Blomström and Norberg 1990 for details), but characterized by unevenness, reflecting the timing of major development projects. Two-thirds of the investments are public and have mainly gone to infrastructure and the mining sector.

The government's budget showed a surplus every year during the 1980s, except in 1981/82, when mineral revenues dipped. Government revenues grew annually by some 20 per cent until 1982, when the Jwaneng diamond mine was opened (Bank of Botswana, *Annual Report* 1990:111). After that, government revenue recorded an annual growth rate of nearly 40 per cent, and government revenue increased from 35 per cent of GDP in 1979/80, to over 50 per cent in 1988/89. Government expenditure had a lower growth rate during this period (25 per cent per annum on average) and, as a proportion of GDP, it only increased from 32 to 36 per cent. However, over the past few years expenditure has grown relatively faster than revenue. In 1987/88 expenditure accounted for 72 per cent of revenue, rising to 81 per cent in 1989/90.

Table 9.5 Botswana: functional classification of total expenditures (percentage)

Sector	*1980/81*	*1984/85*	*1988/89*
Public service	18.1	18.4	15.1
Defence	8.3	5.8	8.4
Education	18.8	14.9	15.0
Health	4.6	4.1	4.9
Food, social welfare	0.6	3.7	3.0
Housing, urban, regional dev.	9.3	7.3	8.9
Community, social services	1.2	1.2	1.0
Economic services	33.6	36.0	37.2
Gen. administration	1.1	1.0	1.1
Agriculture	8.6	8.1	9.6
Mining	6.1	1.4	3.4
Electricity, water	3.7	12.3	3.9
Roads	5.9	4.3	4.3
Air transport	1.1	3.1	3.9
Rail transport	1.3	0.8	7.8
Post	2.6	1.4	1.4
Promotion of commerce and industry	3.0	3.5	1.8
Storage	0.2	0.1	0.0
Unallocated expenditure	5.5	8.7	6.5
TOTAL	100.0	100.0	100.0

Source: CSO 1989.

Expenditure by sector is shown in Table 9.5. Except for a small decrease in General Public Service and Education, and an increase in Economic Services and Welfare, the proportions have remained relatively unchanged during the decade, in spite of large

increases in absolute numbers.

In the section on money, prices and exchange rates it was shown that a large part of the Botswana's diamond incomes has been sterilized and invested abroad. The spending of the remaining part obviously reflects the will of the government to invest in education and infrastructure in an attempt to develop and diversify the economy. There has been no extensive growth in the public sector. Neither has the government chosen import substitution as a policy. The role of the government in the development process has been indirect, rather than direct, where it has tried to create opportunities for private entrepreneurs to act according to market signals (MFDP 1990). It is doubtful, however, to what extent there will be a response to these signals, given the lack of industrial traditions and skills in Botswana.

Dutch disease from Botswana's perspective

In the Dutch disease model, a boom in one sector is expected to draw labour from the rest of the economy, raise wages in all sectors, increase prices in the non-tradable sector, and reduce returns and output in the lagging sector. In Botswana, the capital intensive nature of the mining sector reduces the need for extensive labour movements between sectors. The resource movement effect has therefore been small.

Furthermore, labour mobility from the traditional sector, where the majority of the people are occupied, to the formal sectors has been limited in Botswana, because of differences in skill levels. Thus, unemployment and shortage of skilled labour coexist, and only a small part of the labour force might receive high wages, reflecting the lack of skilled workers, while the majority have a weak bargaining position. This unbalanced negotiating process, together with the lack of extensive labour needs in the booming sector, has resulted in modest overall increases in wages, which in turn has diminished both the resource movement effect and the spending effect.

Nor does the spending effect seem to have affected the Botswana economy through the channels that the Dutch disease theory predicts. According to the theory, the spending effect, which arises when part of the extra income is spent, tends to raise prices on non-tradables relative to tradables and reallocate resources towards the non-tradable sector. In Botswana, the goods that are domestically consumed are, to a large extent, imported, and the effects on the non-tradable sector have therefore been reduced.

Moreover, since the state receives most of the boom revenues, the spending effect depends on the government's priorities and spending decisions. As shown above, revenues from the diamond industry have been kept in foreign capital markets rather than invested or consumed at home, and this policy has largely reduced the spending effect.

CONCLUSION

Despite enormous windfall gains from diamond production, Botswana has managed to avoid serious symptoms of Dutch disease. This paper has shown that this is both because of the structure and characteristics of Botswana's economy and because of government policy. The booming sector is very capital intensive and requires little labour; labour

cannot be considered as fully mobile between sectors, because of huge differences in skill levels; wages are regulated and unions are weak. As a result, the resource movement effects have been limited.

Also the spending effects of the diamond boom have been small, something which is mainly due to government policy. Since the diamond industry is stateowned, the government controls the revenues. These revenues have mainly been used to promote national income, rather than to subsidize different sectors (such as import-substituting manufacturing) and support various interest groups. To maximize national income, a large proportion of the revenues from diamonds have been invested, not in Botswana, but in foreign banks and firms. By sterilizing revenues abroad and executing a non-expansive monetary policy at home, the inflationary pressure has diminished and the negative effects of the diamond boom have been reduced. Moreover, since consumer goods are, to a large extent, imported, the spread effects in the economy from spending have been reduced. Thus, the effects on prices, factor movements and output, which in the Dutch disease model lead to deindustrialization, have therefore been limited in Botswana.

Although Botswana seems more or less immune to Dutch disease, there are other serious problems that will limit future growth of the economy. The country is lacking good soils and water, skilled workers, industrial tradition, and entrepreneurship, and this will reduce the potential for spreading the benefits of the diamonds to other sectors of the economy. It will also limit the possibilities for the majority of Botswana's population to increase its income and welfare. Botswana is thus vulnerable to a disease of its own, the 'Botswana disease', whose main symptoms are unequal income distribution and an undiversified economy.

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Part III
THE MICRO LEVEL

10
URBAN BUSTLE/RURAL SLUMBER: DILEMMAS OF UNEVEN ECONOMIC RECOVERY IN UGANDA*

Steve Kayizzi-Mugerwa

INTRODUCTION

In this chapter we look at some of the dilemmas inherent in a poor country's structural adjustment efforts. In the 1960s Uganda was a promising African economy. Beginning with the mid-1970s, however, it has undergone a long period of economic regression and civil strife. Efficiency in the public service fell drastically as key institutions of government were crippled by mounting financial and administrative difficulties. At the end of the 1970s the modern sector verged on collapse, while peasants, faced with declining income from commodity production, switched to mainly growing food for subsistence. Like most of Sub-Saharan Africa, since the early 1980s the country has embarked on adjustment programmes in a bid to combat the macroeconomic disequilibria.

On the basis of the relatively low urban-sector wages in Africa and, in contrast, the ability of rural dwellers to grow their own food, it has been argued (see, for instance, Jamal and Weeks 1988) that the rural/urban dichotomy, long the basis of the development debate in Africa, has lost its significance. What we now have are two areas, each with a pool of desperately poor people and a sprinkling of rich ones. Policies to redress this new situation would thus be different from those, such as increased producer prices or expansion of rural infrastructure, that were advocated earlier to close the rural/urban gap.

This line of argument has some element of truth. Modern sector and, by implication, urban earnings have fallen in the bulk of Sub-Saharan African countries. However, when assessing the relative impacts on welfare one should take into consideration the shifts in overall income generation that have followed the erosion of the formal sectors. In urban areas informal sectors have flourished, compensating somewhat for the decline of the wage sector, while rural sectors have fallen back to subsistence production.

Our point of departure is the following: both urban and rural groups have suffered from the severe economic contraction of the Ugandan economy. It has been necessary to devise strategies for overcoming the most pressing consequences of the decline. Households have had to find new ways, some ingenious, of generating income. In this regard Kampala's proximity to policy-makers and access to a diversified market structure, enabling exchange of a range of goods and services, have moderated the impacts on its inhabitants. The rural sector, remoter the farther away it is from the capital and other urban centres, has been at a disadvantage. In the northern and north-eastern

parts of the country the relative economic isolation has been exacerbated by the long period of political destabilization. Lack of an economic infrastructure and markets has constrained the rural sector's capacity to respond to the incentives in the adjustment packages. The recent improvement in the economy (average growth has been estimated at 6 per cent since 1987) has thus been skewed in favour of urbanites. As if in response to this, rural-urban migration, which was negative in the early 1980s, is beginning to rise once again.

The policy dilemma is as follows: while the pace of economic rehabilitation depends on the speed at which foreign exchange and government revenue are improved, both, in their turn, have depended, in the past few years, exclusively on the performance of commodity exports, notably coffee. The latter is mainly grown by small-holders in southern Uganda, but a lack of real incentives has discouraged further expansion. The stock of coffee trees is agèd, some of it having been planted in the early 1950s. Given competition from the more lucrative food crops, farmers are understandably reluctant to replant.

Many of the institutions currently under rehabilitation are in urban areas. The relatively-large injections of foreign aid in recent years have thus tended to create a boom in urban activity. This urban bustle contrasts unfavourably with the level of activity in the rural areas. Attempts at reincorporating the rural sector into modern consumption have conflicted with the government's dependence on export commodity taxes. Farmers get a small fraction of the international price for their product. To put it starkly, the country's ability to pay off the loans acquired in the adjustment effort depends on the rural sectors capacity to generate export products. This can only be achieved with improved incentives. The irony is that halting urban decay might imply an increase in rural deprivation.

Uganda also depends on the rural sector for food, the amounts imported being negligible. Since traditional commodity exports like coffee largely are not consumed at home, efforts at stimulating exports have, at least in the short run, worked against the broader ambition of self-sufficiency in food and reduction of the exposure to the vagaries of international commodity prices. We thus argue that, for practical as well as socio-economic reasons, especially for a country like Uganda where the bulk of the population dwells in the countryside, there is need for a specific rural agenda both in the formulation, and execution, of adjustment policy. This could take the form of a better organization of produce marketing, credit facilities and improved access to social services. Implied is that current macroeconomic policies might not, on their own, be sufficient to address the dilemmas outline above.

The data on which some of the tables presented in this chapter are based is from a socio-economic survey of Kampala and rural Masaka households undertaken in April/May 1990. The main focus of the survey was on income structures and access to social services. In Kampala, 239 households were interviewed (see Bigsten and Kayizzi-Mugerwa 1992, for an exhaustive analysis of the Kampala sample) while 220 were interviewed in Masaka, with the exception of the municipality itself. Apart from household demographic variables, data were also collected on wage employment and earnings, business incomes, farming, ownership of assets, and expenditures on health and education.

The rest of the chapter proceeds as follows: in the next section we present Kyanamukaka, a village town in one of the most fertile regions of Uganda, as an example of the difficulty of bringing economic improvements to the countryside. In the third section we provide an overview of the adjustment policy goals and the macroeconomic performance. Impacts on sectoral outputs are also discussed. Comparisons of Kampala and rural Masaka household incomes and expenditures on social services are presented in the fourth section the chapter is concluded in the fifth section.

KYANAMUKAKA AS EXAMPLE

Kyanamukaka is a collection of dusty shops lining both sides of the 'main' road from Masaka town. To get here we had to work our way along the old and swampy road. The local river, normally a small stream winding its way to Lake Victoria, but a frothing giant in the April rains, had carried away the makeshift bridge.

From here, the sprawling informal sector commerce and private sector construction boom in Kampala, partly a product of the expenditure effects of aid money, seem to belong to another country. A village town in the heart of one of its most fertile regions, Kyanamukaka represents both Uganda's promise, especially it's agricultural potential, and its dilemma: how to ensure that some of the current economic improvements reach the countryside and thereby boost marketed output, incomes and rural well-being.

Instead of active engagement in the production of export crops like coffee, tea or cotton as admonished by their local chiefs and politicians from Masaka and Kampala, many peasants seem to have settled for subsistence production. Coffee trees have largely gone to bush, save for the few needed to generate some cash when more lucrative crops failed them. The few shops stock paraffin, maizemeal, soap, matchboxes and bicycle spares. In an area with few sources of cash income, the demand for consumer goods is small.

Like the traveller, social services have difficulty in getting to Kyanamukaka. Agricultural extension services and credit are virtually unknown here. The local clinic suffers from lack of drugs and competent staff. Schools are confined to the lower grades, and trained teachers are not easy to recruit. They prefer the better opportunities for side incomes in Masaka.

Studying Kampala dwellers, Bigsten and Kayizzi-Mugerwa (1992) noted that diversification of income sources was the clearest exposition of the way urban dwellers have reacted to the economic crisis. This response was partly enabled by the existence of a social infrastructure and a market, making the production and supply of informal goods and services possible. Those that seem to have adapted best to the new situation, at least in terms of income, have had to embark on 'business' activities. Those without a good education or contacts in the modern sector of the economy have experienced considerable distress.

In rural areas like Kyanamukaka the market is small. Delayed payment for commodities like coffee has constrained cash transactions and the ability to purchase health and education services. Absence of a public sector infrastructure has also disabled the links, one sees in urban areas, between public expenditure and informal sector

activity. As the bulk of the aid money has been targeted to urban projects, or is spent in towns, the positive expenditure and employment effects 'have not been seen' in the rural villages.

POLICY GOALS AND MACROECONOMIC PERFORMANCE[1]

Adjustment agenda

The 1970s were a period of rapid and unprecedented economic decline in Uganda. A combination of economic mismanagement, external shocks and civil war saw the once-promising country sink into economic misery and political chaos. Though exports once included cotton, tea, tobacco and coffee, the latter was now the only notable export. Commodities were being smuggled out of the country. Inflation had caused havoc to public sector salaries and the parastatals were verging on collapse. Public services, such as health and education, suffered diminished budget outlays while the army was the only growth industry.

In the early 1980s Uganda approached the International Monetary Fund (IMF) for assistance in economic rehabilitation. Since then the IMF and World Bank have been crucial in the formulation of the country's economic policy. The goals of the adjustment effort could be summarized as follows: first, there had to be an overall increase in economic efficiency. This would be best achieved by reducing the discretionary element in the allocation of the country's scarce resources, notably foreign exchange. To maintain macroeconomic stability, responsible monetary and fiscal policies would have to be pursued (World Bank 1989a; Uganda 1981, 1989).

Second, and in relation to the first point, government had to improve its efficiency in the mobilization and utilization of resources. The revenue effort, as well as the ratio of government expenditure to gross domestic product (GDP), are well below Sub-Saharan African averages. The government, with stiff domestic opposition, has embarked on Civil Service retrenchment. This is seen as the only way of improving public sector efficiency by maintaining a small, well-equipped and adequately-remunerated Civil Service.

Third, after a number of years during which speculative activities became more lucrative than production, the incentive structure should be shifted in favour of producers. To reduce the country's foreign exchange constraint, producers of export commodities both traditional and non-traditional would receive extra encouragement. It was presumed that such encouragement would increase the real incomes accruing to small-holder farmers and would reverse the negative real protection suffered by agriculture during the 1970s. The most important element in the incentive structure being the setting of prices.

Fourth, to enhance the speed at which the above goals would be achieved, the government embarked on rehabilitation of the infrastructure and the institutions that deliver social and economic services.

The adjustment debate in Uganda has been fierce (Mamdani 1989; Tumusiime-Mutebile 1990). As in most other African countries, the spectre of economic collapse has led to frantic activity. There has been a multitude of proposals ranging from privatization and cost recovery in the line ministries to retrenchment in the Civil Services. The sharp

discontinuities have led to worries about the social implications of rapid adjustment and how to alleviate the negative consequences. Though there seems to be a degree of consensus on the overall need for change, there seems little agreement on the methods to stop the economic decline. Lacking any real alternative, the government has pursued policies based on the IMF/World Bank mode. This has enabled a reasonable inflow of foreign resources.

Macroeconomic outcomes

Table 10.1 provides indicators of economic performance in Uganda during the 1980s. To reduce pressure on foreign exchange, the government floated the shilling *vis-à-vis* the major currencies in 1981. This was followed by a two-tier exchange-rate system with a favourable rate for government imports and debt. Together with better prices for farmers, the years 1981–3 saw a steady improvement in the economy.

Table 10.1 shows that real GDP grew on average by over 5 per cent per year between 1981–3. Inflation, as measured by the GDP deflator, slowed down. Interest rates moved upwards, though they remained negative in real terms. The wages of urban employees, though still very low (Jamal 1988), remained constant in real terms.

Economic policies are not pursued in a vacuum, however. Obote's second

Table 10.1 Uganda: macroeconomic indicators, 1980–9 (percentage growth[1])

Year	*1980*	*1981*	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*	*1989*
Domestic credit	64.0	104.0	35.0	38.0	65.0	114.0	112.0	116.0	95.0	178.0
Credit to government	9.0	109.0	16.0	25.0	70.0	115.0	74.0	42.0	145.0	–13.0
Money (M1)	31.0	103.0	5.0	46.0	127.0	140.0	174.0	167.0	118.0	93.0
GDP	–1.0	4.0	5.7	7.4	–8.5	2.0	0.3	6.4	7.2	6.6
GDP deflator	103.0	55.0	34.0	44.0	76.0	154.0	135.0	224.0	132.0	90.0
Interest rates[2]	6.0	6.0	15.0	16.0	24.0	24.0	38.0	30.0	40.0	50.0
Wages[3]	1.0	50.0	45.0	52.0	149.0	124.0	103.0	478.0	232.0	–

Sources: Bank of Uganda (1986); Ministry of Planning and Economic Development (1990a, 1990b); World Bank (1989b).

Notes:

1 Figures for domestic credit, credit to government, money supply and wages are nominal, while those for GDP are real.

2 Figures are actual commercial bank lending rates.

3 Derived from the annual wage bill for selected manufacturing industries.

government was split by internecine friction which disabled further liberalization. In 1984, with elections only a year away, the government embarked on expansive policies which where not in the realm of the IMF/World Bank stabilization package. Wages for parastatal and government employees were increased fourfold. Meanwhile the guerilla insurgence fuelled expenditure on the army. GDP fell by 8.5 per cent in 1984. The

military regime that replaced Obote in 1985 was too preoccupied with ensuring its survival to embark on serious efforts in the macroeconomic sphere. By far the most radical policies were to be undertaken by the National Resistance Movement (NRM) government which came to power in 1986.

In 1987, the NRM government embarked on policies whose scope and breadth was to surpass all earlier attempts (Kayizzi-Mugerwa and Bigsten 1990, 1992). The parastatals would be divested, the Civil Service made smaller and more efficient, and a more active stance would be taken *vis-à-vis* the exchange rate, beginning with a currency reform. Interest rates were increased as well as producer prices in agriculture. The supply of allocation of foreign exchange was made simpler initially via a system of Open General Licensing (OGL), and subsequently by the use of Special Import Programmes (SIPs).

The currency reform of 1987 brought no lasting improvement (Table 10.1). The year saw the highest rate of inflation of the decade. Interest rates, though higher, remained negative. Unfortunately for the country, the international coffee prices began to fall with implications for foreign exchange earnings and government revenue. On the domestic front the government was facing internal armed opposition and there was a brief border skirmish with Kenya.

In subsequent years the government has evolved a framework which, when fully implemented, will imply a regime shift in the economy (Bigsten and Kayizzi-Mugerwa 1991). First, there have been efforts at giving the shilling a realistic exchange rate. With a view to preventing undue appreciation, the rate is now revised on a weekly basis. This has eradicated the political implications of huge devaluations. Most recently, 1990, foreign exchange bureaux were introduced to buy and sell foreign currency. This has brought about a degree of stability in the exchange market. It is hoped that the more favourable official rate will only be used for strategic imports such as petrol and for debt servicing, thus eliminating the premiums that for decades have accrued to those transacting at the official rate. Convergence of the two exchange rates has been made difficult by the oil shocks of 1990/91.

The financial sector of Uganda is extremely weak and the government has embarked on plans to restructure it and to deepen its resource base. A crucial factor in all this is the performance of the Bank of Uganda. Its record has been erratic. Central Bank accounts, vital for economic management, have remained unconsolidated for years. The bank is now being refurbished to enable it to regulate the financial sector and manage monetary policy.

Perhaps the most far-reaching plans are those for the reduction of the public sector and the divesture of the parastatals. To remove the lethargy in government and to adequately remunerate staff, plans are on the way to reduce public sector employees by 30 per cent. It is also hoped that screening exercises will weed out 'ghost workers'. A list of 100 parastatals has been drawn up by the government for sale to the private sector. The commodity marketing and exporting parastatals are being turned into commercially-run companies. There are also plans to introduce cost sharing in the health sector. In education parents already bear the biggest share of the costs.

With regard to trade, the bulk of restrictions has been removed and tariffs will replace quotas and other undue trade barriers. It is hoped that trade liberalization will remove the negative effective protection suffered by agriculture during the control regime. The

government is itself embarking on a more streamlined tax administration structure to increase the overall revenue effort and reduce dependence on commodity export taxes.

To stimulate investments, government has put into place an 'investment code'. It makes various concessions to investors including repatriation of profits to abroad. There are plans for the establishment of export promotion zones, on the lines of Mauritius, to take advantage of the fact that there are no export quotas on Ugandan manufactures to, for example, the EEC. A special unit for export promotion and development (EPADU) has been set up in the Ministry of Planning and Economic Development.

The rate of activity is quite baffling, and there must be some concern as to whether the country is capable of satisfying the physical, financial and human capital resources that all these schemes demand. Privatization has, for instance, ownership and political implications which could affect the rate and quality of its implementation.

On the macroeconomic front there has been some degree of success. Inflation has been brought down from over 360 per cent in 1987 to below 30 per cent in 1990. There has been an unprecedented increase in both time and demand savings in the banks, brightening the prospects for a domestic source of investible funds. The government budget is, however, very weak. The low coffee prices and the decreasing aid flows make the immediate balance-ofpayments prospects bleak (see also Table A10.1 in the Appendix).

Impact on sectorial production

Above, we looked at the macroeconomic impacts of adjustment policies. In this section, we shall investigate the impact on sectoral production and smallholder agriculture. We provide some growth indicators for monetary agriculture, non-monetary agriculture, government and manufacturing during the 1980s. The rest of the section dwells on small-holder response.

Table 10.2 shows that manufacturing output responded favourably to the earlier adjustment packages, which had increased foreign exchange inflows. However, it fell in 1984 in response to the unfavourable cost situation, notably the stiff increase in wages (see Table 10.1), and stagnated between 1985 and 1986. After 1987 there has been a strong expansion. This has been mainly due to some rehabilitation and restoration of existing capacities in a number of key industries. Some twenty-two industries, on the Bank of Uganda's OGL list, including breweries, soap and foam industries, have had unprecedented expansion. For textiles, production has only improved to about a third of what it was twenty years ago. The slow rehabilitation of the cotton subsector has been a key obstacle.

In terms of production, manufacturing output increased by over 65 per cent between 1986 and 1989. The slowdown after the May 1987 devaluation and currency reform was followed by a strong recovery. There was a similar fall after the release of the 1988/89 budget, which also included restrictive measures, followed by another expansion. Some industries, like breweries and soap, seem to have reached output levels that exceed domestic demand. Lack of export markets is constraining further expansion.

Table 10.2 Uganda: real sectoral and GDP growth rates, 1981–9 (1981 = 100)

Year	*1981*	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*	*1989*
Monetary agriculture	100	102.0	106.2	91.3	97.1	96.5	103.0	111.7	119.7
Non-monetary agriculture	100	108.4	119.5	109.8	109.8	111.3	116.4	121.2	126.7
Government	100	103.8	107.6	112.5	116.6	119.8	123.0	126.1	128.9
Manufact.	100	116.0	125.6	121.6	109.7	103.2	120.5	147.9	175.3
GDP per capita	100	103.1	107.5	95.6	94.9	92.6	95.8	99.9	103.5

Source: Ministry of Planning and Economic Development (1990b).

The government sector grew at about 3.5 per cent per year in real terms between 1981 and 1985 (Table 10.2), but by 2.5 per cent after 1986. Lower growth in the latter period was related to the contraction of the revenue base, notably the fall in coffee-related revenue. In the 1987/88 budget year, coffee export duty had been expected to generate 19 billion shillings but ended up generating 6 billion. In the service sectors, decreasing outlays, in real terms, have reduced per capita government expenditure on education, health and other services. Defence and debt servicing have continued to account for the lion's share of government expenditure.

Table 10.2 shows that there was an upswing in agriculture as a whole between 1981–3 in response to the improved incentives for commodity producers. The sharp fall in 1984 was followed by relative stagnation between 1985–6. Since then, agricultural production has expanded quite satisfactorily. The improvement is, however, not so closely correlated with the general price shifts. Favourable weather conditions have been a factor, as well as the return of relative peace and improvement in the infrastructure. The latter two have improved access to markets. With regard to monetary agriculture, the drastic increase in relative prices for exportables since the early 1980s has been a precondition for expansion of cash-crop production.

We shall now look specifically at responses in agriculture at the disaggregated level.

Table 10.3 shows that price indices for cash crops have been growing faster than the implicit GDP deflator for food. Except for bananas, the main staple in the southern parts of the country, prices of many food crops had a poorer development. Thus, there seems to have been a shift in relative prices within agriculture in favour of cash crops. This is what often comes with devaluations, especially when the commodity to be boosted, in our case coffee, is not

Table 10.3 Uganda: agricultural producer prices, 1981–9 (1981 = 100)

Year	*Coffee*	*Tobacco*	*Cotton*	*Tea*	*Food*[1]
1981	100	100	100	100	100
1982	250	127	267	250	131
1983	400	190	600	625	215
1984	650	278	800	1,125	354
1985	1,350	747	1,467	2,000	994

1986	4,250	1,266	2,667	3,500	2,446
1987	12,000	4,810	12,667	12,500	8,130
1988	30,000	27,848	53,333	50,000	19,838
1989	30,000	51,899	86,666	87,500	39,805

Source: Ministry of Planning and Economic Development (1990a).
Note:
1 Implicit GDP deflator for food.

consumed at home. There is thus a real friction between the goal of external stability and food production in Uganda.

Coffee is the main cash crop and production was initially improved by a better supply of inputs, streamlined crop finance and road repairs, which eased transport. As already noted, prices have increased a lot since the early 1980s, though the trend of increasing relative prices was reversed after 1987 due to adverse external terms of trade and infrequent adjustments of producer prices. Note for example (Table 10.3) that increases in food prices have exceeded those for coffee in the past few years. This has held back coffee production, current output being at par with that of 1982 (see Table 10.4).

Table 10.4 Uganda: indices of agricultural production, 1981–9 (1981 = 100)

Year	*1981*	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*	*1989*
Coffee	100	170.9	161.4	142.3	159.0	147.0	163.5	157.5	178.5
Cotton	100	124.4	243.9	297.6	397.6	107.3	70.7	43.9	63.4
Tobacco	100	600.0	1,600.0	2,000.0	1,500.0	900.0	1,300.0	2,500.0	3,800.0
Tea	100	152.9	182.4	305.9	329.4	194.1	205.9	205.9	270.6
Bananas	100	111.8	109.9	105.9	109.6	111.3	119.3	123.6	126.6
Maize	100	114.9	120.8	98.8	103.5	94.2	104.4	128.7	182.7
Beans	100	98.8	130.8	122.9	113.3	113.3	126.4	140.8	162.1

Source: Ministry of Planning and Economic Development (1990a).

Cotton and tobacco used to be very important export crops. They responded readily to better producer prices up to 1984/85. Due to the prolonged wars in the north and north-east, the main producing area, there has been a fall in cotton output, in spite of the continued increase in prices. Tobacco production has continued to rise, strongly after 1987. Tea production, as opposed to coffee where small-holders are the main producers, is dominated by plantation estates. Next to the sugar subsector, rehabilitation of tea production has demanded more, in terms of capital inputs, than other subsectors. Output is still far below that achieved in 1985.

Food crop production is improving but not as dramatically as that for cash crops. Due to a large subsistence component, food production did not fall as much as that for cash crops. For while it was necessary to grow food to survive, it was often unprofitable or outright impossible to grow cash crops.

URBAN VERSUS RURAL HOUSEHOLD RESPONSES[2]

Introduction

The long period of decline in Uganda has left the bulk of the population worse off. However, absence of mass starvation in the country or large migrations to the countryside suggest ingenious adaptions to the crisis. In both urban and rural areas cash incomes were needed to purchase goods and services. Petty trade and informal sector production became the main sources of income in the urban sector. The remoteness and small size of the rural market constrained the level of cash transactions. Subsistence food production became the main form of livelihood for the rural household. Increasingly, rural dwellers depend on traditional herbs and medicines to cure their ailments. In some cases diseases were left unattended, 'the poor do not get sick' claimed one rural Masaka respondent.

Sources of household incomes

The across-the-board decline of the modern sector in Uganda has brought forth a variety of survival strategies, including new ways of generating income. In Tables 10.5 and 10.6 we present summaries of the main sources of urban and rural incomes. We differentiated five main income categories in Kampala. These are wages, allowances, farming, business, remittances. In the rural areas (rural Masaka) we added a further category, wages from working on other peoples farms (labourer).

In the Kampala sample we see that wages were, on average, less than a fifth of total urban incomes, being most important for the poorest 40 per cent of the urban households. The pitiful size of the nominal wages, in contrast to the

Table 10.5 Uganda: monthly urban incomes by quintile (U.Sh.)[1]

Income source	*Q1*	*Q2*	*Q3*	*Q4*	*Q5*	*Average*
Wages	3,793	7,975	18,397	19,677	50,575	20,083
Allowances	3,632	6,183	19,647	36,803	96,172	32,487
Farm income[2]	137	–410	8,976	12,597	27,201	9,700
Business	7,238	6,058	16,770	52,563	203,305	57,187
Remittances	–24,821	–977	–9,383	–2,244	–5,270	–8,539
Total income	–10,021	18,829	54,407	119,396	371,983	110,918
Per capita	–1,222	2,445	6,887	14,560	50,268	14,040
Hhld size	8.2	7.7	7.9	8.2	7.4	7.9
(% of total income)[3]						
Wages	–	42.4	33.8	16.5	3.6	18
Allowances	–	32.8	36.0	30.8	25.9	29.3
Farm income	–	–2.2	16.5	10.6	7.3	8.7
Business	–	32.2	30.8	44.0	54.7	51.6

Remittances	–	5.2	–17.2	–1.9	–1.4	–7.7

Notes:

1 Due to large negative incomes, Q1 is difficult to interpret. Percentages of the different different incomes sources are not calculated.

To derive averages we sum over quintiles and divide by five (percentages in the average column are derived from average incomes in the upper part of the table).

2 Includes income in kind

3 Due to 'rounding-up' percentages may not sum to 100.

high cost of living in Kampala, has been a source of much debate and policy recrimination. The collapse of real wages has had many causes. Foremost being the sharp decline of the public sector in Uganda. Government has always been the single largest employer. In the 1960s the sector was also the wage leader. But the crises of the 1970s and 1980s saw a growing budgetary crisis, and many government functions ceased. At the same time its employees increased, mainly due to political pressure (for instance, the expansion of the army). That workers still continue to perform their duties at all, given the level of remuneration, is a subject of much empirical interest (Bigsten and Kayizzi-Mugerwa 1991a). Within the framework of urban adaptation to the crisis, a job, though poorly remunerated, is a good base for the generation of other income. Examples range from the imposing of private property rights, by civil servants and politicians, on government property, cars, stamps, and so on, and thereby gaining rents, to outright corruption.

Allowances were traditionally reserved for the higher echelons in administration and business. However, they are currently an important feature of remuneration policy, both for government and private employers. They range from the traditional medical and housing allowances to night allowances and 'food baskets'. Some employees have access to houses, which we also included in the allowance package. As shown in Table 10.5, their share of total income in the urban sector far outweighs that of wages. In the urban sample, allowances ranged from 3,600 shillings per month for the lowest (poorest) quintile to 96,000 shillings for the highest (richest). Individual figures ranged from 0 to 400,000 shillings per month. Added together, wages and allowances (the remuneration package) were 47 per cent of total income.

In both urban and rural sectors, non-wage incomes have had the largest shares in total income. A significant feature of urban adaptation to modern sector decline has been the increasing engagement in farming. Kampala and many other urban centres have become 'ruralized' as farming activities increase on mainly public land. Use of this land is illegal but authorities have been lax in reinforcing regulations. In some of the less-populated suburbs, such as Nakawa, coffee is grown. Farming generates about 9 per cent of urban incomes, including a subsistence component. Surprisingly, farm incomes are most important for the higher quintiles, from the third upwards (see Table 10.5). This is because the poorest quintiles have little access to suitable land in urban suburbs on which to engage in serious farming. So even here it is the relatively richer, and thus better connected, who have had good incomes from farming.

Table 10.5 also indicates that business incomes are the differentiating category in

urban areas. Petty trading and retailing is the commonest business type, accounting for 39 per cent of the business engagements in the Kampala sample. However, services including small dispensaries and transport com-panies, were the most profitable. On average, business accounted for 51.6 per cent of urban incomes. The richest 40 per cent of the households had the biggest share of business incomes in their total incomes. The heads of these households had, on average, a high education.

In a paper on circular small-holder migration, Bigsten (1988) argues that migration of a member to an urban area is a form of social insurance for the members remaining behind. In Kampala, individual household concerns have overshadowed rural obligations. The size of net remittances was, on average, only 7.7 per cent of total income.[3] Apart from the first quintile, for which remittances exceeded reported income, and the third quintile of medium income earners, who remitted about 17 per cent of income, the rest remitted below 6 per cent of their incomes. Notably, the richest 40 per cent of the households remitted less than 2 per cent of their incomes. Thus the urban contribution to rural well-being was found to be low. Considering that rural dwellers remit food to urban relatives the net value of urban-rural remittances could very well be negative.

We now turn to rural Masaka. Not surprisingly, wages and allowances account for a small share of incomes in the rural sector (Table 10.6). The remuneration package was less than 9 per cent of total rural incomes, with slightly bigger ratios for the lower rural quintiles. The remuneration package accounts for only 5.8 per cent of the income of the richest quintile. As sources of cash income, allowances and wages accounted for 32 per cent (we assumed that 15 per cent of farm income is from the sale of crops for cash).

Table 10.6 Uganda: monthly rural incomes by quintile (U.Sh.)

Income source	*Q1*	*Q2*	*Q3*	*Q4*	*Q5*	*Average*
Wages	1,453	632	1,329	1,985	11,586	3,397
Allowances	506	170	409	833	975	579
Labourer	132	526	783	1,104	10,441	2,529
Farm income[1]	5,343	2,786	12,907	16,570	142,942	36,110
Business	1,430	3,652	2,632	9,367	39,488	11,314
Remittances	–35,311	–836	–779	1,269	–7,234	–8,578
Total income	–26,447	6,930	17,282	31,128	198,189	45,419
Per capita	–2,939	1,034	2,134	4,264	24,775	5,823
Hhld size	9	6.7	8.1	7.3	8	7.8
(% of total income)						
Wages	–	9.1	7.7	6.4	5.8	7.5
Allowances	–	2.5	2.4	2.7	0.5	1.3
Labourer	–	7.6	4.5	3.5	5.3	5.7
Farm income	–	40.0	74.7	53.2	72.1	79.5
Business	–	52.7	15.2	30.1	19.9	24.9
Remittances	–	–12.1	–4.5	4.1	–3.6	–18.9

Notes:
1 Cash component is on average 15 per cent.

In the rural sector farming is by far the main source of income. The bulk of this income is, however, computed from the value of subsistence consumption. Farm income thus derives from the sale of crops and animals and their products, value of the subsistence component and the valuation change in livestock. The cash component is on average 15 per cent of farm income. Farm income comprises an average of up to 79.5 per cent of total income in the rural areas. It is smallest, again surprisingly, for the lower quintiles. These were found to have a smaller area for growing crops and kept only a few animals. Farm income accounted for 72 per cent of the total income of the richest quintile. This group had an average of 11 hectares of land and a substantial part of the income derived from livestock. Besides a better access to land, the richer quintiles used relatively more fertilizer than the lower groups, as well as more own labour.

In the rural sector engagement in business accounted for 25 per cent of rural incomes. So in terms of expenditures on such items as school and medical fees, business incomes are crucial sources of finance. Business engagement appears to be most important for the poorer households. The ratio of business income in total income was over 50 per cent for the second quintile. Shortage of land, an average of 1.5 hectares for the second quintile, seems to be an important factor behind the poorer households' decision to go into 'business'. Business accounts for only 20 per cent of the incomes of the richest quintile in the rural sector. In rural areas business is mostly confined to simple roadside stalls, shops and participation in weekly markets.

Relative to their cash incomes, the amount of remittances from rural households is substantial. Given the number of children and other relatives resident in the urban areas, it is reasonable to assume that some of the remitted money ends up in the urban sector. Adding to this the amount of food sent to urban relatives, the rural-urban transfer of resources is considerable. Thus to some extent, urban dwellers have survived the economic decline due to support, in terms of money and food, from the countryside.

To summarize, we have noted that both rural and urban areas have diversified their income sources. Increased farming in urban areas is a notable feature of urban adaptation. Engagement in business is, however, the differentiating category in the urban area. The richest and best remunerated households also have large business incomes. In the rural sector, farming is the main source of livelihood. The better-off groups derive their incomes almost exclusively from farming, while the poorer quintiles engage in business to a considerable extent. Ownership of land assets is an important determinant of the incomes from farming. Cash incomes are low in rural areas. This constrains, above all, rural access to social services.

Expenditure on education services

On average the Ugandan household seems to have been able to procure enough food to survive, even at the height of the domestic crisis. However, the continued decline of the public sector has reduced the flow of social services. Though officially free, both health and education costs have increasingly been passed on to the consumers. We estimated that, on average, urban households spent 320,800 shillings a year on children's education, including transport, pocket money, and so on. This makes an average monthly expenditure of 26,700 shillings and a per student expenditure per month of 7,035

shillings (urban households have an average of 3.5 children going to school). The latter expenditure equals the wage levels of the two lowest urban income quintiles (see Table 10.5).

A typical rural Masaka household spent 105,900 shillings a year on school fees, equivalent of 9,000 shillings a month and 2,380 shillings per student. As a comparison, the latter figure exceeds the average wages received by the first four quintiles in the rural Masaka sample (see Table 10.6). The student ratio per household is higher in rural Masaka than in Kampala, which is due to the fact that, on average, rural households have a lower average age.

The whole education system is in crisis (Kayizzi-Mugerwa and Bigsten 1990). The government has not been able to construct new schools since the 1960s, while a number of school structures, especially in northern Uganda, have been destroyed in the course of civil conflict. The bursary system and support to schools in terms of equipment have all but ceased. Today the government tries to meet the very basic needs and the rest of the burden falls on parents (UNICEF 1989). The latter have formed Parent and Teacher Associations (PTA) which have helped in financing schools. Their work has been controversial (*Weekly Topic* 15 February 1991) and in the rural areas has left much to be desired. The cost spiral has meant that a number of households have been excluded from the education system altogether.

It might be instructive to look at the income structures of the thirty-one urban households, Kampala2 (12 per cent of the Kampala sample), and sixty rural households, Rural2 (27 per cent of rural sample), who had at least one child not going to school (see Table 10.7) due to lack of school fees, and so on. These 'vulnerable' households were relatively large, with average household sizes of 8.5 in Kampala2 and 9 in Rural2. Kampala2 households were more dependent on wages and allowances, which accounted for 80 per cent of their incomes (compared to 47 per cent on average), than others. Businesses accounted for only 20 per cent of their incomes (52 per cent on average). They also remitted more money than average. Heads of households were poorly educated, quite a number were female and some were refugees from regions destabilized by civil war. Rural2 households showed a higher dependence on subsistence. This generated 88 per cent of their 'income'. Engagement in business was small, generating 11.5 per cent of total income

Table 10.7: Uganda: incomes for households with at least one child not going to school (U.Sh. per month)

Source	*Kampala*	*%*	*Kampala2*[1]	*%*	*Rural*	*%*	*Rural2*[1]	*%*
Wages	20,083	18.0	17,971	23.3	3,397	7.5	3,997	11.7
Allowances	32,487	29.3	44,081	57.0	579	1.3	460	1.3
Farm income[2]	9,700	8.7	7,347	9.5	38,707	85.2	30,043	88.1
Business	57,187	51.6	15,703	20.3	11,314	24.9	3,891	11.5
Remittances	–8,539	–7.7	–7,864	–10.0	–8,578	–18.9	–4,294	–12.6
Per capita	14,040		9,087		5,823		2,468	
Households	239		31		220		60	

Hhld size	7.9	8.5	7.8	9

Notes:
1 Kampala2 = urban households with children not going to school. Rural2 = rural households with children not going to school.
2 Includes both income in kind and income from working on other peoples's farms (see Tables 10.5 and 10.6).

(compared to 25 per cent for the rural sector). Their remittances were lower than average.

Households were asked to identify the main source of finance for the education of their children. Wages, including allowances, were cited by 25 per cent of the urban households as the main source of finance. Business was cited by 38 per cent, by far the largest single source. Borrowing and remittances were the main sources for 10.2 per cent of the urban households. Interestingly, farming was cited as the main source of finance by 12 per cent of the households, giving it more importance than would appear in the income figures. In rural sectors, cash incomes from farming was the main source of finance for the children's education. Notably, 25 per cent cited business as the main source of finance. Wages and remittances were of minor significance.

Expenditure on health services

We shall now look at health expenditure. In terms of personnel, outlays from government and maintenance of buildings and equipment, the health sector in Uganda has suffered as much as education. The whole of the health delivery system needs to be overhauled. There are plans to improve incentives for workers in the sector by increasing salaries, streamlining the promotion structure, and introducing in-house training programmes. To finance the reform the government is considering a number of cost-sharing schemes. Mulago, the country's biggest hospital, has resumed its role of a referral institution and many of its specialized services are under rehabilitation, with World Bank support.

For some time the reality has been that patients pay a certain amount of money for treatment, though often unofficially in government institutions. Kampala has, besides Mulago, a number of large mission-run hospitals. There are also a number of private clinics. They have reduced the pressure on the larger institutions. But since they cannot handle complicated medical cases the quality of medical services has not dramatically improved. The supply of medical services in the rural areas is quite limited.

Average household expenditure on health services are presented in Table 10.8. Urban households had spent an average of 18,656 shillings on costs related to medical treatment (medical fees, travel costs and other costs, including food and sundry) in the month preceding the interview. This equals 15 per cent of total monthly income. In Kampala, medical fees (including drugs) comprised 72 per cent of total outlays, 13 per cent went to travel costs and 15 per cent to other costs. Rural Masaka households spent an average of 8,294 shillings a month on health-related outlays. This adds up to 66 per cent of total rural monthly cash incomes. In rural Masaka thirty-eight households reported using herbs and other local cures, in at least one case, instead of visiting a hospital or clinic. Costs for the traditional cures were not reported but were presumably small and based on the barter

of goods or services.

Table 10.8 Uganda: average household medical expenses 'last' month (U.Sh.)

Expenditure type	*Kampala*	*Rural Masaka*
Medical fees	13,370	5,324
Travel costs	2,490	1,500
Other costs	2,796	1,470
Total	18,656	8,294
No. of treatments	2.6	2.8
Households[1]	195	203

Note:
1 In rural Masaka up to thirty-eight households reported use of local herbs to treat a member instead of visiting hospital.

As already noted, the supply of health services is much better in Kampala than in rural areas. In Table 10.9, we compare the 'supply' of health services, by institutional type. This is proxied by the number of individual treatments at each of the institutions: government hospital or clinic, mission-owned and private. In Kampala 13 per cent of the treatments (507 in all) were in a government institution, 24 per cent in a mission-run hospital or clinic and the majority, 63 per cent, in a private hospital or clinic. It is important to note that clinics handle relatively simple cases such as fevers and colds, the average period of admission for a private institution being one seven-tenth of a day. Government hospitals had the lowest medical fees, an average of 2,000 shillings per visit. However, they generally have high 'other' expenses including bribes to health workers. Mission hospitals charge the highest fees, but are also the most efficient.

Table 10.9 Uganda: average medical costs per treatment and hospital type (U.Sh.)

Hospital type	*Visits*	*Kms[1]*	*Days*	*Fees*	*Transport costs*	*Other costs*
				Urban		
Government	65	3.6	4.0	1,992	1,189	2,196
Mission	120	3.2	3.6	9,376	1,615	1,655
Private	322	4.5	0.7	4,202	665	632
				Rural		
Government	150	5.5	15.0	1,260	1,170	2,900
Mission	97	7.7	17.5	4,690	2,350	2,812
Private	302	3.0	23.4	1,971	940	1,130

Note:
1 Distance in kilometres.

In rural Masaka, 27 per cent of the treatments are in government institutions. Patients travel a longer distance to reach the hospital and pay almost as much as their urban counterparts for treatment. 18 per cent of the treatments were in mission hospitals, while

55 per cent went to private hospitals or clinics. Rural Masaka dwellers are an unhealthy lot. Those visiting government hospitals 'last month' were admitted for an average of fifteen days. Average length of admission in mission hospitals was seventeen and a half days and twenty-three days in private institutions. Private hospitals are more common in the rural areas. They are also relatively cheaper.

Perceived and desired improvements

In the above sections, we looked at patterns of household income generation and expenditure on social services. They reflect responses to shifts in relative prices and quantities. To have some direct indication of how households perceive changes in the economy, we asked the heads to indicate areas, related to social and economic infrastructure, where they had noted improvements since 1985 and others where improvements were desired. The results are reported in Table 10.10.

Both rural (48 per cent) and urban (56 per cent) households saw road repairs and construction as the most notable improvement since 1985. An equal number of rural and urban households (14.2 per cent) thought that the most notable improvements had been in the area of social infrastructure, including health and agricultural extension services. Urban households saw almost no notable improvement in education while 3.8 per cent of rural households did so. In either area the most notable improvement was 'other'. In most cases this refers to return of peace in southern Uganda, a rare commodity in the early 1980s.

With regard to desired improvements, social infrastructure (health, agricultural and social services) was the most frequently cited by the households,

Table 10.10 Uganda: perceived and desired improvements, April, 1990 (percentage response)

	Improvement since 1985	*Improvements desired*
	Urban	
Roads	56.0	8.8
Social infrastructure	14.2	54.8
Education	0.2	13.8
Other	29.6	22.6
	Rural	
Roads	48.0	7.7
Social infrastructure	14.2	40.0
Education	3.8	25.3
Other	34.0	27.0

55 per cent in Kampala and 40 per cent in rural Masaka. Fourteen per cent of urban households thought improvements in education to be top priority against 25 per cent in rural areas. Twenty-three per cent of urban households and 27 per cent of rural households wanted urgent improvements in 'other' items, commonest among these being improvements in the working of the local administrative units, the resistance councils,

and the reduction of corruption.

CONCLUSIONS

In this paper, we have described some of the dilemmas facing a resource-constrained economy in attempts to undertake structural adjustment. At the centre is the traditional conflict between urban areas, where policy-makers reside, and the rural sector which generates the resources necessary for the realization of the goals of the adjustment programme.

Uganda has experienced a long period of deep economic and social crisis and any scheme remotely promising a positive change in fortunes was bound to be welcome. The return of a modicum of peace to the country, especially in the south, has established an 'enabling environment' on which the reform package could be based. It is already being argued, however, that the 'peace premium' has been exhausted. Indeed, in the many deprived urban slums and rural villages one hears the, not wholly illogical, comment that 'you cannot eat peace'.

In the adjustment effort, the rehabilitation of the institutions of government has been emphasized. Being urban-based, this has tended to concentrate both government and foreign assistance expenditure on urban areas where these institutions are based. Coupled with related private-sector outlays, this has led to something of an urban bustle in Kampala. However, for the foreseeable future, rural production will remain the country's most important source of livelihood. Thus for social and macroeconomic reasons the emphasis that agriculture and the rural sector enjoy in policy statements should also be seen in implementation.

APPENDIX

Table A 10.1 Uganda: balance-of-payments statistics 1982–9 (millions of US $)

Year	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*	*1989*
Exports	347.1	367.7	407.9	379.0	406.7	333.7	272.9	251.6
Imports	–422.0	–428.1	–342.2	–204.1	–476.0	–634.5	–627.4	–659.1
Trade balance	–74.9	–60.4	65.7	114.9	–69.0	–300.8	–354.6	–407.6
Services net	–102.3	–115.4	–44.0	–98.9	–143.5	–113.6	–126.9	–131.6
Unrequired transfers	107.3	103.5	85.4	61.0	208.7	244.6	287.3	332.0
Current account	–69.9	–72.3	107.1	77.0	–4.2	–169.8	–194.1	–207.2
Capital account	14.6	27.7	–88.3	–27.4	51.1	142.3	54.7	243.4
Net changes in arrears	22.4	8.3	–77.3	17.3	44.3	19.1	142.0	–41.5
Overall	–32.9	–36.3	–58.5	–66.9	91.2	–8.5	2.6	–5.4

Source: Ministry of Planning and Economic Development (1990c).

NOTES

* I would like to thank Göteborgs Handelshögskolefonder for financial assistance.

1 This section draws on Kayizzi-Mugerwa and Bigsten (1992).

2 All tables in this section are based on survey data.

3 Some workers in Kampala have their families permanently based in the countryside. A number of respondents reported borrowing to maintain them. We here report net remittances, that is remittances 'in' minus remittances 'out'.

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11
GUINEA-BISSAU: IMPACT OF THE STRUCTURAL ADJUSTMENT PROGRAMME ON THE WELFARE OF SMALL-HOLDER FARMERS

Magnus Alvesson and *Mario Zejan**

INTRODUCTION

For many small-holders in the Third World conditions determining the exchange of goods and services are important determinants of their welfare. These, in turn, depend on relative prices and the supply of consumer and investment goods in the rural markets. In Guinea-Bissau, a structural adjustment programme has been in place since 1986 and there has been considerable speculation on the impacts of the policy reforms. In this paper we analyse changes in the welfare of small-holder farmers in the period 1986–9 using unique farm-level data from the rice-producing region of Catió in southern Guinea-Bissau. The analysis focuses on changes in the terms of trade between goods produced and consumed by the farmers, and in the supply of consumer and input goods in rural markets.

In analysing the impact of changes in relative prices and in the supply of consumer and investment goods it is necessary to distinguish between incentive and welfare effects. Assuming no shortages of consumer or input goods in the rural markets, incentives for production and trading increase with prices for produced goods. When assessing the welfare impact, price changes for consumer and input goods also have to be taken into account. If these increase relatively more than producer prices, farmers will have to sell more produce in order to buy the same amount of consumer and input goods. Although this, in fact, implies increased incentives for production and trading, it also means a deteriorating welfare. The distinction between incentive effects and welfare effects is the starting point of this paper.

The presence of shortages in the rural markets alter the effects of changing relative prices. Up to the point where equilibrium prices are reached in the markets for consumer and input goods, increased producer prices actually lead to decreased incentives for production and trading. Welfare, on the other hand, improves due to the smaller labour input needed to earn enough to buy the same amount of goods (the same reason why the incentives decrease). Therefore, in the presence of shortages in the rural markets, the evolution of the supply of consumer and input goods in the rural markets has to be included in an analysis of the welfare impact of changing relative prices. This is the second distinction on which this analysis builds.

Prices and the supply of consumer and input goods are sensitive transmitters of

changed economic policies in the short run, but not the only factors influencing the welfare of small-holders. In the long run other aspects, such as health, social services and education, are likely to play a more important role. This study deals with a relatively short period, between 1986 and 1989, which justifies the focus on prices and quantities.

The paper is organized as follows: in the second section we give a short description of the economic development in Guinea-Bissau since independence and of the structural adjustment programme of 1986. This is followed by the third section which provides an outline of the farm level survey. The fourth section contains an analysis of the income generation of the farmers and the development of the producer prices received by them, followed by the fifth section which discusses the farmers' consumption expenditures, and changes in prices and the supply of consumer goods in the rural markets. The sixth section deals with expenditures on investment goods as well as changes in their prices and supply. In the last section we draw the main conclusions.

STRUCTURAL ADJUSTMENT IN GUINEA-BISSAU

After an eleven-year-long war, Guinea-Bissau became independent in 1974. The PAIGC, Partido Africano da Independência da Guiné e Cabo Verde, the leading political and military force of the independence movement, aimed at establishing a centralized economic structure in accordance with the then prevailing belief in planned economic development. In 1977 a system of controlled prices was implemented. Despite the strong agricultural bias of the economy the development strategy of the new government was based on industrialization. Large development budgets and a high import content in investment projects crowded out imports of consumer goods, causing shortages in the urban and the rural markets. The strategy also implied, as usually is the case in import substitution, a strong overvaluation of the domestic currency. Price controls, in conjunction with growing shortages of consumer goods in rural markets, eroded incentives for farmers to produce for the official markets. In the beginning of the 1980s growing macroeconomic imbalances in the economy forced the government to turn abroad for financial assistance. At the same time attempts were made to reverse the economic development strategy, and in 1983 an economic recovery programme was launched. However, due to adverse external conditions and insufficient budgetary discipline, the programme failed.

The years that followed were characterized by high inflation, thriving parallel markets both for foreign currencies and domestically-produced goods, smuggling and a decline in official commercial activities. The external position was not any less dramatic. Gross foreign currency reserves corresponded to only two weeks of imports and the debt service ratio was 90 per cent (World Bank 1987). In the internal markets, in particular the rural ones, the shortage of consumer goods remained acute. These shortages, combined with high inflation, further eroded the welfare of the farmers and their incentives for rural production.

In 1986 a structural adjustment programme was prepared with the assistance of the World Bank. One of its primary purposes was to shift the internal terms of trade in favour of traded goods, that is, goods that are either imported or exported. The shift in the prices

of traded goods relative to those of non-traded goods was to be achieved by devaluations of the local currency, the peso, and simultaneous price liberalization. Since the effects of a devaluation are eroded if inflation is not curbed, the programme also advocated budgetary discipline and a restrictive economic policy, in order to decrease aggregate demand. It was not sufficient to merely increase the farmers' incomes; increased supply of consumer and investment goods on the rural markets was also necessary. Thus, the adjustment programme included the liberalization and privatization of the internal market structure which, together with price and external trade liberalization, aimed at stimulating private traders to import and distribute these goods.

OUTLINE OF THE FARM-LEVEL SURVEY

To collect data for the study, a farm-level survey was undertaken in March and April of 1990. Sixty-seven interviews in approximately twenty-five villages (tabancas) in the Catió region of southern Guinea-Bissau were carried out in March and April of 1990. Questions were asked regarding the prices and quantities of goods bought or sold by the farmers. We also asked about the perceived availability of consumer and investment goods on the markets.

The target group of the study comprises the rice-producing farmers of the Balanta tribe. There are several motives behind this selection. First, the Balantas of the south provide almost all the domestically-produced rice on the internal market, and rice is the most important staple crop of the country. From being self-sufficient in rice, Guinea-Bissau has, since independence, spent a large part of its foreign exchange on imports of rice. Thus, the Balantas of the south can be considered an important target group of the structural adjustment policies carried out in the country since 1986. Second, the different ethnic groups in Guinea-Bissau are relatively specialized in production: the Balantas cultivate rice, the Fulas grow groundnuts and take care of cattle, the Manjacos specialize in palm products, and so on. In terms of culture, religion and social organization, the ethnic groups are also relatively homogeneous. Therefore, limiting the target group to one ethnic group simplified the practical aspects of the survey, and allowed us to speculate about the possible results for a larger group of the same ethnical origin.

The primary purpose of the farm-level survey was to collect the data needed to construct a Laspeyres price index for the period 1986 to 1989. The index can be used as an indicator of the nominal internal terms of trade of the target group. The terms of trade are, in turn, an indicator of changes in the farmers' welfare, as argued above. The data on the supply of consumer and input goods complement our analysis of the welfare development. Other indicators of the welfare of the target group, such as the diversification of income and expenditures, will also be discussed.

The small city of Catió served as the base during the field-work. The selection of the sample villages was undertaken with personnel from the planning department of the Ministry of Agriculture. The sample selection procedure could be a possible source of skewness. First, Catió as a base possibly gave preference to the villages close to the town. This might exaggerate the level of commercial activities in the villages, as more remote farmers do not have access to as many stores and mobile traders (*djilas*) and have poorer

transport facilities than villages closer to Catió. The fact that only men were interviewed implies a risk that, at least to the degree that they were unknown to the men, the economic activities pursued by women were omitted. The economic unit of the survey is considered to be the man who was interviewed and his household, which among the Balantas consists of, on average, six or seven people (Funk 1987). Since some economic activities are undertaken by larger groups (*morança*[1]), for example, hiring labour, forming work groups and sharing the meals, the economic unit might sometimes be unclear. This has to be taken into account when evaluating the quality of the data.

The material presented below should be viewed in the light of the limited number of farmers interviewed, and the manner in which data were collected, that is, that the farmers had to recall events between one and four years back in time. Our results thus indicate the direction of the changes in the period considered but not necessarily their precise magnitudes.

THE COMPOSITION OF INCOME GENERATION

Table 11.1 shows the income that originates from selling an item as a share of the total income of the average household in 1986 and in 1989. Wage income is excluded from the analysis of income sources. As can be seen, rice accounts for the largest income share; almost 50 per cent of the total in both years. Despite an almost threefold nominal increase in total income over the period, rice kept its position as the prime income generator. The income earned from cashew products, such as cashew nuts and cashew wine, increased from 6 to 9 per cent of total income. This increase is most likely due to the large cashew-tree planting campaign led by the government in the first half of the 1980s. Cashew nuts are a good complement to rice production. For most of the year they demand little labour and cultivation occurs outside the rice season. Possibly, cashew-nut production has crowded out other off-season activities, for example, the making of baskets, which has decreased in quantity sold (see Table 11.2). Sale of cattle, pigs and goats account for 16 and 15 per cent of income earned in 1986 and 1989, respectively.

Table 11.1 Guinea-Bissau: income generation shares in 1986 and 1989

	1986 (%)	*1989* (%)
Rice (paddy)	28	29
Rice (milled)	20	18
Cashew nuts	4	6
Goats	2	3
Bananas	2	4
Sweet potatoes	2	3
Cows	10	8
Pigs	3	4
Salt	4	3
Baskets	8	5
Pots	4	4

Cassava	3	4
Other	8	6
Cashew wine	2	3
TOTAL	100	100

Table 11.2 lists the average prices received and the quantities sold for each of the items included in Table 11.1. Table 11.2 also lists the number of farmers who sold a specific item as a percentage of all farmers interviewed.[2] In 1986 85 per cent of the farmers sold rice in paddy form (unmilled rice). This proportion increased to 88 per cent in 1989. Thirty-nine per cent sold milled rice in 1986 and 58 per cent in 1989. This confirms the information in Table 11.1 to the effect that rice is the main income generator. It is worth noting that the number of farmers who sold milled rice increased by 50 per cent between 1986 and 1989 (compared to the unchanged share for farmers selling unmilled rice). A plausible explanation for this is the growing number of rice-husking machines distributed in the rural areas (Zach *et al.* 1989). It is possible that the increased supply of milled rice at the farm level has contributed to the relative price decrease of milled *vis-à-vis* unmilled rice. Bananas have also been subject to government campaigns aimed at increasing the production of horticultures. There has been a large response in quantities sold, accompanied by a decrease in the unit price.

The government campaign for the planting of cashew trees has generated only moderate increases in the average quantities sold. This is probably due to

Table 11.2 Guinea-Bissau: prices, quantities and number of farmers selling respective items

Item	*1986* *Households* (%)	*Quant.*	*Price* (PG)	*1989* *Households* (%)	*Quant.*	*Price*(PG)[1]
Rice (paddy, kg)	85	563	195	88	853	382
Rice (milled, kg)	39	154	452	58	291	701
Cattle (each)	18	0.39	137,956	19	0.51	189,681
Cashew nuts (kg)	21	66	307	45	107	743
Cashew wine (l)	30	41	161	45	76	425
Baskets (a piece)	21	24	1,261	27	23	3,416
Pots (a piece)	25	6	1,886	28	9	3,632
Cassava (kg)	12	80	117	21	103	410
Bananas (bunch)	20[2]	3	1,714	19[2]	4	5,600
(a piece)		33	300		88	75
Pigs (a piece)	28	0.78	25,029	33	1.12	47,305
Salt (a piece)	33	61	218	40	59	479
Goats (each)	16	0.66	11,077	33	0.77	36,803
Sweet potatoes	16	38	255	27	79	528

(kg)

Notes:
1 PG = Guinean pesos.
2 Includes farmers selling both by the piece and in stem.

the maturing period of cashew trees; they give full crop after five to ten years. The price increase of cashew nuts at the farm level was 142 per cent despite the decrease of the world market price by 12 per cent (World Bank 1987). This decrease between 1986 and 1989 was aggravated at the national level by the effect of an export tax, increased from 9 per cent to 38 per cent. This was, in turn, counteracted by the devaluations that took place during the period, which implied a higher price for cashew nuts in domestic currency. Another factor behind the large farm-level price increase is likely to be the very low price paid to the farmers in 1986 in comparison to the world market price.

To estimate increases in the price for sold goods a Laspeyres index is used. It is a measure of the price changes in the income generation bundle between the base year 1986 and 1989, with the base year quantities as weights. The formula for the Laspeyres index is:

$$L = \frac{\Sigma P_i 89 \times Q_i 86}{\Sigma P_i 86 \times Q_i 86}$$

where $P_i 89$ and $P_i 86$ are the prices for item *i* in the two years respectively, and $Q_i 86$ is the quantity sold in 1986, the base year. The value of the index for the items sold by the farmers in 1986 and 1989 is 1.94. This means that a farmer who received 100 pesos in 1986 for 100 units of a composite commodity, would receive 194 pesos in 1989.

The income of the average farmer, including the value of barter,[3] but excluding own-consumption and wage income, increased by almost three times from 1986 to 1989. The share of barter transactions in total income decreased from 14 per cent to 11 per cent despite the growing trade in cashew nuts, which traditionally is exchanged for rice. This indicates a growing monetization of farmers' activities. This, in turn, could be a sign of increased confidence in the local currency or a greater need of money due to greater availability of goods in the rural market.

The use of concentration curves and the Herfindahl index (H index), a concentration measure, makes it possible to analyse changes in the income generation pattern over the period. These measurements show the level of dependence of the farmers on a certain number of items for their income generation. A diversification of the income generation corresponds to a decrease in the relative share of each item in total income. The measures illustrate the farmers' vulnerability to external factors, such as weather conditions or changes in world market prices, and also internal factors, such as shifts in demand. Increased diversification of the income generation bundle can be expected to reduce this vulnerability.

Figure 11.1 shows the concentration curves of the income-generating bundles in 1986 and 1989. In this figure the *y*-axis depicts the cumulative percentage share of total income and the *x*-axis lists the items sold according to their relative share, starting with the

largest share. As can be seen, the farmers diversified their income sources between 1986 and 1989. The commodity accounting for the largest share increased it (see unmilled rice in Table 11.1), while the remaining items saw falling shares due to diversification. The Herfindahl index of concentration sums up the slopes of all segments of the concentration curve separately, and thus reflects both the number of items in the income-generating bundle as well as their relative share in total income generation. In this case the index is:

$$H = \sum_{i=1} (s_i)^2$$

where s_i is the share of item *i*. If every item had an equal share of the total value, the value of the H index would be equal to $1/n$, where *n* is the number of items. When only one item accounts for all the income generation the value of the H index would be 1. The values of the H index for 1986 and 1989 are 0.146 and 0.139 respectively. This indicates that the income generation has diversified between 1986 and 1989. A number equivalent of the H index makes it intuitively clearer (Adelman 1969). By inverting the H index the number equivalent is obtained, that is, $N = 1/H$. The number equivalent then shows how many items of equal share it would take to generate the same value of the H index. In the present case, 6.8 items were necessary in 1986 to get a value of the H index of 0.146, while 7.2 items have to be sold in 1989 to obtain a value of the H index of 0.139. Thus, both the concentration curves and the values of the Herfindahl index indicate that there has been a diversification in

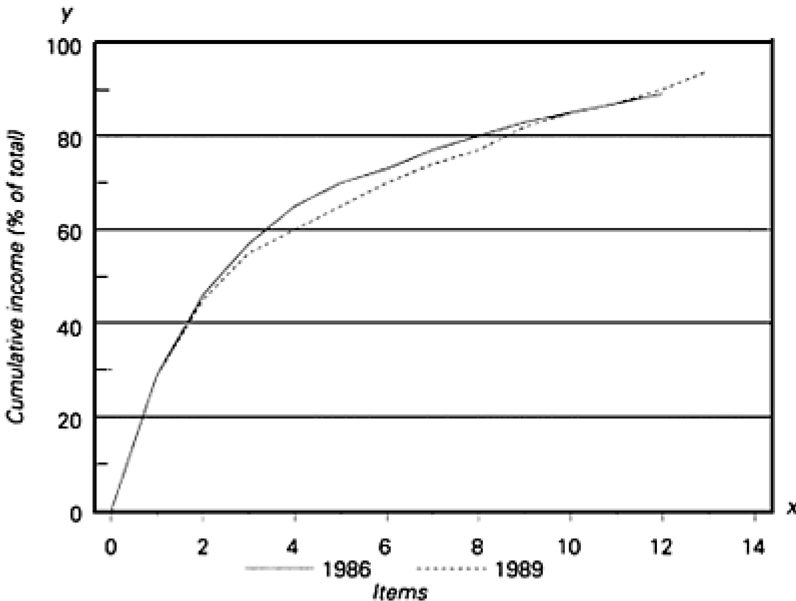

Figure 11.1 Guinea-Bissau: diversification of income generation in 1986 and 1989

the income generation of the farmers. Although small, the change indicates an improved base for income generation.

THE COMPOSITION OF CONSUMPTION EXPENDITURES

There are several reasons why the composition of consumption should be studied. By deflating the nominal price changes of income-generating goods with those of consumer prices it becomes possible to evaluate the real change of income. To do this, we need to know the quantities and prices of the items bought by the farmers. The quantities of consumer goods bought are also an indication of the supply of consumer goods on the rural market. Using the concentration index introduced above, it is possible to measure the diversification of consumption. This is perhaps even more than in the incomegeneration bundle, a measurement of welfare, since it reflects the diversity of the consumer goods available on the rural market. Assessment of the welfare effects was further extended by looking at farmer perceptions regarding the availability of consumer goods in the rural markets.

Table 11.3 shows the relative shares of commodities in the total consumption expenditure bundle of the interviewed farmers in 1986 and 1989. Unlike the income-generation bundle there are large differences in the relative

Table 11.3 Guinea-Bissau: consumption expenditure shares in 1986 and 1989

	1986 (%)	*1989 (%)*
Rice (paddy)	13	5
Clothes	27	20
Mosquito nets	9	5
Soap	5	5
Rum	12	16
Shoes	5	7
Sugar	6	11
Honey	3	3
Cashew wine	3	1
Medicine	4	3
Tobacco	4	7
Palm oil	2	7
Other	7	10
TOTAL	100	100

shares between the two years. In both years clothes account for the largest single item in consumption expenditures. However, there is a large decrease of their share between 1986 and 1989. Unmilled rice, which in 1986 accounted for 13 per cent of expenditures, accounts in 1989 for only 5 per cent (this corresponds to a decrease in the quantity bought by the average household from 112 kg to 48). This is a sign of increased home production and therefore a diminishing need for rice coming from other farmers. Mosquito nets also

show a large decrease, both in quantities bought and as a share of total outlays. On the one hand, their cost increased substantially over the period (by 134 per cent) and, on the other, mosquito net is a durable good. With the exception of cashew wine the other goods have increased their relative shares. The increased share of rum consumption may be associated with increases in farm production, since rum accounts for a large share in the payment for hired labour. The increased amount spent on palm oil suggest an improved standard of the daily food intake, since it is considered to be both nutritious, healthy and tasteful.

Table 11.4 shows prices and quantities of the average household for the items listed in Table 11.3, as well as the percentages of households buying each item. Although imported clothes increased in value by only 40 per cent in value between 1987 and 1989 on the national level, the increase in the average household's consumption bundle was 106 per cent. This possibly indicates that a growing number of the imported consumer goods now reach the rural areas. Many of the items consumed by the farmers have seen fairly moderate price increases over the period (for example, sugar, tobacco and rum). Exceptions are palm oil and shoes, which both show relatively large price increases.

Table 11.4 Guinea-Bissau: prices, quantities and numbers of farmers buying consumer goods

	1986			*1989*		
Item	*Households* (%)	*Quant.*	*Price* (PG)[1]	*Households* (%)	*Quant.*	*Price* (PG)[1]
Clothes (total)	64	1[2]	68,960[2]	73	1[2]	141,928
Rum (l)	66	15	2,226	79	30	3,915
Sugar (kg)	39	11	1,512	64	27	2,910
Tobacco	72			81		
cabeça[3]		1	5,667	8		10,313
leaf		7	357		46	474
Shoes (pair)	63	4	3,007	81	7	6,218
Palm oil (l)	19	3	949	30	15	1,959
Rice (unm. kg)	22	112	291	27	48	570
Soap (a piece)	72	6	2,224	85	12	3,821
Mosq. net (a piece)	58	2	8,910	51	2	20,838
Sweet potatoes (kg)	3	1	498	7	2	1,596
Medicine (total)	31	1[2]	8,974[2]	45	1[2]	20,685
Honey (l)	28	11	994	51	15	1,572
Cashew wine	15	8.3	717	24	11	380

(1)

Notes:
1 PG = Guinean pesos.
2 For clothes and medicine most farmers only responded with the total amount spent on these items. Therefore the price index for consumption goods is calculated in two ways. One way which includes the items clothes and medicine, and thus implies that quantity changes for the items are included in the price index. The other way excludes these items which means that the price changes of these items do not affect the index.
3 '*cabeça*' is a local unit consisting of several 'leaves' (*folha*).

In this case the Laspeyres price index for a weighted consumption bundle is 1.98 when including the value increase of clothes and medicine in the consumption expenditures, and 1.82 when these items are excluded (see note in Table 11.4).

The diversification of consumption expenditures reflects a change in the farmers' welfare, since increased diversification implies that farmers are consuming more in line with their preferences. Figure 11.2 shows the concentration curves for the consumption bundles of 1986 and 1989. As can be seen from the figure, the diversification of the farmers' consumption expenditures has increased over the period. A plausible explanation for this is the increasing number of consumer goods on the rural market. The values of the Herfindahl index for the consumption bundle are 0.125 for 1986 and 0.097 for 1989. The number equivalent for 1986 is 8 items, to be compared with 10.3 items in 1989. There is then a clear indication that the farmers diversified their consumption expenditures over the period. As pointed out earlier, this might imply an increased supply of consumer goods on the rural market.

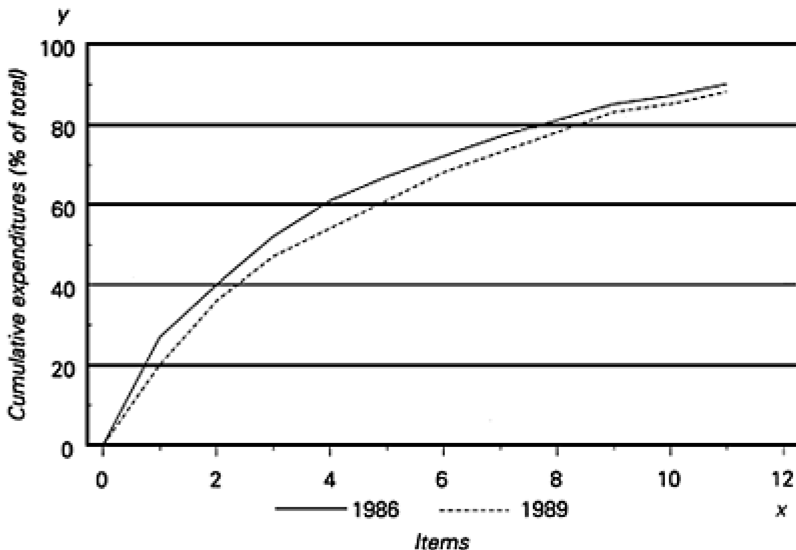

Figure 11.2 Guinea-Bissau: the concentration curve of the consumption bundle in 1986 and 1989

In order to have an idea about the shortages of consumer goods over the period, we asked the farmers whether they wanted to buy more of each particular item in 1986 and 1989. If the answer was 'yes', the subsequent question was why the farmer did not buy more, with two alternative answers: 'lack of money' and 'lack of the item on the market'. The answer 'no need for more' indicates no constraint on the market, 'lack of money' that the farmer is constrained by the price of the article, and 'lack of goods on the market' that the farmer is constrained by a shortage on the market. Table 11.5 shows the results. The overall impression is that the farmers were more satisfied with the level of purchases in 1989 than in 1986. Of those wanting to buy more, a larger group claimed to be price constrained in 1989 than in 1986. The results suggest that there were more desired goods on the market in 1989 but at higher prices than in 1986. Thus, in 1989 they are more constrained by the prices than by the quantities of consumer goods available. These results are in accordance with the increased quantities of consumer goods bought, as shown in Table 11.2 and with the increase in the value of the Laspeyres index of consumer goods prices. Looking at the individual commodities, we can see that there are three items that the farmers desire to buy more of in 1989 than in 1986: mosquito nets, tobacco (in leaf form) and honey. For all these three items, the farmers considered the price to be too high.

Table 11.5 Guinea-Bissau: perceived availability of consumer goods on the rural market

	1986 (% of total)			*1989 (% of total)*		
Goods	*1*	2	*3*	*1*	2	*3*
Clothes	18	27	55	67	22	11
Rum	23	60	18	42	33	26
Sugar	20	52	28	20	56	24
Tobacco						
cabeça	26	46	28	28	47	26
folha	18	57	25	14	63	23
Palm oil	33	40	27	25	63	13
Rice (unm.)	18	39	43	29	31	40
Soap	64	17	19	71	22	7
Mosq. net	47	38	16	45	40	15
Potatoes	17	54	28	39	28	33
Medicine	26	50	24	43	38	19
Honey	47	26	28	24	54	22

Notes:

1 No need for more.

2 Lack of money.

3 Lack of goods on the

THE COMPOSITION OF INVESTMENT EXPENDITURES

Household expenditures on investment goods are treated separately from expenditures on consumer goods for several reasons. First, investment goods were subsidized by the government before the implementation of the structural adjustment programme. Thus, when prices in general were liberalized, prices for investment goods were likely to behave differently from those for consumer goods. Second, the importance of investment goods in production motivates an explicit treatment. For example, the data on the number of tools bought indicate not only that the farmers are stimulated to buy more, and that there are more goods to buy, but also that they are stimulated to increase production. Likewise, the prices of investment goods also represent costs of production.

Table 11.6 shows the distribution of expenditure on investment goods in 1986 and in 1989. Over half of the total expenditure on investment goods was spent on '*ferro do rado*', which is a piece of metal covering the edge of the special plough used by the Balantas (the *catana lagarto*). Although total expenditure on investment goods increased by 110 per cent, the relative amounts spent on the specific tools are on the whole unchanged between the two years. Assuming that the tools are used to cultivate the same crop types in both years, these results are in accordance with the results of the

Table 11.6 Guinea-Bissau: investment expenditure shares in 1986 and 1989

	1986 (%)	*1989* (%)
Balanta hoe	12	10
Hoes	5	4
Axes	6	6
Knives	4	5
Sickles	3	3
Metal bucket	3	4
Plastic bucket	3	3
Ferro do rado[1]	55	56
Sack	3	1
Other	6	8
TOTAL	100	100

Note:
1 The piece of metal covering the edge of the Balanta hoe (*catana lagarto*).

income generation pattern in that the relative shares of the different crops in total income generation are, on the whole, unchanged.

Table 11.7 presents the ratio of households that bought each item, the average quantities bought and the average prices paid. The increase in the average amount of *ferro do rado* corresponds to the increased trading of rice, if we assume that this, in turn,

stems from an increased production. The large increase of purchased plastic buckets can probably be explained by the growing production of cashew nuts; the nuts are picked in the buckets and later the cashew wine is made in them. The number of the households that bought plastic buckets also increased. This is probably a response to the increasing planting of cashew trees, mentioned above. Price increases for the agricultural tools are generally higher than for the consumer goods of Table 11.1. The value of the Laspeyres price index for investment goods shows a larger increase than the price index for consumer goods in general; 2.14 compared to 1.98 and 1.82, respectively. The only exceptions to the relatively large price increases are the prices for *ferro do rado* and for plastic buckets. The removal of government subsidies most likely contributed to the larger increase. Another factor could be the small amounts of trade in investment goods. This could discourage traders from dealing in these items, when it is more profitable to trade in consumer goods. A project launched by the International Fund for Agricultural Development (IFAD) and the Gabinete de Planeamento do Ministerio do Desenvolvimento Rural e Agricultura (GAPLA), the Rural Incentive Programme, with the purpose of increasing the amount of incentive goods in the rural markets, has had problems stimulating wholesale merchants to import and distribute investment goods in the countryside (GAPLA/IFAD 1989a, 1989b, 1990).

Table 11.7 Guinea-Bissau: prices and quantities of investment goods

Item	*1986*			*1989*		
	Households (%)	*Quant.*	*Price* (*PG*)[1]	*Households (%)*	*Quant.*	*Price* (*PG*)[1]
Ferro do rado	64	3.2	5,350	67	3.8	11,286
Balanta hoe	69	2.0	1,980	66	2.0	4,641
Hoe	40	1.0	1,876	34	0.8	3,755
Sickles	46	1.9	737	55	1.5	1,621
Axes	31	0.8	1,665	39	1.1	3,907
Knives	27	0.9	1,661	39	1.0	3,774
Metal bucket	19	0.4	2,003	25	0.6	5,667
Plastic bucket	10	0.2	4,333	24	0.4	6,422
Sacks	19	0.5	2,296	15	0.3	1,603

Note:
1 PG = Guinean pesos.

The relative shares of each specific item in total investment expenditures are relatively unchanged. This is illustrated by the value of the Herfindahl index, which for 1986 is 0.324 and 0.334 for 1989. Thus, there is a small, almost negligible, growth of concentration in the expenditure directed towards investment goods. As in the case of consumer goods, households were asked to say what was constraining them on the market for investment goods. Apart from their impact on the real terms of trade, the

availability of investment goods gives information on the conditions of production. It appears from Table 11.8 that there is a growing dissatisfaction with the number of *ferro do rado* available on the market. The decrease in the number of farmers constrained by the price corresponds to the relatively smaller price increase of the item.

Table 11.8 Guinea-Bissau: perceived availability of investment goods on the rural market

	1986 (% of total)			*1989 (% of total)*		
Item	*1*	*2*	*3*	*1*	*2*	*3*
Ferro do rado	53	21	26	47	21	32
Balanta hoe	20	35	46	11	43	46
Hoe	13	26	62	11	28	62
Sickles	33	20	47	39	15	46
Axes	21	19	60	26	23	51
Knives	36	21	43	32	28	40
Metal bucket	11	19	70	9	24	67
Plastic bucket	21	26	53	22	22	57
Sacks	38	21	42	40	21	40

Notes:
1 No need for more.
2 Lack of money.
3 Lack of goods on the market.

THE COMPOSITE PRICE INDEX AND THE SUPPLY ON THE RURAL MARKET – CONCLUSIONS

The purpose of this paper has been to evaluate welfare changes for small-holders in Guinea-Bissau between 1986 and 1989. Development of the internal terms of trade and changes in the supply of consumer and input goods in the rural markets are used to measure the welfare changes. The internal terms of trade can be estimated by a composite price index consisting of the price index for income-generating goods and the price indexes for consumption and investment goods. The income price index is 1.94, while the price index for the goods included in the consumption bundle is 1.82, excluding the price and quantity increases for clothes and medicines, and 1.98 when including them. For investment expenditures the price index is 2.14. Weighting the two groups of expenditures according to their relative shares in total expenditures, the price index for total expenditures becomes 1.85 (without clothes and medicine) and 1.99 (with clothes and medicine).[4] The internal terms of trade can be calculated by deflating the income price increase by the composite expenditure price increase using the Laspeyres index:

$$L_i = \frac{\Sigma P_{89} \times Q_{86}}{\Sigma P_{86} \times Q_{86}}$$

$$L_e = \frac{\Sigma P_{89} \times Q_{86}}{\Sigma P_{86} \times Q_{86}}$$

where L_i is the weighted price index for income generation and L_e for total expenditures. The result of the calculation is 0.97 when clothes and medicine are included and 1.05 when they are excluded. Since in both cases the index is very close to 1, our results indicate neither an improvement in the farmers' internal terms of trade nor a deterioration over the period. This conclusion is, due to the limitations of the empirical investigation, only indicative, but it suggests that the welfare effects of changes in the relative prices has been neutral for small-holders during the period considered. The effect of the price increases for inputs goods, due to the elimination of price subsidies at the beginning of the period, has been the subject of much debate. The data presented in this paper reflect the removal of subsidies. Changes in the relative prices of input goods and consumer goods stimulated farmers to buy more consumer goods relative to input goods. This relative increase in the cost of production could discourage the farmers from increasing production. In the long run, though, it is likely that the removal of the subsidies will create a more sound economic environment.

As argued in the introduction, the changes in the supply of consumer goods in the rural markets also has to be taken into account when analysing the welfare effect and the incentive effect of the changing relative prices. The results of the survey can give some information on this. First, the quantities actually bought, illustrated in Tables 11.2 and 11.4, indicate increased supply of consumer goods on the rural markets. The households bought on average 175 per cent more of each item in 1989 than in 1986. The average number of households buying a specific item of consumer goods increased on average by 34 per cent. For investment goods the corresponding figures are 14 and 23 per cent. Further, by asking the farmers about the constraints perceived by themselves, additional knowledge on the issue was gained. During the period studied, the number of farmers claiming that they were constrained by shortages of consumer goods in the market decreased from 28 per cent to 22 per cent. As for the scarcity of investment goods the number remained the same, around 50 per cent. For consumption goods both the number of satisfied and the number of price-constrained farmers increased. In the light of a growing income this indicates increased supply on the rural market to higher prices. The number of farmers dissatisfied with the amount of investment goods actually purchased grew over the period. Considering the increased amount actually bought, this indicates a growing demand and possibly willingness to increase farm output. Also the number of farmers that claimed they were constrained by the increased prices grew, which corresponds to the increasing prices of investment goods. Since the welfare effect of the terms of trade was neutral, the impact of the changes in supply of the consumer and investment goods can be analysed separately. All indicators suggest that the supply of consumer and input goods has increased. This implies a welfare increase, since the farmers can improve their material standard by producing and trading more. Also the

incentives for production and trading improved since the extra money earned from increasing production has increased in real value.

Finally, the diversification of expenditures, as measured by the Herfindahl index and by the number equivalent, reflects the variety of items available in the rural markets. The diversification of households consumption grew over the period, as indicated by the Herfindahl index. This means that a larger variety of items were available in the rural markets, which implies a positive effect on both incentives and welfare. For investment goods the values of the index were more or less constant over the period, probably reflecting an unchanged combination of production.

The conclusion is that the welfare of the target group over the period 1986 to 1989 has increased, but this is not due to a favourable evolution of the internal terms of trade, but to the growing supply of consumer goods in the rural markets. Seen in a longer perspective, the effects of this increased supply are likely to level off. When equilibrium prices are reached in the rural markets for consumer goods, the increased supply will no longer have a large positive effect on incentives and welfare. Improvement of incentives and welfare has from that point to rely on institutional reforms. These could include, for example, improved physical infrastructure to decrease the costs of transportation and increase accessibility to markets. This would stimulate competition among traders and is likely to decrease prices for consumer and input goods and increase the producer prices. Reforms aimed at increasing profitability in production, such as an extended and more effective credit system, would have the same effect.

NOTES

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1 A group of enclosed houses where the male heads are usually kin.

2 The averages are calculated with the number of statements used as a weight (compared to the possibility of using the units as, for example, kilos sold or bought, as weights).

3 The value of barter trade is calculated using the price the farmer would have paid if buying the item cash, or received if selling cash.

4 The weight of consumption expenditure is 0.88 and the weight of investment expenditures is 0.12.

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12
AFRO-MARXISM AND ITS DISASTROUS EFFECTS ON THE ECONOMY: THE CONGOLESE CASE

Kajsa Ekholm Friedman

INTRODUCTION

This paper is an attempt to explain the lack of economic development in the Congo. I will focus on the political system and its disastrous effects on various sectors of the economy, especially the rural sector. Anthropological fieldwork was carried out in the period 1986–90 (thirteen months) in the two cities, Brazzaville and Pointe Noire, and the countryside of the Pool and Kouilou provinces. Changes in the political system seem to be under way but it is too early to be specific about the outcome. I will argue that the economic crisis of today is very much produced by the Congolese state and the state class. The responses to the crisis are therefore divided. There is a response from circles outside the power core in the direction of democratization and an apparent determination to put an end to the privatization of the state economy, while the state class itself seems to have accelerated its flight of capital during the second half of the 1980s.

ECONOMIC CRISIS IN SPITE OF OIL

During the 1980s it has become clear that most countries in Sub-Saharan Africa are in deep economic crisis. The optimistic visions of the 1960s were never realized, nor was foreign aid able to alter the downward trend. Many African countries are much worse off today than they were at independence.

The Congo is no exception. The country, situated in West Central Africa north of the Congo river, has about two million inhabitants in an area of 342,000 square kilometers. The industrial sector is more or less limited to oil. A great deal of money has been spent on state enterprises, both industries and state farms, but their performances were bad in the 1970s and even worse in the 1980s. Production of food for the domestic market as well as crops for export is decreasing. Agriculture is carried out in two very different domains; there are modern farms, most of them state-owned, and there is peasant agriculture. The Congo has one of the highest rates of urbanization in Africa, about 60 per cent, which is absurd given the lack of salaried jobs available. Large parts of the country are depopulated. Whole villages have disappeared and many of those that still exist harbour only social categories that cannot survive in town – old people and abandoned women with small children who have been forced back to the village in search

for food. The Congo's external debt per capita is one of the highest in Africa. But it also has the highest number of Mercedes per capita in the world.

The Congo has referred to itself as a Marxist-Leninist state under the PCT, the Congolese Labour Party (*Parti Congolais du Travail*). But in a country where there is no real working class and where the domestic basis of political power is the military, the name of the party is misleading to say the least.[1] Political meetings, covered by TV, often end by the singing of *the International* by representatives of the state class and the army. The president raises his right fist and shouts '*Tout pour le peuple*' and the others answer '*Rien que pour le peuple*'. In 1989, people in Brazzaville joked about the new version being '*Rien pour le peuple*'. Brazzaville is heavily militarized. When the president leaves his palace, large parts of the town are closed and guarded by armed soldiers; the procession is protected by soldiers sitting back to back in jeeps with their machine-guns directed towards the sides of the streets, ready to fire.

Offshore oil was found in 1968 and extraction started in 1972. The country has had huge oil revenues for twenty years, and yet it is no exaggeration to say that people are much worse off today than twenty years ago. The Congo's growth in gross domestic product (GDP) at the beginning of the 1980s did not affect the majority of the population to any significant extent. It gave rise to impressive buildings and a class of rich politicians, with money in Swiss banks and conspicuous consumption in Brazzaville and Pointe Noire. But it did not lead to economic development, and it did not improve the living conditions for the people. Oil production is carried out by foreign companies in joint venture with the Congolese state, ELF Congo (French-Congolese), AGIP Congo (Italian-Congolese) and, more recently, AMOCO (American-Congolese). In 1973 production amounted to 2 million tons and in the middle of the 1980s to more than 5 million. What has happened after that is controversial. If it is true that production today is 7–8 million tons, the country's oil revenues could not possibly be as low as is officially claimed. For some years the state has cherished the idea that it no longer has any money to spend. It has been explained by the shrinking dollar and the lower oil price. Schools, the university, the health care system and low- and middle-income salaries are deteriorating due to the lack of money. In 1990 there were open accusations about part of the oil revenues going directly to the president.

In the following I will take up three interrelated perspectives. The first is a brief overview of the economic history of the area in order to demonstrate that the situation has seriously deteriorated since 1970. There was a period of economic development after the Second World War up to independence, and this tendency was maintained and even accentuated during most of the 1960s. The second is an analysis of the political system as the ultimate cause of the Congo's underdevelopment. It is evident that African countries with a socialist and Marxist-Leninist orientation have failed economically most conclusively. I will argue that this is due to a structural problem, most clearly developed in one-party systems, but which may exist in other countries in Sub-Saharan Africa as well. This structural problem has to do with the survival of the traditional African kingdom. Africa was certainly influenced and transformed by European colonization but not as thoroughly as one would imagine. After independence it has successively shaken off foreign influences – and Africa is again Africa. The third perspective deals with the effects of the political system on various aspects of the economy, primarily the rural

production. I will here take up material from a study of co-operatives and individual peasants in the southern part of the country and show what the problems look like from the peasants' point of view. Finally, I will touch upon the ongoing democratization process as a response to the economic crisis.

ECONOMIC BACKGROUND

The historical material indicates that the Congo was relatively wealthy and developed at independence. Its wealth emanated partly from its position as a transit country for trade towards Chad, the Central African Republic and Gabon and from its position as centre for the colonial administration of Afrique Equatoriale Française (AEF). But part of it came from the relatively high level of industrialization. The Congo exported industrial products such as sugar, soap, cigarettes, shoes, and so on, to neighbouring countries. The development of light industry continued until the end of the 1960s when it was suddenly interrupted. It seems plausible to connect this deindustrialization with the military take-over in 1968 and the proclamation of Marxism-Leninism as the official ideology. But it is, of course, possible that the tendencies were there before and that it took a while for them to be fully manifest.

For centuries this part of Africa experienced a devastating trade in slaves that drew attention away from productive activities. However, from about 1860 to colonization, a rapid expansion of agricultural production for export took place (Ekholm Friedman 1991). This development came to an end at the colonization of the area in 1885. Large pieces of land were given as concessions to European companies with rights of tenure and exploitation in exchange for a fixed annual payment and 15 per cent of the profits (Cornevin 1986:23). This first phase of the colonial period, up to 1920, was characterized by the collection of rubber and ivory. The concessionaires only took what nature offered spontaneously, and no transformation of the indigenous economy took place. The weak performance of the concessionaries has been attributed to low population density, the lack of adequate infrastructure, the generally low level of development and their own deficiency of capital (Bertrand 1975:80; Cornevin 1986:23).

The second phase of the colonial period, from 1920 to 1945, is characterized by the elimination of the big concessionaires and the development of forest exploitation and commercial agriculture. Forestry developed in the Kouilou region and early became the most important export category. The more substantial investments in agriculture did not appear until after the Second World War. 'Colons' settled primarily in the Niari Valley where they found an area with relatively high fertility, large tracts of flatland and transportation facilities (Vennetier 1963, 1965). Here they started monoculture in peanuts and later developed a more diversified agriculture in combination with cattle. Cattle were introduced after 1947 and a number of ranches appeared, both private and administrative. The biggest industrial enterprise, SIAN (Société Industrielle et Agricole du Niari), started with mechanized monoculture in peanuts, supplying the whole country with peanut oil. It went later over to sugar and not only supplied the entire Congolese market, but also exported its product to the Congo's neighbours within the subregion.

Amin (in Amin and Coquery-Vidrovitch 1969:128,56) emphasizes the Congo's

relatively high degree of industrialization at independence and he even characterizes the third phase of the colonial period, from 1946 to 1960, by the development of light industry. Even Bertrand (1975:218) makes the remark that the Congo, at independence, had a relatively large number of agricultural industries, but he adds the word 'paradoxically', as if it was an anomaly. Amin and Bertrand, faithful to their Marxist orientation, distrust, in general, an 'export-dependent' economy. Their view of the economy of a developed country is like a biological organism, the different parts of which are interrelated and integrated and which has its own internal dynamics. To Bertrand, the Congo's economy, in spite of all the industries, 'lacks internal dynamics', it lacks 'a national motor' (ibid.:198,199). An economy must be 'self-centered' and 'auto-dynamic' according to them both, meaning that it should produce for its own needs, be governed by local demands, and that the driving force should be found within the country. It is, however, very clear from their presented material that the Congolese economy, at independence, displayed a very promising pattern. The industrialization process was then accentuated during most of the 1960s. The value of the total export increased from 6 billion CFA Fr. in 1960 to 12 billion in 1968, of which 50 per cent came from forestry; agricultural products, mineral products (lead, zinc, copper) and oil accounted for only a minor part, while industrial products towards Union Douanière des États Afrique Centrale (UDEAC) (for which figures are known), such as sugar, tobacco, beer, oil, soap, and so on, constituted 28 per cent of the export. Sugar did very well in the 1960s. The export value was 700 million CFAFr. in 1960 and 1.5 billion in 1965. After 1966 the Congo even exported refined sugar to Zaïre, France and Iraq, and molasses to France and The Netherlands (Amin in Amin and Coquery-Vidrovitch 1969:110).

This is an important aspect of the Congo's post-colonial history, as it seems to indicate that an early process of industrialization was interrupted around 1970. The investment rate was also very high during the 1960s. The state stood for almost 50 per cent of industrial investments after 1965 (ibid.:75). Private investments were made in oil prospecting, sugar, forestry and industries (Guichaoua 1989:28). It is even possible to discern a positive change in the investment pattern from the period 1960–3 to the period 1963–8. During Youlou's regime the investment distribution followed the general pattern for African countries, that is two-thirds to infrastructure, transportation, social services and administration and one-third to directly-productive activities. During the following period, 1963–8, the former kinds of investment were reduced to 50 per cent to the benefit of directly-productive investments. Investments in industry increased from 15 to 29 per cent. On this point the Congo was doing very well, not only compared to the average of the continent but also compared to countries such as the Ivory Coast and Senegal (Amin in Amin and Coquery-Vidrovitch 1969:75). A great number of state enterprises was established during Massamba-Débat's regime at the same time as he explicitly opposed the idea of nationalization as a way of improving economic conditions of the country. The wave of nationalization in the Congo did not happen until Ngouabi's regime.

Around 1970 the Congo lost many of its regional functions at the same time as competing industries were established in the neighbouring countries. Bertrand (1975:198f) writes about 'a serious recession' in 1970–1 due to the appearance of competing industries for beer, cigarettes, soap and sugar in surrounding areas. Figures for the production of sugar show an abrupt fall after 1969. The sugar industry is an

illustrative example of capital flight from the Congo at the end of the 1960s. SIAN was owned by *Grands Moulins de Paris.* After 1967–8 it started to close down its activities in the Congo while moving its production to other countries within UDEAC. Competing activities, for instance, sugar plantations, were established in neighbouring countries which formerly depended upon the Congo. The various companies in the Congo did not renew material or even maintain the plantations, and in 1970 the Congolese state felt prompted to nationalize (Bertrand 1975:218). After that production fell abruptly.

Foreign capital thus abandoned the Congo around 1970, apparently as a reaction to the political situation. The military coup happened in 1968 but the situation had been aggravated somewhat earlier by the conflict between the government and the army and the killing of oppositionals. Massamba-Débat had no control over the army and when he tried to get rid of Captain Marien Ngouabi, the army took over. Marxism-Leninism was adopted as state ideology by the military regime at the beginning of 1970, and the USSR and Eastern Europe became models for the political system. Bertrand says in his work of 1975, which was apparently written in 1972 judging from the statistical material, that the most important part of the Congolese industry was then dying at a fast rate (ibid.). Private capital did not want to stay, or invest, and state enterprises functioned miserably. It is worth noting that the unwillingness of foreign capital to invest in the Congo (outside the oil sector) is shared by today's politicians with big money, honestly or dishonestly earned. 'Where is the oil money' is a question that has never been answered in a satisfactory way. When preventing oil money from entering the sphere of production in the Congo, the Congolese state class is, one could say, as rational as was foreign capital at the end of the 1960s.

THE POLITICAL SYSTEM

The state's disengagement of the people

The African state has been treated by a number of political scientists (see Hydén 1983; Markovitz 1977, 1987; Jackson and Rosberg 1982; Sandbrook 1985). The best portrayal is that it is privatized. Politicians and civil servants do not occupy functions of a state apparatus as in the west where they have to separate their private interests and economy from those of the state. The Congolese state is, instead, a social group, a network of personal alliances, much more like the mafia than a western state.

A strong state is, according to official ideology, an absolute prerequisite, not only for economic development, but also for the development of socialism and the liberation of the masses. Around 1985 when it was more pronouncedly Marxist-Leninist than today, it was claimed that the Congo now is in the transition from neo-colonialism to socialism (see Goma-Foutou 1985; Mouamba 1985). Workers and peasants cannot play their historical role without a strong state, it is claimed, as they are opposed by a number of 'reactionary classes'; French imperialism of course, but also indigenous 'classes', such as the national bourgeoisie and the 'feudal lords'. 'Feudal lords' are, in this context, clan chiefs administering land that belongs to their kin groups. There has been no feudalism in Central Africa. The official view of today's crisis is very much in accord with the

Dependency School. It is all blamed on external factors which are beyond control for the political élite. The Congo's development problems and the sufferings among the poor is, according to the political ideology, caused by imperialism and the malfunctioning of the capitalist system. The political leaders are powerless against such vicious forces, but they are doing their best and in due time they will solve all the problems.

Reality is, as usual, very dissimilar from political ideology. The state has not been able to promote any economic development; and worse, it constitutes the very obstacle to development. Neither has the Congolese state contributed to the liberation of the 'masses'. According to the official model the political leaders are true servants of the people, constantly listening to the people in order to learn about their needs and wishes. I cannot judge if this extreme falsification of the relationship between rulers and people appeared more convincing before 1986; it was, in any case, laughed at in 1987 and not even commented upon in 1989. The political élite is a ruling class that represents no one but itself.

The Congo can be seen as composed of two more or less separated spheres, *the state*, dominated by a ruling class controlling all the resources of the country and *the popular sector* where people are left to survive on their own. The ruling group has disengaged itself from the people, in spite of its rhetorical assurances of the opposite, and it forms an enclave in the country with its own economy, political party and military (Ekholm Friedman 1990a, 1990b). The inflow of money emanates from three main sources; export revenues (mainly oil), aid and foreign loans, all controlled by the state. It is not dependent upon ordinary people in any significant way, and it can therefore turn its back to them. The Marxist model of the relationship between classes, in which they mutually condition each other's existence, was based on the realities of nineteenth-century Western Europe. Here the relationship is quite different. The upper class is not super-rich because it exploits the working class but because it controls all the valuable resources of the country and all the money that is channelled through the state from the outside world. Hydén's (1983) view is that the African state is weak because the people, protected by its 'economy of affection', is strong and self-sufficient. My view is rather the opposite. The Congolese state is strong, much too strong and self sufficient, and that forces people to survive on their own, in other words to develop and maintain an economy of affection.

The Congolese state is based on two main pillars, the military and the alliance with foreign interests. The military *coup d'état* in 1968 brought the military in close contact with the political realm. Both Yombí (1977–9) and Sassou (1979–) are from the ranks of the military. Today it is often underlined in Brazzaville that Sassou started as a schoolteacher and was enrolled in the reserve during a period when there was a high demand for military personnel. He has, in other words, no military merits. The unofficial figure for the number of soldiers is 20,000–25,000. Most of them are stationed in Brazzaville and Pointe Noire, an indication of their principal purpose. The Congo has also a feared secret police, the agents of which have been trained by Securitate, Stasi, the Libyans, the Abu Nidal group, and so on. The ruling class is intimately connected to various metropoles of the world system and a great deal of the money that is generated in the Congo, or obtained from the outside, is exported to these areas, in the form of consumption and above all in investments, the purchase of real estate and savings in foreign banks.

The popular sector is more or less cut off from the self-sufficient state. There is, of course, a certain amount of salaried jobs and some money trickles down from the ruling group. But most people do not have a cash income. The fact that there is still no widespread starvation is an effect of the clan system and of bread (made of imported wheat) being subsidized. Every income creates a group of dependents tied to its holder. The actual devolution of the Congolese countryside is an illustrative example of how impossible development is in a situation of isolation.

Money is concentrated in very few hands. It enters the central sector of the country, and it stays there. The political élite has all the money and one person can only eat so much. Besides, the Congolese upper class is not satisfied with Congolese food but prefer to buy canned peas from France and apples from Spain in air-conditioned supermarkets where they can also find a variety of French cheese, different kinds of ham and paté, red wines of good years and champagne. Food is not imported because of agricultural problems but rather because imported food is what people with money want. Thus the buying power of the country is only to a limited extent directed towards its own producers.

The domestic market, in its turn, is too limited due to the fact that ordinary people have very little money. The buying power in the popular sector is not enough to enable the peasants to sell their agricultural products. The Congo's decreasing production of food is not primarily a consequence of lacking capacity to produce but rather of problems with the market. At the same time as people are undernourished, search for food in garbage heaps, steal from manioc fields and steal their neighbours' hens, there is an overproduction of food. Much food rots because there is nobody there to buy. Furthermore, Congolese products are in competition with cheaper food being smuggled from Zaïre (in Brazzaville) and Cabinda (in Pointe Noire), due to cheaper currencies.

Traditional African kingdom under Marxist-Leninist flag

Why did African states declare themselves Marxist-Leninist around 1970? Why this interest in Marxism-Leninism? One way of answering this question is that it fitted the state class perfectly, as it did in Eastern Europe. It legitimatizes state control. The state shall control the whole economy, there must not exist more than one party, no competitors are allowed, all attempts at organizing from the bottom are illegal and contrarevolutionary. The Marxist ideology fitted the political élite very well when it came to the identification of the main enemy of the people and the revolution. It has been used against entrepreneurs of various types, what Amin (in Amin and Coquery-Vidrovitch 1969:147) called 'the embryonic local bourgeoisie'. This early class of 'capitalists' has been jealously combatted in the name of Marxism-Leninism and minimized to petty dealers.

But Marxism-Leninism also fitted the Congo at a deeper level. It has masked the fact that the Congo still, to a large extent, is constructed as a traditional Central African kingdom. The ancient kingdoms were composed of a number of structurally isomorphic local units, hierarchically related to each other through exchange. 'Tribute' was transferred from lower-ranked group to higher, and in the other direction a distribution of foreign goods, which were obtained through external trade, took place. All the different

units were more or less complete societies, so to speak, with their proper economies and politics. The central, or highest-ranked, unit was larger than the others, it had more people, more slaves, more of everything, but it was not structurally different. Its position was based upon the monopoly over external trade, that is, over the inflow of resources from the outside. Under traditional conditions it still depended upon the other groups for its social reproduction; it needed their resources and production for its participation in the international system. Those kingdoms were composed of long chains of such hierarchically-related groups. The principal strategy of a Central African king was to use his resources in expanding the size of his own group and in establishing and maintaining alliances with other groups.

President Sassou's ruling group resembles the central unit of the kingdom in various aspects. It still constitutes a world of its own, with no national consciousness or concern for the country as a whole. The president has a monopoly over external exchange. There is no separation between the private and public economy. The ancient kings controlled domestic resources and external trade in a way that we would find clearly private. European trade goods went first to the king who then distributed them among his vassals. This is how the Congo's resources are handled today. Part of the oil revenues is first transferred to President Sassou and from him further to his vassals. There are still hierarchies where wealth is distributed from higher to lower in exchange for loyalty. Another characteristic trait of a traditional African kingdom is that political power ideally should be conquered by *the king-and-his-men.* In myths about the origin of the Kongo kingdom, the founder was first made king by his men and together they crossed the river to conquer new land. The political system was, ideally, established with military means and the king was, above all, a conqueror. The Congo's military regime is, in other words, rooted in the traditional system. Kings were always, per definition, rich and militarily powerful. This pattern can even be found after the colonization when the 'king' was, in reality, deprived of political power but battles for the throne and the king's exceptional power were expressed in ritualized form.

The main difference between the ancient kingdom and today's Congo is the self-sufficiency of the central group. The ruler now controls directly the principal resources of the country, in the name of Marxism-Leninism, and he does not need the rest of the country for tribute or alliances.

Marxism-Leninism thus suited the African structure very well. It fitted into traditional Congolese thinking and practice. This is especially obvious when we look at the notion of 'collective ownership'. In both cases it means that the ruling group or the management of a state enterprise controls and absorbs all the wealth that is generated. This constitutes today a problem, as we will see below, not only at the level of the state and state enterprises but also in peasant co-operatives.

The hierarchical clan structure of the Congolese state/society

The Congo's political system is, in spite of the segregation between the state and popular sectors, a pyramidical structure. The country is, according to its constitution, a Marxist-Leninist one-party system. The political organization and the party are two parallel structures that go from top to bottom, embracing the country as a whole. Before the

summer of 1990 when the union (the only trade union in the country) suddenly offered the regime resistance and finally declared itself independent of the party, the political structure revealed no conflicting interests but was hierarchically-encompassing, with the party (with its *Bureau Politique* and *Comité Central)* and government at the top and all the various 'mass organizations' and the army under their dominance.

The union and the youth organization had more autonomy during the 1960s but were brought under the hegemony of the party at the beginning of the 1970s and were controlled by the ruling group through loyal clan brothers in leading positions. The popular sector is controlled through the various mass organizations. All women, for example, are included in the Union Révolutionnaire des Femmes du Congo (URFC) (the Women Organization). There are four different categories, workers, peasants, tradeswomen and housewives/members of associations. The party, or rather, male members of the ruling group, appoint female leaders of the URFC and its four sections. Ordinary women are ordered to meetings, receptions for visitors and political spectacles under the threat of punishment. The URFC is thus part of the power structure and not a 'social movement' in the western sense where people get organized around certain common goals.

Ordinary people look upon the state, or at least they did, as another world. There is no idea of the state being theirs, that politicians would be their own representatives. The call for *multipartisme* (a multiparty system) and democracy in today's Congo does not come from the people. When the hierarchy finally breaks down, if it really does, the break appears very high up in the pyramid, within the ruling organizations themselves; the party, the *Bureau Politique*, the *Comité Central*, the army, the *Union* and the youth organization.

In all the ruling organizations there were members of the Sassou clan in top positions, but there were also others, from other ethnic groups, in what seemed to be a fairly stable alliance structure. But suddenly the others revolted. In some cases it is evident that the Sassou clan abused its dominant position, for example, in the army where high military officers climbed the career ladder without having any real military merits, just by being clan brothers or conspicuously loyal. That was also the case at the university where some of the 'researchers' and 'teachers' had no formal merits.

The breach in the pyramid between the state and the popular sector is clearly experienced (and clearly observed by the anthropologist) in the agricultural domain. The 'co-operative movement' is officially presented as a hierarchical organization, starting at the top with the *Ministère du Developpement Rural* and then following the political-administrative structure, the *Direction Régionale du Developpement Rural* at the regional level and the *Secteur Agricole* at the district level. Co-operatives are to be found at the bottom of the hierarchy. Correspondingly there is a *Union des Paysans* (UNPC) represented at the different territorial levels. In reality the hierarchy is cut into two, an upper part composed of wealthy politicians and civil servants without any experience of peasant life, living in Brazzaville or Pointe Noire, and a lower part composed of the poor peasants. The top is very far away from the life of an ordinary peasant. In the middle there is a level of low-paid agricultural advisers in charge of the immediate contact with the co-operatives. The breach in the hierarchy is heavily experienced by these men and women as they are supposed to help the co-operatives by identifying problems and

seeking to implement solutions. When car and gas can be obtained they may visit the co-operatives; they write a report where the situation of the area is described and analysed and they send it up the hierarchy. And after that nothing happens because nobody is interested. When the peasants get angry because they are sitting there with their bags of paddy waiting for the agents of the marketing board, they have nobody else to attack but the agricultural adviser. When a representative of this category arrived in a village in the Kindamba district, she thought for a while that she would be beaten up by angry peasants. 'You come here to talk to us; you better talk first to the rice that has been standing here since last year'. They forced her to enter the hut where the unsold rice was kept.

She understood their anger, and also the insuperable difficulties of her own work:

> The peasant usually does what you tell him to do, but afterwards, when his products are not bought, he gets angry and when he gets angry, it is not the president who is present but I. I am the one who has asked him to work. The president, he just gives his 'mots d'ordre'. We carry them out. But then, the producer will ask us why their products are not bought.

The peasant union reveals the same pattern of hierarchy, with high-ranked party members at the top with no experience of rural life whatsoever and a lower level of true representatives of the peasants, frustrated in the same way as the agricultural advisers because their work seems quite meaningless. Cars belonging to projects, donated by international organizations, are often used privately by the 'chefs'. In Kinkala, l'*Union Régional des Paysans* had, on paper, three cars at its disposal, two Mercedes Benz lorries and one Toyota pickup, all of them donated by the United Nations Development Programme (UNDP) (*Rapport Annuel*, Kinkala, April 1987:10). None of these cars were, however, available at my visit in 1988. The president of the union, a man in his late fifties, was expected to visit co-operatives within a large area but no car was made available. So how could he do it? He thought he was too old to walk and he later left his position in anger.

THE EFFECTS OF THE POLITICAL SYSTEM ON ECONOMIC PERFORMANCE

I will here take up the effects of the political system on state enterprises, entrepreneurial activities and foreign companies. State enterprises have been established, modern equipment has been bought, but very little production has taken place. 'While our ancient kings built palaces and pyramids, our modern presidents erect steel mills and hydroelectric dams', says Mazrui in an article about Africa in general and Uganda in particular (1988:339). He calls the new structures 'temples'; 'because like temples they are built in faith rather than through rational calculation'. In the Congo's case it is clear, however, that these 'temples' are not only for the gods; they are first and foremost a constant source of private wealth for the political élite. And why should they bother to produce when they can receive what they want in an easier way. All state enterprises are failures. Private farms, owned by whites, were nationalized at the end of the 1960s and

deteriorated gradually. A number of state farms and ranches have also been established in the later period, with the same negative results. Modern agricultural equipment, imported from various countries, both in the west and in the east, can be observed abandoned all over the country. Some of them have never been in use. Instead of generating incomes for the state, these enterprises have constantly needed funding from the state (see Atipo 1985). The very high wages and other exorbitant payments to the management would be enough to explain the failure. But to make it worse, the directors of these state enterprises have constantly been embezzling funds. Private capital left the Congo and has not come back, except in the oil sector. It is unclear what the deal is between the oil companies and President Sassou. There is today very little private foreign investment in other sectors of the economy.

The entrepreneurial class that emerged in the 1960s, has been outcompeted by the political élite. Today the free 'capitalists' are few and usually involved in a number of different activities simultaneously, usually as an attempt to escape the long arm of the cleptocratic state. At the same time the members of the state class enter all kinds of entrepreneurial activities. Everything that generates money is absorbed; gas stations, bakeries, pharmacies, transports, import business, hotels and restaurants. It is important to notice, however, that the political class does not become entrepreneurs just by conquering entrepreneurial activities. Its members are incompetent in these activities in the same way as they are incompetent at running state enterprises. They identify sources of wealth, catch them, exploit them, but when problems arise they look elsewhere.

One of the few mixed enterprises that has been recently established and not yet gone bankrupt is the cement factory in Loutete, SOCICO. It is owned by Scancem, a Norwegian-Swedish company in joint venture with the Congolese state. I will take this factory as an example of how difficult it is for companies to operate in the Congo. There is no legal system to protect their interests. The management does not know from one day to the other which rules are operative. New laws and taxes are introduced and they may have to pay fines for 'crimes' the meaning of which they do not understand. All this makes the situation uncomfortably insecure. Besides, the political élite is continuously attempting to plunder them of their profits.

Scandcem entered the Congo at the beginning of 1988 after the old factory in Loutete had been rebuilt (after a fire). At that time cement was imported from Spain by SIACIC, a company of uncertain composition. According to the management the company would probably not have gone in at all if initial information about the market had been correct. The Congolese state provided an unrealistically optimistic view of how much cement the factory would be able to sell. This created serious problems from the very beginning. It also turned out that SIACIC was maintained in spite of the fact that cement was now produced in the country. There even existed an agreement which entitled SIACIC to buy cement from SOCICO below the cost of production. In 1988 the factory could not sell its cement. SIACIC 'bought' (on credit) about 30 per cent of the cement at the same time as it continued to import cement from Spain. The Loutete factory found itself in the position as supplier to SIACIC. This company even had a monopoly of the Brazzaville and Pointe Noire markets. SOCICO was only allowed to sell cement freely in the rest of the country, which was quite meaningless since there was no one there to sell to. Collapse was near at hand. An ultimatum was put forward by Scancem and it was decided that all imports of

cement should stop and that SIACIC should pay for the cement that was bought from SOCICO. In 1990 the problems still prevailed, however. Several boats arrived in Pointe Noire with cement and the Loutete factory still had to sell 20–30 per cent of its output to SIACIC.

SOCICO is, of course, an important production unit in the Congo that ought to be supported and encouraged. Of its 5–6 billion CFAFr. in turnover, 3 billion go back into the economic system. In addition to the jobs that are created in Loutete it is the country's biggest consumer of fuel oil, electricity and transport. All the three are remarkably expensive in the Congo, which makes it impossible for SOCICO to sell its product to neighbouring countries. Instead of being supported it is constantly balancing at the edge of a catastrophe. And why does it still exist? Why has it not been forced to close down yet? The management's guess was that it would look bad for the International Monetary Fund (IMF) and the World Bank, and that the Congolese state today is in a situation where it has to take their opinions into account.

In a capitalist country the state has no economy of its own, no resources of its own (or little) but is, instead, based on the taxation of capital and labour. Politics and economy are two separate spheres, even if the state may play an active role in supporting and regulating both production and market. In countries such as the Congo there is no economic bourgeoisie separated from the political élite. Instead the political rulers control the resources and use them for their own purposes as if they were part of their private economy. A person who obtains control over a state enterprise by political means, through kinship or friendship, has a very different interest in the enterprise than a private entrepreneur. The latter has no other security but his enterprise and he must therefore ensure its survival. His own position is intimately linked to the well-being of his company. The Congolese executive in charge of a state enterprise is not dependent in this way. He acts from a predatory position and for him the enterprise is only a means of personal enrichment. He does not have to care about its well-being. When he has emptied it of its capital, it has served its function. He is ready for his next prey. To him it is only a question of using the opportunity while in power to despoil, in his own name or in the name of cousins and other decoys. His life at the top may be uncertain. He does not know how long he will remain in power and therefore it is wise of him to take all the opportunities to plunder the state while there is time. In the present situation, however, the political élite seems to be fairly stable and those in power revealing themselves as embezzlers are only moved from one position to another, sometimes after a short period of quarantine. There is even a Congolese expression for this phenomenon; to be 'in the garage for repair'.

THE RURAL PROBLEM

Traditionally agriculture was mainly a female task; men only participated in the initial phase of the cycle, cutting down trees and burning. Nowadays men do more. But while they may work in the fields, they still do not take part in the time-consuming preparation of the manioc, still the basic food in the Congo even if it has been replaced by subsidized bread to some extent. Men also concentrate their work on produce that is more directly

aimed at the market, such as vegetables, fruit, fish (aquaculture) and live stock. Manioc is produced for the household's own consumption as well as for the domestic market. Women must have their own economy in the southern part of the Congo. In a matrilineal society, wife and children do not inherit from the husband. Instead his inheritance goes to 'his own family', that is his matrilineal relatives, his brothers and sisters and his sisters' children. The man has certain duties towards his wife and children, but the rest of his money is for himself and 'his family'. It is important for a woman to feed herself and her children while he is alive and it is as important for her to have her own parcel and house. After his death, 'his family' will probably come to 'chase her away' from 'his' house which now belongs to them. It does not help that she contributed economically to both construction and maintenance of the house. His relatives are usually of the opinion that they have the right, according to customary law, to take it.

Today peasant agriculture includes both the production of export crops, such as coffee and cacao, and the production of crops for the domestic market. It is carried out either individually or in co-operatives. Peasant agriculture is generally extremely backward. The peasants still use the same kind of tools as they did in the nineteenth century, hoe, machete, axe and spade, and they practice slash-and-burn, resulting in erosion and exhaustion of the soil in the more densely-populated areas. There is no regular use of fertilizers or pesticides and productivity is consequently very low. The roads, where they exist, are in poor condition. The practical problems of the peasants are enormous. And worst of all, in spite of all their efforts they are unable to sell their products. People have consequently left the countryside, in an accelerating scale during the last decades. The villages are depopulated, people are poor, depressed and apathetic. Life is here reduced to mere survival. The seriousness of the rural problem is perhaps most clearly expressed in the dramatic depopulation of the countryside. Recent works on the rural problem underline how critical the situation has become. Desjeux (1987:112) declares that there will soon be no 'peasant dynamics' to study because there will be no peasants left. And Guichaoua writes in his work of 1989, with the subtitle: 'liquidation of the "peasant world"', that the Congo's agricultural policy has led to a depopulation of the countryside that is unrivalled in Africa (ibid.:97).

The rural problem is often presented as a problem of mentality by the authorities. 'Our young have a negative attitude to practical work. They all want to go to school and to the University. This mentality must be changed if we intend to reach our goal, self-sufficiency by the year 2000'. But the young generation's unwillingness to stay in the countryside, or go back there, rather, is a quite rational choice. It is not a mental problem. Sassou presented, in 1987, a slogan called 'the return to the land' ('*le retour à la terre*'). The young and unemployed must not stay in Brazzaville and Pointe Noire and, at the best, do nothing, but should go back to the countryside and start cultivating the land, was his message. Sassou, himself, gives the impression that it is quite simple. People just have to go home. There is no need for expensive state projects. This is a completely unrealistic view of the urban/rural problem. To reintegrate people from the cities into the rural milieu is a much more complicated matter than it may seem.

There is no shortage of land in the Congo. Even if land always belongs to somebody and the 'owners of the land' ('*propriétaires fonciers*') constitute a certain problem for the cultivators, especially in town and other densely-populated areas where land is scarce, it

is always possible for peasants to obtain the right to use land. In cases where the co-operative, as well as the individual peasant, has no land of its own, it must 'rent' from such an 'owner of the land'. The rent is low. In the Kinkala district peasants pay 15,000 CFAFr. (300 French francs) for *nsitu* (forest) and 5,000 CFAFr. (100 French francs) for *nseke* (savanna) in Kinkala centre; in more peripheral areas the payment is a little lower. The payment is usually for a three-year period. Traditionally all land was 'owned' by lineages and every woman obtained fields through her own lineage chief and her husbands'. Today land can be sold. There is, however, a great deal of ambiguity about this activity. There is a law from 1972 that says that all land belongs to the people and that the traditional land ownership from then on is abolished. But since the state has not shown any interest in the matter customary law prevails. In any case, the difficulties with reintegrating people has nothing to do with the land. In a situation where rural production is a dynamic activity it would be even less of a problem because the peasants would then be strong enough to claim their rights in relationship to the traditional 'owners'.

Still it is a very complicated task to move out unemployed urban dwellers to the depopulated countryside. It will certainly need financing and organization. A young unmarried and unemployed woman in Brazzaville, with a couple of children, cannot just go to a village and ask for a hut and a field to cultivate. The first problem, which she can overcome with motivation and strong will, is that she has no experience of agriculture. A growing portion of the Congo's young women is in such a situation. The second problem is more difficult to solve. If she is not a relative, she will not be accepted in the village. Villages are not open to anybody. Many young in Brazzaville are alone in the world. They have lost both the ties to their natal villages and to their clans, and they have nothing to 'go back' to.

The Congo's rural policy

As long as we only judge from what is said, the Congo's agricultural policy looks remarkably competent. Agriculture was declared 'the priority of priorities' in the Three-Year Plan 1975–7 and it has played a prominent role in political rhetoric and propaganda ever since. A strategy for a 'self-centred and auto-dynamic development' was adopted at the end of the 1970s and was later underlined at both the Third Extraordinary Party Congress in 1979 and the Third Ordinary Party Congress in 1984.

All the plans look good on paper; the problems are identified and solutions suggested. Sassou often talks about the need for 'concrete actions'. But no plan has ever been realized. The Agricultural Conference in 1987 resulted in a programme for action which is right to the point, besides 'auto-suffisance d'ici à l'an 2000' the communiqué of 16 November mentions the development of agrarian research, reactivation of the co-operative movement and of 'Operation Village-Centre', the mobilization of funds for more efficient commercialization, the establishment of a financial institution for the agricultural sector, a social welfare system for the peasants, maintenance of roads, lowering customs taxes and other fees for agricultural equipment, encouraging unemployed people to take up agriculture, adapting consumption pattern to national production, integrating agricultural knowledge into education, and so on. This programme was referred to in 1989 when politicians were asked what the government

was going to do to solve the rural problem. But nothing has been done and the agricultural crisis is instead accelerating.

The problems are identified and discussed but the measures adopted are the creation of more bureaucrats and more committees; the concern leads to conferences, debates, speeches and reports, but not to any concrete actions in the rural sector. Bertrand (1975) compared registered peasant incomes with the costs for officials and civil servants in charge of 'encadrement' and the management of state farms and found that the costs for 'encadrement' were increasing while agricultural production was stagnating. There was a dramatic increase of the former between 1970 and 1971; after 1971, the costs for 1,700 civil servants were higher than the income for 600,000 peasants. Donor agencies have been either extremely naïve, or cynical, in their support of the African states. It should be obvious to anybody that the state class in countries such as the Congo does not have any development policy for the country. It has learnt to master the ideology and rhetoric of development, to make it look good on paper, but their efforts stop at the boundaries of their own group. How can donor agencies believe for decades that the African state is a plausible agent of economic development (when the only interest of its representatives seems to be the development of their private bank accounts).

The 'co-operative movement' and its failure

The state has, since the 1970s, provided a half-hearted support to the establishment of co-operatives, mainly by handing out credits. A rural development project was established in the Pool province already in 1970, financed by UNDP and administered by the International Labour Organization (ILO). The appreciation of co-operatives can be found in both the West and the East, and it has also been delineated in positive terms in the Congo. The explicit purpose of the 'co-operative movement' has been to 'organize the peasants according to their own interests and to integrate them in political life as well as in the process of economic and socio-cultural development' (*Direction de l'Action Co-operative*, December 1986:1). It is underlined that it is not at all a foreign idea in the Congo. There exist traditional forms of co-operation, such as *dibundu, kintuari, ekelimba, kitemo, nsalasani*, and so on, very similar to co-operatives. Co-operation is, in this sense, traditional at the same time as it is a step on the way to socialism. This form of production occupies, it says, the position between the state farm and the small household production (ibid.:2f). Co-operation may be traditional, but it was not an appreciated form of work in pre-colonial society, and it is certainly not more popular today. Instead it constitutes a major problem for the peasants. If they can exercise free choice they are in favour of private ownership.

Today co-operatives are found all over the country, in all the nine provinces. They are mostly production co-operatives (94 per cent). There are a few specialized in trade (between villages and the big cities) and handicraft. The boundary between individual peasant and co-operative enterprise is vague. Peasants often do both, working 1–2 days for the co-operative and the rest for themselves, plus maybe one day for the church or the party. A co-operative has usually not more than fifteen to twenty-five members; it must not have less than seven. It has a name and a management, composed of a president, a vice-president, a secretary and a treasurer. The relationship between its members shall be

egalitarian and not based upon kinship. Even if statistical figures indicate an unbroken increase in the number of co-operatives and members, the so-called 'co-operative movement' is an unambiguous failure. The reason why this is not easily discerned in the statistical material is that new co-operatives are constantly added while those which cease to exist are not removed. Co-operatives can easily be dissolved for one reason or another, as a negative reaction to marketing problems or to embezzlement by the leadership, and they can, as well, be easily reactivated. If this is not taken into account it leads to a very distorted picture of reality.

The whole idea that co-operatives could solve the problems of the Congolese countryside is absurd. The rural sector is in profound crisis, the symptoms of which are the accelerating depopulation of the countryside and the constantly decreasing production. The rural exodus is not just peasants abandoning their villages. The countryside has also been abandoned by all other social categories. Large areas are today socially dead. There is no social or cultural life, nothing to do, no amusements, nothing interesting and engaging that makes rural life worth living, and no future for their children. The atmosphere in the half-emptied villages is permeated by boredom. No wonder that people prefer the struggle for survival in socially fervent Brazzaville and Pointe Noire instead of remaining in a social vacuum where the only activity left is the procuring of food. The 'co-operative movement' cannot change this situation. Instead the co-operatives are struck by the same problems and become part of the same process of decay. The co-operatives have not been 'integrated in the political life and the process of economic and socio-cultural development' simply because the peasants cannot sell their products. The state's disengagement from the people means, in this context, that the peasants are left to operate in a vacuum.

Peasants prefer working individually in their own fields. They do not like collective work, in the sense that fields and products are collectively owned. They suspect, and on good grounds, that 'collectively owned' means that the leadership will draw the exclusive benefit of their work. Members of co-operatives frequently withdraw from work in the collective field. They would rather pay the fine of 200 CFAFr., and individual fields are usually larger than collective fields. They suspect that somebody has 'eaten' the money ('*bouffé l'argent*'), or they complain that the president and the secretary do not arrange for meetings or that the president's wife does not go to the fields, and so on. The peasants constantly suspect the leadership of the co-operative of embezzlement, which creates an atmosphere of reluctance to perform collective work. There are also frequent cases of embezzlement leading to the dissolution of co-operatives, and their suspicions are thus often quite accurate.

'Collectively owned' is nothing new in the Congo and it has always meant exploitation. Both the so-called 'co-operative movement' and the Marxist-Leninist state are based on a traditional Congolese model for power and exploitation where the ideology of 'collectively owned' hides the real conditions. At the state level it allows the political élite to suck out the wealth of the country and at the local level we find leaderships of co-operatives occupied in the same type of project for personal gain. There is, however, a type of co-operation that is both traditional and commonly appreciated which entails exchange of work between equals. A woman may be a member of a *dibundu*, and when she needs help in her fields she asks the other members to come and

work for her. After the work is done she gives her friends food and sometimes some money. She co-operates with others to their mutual benefit, but she has her own fields and she owns her own products. Any rural development project must, in order to be successful, take these conditions into account.

But if it is true that peasants do not like co-operatives, why have they willingly participated? The explanation is that co-operatives have been established in response to credit opportunities and unrealistic expectations. They often dissolve rapidly when the peasants face the bitter reality. In the beginning I was astonished by the constant complaints about the interruption of PAM (*Programme Alimentaire Mondial*), a UN gift of sardines, flour, milk, cheese, egg powder, and so on). When I asked peasants which was their major problem, they often responded that it was the loss of PAM. I thought I had misunderstood. How could the loss of a couple of cans of sardines and a bag of egg powder be the most important problem.

The PAM products were distributed to members of co-operatives as an encouragement. According to my informants among the agricultural advisers, many co-operatives were established in order to receive PAM. ‘Every day, new groups appeared like mushrooms in the savanna. When I visited them, I understood that their motives were not serious. The peasants thought that following the PAM products the Congolese state would integrate them into the state economy’.

The peasants ‘misunderstood’ the message of the state. When they were offered credits and PAM they thought the state would integrate them into the economic and political hierarchy of the country. They imagined for the future a constant inflow of money and sardines from above, in exchange for their rural products. The symbolic meaning of PAM was the expectations of being economically integrated into the People’s Republic of Congo. The co-operatives expected a position like the lower-ranked groups in a traditional Central African kingdom. But when the state was talking about ‘organizing the peasants according to their own interests’ it rather meant the opposite of integration. It saw perhaps a possibility of exploiting the peasants through the system of credits but the co-operatives in both Pool and Kouilou have not paid back more than about 40 per cent of the credits (which is, in any case, better than the 10–20 per cent by state enterprises). The peasants are, intuitively, aware of the segregation of the state sector from the popular sector and they seek a solution to their own problems in the re-linking of the two sectors. Credits make no sense to them, and they do not envisage their existence and future as ‘free’, capitalist farmers, ‘organized according to their own interests’, but as clients in a hierarchical society.

Problems with the market and technological backwardness

For both co-operatives and individual peasants the market is the decisive problem. There are also critical problems of technological and infrastructural backwardness. The poor condition of existing roads makes transportation difficult. In some parts of the area there are practically no roads at all. For those who live along the railway between Brazzaville and Pointe Noire, it is, of course, possible to transport products by train, if the train stops there. But timetables are extremely unreliable. Some peasants believe that the primary obstacle is transportation and, consequently, that a car would solve their problems. This is

especially true for those who are stuck with their products in the villages and have had no experience of the problems of the market. Better roads and access to means of transportation would certainly facilitate the transfer of the products from fields to market-place, but it would not, by itself, solve the problem. If the peasant cannot sell his products in Brazzaville or Pointe Noire he has not got very far just by taking them there. Higher productivity is certainly a decisive factor where export crops, such as coffee and cacao, are concerned, but it would not guarantee his products being sold in the domestic market.

The lack of electricity and running water is a serious predicament, especially in situations where the peasants make efforts to increase their production. Peasants growing vegetables during the dry season have to carry water from the nearest river for their plants. Chicken and pig houses are usually placed in the outskirts of the village, and in the dark, tropical evening, it is difficult for the peasant to care for his animals by the light of a petroleum lamp. When a chicken-house has been flooded by heavy rains, the peasant has to take out the sawdust by hand in order to dry it outside in the sun. And when it is dry, he has to put it back again, by hand. Chickens cannot be hatched on a large scale in the country but are imported from France. Even in modern buildings with electricity the current is too irregular for eggs to be hatched under secure conditions. This makes domestic chickens expensive and difficult to sell. Besides, there are constant practical problems connected with the importation of chickens. A freight of chickens arrived at Maya-Maya and died there because the co-operative was not informed of their arrival.

In some cases I found that material conditions had deteriorated considerably since the 1960s. In Pointe Noire there are two co-operatives producing vegetables along the River Songolo, on land that earlier, between 1965 and 1971, was occupied by a French company with about the same production profile. In 1989 the river was filling up with mud leading to a loss of arable land and to the creation of an unhealthy environment in which mosquitoes thrive and reproduce. The co-operatives worried about the situation but saw no possibilities to counteract the process. They knew that the French company regularly used a machine to clean the river but declared that they could not maintain this activity due to their financial situation. The lack of processing industries leads to unnecessary waste. Fruit and vegetables do not last very long after collection if not processed or kept in refrigerators, and consequently they have to be thrown away in large quantities. Tomatoes cultivated in Kindamba and taken to the market in Kinkala, are often in poor condition already at the arrival at the market. There are usually no freezers to keep the meat fresh, which means that the farmer has to sell it right after slaughter. It can take up to two weeks to sell a pig of about 100 kilo, which is much too long in the heat of the rainy season. For vegetables such as cabbage, there is also a need for storage to protect them from being destroyed by flooding, which will happen if they are kept on the floor.

There are three different situations where peasants sell, or try to sell, their products. They sell (1) food at the domestic market, or market-place, (2) industrial crops such as corn, beans and rice (paddy), and sometimes also manioc, to OCV (*Office des Cultures Vivrères*) and (3) coffee and cacao to OCC (*Office du Café et du Cacao*). The marketing board of the 1960s, Office National de Commercialisation des Produits Agricoles (ONCPA), was replaced by three new organizations in 1979, OCV, OCC and OCT (*Office de la Commercialization du Tabac*). In all these three situations there are three

main components involved: peasants, middlemen and market. Both OCV and OCC have the function of middlemen. The market is, in the case of OCV, state enterprises such as Usine d'Aliment-Bétail (UAB), using corn for the production of animal fodder, and in the case of OCC, external markets (see table below):

PEASANTS	MIDDLEMEN	MARKET
food production	merchants	domestic market
corn, rice	OCV	state enterprises
coffee, cacao	OCC	external markets

The domestic market for food

Peasants, or co-operatives, either take their products themselves to the market-place or they use a middleman/woman for it. In both those situations the peasants are facing serious problems. At the market they often find that they cannot sell their products because people lack money to buy. The whites and the Congolese upper class, where money is concentrated, both tend to buy imported food in western-type supermarkets instead of buying at the local market-place. The peasants often have high transportation costs, the productivity is low, a great deal of food is destroyed, and so on. In combination with the general poverty of the potential customers and the intrusion of cheaper goods from Zaïre and Cabinda, it leaves the peasant with no, or almost no, income. Peasant production of chicken in Pointe Noire was also outcompeted by the state enterprise SOCAVILOU while it was still operating.

The co-operatives have been encouraged to cultivate commercial crops, such as vegetables, and to raise chicken and pigs for the domestic market. Chicken is consumed by both whites and Congolese, while vegetables and pork find most of their customers among the whites. In 1989 the two co-operatives specializing in vegetables in Pointe Noire tried to deliver directly to customers such as the different hotels and Score, the supermarket. As they did not own a car they had to carry their products, or take a taxi, which would considerably reduce their income. In spite of their efforts to please the customer they often had large quantities of unsold vegetables left in the afternoons.

The problem with chicken is the relatively high costs of production. In the Kinkala district, domestic chicken was sold for 1,350 CFAFr. in 1987 while it was possible to buy chicken for 800–1,000 CFAFr. in Brazzaville, imported from Zaïre or, rather, smuggled. The Congo's agricultural production is today competed with by the neighbouring countries' production because of the overvalued CFA franc. The poor Congolese consumer must, of course, buy the cheapest product and today it comes from Zaïre and Cabinda (Angola). The productivity is not higher in these countries but the difference in value between the different currencies makes it possible for the Zaïrian and Cabindan peasants to sell their products at a considerably lower price. Brazzaville and Pointe Noire are also overrun by artisans (for instance tailors) and prostitutes from Zaïre, competing with their Congolese colleagues.

The state has, in the case of both chicken and pork, encouraged production of a type that does not work, and which cannot work under the present circumstances. Congolese chicken is too expensive and pork is, in general, a difficult product in the Congo. It has a

bad reputation and for several groups it is even taboo to eat it. Some people explain their antipathy by claiming that it is hard to distinguish from human meat. Besides, the lack of refrigerators and freezers makes the meat not very appetizing for the white customers who basically appreciate pork. The state has not taken responsibility for the negative results of livestock production but tries to pressure the peasants to pay back on credits. There are many absurd cases. A farmer gets a credit in order to build a *porcherie* (house for pigs). When this is done, he waits for the pigs to arrive. But no animals arrive. Or, he gets his pigs, he feeds them, but when it comes to the selling, he cannot find customers. In spite of the fact that he has not sold any pigs and, consequently, has no money, he is still supposed to start paying back the credit.

The co-operatives in the Pool province have, in response to the market problems, gone over to the production of manioc. Manioc is a relatively 'safe' product as most Congolese eat it regularly. But even the production of *manioc* and *foufou* (dried and grinded manioc) is shattered. *Manioc* is left to rot and *foufou* is competed with by bread, which is made of imported wheat and subsidized by the state. The peasants earn today too little even on their manioc production.

The middlemen constitute another problem for the peasant. When he, or she, cannot take his products to the market-place, he is compelled to leave them to somebody acting as a middleman. This person can also be a woman. A common story, in both Pool and Kouilou, is about a merchant, often a 'Malien' or 'Senegalais', who appears one day, offering to take products to the market-place. 'I will come back later with the money', he says. And after that he disappears. But ordinary middlemen/women, Congolese and basically honest, also take products on credit because they cannot pay cash and they also turn out to act in the same negative way towards the producers because they, in their turn, have to sell further on credit. First they buy manioc and other products on credit in the villages. The peasants have no choice. At the market-place, or in its vicinity, the middleman sells in his/her turn to market-women, also on credit because neither does this category have any money. The middleman has no choice because his/her manioc will rot after a couple of days. In the end, when the products rot at the market-place, there is a whole network of losers who have worked hard and made efforts to earn their living but who are left with nothing.

OCV and OCC

Both OCV and OCC create problems for the peasants by not buying their products, or by not paying for them. Partly, this is a problem of the same type as described above. OCV and OCC have the function of middlemen and the agents are, if possible, worse than individual merchants when it comes to cheating the peasants. There are endless stories about these agents giving the peasants too little money, if any, while putting the rest of it into their own pockets. There are stories about agents giving the producer a receipt to be saved to next year. 'Right now, I have no money, but I will come back next year and then you just show me the receipt and I will give you the money'. And next year he does not come back, or he comes back but cannot accept the receipt, or the receipt has been eaten by cockroaches or termites.

Another problem is that they often do not appear at all to buy the products; their own explanation is the lack of money. This explains why the figures for production of paddy can go down at the same time as the official price to the peasant has doubled. If nobody comes to buy the peasant's paddy, it does not help him that the official price has gone up.

In the case of OCV there is also a disturbance in the 'market', that is, in the state enterprises that are supposed to buy and use the products delivered by OCV. When these enterprises are out of function, as is usually the case, the assignment of OCV is rather meaningless. These conditions explain why OCV sometimes says that it cannot *afford* to buy more than it does from the peasants. The purchase has no purpose.

The decrease in the production of export crops has, in the debate about the African crisis, been blamed on marketing boards such as OCC. This type of organization has been criticized for being a mode of exploiting the peasants. The argument has been that it enables the state to use fixed prices to the peasants and that these withdraw from production when the price is too low. There are many reasons to be critical towards the activities of OCC, as well as of OCV, but not primarily for that reason. The main cause of the decrease in Congolese agricultural export production is, as I understand it, that OCC cannot sell its coffee on the world market because of the low productivity. The peasants are old, their tools are primitive, they lack fertilizers and pesticides, and their knowledge of this type of agriculture is extremely limited. Today even countries such as Cameroon and the Ivory Coast have problems with their coffee (*Jeune Afrique:économie*, September 1989). The cost of production is, in both cases, higher than the price at the world market. OCC's monopoly was abolished in 1988 due to recommendations from IMF. And what happened? Private traders that were expected to step in and take over the purchase of coffee and cacao, simply did not show up. Instead they went to the border of Cameroon to buy. The costs of production are too high (due to low productivity) and the quantity is too low to make the transportation worthwhile.

RESPONSES TO THE CRISIS

In 1991 there is a democratization process going on in the Congo. The immediate reason was an attempt by the ruling élite, in June 1990, to carry through a reduction of public spending by lowering the age of retirement from 55 to 50. The union, which is composed of a number of different branches, reacted with fury and it did not take long for it to declare its determination to establish autonomy from the party.

Retirement often leads to a social catastrophe for the man in question even when it happens at 55. The pension is one-third of the salary. As there are so few jobs available the young and unemployed in Brazzaville tend to flock around the middle-aged men with salaries. Such a man often has to feed his grown-up children, both sons and daughters, his unmarried daughters' children and in addition, his sisters' children in need of material support. The pressure is intense, but he is rewarded in terms of power and authority and by being the very centre of a social group. At 55 his group dissolves. Now when he has no money they all tend to abandon him. No wonder that retirement is feared by this category of men.

Therefore, when the union was informed about the plans for further worsening their

situation, it therefore reacted with fury. It was regarded as a deadly threat. An impressive counter proposal was made where it was demonstrated how much the country would save if the cut was instead made in the various types of benefits to the political élite. Figures were compared and the result was shocking. The union has a long history of political struggle and resistance. It was the driving force in the opposition against Youlou, which culminated in the Three Glorious Days of 13, 14 and 15 in 1963 and the socialist government under Massamba-Débat. It was also active around 1970, much too active for the Marxist-Leninist regime, and at the beginning of the 1970s it was brought under the party's dominance.

After this crucial event, a conflict suddenly appeared in all the ruling organizations. Brazzaville was flooded by pamphlets in the fall of 1990. Sassou's assets abroad were discussed, and compared with Congo's foreign debt, the Sassou clan's ramifications into various sectors of the state, the Boeing accident, the murder of Marien Ngouabi in 1977, and so on. The Sassou clique seemed all of a sudden quite isolated. The one-party system was accused of bringing the country to the edge of complete disaster, and a transition to a multiparty system was demanded.

Change of the political system in the direction of democracy will probably have very positive effects on the economy. Parliamentary democracy, or a multiparty system, would free the economy from the state's paralyzing grip and prevent the rulers from jealously combating all initiatives that have taken place outside the realm of political power. The most important aspect of this process is the transformation of the Central African clan system to a 'modern' society. The clan structure, its hierarchies of rulers and dependents and its ideology of 'collective ownership' prevails, as we have seen, at both the national and the local level. It is found in state enterprises as well as in co-operatives. This clan structure makes possible the appropriation, or embezzlement, of funds by the rulers, because there are no mechanisms to prevent it. This is devastating for the country since it thwarts economic development, creates a class of super-rich politicians whose assets are reallocated to other parts of the world, bringing in its wake a general feeling of apathy among ordinary people. The newly-industrializing (NIC) countries proved to the world that it is possible for Third World countries to experience economic development. This was devastating for the Dependency School's postulate of a structural impediment to development as the nature of the relationship between North and South. Hydén's contribution to the general discussion about the African crisis has been very important since it focuses on internal factors. The main mistake of the social sciences, in the 1960s and 1970s, was the underestimation of cultural factors. The African ruling élites were supposed to act in the same way as capitalist entrepreneurs during the industrialization of the west. In the Congo the group in power has shown no interest in development. The Congo's rulers have only been interested in their own private economy, and if they can obtain money by just grabbing it, so much the better. Enterprises are primarily seen as a source of money, not as a structure that is able to generate wealth and further economic development. This type of behaviour seems, however, quite understandable from their own perspectives and our mistake is perhaps not so much that cultural factors have been neglected but that we have had no clear understanding of the structural position of the African ruling élite within the world system.

NOTE

1 Marxism-Leninism was proclaimed all of a sudden by the military regime at the beginning of 1970 and it was, as suddenly, abolished on 4 July 1990 by the *Comité Central.*

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Part IV
ECONOMIC REFORMS AND SYSTEM REFORMS

13
ANGOLA ON THE VERGE OF ECONOMIC REFORMS

Renato Aguilar and *Mario Zejan**

INTRODUCTION

At the end of 1990 the Angolan economy was in very bad shape. The currency was enormously overvalued, and the price system widely distorted with a strong bias against production and agriculture, and for urban consumption. Public finances were in disarray. They depended on highly-variable oil-related incomes. There was a large deficit. Non-oil production was decreasing sharply and non-oil exports were ruined. Other signs of economic disruption were the economic isolation of rural areas, demonetization of the economy and deterioration of public services and the infrastructure. The future economic viability of the country is in balance.

There are several reasons for this situation. The costs associated with the war of independence and those due to the colonial legacy are to blame for some of the economic problems. The on-going civil war and international intervention have also contributed to the present economic situation. However, the economic policies pursued by the Angolan government have aggravated the effects of war. For example, the overvalued currency and distorted price system have helped buttress the isolation of the rural areas caused by the military conflict.

It was increasingly clear that the Angolan government had to do something drastic in the field of economic policy. But it was also apparent that the government had difficulties in implementing reforms. Since the creation of the SEF (Programa de Saneamento Económico e Financeiro) in 1987, a couple of policy packages had been announced but never implemented. Several policy packages had been discussed with the international financial community, the World Bank and the International Monetary Fund (IMF). Broad agreement had been reached regarding what should be done.

At the end of September 1990 the government announced a strong reform programme which was aimed at stabilizing the economy. The aim of this article is to present Angola’s economic situation as of September 1990, to discuss the economic policy alternatives open to the government at that time, and to asses the possible outcome of the recently-introduced policy package.

In studying the Angolan economy one is faced with two problems. The first is the lack of reliable statistics. Few data are currently collected in the country, and even less published. Moreover, the statistical definitions used are often obscure and do not follow standard procedures. Data are thus inaccurate and provide an inadequate basis for macroeconomic analysis. The second major problem is the high degree of uncertainty

about the political, military and economic outcomes. At present (January 1991) preliminary negotiations to end the war have taken place between the Movimento Popular de Libertaçao de Angola–Partido de Trabalho (MPLA–PT) government and its major rival, União Nacional para a Independência Total de Angola (UNITA). However, there are also signs that an intensification of the military conflict is in the offing. There is considerable uncertainty about how these events will influence the political scene and, more particularly, the willingness of the government to undertake further economic reforms.

The article proceeds as follows: the next section provides an insight into the country's overall and sectoral performance. In the third section we examine the workings of Angola's peculiar price, wage and exchange rate systems. The fourth section analyses the government's fiscal and monetary policies. The economic policies discussed by the government before September 1990 are presented in the following section, where a critical assessment of them is also given, and in the sixth section we present and discuss the policy package of September 1990. The last section summarizes the article.

ECONOMIC PERFORMANCE

Immediately after independence the MPLA government faced huge economic difficulties, worsened by the lack of skilled manpower. Having adopted a Marxist-Leninist orientation, the new government sought to establish a centrally-planned socialist economy. The immediate aim of the economic programme was, however, to regain the levels of economic activity prevailing before independence. Thus initially collectivization and nationalizations only played a secondary role. However, after a few years the government nationalized both the properties abandoned by Portuguese settlers and the banks, and assumed a monopoly on foreign trade. A centralized price control mechanism was also introduced.

The system has proved difficult to manage, the plans have been poorly executed, if at all, and policy decisions are badly co-ordinated. The high degree of centralization and bureaucracy, and the lack of incentives, discipline and flexibility, seem to be the main sources of trouble. The price control resulted in relative prices which favoured consumption and penalized domestic production. A consequence of the economic system implemented in Angola, and aggravated by war, is the disruption of the relationship between urban and rural areas. A proportion as large as two-thirds of the total population could today be under subsistence.

Table 13.1 gives an estimate of the development of gross domestic product (GDP) for the period 1960–87, with real GDP presented as an index with 1974 = 100. The series has been constructed from two statistical sources: the series presented in Summers and Heston (1988), and data from Angola's Ministry of Planning. Due to the highly-distorted price system of Angola, and the extremely overvalued domestic currency, the index and other estimates of GDP should be treated with caution.[1]

of

Table 13.1 Angola: GDP development, 1960–87

Year	*Index GDP*	*Growth (%)*	*Year*	*Index GDP*	*Growth (%)*
1960	81.0	n.a.	1974	100.0	–8.3
1961	84.7	4.5	1975	67.1	–32.9
1962	85.5	1.0	1976	60.1	–10.4
1963	87.0	1.7	1977	60.1	0.0
1964	88.2	1.4	1978	62.8	4.4
1965	92.8	5.2	1979	62.8	0.0
1966	93.5	0.7	1980	63.9	1.8
1967	96.8	3.5	1981	61.9	–3.2
1968	97.3	0.6	1982	57.9	–6.4
1969	103.2	6.1	1983	55.0	–5.1
1970	105.5	2.2	1984	54.8	–0.3
1971	104.8	–0.7	1985	56.1	2.4
1972	102.2	–2.5	1986	51.0	–9.0
1973	109.0	6.7	1987	54.1	6.0

Source: Aguilar and Zejan (1990).

Except for a brief depression at the beginning of the 1970s real GDP grew steadily during the 1960s. Independence, in 1975, was preceded by a short period of rapid growth. The post-independence period has seen a precipitous decline in real GDP. Performance in the late 1970s and 1980s was directly influenced by the evolution of the international oil and financial markets, domestic economic crises, as in 1982, and civil war. According to the Ministry of Planning, GDP per capita increased by 10.4 per cent in 1987. This was due to a parallel 15.7 per cent increase in the oil sector. Per capita non-oil production fell by 5.2 per cent in real terms in 1987. This last figure is also the average rate at which GDP per capita in the non-oil sector has been declining since 1980.

Table 13.2 gives examples of how contradictory estimates of GDP, by sector of origin, from different sources can be. The two first columns present estimates for 1985 from two sources, the two columns in the middle are average estimates for the period 1980–7, while the last two give those for 1987. Obviously, different sources provide disparate pictures of the Angolan economy. Most probably the estimates given by the Economist Intelligence Unit underestimate the share of agriculture, while those of the World Bank overestimate it.

Table 13.2 Angola: GDP by sector of origin

	EIU[a] *1985*	*UNDP*[b] *1985*	*UNDP*[b] *1980–7*	*World Bank*[c] *1980–7*	*World Bank*[c] *1987*	*UNDP*[b] *1987*
Agriculture[d]	9.7	20.3	21.0	44.5	46	15.2

Industry[e]	47.7	47.1	44.7	26.5	23	57.0
Service[f]	42.6	28.9	34.3	29.0	31	27.8

Notes:
a Constructed from EIU (1989/90:13). GDP at factor cost in current prices.
b UNDP/World Bank (1989: Table C.4:325). GDP at factor cost and at 1980 official prices.
c Calculated from World Bank (1989: Table 3:224). At producer prices, calculated from dollar values.
d Agriculture also comprises forestry, hunting and fishing.
e Industry covers mining, oil, manufacturing, construction, electricity, water and gas.
f Services include transport and communications, commerce, as well as social services.

Agriculture

After independence most of Angola's commercial farms were abandoned. The state-owned farms and trading companies set up to replace the previous system failed to reactivate production. There were several reasons for this: lack of entrepreneurial and technical capability, shortages of inputs, collapse of the transport system, other war-related disruptions and the displacement of people. From being an exporter of agricultural products[2] during the 1960s and early 1970s, Angola has become, as a consequence of the difficulties mentioned above, a net importer of food. Famine has gripped the countryside since 1985. Table 13.3 shows some rough figures on agricultural output, published by FAO. As can be seen, the total production of food, agricultural products, crops and cereals has stagnated, while per capita production shows a noticeable decline since 1977.[3]

Manufacturing

After 1940 Angola received an important influx of Portuguese immigrants. Immigration increased further during the economic 'boom' of the 1960s, and by 1975 the number of Portuguese settlers was about 340,000 (Bhagavan 1986:7). This sizeable group of medium- and high-income earners formed the basis for the expansion of a small industrial sector, oriented to the domestic market.[4] In 1972 there were 5,561 manufacturing firms, 85 per cent of which were small establishments owned by white settlers. After independence a massive exodus of Portuguese settlers took place. Over 300,000 left, taking with them two-thirds of the country's 28,000 trucks and sabotaging the physical structures of their enterprises (Ottaway and Ottaway 1981:111–12). Many technicians, managers, skilled workers, civil servants and shopkeepers joined the exodus and manufacturing production collapsed.

In 1981 the number of manufacturing firms amounted to only 148 (97 of which were state-owned) and capacity utilization was down to 20 or 30 per cent (Bhagavan 1986:25).[5] The manufacturing sector never recovered the output volumes reached before independence. Data for 1987 indicate that the main industrial branch is light industry.

Food processing makes up about one-third of total manufacturing production, while heavy industries contribute 15 per cent. A picture of the extent of the industrial sector's decay is given in Table 13.4.

Table 13.3 Angola: indices of food and agricultural production

	Production indices (1979–81 = 100)				Production indices per caput (1979–81 = 100)			
Year	*Food*	*Agricult.*	*Crops*	*Cereals*	*Food*	*Agricult.*	*Crops*	*Cereals*
1977	98.05	103.35	106.79	115.65	108.31	114.16	117.95	104.41
1978	97.06	99.46	101.01	124.09	103.61	106.18	107.82	102.80
1979	98.90	98.04	98.03	96.08	102.10	101.21	101.19	101.33
1980	101.06	103.09	103.90	116.34	100.99	103.02	103.82	100.00
1981	100.03	98.87	98.07	87.59	96.90	95.77	94.99	98.66
1982	101.22	99.63	98.38	87.18	95.26	93.76	92.57	98.25
1983	101.95	99.50	97.93	93.94	93.49	91.23	89.79	96.80
1984	101.88	99.57	97.74	90.00	91.38	89.30	87.66	95.66
1985	102.06	99.31	96.93	86.30	89.97	87.55	85.44	95.02
1986	103.39	100.82	98.32	92.85	88.93	86.72	84.56	93.63
1987	104.01	101.76	99.35	99.51	87.19	85.30	83.28	92.42
1988	104.29	101.95	98.87	92.53	85.09	83.18	80.66	92.06

Source: FAO (1988).

Table 13.4 Angola: index of industrial production, 1973 and 1987

	1973	*1987*
Food processing	100	42
Light industry	100	61
Heavy industry	100	36
Mining	100	17
Total	100	43

Source: UNDP/World Bank (1989: Table 4.5:79).

Industrial output stagnated between 1983 and 1986, and has declined since then, mainly due to the lack of inputs and maintenance. These problems are, in turn, a result of the increasing lack of foreign exchange after the fall in the oil prices in 1986. Firms in the manufacturing sector are operating at a loss. This is due to low capacity utilization, an overvalued exchange rate, price controls and a huge wage bill. Managers of public sector firms, which are selected from party ranks, often lack entrepreneurial skills. Lack of trained manpower and petty theft also contribute to the poor performance. The government subsidizes industry both directly and indirectly. For example, it often finances wage bills or supplies free materials and inputs. There is a growing awareness of

the burden on the fiscal budget implied by these practices.

Oil

Oil extraction began in 1958 and it became Angola's main export generator in 1973. In 1976 a new state oil company, Sonangol, was formed. This was followed by a new oil code in 1978. The code detailed the government's royalties, taxes on profits and shares in the profits of Sonangol.

After the fall in the price of crude oil in 1986 the Angolan authorities improved the terms offered to the oil companies in order to keep them in the country. These included better incentives for exploration and reduced taxes. Thanks to the new policies and favourable geological conditions, Angola has been one of the leading countries with regard to exploration and development activities since the second oil price shock (Rodriguez Padilla 1990:199–203). This has made the oil sector an important exception to the general economic decline. In 1989, 86.6 per cent of total export earnings came from oil, while taxes on petroleum comprised 62 per cent of government revenues. Nevertheless, the oil sector continues to be an enclave, with few linkages to the rest of the economy.

Mining

Angola has vast mineral endowments, but so far only diamonds and iron-ore have been exploited on a commercial scale. Mining of the latter has been at a standstill since 1975. After independence the large diamond company Diamang,[6] owned by Portuguese and other foreign interests, was liquidated and the state assumed responsibility for the diamond-mining operations, through its own company Endiama.[7]

Due to the insecurity created by war, and increasing theft and smuggling, diamond production was in 1986 at its lowest level since independence. A new strategy was adopted that year, based on production-sharing agreements similar to those which had proved successful in the oil sector. This led to recovery in output. Better prices have also been obtained through direct sales on the open market. The present arrangements should ensure a production level of about one million carats per year, with some expansion in the near future, if installations are not attacked. A significant increase of production requires new investments, which cannot be expected until peace and stability are restored. Since 1988 diamond exports have accounted for about 6 to 7 per cent of export earnings.

PRICES, WAGES AND EXCHANGE RATE

After independence the Angolan government introduced a cumbersome system of price controls. It included fixed prices (for essential goods and services), minimum or maximum prices (for agricultural products, raw materials and services), prices approved by the appropriate ministry and prices based on mark-ups over costs. During the last few years price control has got out of hand. Price decisions have given no consideration to efficiency or resource allocation. Resultant prices fail to clear markets.

Many prices remainded unchanged for several years and adjustments have been few. There has been a huge increase in money supply and the system of relative prices has also been seriously distorted. Goods with fixed prices were artificially cheap, especially essential goods (maize, rice, cassava, margarine, sugar and so on), exportables like gasoline, and services like international telephone calls and air travel fares. These distortions favoured consumption and discouraged production. This led to shortages and rationing, which has entailed cumbersome systems of coupons and cards. Employees also have the right to buy given amounts of products from their firms at official prices (own-consumption entitlements). Different cards, coupons, rights and even shops exist (for instance, shops for managers, senior personnel, ministers, important party functionaries and so on). In many cases the level of official prices are almost negligible. Consumers tend to purchase as much as their rights allow. The goods are then sold at the parallel market or used in barter transactions. Supply of goods in the official market also shows large regional differences.

The official price system coexists with a growing parallel market (the Candonga) where prices, on the eve of the monetary reform of September 1990, were between twenty and forty times higher than in the formal market. The Candonga operates as a free market, tolerated and not regulated by the authorities, with prices set by the forces of demand and supply. Demand in the Candonga is a consequence of the excess demand in the official market. Supply is from several sources: (a) products acquired by consumers at the official market, (b) smuggling, (c) production exclusively directed to this market, and (d) goods stolen from firms or from port installations (*desvios*). There are also parallel markets for services in more or less institutionalized forms, for example, in urban transport services.

Before the monetary reform, parallel markets grew steadily and offered a wide range of products. They fulfilled a positive function, stimulating production and satisfying consumers needs, but they were also the counterpart of a distorted system of controlled prices. It was the coexistence of these two markets which encouraged contraband, *desvios*, robbery and corruption and induced consumption and production patterns against the social opportunity costs.

The parallel markets probably operated under fairly competitive conditions, with many sellers and buyers. Prices showed considerable seasonal fluctuations and there were also large regional variations, particularly between agricultural and non-agricultural regions. In Luanda prices of essential goods tended to be the same in the different parallel markets, which suggested some price collusion, that is, a group of few entrepreneurs controlling retail and distribution systems.

As already noted, the fixed exchange rate is a major distortion of the price system. In fact, the local currency is enormously overvalued. Before the monetary reform the black market exchange rate was between sixty and one hundred times higher than the official rate, and after September 1990, twenty times higher than the official rate. The overvaluation led to a reallocation of resources in favour of imports and against non-oil exports. This probably explains why Angola has become a food importer during the last few years. The black market for foreign exchange is thin, and small fluctuations in demand and supply affect the parallel exchange rate. In fact, the market seems to be made of several segments. Moreover, foreign exchange operations in the black market are

strictly punished by the authorities.

There are no systematic price data in Angola. This is one of the main shortcomings in designing economic policy. Comparing lists of prices published in different reports, inflation in the Candonga can be estimated to an annual rate of between 12 and 20 per cent since independence. This rate could be higher than 20 per cent annually for the last three years. However, lack of reliable data about the evolution of prices in the parallel market makes it difficult to determine whether there have been hidden inflationary pressures in the Candonga. Many parallel prices have not increased much after November 1987, because the authorities increased substantially imports of consumer goods.

Wages are determined centrally, lack flexibility and do not provide incentives to work. Money wages are determined in accordance with the official prices, and only account for a fraction of total remuneration. Due to the system of rationing coupons, cards and consumption entitlements, there is a huge discrepancy between money wages and real wages, which include entitlements to goods and services. Thus, the workers' purchasing power is not related to the nominal wages and does not reflect the scarcities of the different skills.

The duality in the price system generates negative and perverse effects on income distribution. There are no studies on income distribution in Angola, but it is easy to see that the price system is biased in favour of the urban sector. This distorted price system also contributes to the wide differences in the real incomes of the population, which vary according to the level of access to rationed goods through cards, coupons, self-consumption or bribery.

ECONOMIC MANAGEMENT

Angola's poor economic performance has many causes. It is clear that the war of independence, Portuguese emigration, foreign intervention, civil war and the instability of the oil markets are important factors in explaining the country's economic deterioration. However, it should be stressed that the economic policies pursued by the Angolan government have played a crucial role in this process.

The evolution of fiscal policy in the period 1981–6 is shown in Table 13.5. Once again, reservations on data quality should be noted. There are significant differences between the budget deficit based on budget information, and figures computed from financial data. On the other hand, it is not clear how much of the public sector is accounted for in budget information.

It is easy to see that a major problem for Angola's public finances has been the high variability of revenues due to changes in both production levels and price of oil. The increased oil tax revenues in 1984 were, for example, the result of increased production due to the doubling of investment in oil exploration during 1981 and 1982.[8] The fall in oil tax revenues in 1986 was, in turn, the result of the oil price fall.[9] It is also apparent that the nominal value of non-oil taxes declined as a result of the increasing demonetization and disintegration of Angola's economy. On the other hand, while current expenditures have been increasing, taxes financed a decreasing share of both current and total expenditures. The overall budget deficit also shows a high variability,

both in nominal terms and as a proportion of GDP. The variability of the deficit is also a function of oil tax revenues.

Table 13.5 Angola: summary of government finances, 1980–6 (billions of kwanzas)

	1980	*1981*	*1982*	*1983*	*1984*	*1985*	*1986*
Revenue	59.8	73.7	50.7	55.5	74.6	78.5	71.2
Taxes on petroleum	33.9	45.2	21.0	26.7	42.3	41.7	30.1
Other taxes	17.7	17.5	20.5	20.5	20.7	24.5	21.7
Total expenditure	76.9	91.7	72.2	67.6	82.3	90.5	86.2
Current expenditure	58.8	57.5	54.4	58.1	69.7	81.2	75.7
Overall budget deficit	17.2	17.9	21.5	12.1	7.7	12.0	15.0
GDP (market prices)	–	–	110.00	125.49	140.86	142.99	130.09
Deficit/GDP (%)	–	–	19.5	9.6	5.5	8.4	11.5

Source: Data provided by the Angolan authorities.

Table 13.6 Angola: summary of government finances, 1987–90 (billions of kwanzas)

	1987	*1988*	*1989*	*1990 (Budget)*	*1990 (Est.)*
Revenue taxes	64.4	63.1	64.9	76.7	69.8
Taxes on petroleum	33.7	33.1	40.2	39.5	41.2
Other taxes	13.1	12.2	17.3	23.4	21.0
Other	17.5	17.8	7.4	13.8	7.5
Total expenditure	87.4	119.7	119.7	132.5	131.6
Current expenditure	76.4	79.2	80.0	98.6	89.1
Wages	47.5	51.5	55.0	59.1	59.1
Materials	12.1	12.6	9.2	14.7	12.8
Subsidies	5.6	3.6	2.8	1.0	2.8
Other	11.2	11.5	13.0	23.8	14.5
Capital expenditures	11.0	16.4	17.9	28.9	20.0
Investments	3.6	3.4	3.8	13.4	5.0
Subsidies	7.4	13.1	14.1	15.5	15.0
Outside budget	n.a.	24.1	21.8	5.0	22.5
Overall budget deficit	23.0	56.6	54.8	55.8	61.9
Financing					
Banco Nacional		46.4	47.7		
External		10.2	7.1		

Source: Data provided by the Angolan authorities.

Table 13.6 gives a summary of fiscal balances for the period 1987–90, for which more

reliable and detailed data are at hand. The data include outlays of the central government, provincial authorities and, to some degree, public enterprises. However, some expenditures, for example, those financed by external grants, are not included. Revenues have stagnated, because the increase in both oil and non-oil taxes is outweighed by a decrease in non-tax revenues, the latter reflecting the rigid prices for public services. Since spending has not been reduced, the gap between revenue and expenditure has, since 1988, become unmanageable. Three main causes for the budget deficit can be mentioned: (a) wages, (b) transfers to public enterprises and (c) investments.

Salaries accounted for 67.8 per cent of current expenditures in 1989. Since the wage bill includes both Civil Service and military wages, the increase is, to some extent, an outcome of the war. However, the government has still no reliable information on the size of the Civil Service.[10] The expansion of public sector employment is partly due to the lack of financial discipline.

Transfers to public enterprises are mainly of two kinds. On the one hand are firms in the public sector which have not received foreign exchange to maintain ongoing operations, either because their foreign exchange allocations have not been approved, or due to foreign exchange shortage. The firm is paralyzed in its productive activities, but must continue paying salaries. On the other hand, some firms indulge in own-consumption and deviation of goods (an euphemism for robbery). These reduce profits and generate deficits for the firms. The gap is covered by government subsidies.

Three big items currently undertaken and presented as investments in the accounts can be mentioned: the Capanda dam, the mausoleum for Agostinho Neto, and the war. War expenditure is spread in the budget under several items, like investments (capital expenditures) and materials (current expenditures).

Today, the fiscal deficit is estimated at between 15 and 20 per cent of GDP. This is definitely a non-sustainable situation. With only some anecdotal exceptions, budget deficits have been financed by monetary expansion. The inflationary implications are very serious. The consequences of this fiscal situation are, however, mitigated by the demonetization and fragmentation of markets in the Angolan economy. In fact, a large share of the population, especially in the countryside, has turned to a more or less subsistence economy. This provides some degree of insulation from inflationary risks and other problems related to monetary mismanagement.

As we mentioned above, the government budget deficits have been mainly financed by the Banco Nacional de Angola through money creation. Table 13.7 shows the variations in the main monetary aggregates. Credit to the public sector constitutes the main component of credit expansion. Non-government credit increased at the same rate as government credit during 1989. During the period 1983–9, the stock of broad money (M2) seems to have increased at an average annual rate of at least 15 per cent. The budget deficit is the reason for the increase in the stock of money and this, in turn, fuels inflationary pressures. With controlled official prices, these pressures manifest themselves in the parallel market.

Table 13.7 Angola: variations in main monetary aggregates, 1988 and 1989

Main monetary aggregates	*Dec. 1988* (*Annual variation in bill. kwanzas*)	*Dec. 1989* (*Annual variation in bill. kwanzas*)
Net domestic credit	44	55
Claims on government	46	48
Claims on other sectors	–2	7
Stock of broad money (M2)	62	39
	(%)	*(%)*
Net domestic credit	16	17
Claims on government	20	17
Claims on other sectors	–4	16
Stock of broad money (M2)	23	1

Source: Data provided by the Angolan authorities.

POLICY OPTIONS AND PROPOSALS

The SEF programme was announced in August 1987. Angola also decided to apply for membership in the World Bank and the IMF. This application was accepted in 1989.

The SEF programme had two main goals: macroeconomic adjustment and the recovery of production. It was admitted that faulty economic policies and inefficiency in the planning and operation of the public sector were behind Angola's economic difficulties. Henceforth, the private sector would be given an enhanced role. The programme also recognized the need to reduce the public sector deficit, to finance it without monetary expansion, and to increase efficiency in the public sector. The rehabilitation of the physical infrastructure was also emphasized.[11]

By the end of 1988 the government introduced several laws providing the necessary legislative framework for economic reform, notably the budget law, the law on economic activities, the law on foreign investments, the law on foreign exchange and the law on public enterprises. These laws were supposed to be implemented within sixty days but this has still not been done. At the beginning of 1989, the government announced a 'Programa de Restructuração Económica' to be implemented in 1989/90 as the first phase of the SEF. This included several measures, like the transformation of the price system, devaluation of the kwanza, rationalization of the wage system, privatization of public enterprises producing 'non-strategic' goods and services, and so on. By the beginning of 1991, very little of this programme had been implemented.

Intensive discussions have taken place in the last few years between the Angolan government, the international aid community, the World Bank and the IMF. Though considerable agreement was reached, little was done in terms of implementation until the government launched a monetary and fiscal reform in September 1990. In the rest of this section we look at the situation and the measures that had actually been undertaken before the monetary and fiscal reform, and our views on the policy options Angola faced at that time.

Exchange rate policy

The discrepancy between the official and the parallel market exchange rate was enormous and constituted one of the major sources of distortions in the Angolan economy. It was clear that the economy had little chance of sustained development given the large gap between the official and black market exchange rates. The huge overvaluation of the kwanza made the development of non-oil exports or the production of tradable goods practically impossible. The differentiated access to foreign exchange, depending on levels of income and hierarchical position in the power structure, contributed to a regressive distribution of income and wealth. A substantial devaluation would promote export and discourage imports, even considering Angola's limited capacity for resource reallocation.[12]

Thus, in the case of Angola, with such a large distortion in the price system and very little economic information, the main target of devaluations should be to reach a foreign exchange rate which significantly encourages non-oil exports. It was clear that this target could not be reached through just one massive devaluation of the kwanza against the dollar. There are two reasons for this. On the one hand the target to be reached cannot be determined quantitatively. On the other hand, as most prices are more flexible upwards than downwards, we could expect, not only changes in relative prices, but also considerable movements in the absolute price level. Thus, one could expect a high level of inflation in Angola after the devaluation, and this would, in turn, affect the real exchange rate, changing the nominal level of the target rate.

Price and domestic trade policies

Another important area for economic policy reform is the increased economic disintegration between the rural and the urban sectors and the demonetization of the economy. These happen to be the major problems of Angola. A policy to get the economy reintegrated should go through adequate prices and wages. This process must be undertaken at a rather fast pace, mainly because the Angolan government does not have a real capability to carefully plan and monitor the process. In such a situation it is important that minimal targets of price liberalization and wage remonetization are reached before mounting social and political pressures stop the whole process.

The system of controlled prices and rationing cards subsidized the urban population's consumption. A liberalization of prices and remonetization of wages would leave the urban dwellers without these subsidies. It is very difficult to assess a priori how a new system would affect people's incomes and consumption structures. A good approach to

this problem seems to be to liberalize prices relatively fast and provide a system of subsidies allowing people to cope with a slower remonetization of wages.

Before September 1990 the government announced some measures in this direction. Retail trade was being transferred to the private sector although firms claimed that the rules under which they were supposed to operate were still unclear. The prices of fruits and vegetables had already been liberalized, leading to a significant increase in supply. The government announced the introduction of a new price system, comprising three types of prices: fixed prices, prices based on a price-cost margin, and free prices. The goal was to establish a system of flexible prices before the devaluation.

A plausible approach to wages should be pragmatic and gradual. Remonetization should be carefully planned, implemented and monitored. Since the increase in the money stock has been fuelling inflation, some reduction of real wages would be required. Programmes to alleviate the immediate hardships, for instance, distribution of basic foodstuffs, are needed to ease the transition to a monetary economy.

The new wage system should allow for broader wage differentials reflecting scarcities of labour categories and productivity differences. Legislation has to allow for dismissals and labour mobility between firms and sectors. At the same time an unemployment insurance system, financed largely by both employers and employees, should be created.

Fiscal and monetary policy

The main goal of fiscal policy in Angola should be to reduce the fiscal deficit, which was, and still is, almost entirely financed through monetary expansion. It is thus imperative to increase public sector revenues and reduce expenditures. Devaluation of the kwanza would have a positive effect on revenues by raising the government's oil tax income. Another revenue-increasing measure would be through improvements in administration. Various measures had been undertaken (for example, consumption taxes and stamp taxes), and others were to be carried out in the course of 1990, for instance, the elimination of subsidies. Several goods and services were heavily subsidized (for example, gasoline, international telephone calls, air travel fares) because they were transacted at the official exchange rate. Thus, a litre of gasoline, which at the official exchange rate cost US $0.80, cost roughly 1 to 2 cents at the parallel exchange rate. The government announced a substantial increase in the (controlled) price of these goods and services.

Measures were also announced to eliminate subsidies to public sector firms. These would be forced to finance their activities from own resources or through bank credits. It is difficult to predict the extent to which these measures will affect the budget deficit but it seems reasonable to presume that the change will be small. Without a more effective system of revenue collection and expenditure control, including a drastic reduction of defence expenditures, positive results should be limited.

Another problem faced by policy-makers in Angola is how to eliminate the extensive system of cards and entitlements used in the public sector. A clear objective of fiscal policy should be to revert to money wages. This would identify and quantify an important source of the fiscal deficit which is currently partially hidden. On the other hand, returning to money wages is possible only if, at the same time, a more rational price

system is developed supported by a functioning financial sector. Confidence in money is a pre-condition for a complete return to money wages.

It was clear that two objectives had to be pursued concurrently in the field of monetary policy: the encouragement of savings and the control of monetary expansion to avoid inflationary pressures. The reorganization of the banking system, and the creation of a Central Bank were crucial in the implementation of a coherent monetary policy, with quantitative limits to credit expansion. The real rates of interest had to be positive to promote savings, which would fund the financial system.

THE ECONOMIC REFORM OF 1990

On 21 September 1990 the government presented a new policy package with the aim of reactivating the SEF. This package was secretly prepared and surprised most observers of the Angolan economy. The new policy package included a broad range of measures which can be grouped in several categories.

Reduction of the budget deficit

A drastic reduction of public expenditures was announced, as well as measures directed at increasing revenues. For example, tax-free rights were denied to shops operating in foreign exchange. New taxes were introduced and others, on services with low prices due to kwanza overvaluation, were strongly raised. For example, a 400 per cent tax on international air fares was introduced.

Modification of the price system

A new system, limiting controlled prices to a list of about twenty-five goods, was introduced. Some prices, especially gasoline and diesel oil, were strongly raised. For example, the controlled price of gasoline increased from 25 to 62 kwanzas per litre.

Devaluation

The kwanza should be devalued by about 100 per cent. That is, the new price of the American dollar should be about 60 kwanzas. Simultaneously, the wage bill should be raised by 20 per cent.

Import expansion

This aimed at improving the supply of consumption goods in official markets and access to inputs for local firms, thus reactivating productive activity.

Monetary reform

A new currency, the new kwanza, was introduced, replacing the old kwanza at a one to

one rate. The old kwanza bills could be changed by the new ones during a week, beginning on 21 September 1990. Only 5 per cent of the liquid balances in the hands of the public could be changed. Receipts were issued for the rest, 95 per cent, of the liquid balances. There is a vague promise that these receipts will be converted, in the future, into interest-bearing bonds. In the case of bank deposits, 85 per cent of the balances were frozen during a 180-day period.

The government lacked the ability to implement the programme properly. In many towns the currency change could not be undertaken within the stipulated period. The stock of new currency was insufficient and the denominations of the new bills were inadequate. As a consequence there was scarcity of currency for small daily transactions, such as buying newspapers or paying public transportation fares. The expansion of imports did not take place. Finally, the devaluation, announced on 21 September as taking place on 1 October, was postponed indefinitely.[13]

The immediate reaction of the public was to flee from holding money, with a consequent explosive increase of prices at the parallel markets. A few hours after the announcement of the programme the scarcity of goods could be observed at the parallel markets in Luanda. Some prices tripled during the first day. After a few days the deflationary contents of the policy package began to be felt, and prices fell at the parallel markets. The monetary reform affected prices but also quantities offered at the parallel markets, where activity decreased markedly. The scarcity of currency, especially of small denomination bills, hindered many transactions.

CONCLUSIONS

It is too early to provide a complete assessment of the policy package presented in September 1990. Practically no information has been published. However, it is possible to venture some general comments, mostly based on qualitative observation of the economic environment.

The September 1990 policy package included some measures aimed at correcting the large distortions in the prices of some services. For example, international air fares, international telephone calls, and so on. However, most of these isolated price corrections can be interpreted as substitutes for a devaluation of the kwanza. A devaluation would achieve this result much more efficiently, the new prices reflecting real scarcities and inducing a rational allocation of resources. On the other hand, some of the price changes have a negative effect on the budget. For example, the government is the main consumer of gasoline and diesel oil. The elimination of tax exemptions for the foreign exchange shops is probably the measure more likely to have a positive effect on the budget. The programmed expansion of imports is not consistent with the planned reduction of aggregate demand.

The main criticism one can direct at this package is that it is meant as an alternative to a much-needed economic liberalization. The main goal of the policies discussed before September was the integration of the official and parallel sectors of the economy, and remonetization. A crucial strategic element was, naturally, the devaluation of the kwanza, in order to restore the rationality of the relative prices. In this way local production of

exportables and import substitution would be encouraged, and local consumption of imports would be discouraged, contributing to the equilibrium of the foreign sector. Devaluation would also discourage improductive rent-seeking activities as *desvios*, for example.

The philosophy of the September 1990 package is very different. The goal is no more the integration of the official and parallel sectors of the economy. On the contrary, it is now to destroy parallel markets altogether. The forced reduction of liquid balances held by the public is directed at reducing the level of prices in the parallel markets. These markets are considered to be the expressions of speculative activities. The government refuses to accept that the development of these markets is a consequence of deep disequilibriums in the economy; particularly, of a largely distorted price system and a strong expansion of money. This attack against the parallel market has clear social consequences. A large proportion of the Luanda population depends on activities in the informal sector for a living, and lack ration cards or any other form of access to the official markets.

The expropriation of the liquid balances[14] destroyed the confidence of the public in the financial system and in domestic currency as deposits of value. It is difficult to assess the consequences of the expropriation of the liquid assets. However, it is easy to see that Angola's capacity to develop a working financial system has been radically diminished.

The package then seems directed at destroying the structures that the private economic activity has created in response to the weakness of the official economy. A clear signal has been sent to the market in the sense that the only acceptable economic activity would be that in the official markets. Failure to devalue the kwanza can be interpreted as a refusal to liberalize one of the most central prices of the economy. In this context, commitments made by the government to liberalize the economy and encourage private economic activities seem contradictory. On the contrary, in September 1990 Angola seems to have taken a step backwards on the road to economic liberalization.

NOTES

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1 Value added in the oil sector can be directly computed in US dollars, since transactions in this sector are in this currency. Combining these estimates with those of value added in non-oil production is more complex, because the choice of a suitable exchange rate between the Angolan kwanza, and US dollars plays a crucial role. On the other hand, very few data are collected on non-oil activities.

2 Agricultural products accounted for 60 per cent of exports in the 1960s, 45 per cent in the early 1970s and 34 per cent in 1974. This fall in the share of agriculture in exports was not due to a decline in production but to the huge increase in oil exports (Somerville 1986).

3 The reliability of these data is difficult to assess. They are probably no more than very rough estimates. EIU (1989/90) points out that cereal production declined from an average of 500,000 tons/year in the mid-1970s to an estimated 300,000–350,000 tons/year in 1986–8. If this is correct, then FAO data underestimates the fall in production (EIU 1989/90:16).

4 In 1973, 37 per cent of manufacturing output was in luxury consumption goods, 33 per cent

in mass consumption goods, 20 per cent in intermediate and 10 per cent in capital goods. Non-Portuguese capital in manufacturing was modest. At least 55 per cent Portuguese ownership in each manufacturing firm was required by law (Bhagavan 1986:15–17).

5 This figure cannot be compared with that for 1972, because the latter includes many small workshops.

6 Companhia de Diamantes de Angola.

7 Emprêsa Nacional de Diamantes de Angola.

8 Accordingly, oil production increased from an average of 130,000 barrels per day in 1978–82 to 179,000 barrels per day in 1983 (EIU/QER 1985/3).

9 In February 1986 the price of oil dropped from US $25 to US $18 per barrel.

10 A survey of the Civil Service was undertaken in 1991.

11 For a detailed presentation of the SEF programme, see Carneiro and Abreu 1989.

12 In 1989 the government approved a devaluation of the kwanza by 50 per cent, but this measure was never carried out. This devaluation had to be followed in 1990 by a further 50 per cent devaluation. In fact, given the huge gap between the official and the parallel market rates, an even more active exchange rate policy had been required. The monetary and fiscal reform also included a 50 per cent devaluation announced to take place on 1 October 1990. However, the devaluation was not implemented until March 1991.

13 It is difficult to understand why the devaluation was announced in advance.

14 The expropriation of the liquid balances can be interpreted as a regressive tax.

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14
ECONOMIC RECOVERY UNDER INSTITUTIONAL CONSTRAINTS: TANZANIA FACING THE ECONOMIC CRISIS

Gun Eriksson and *Mats Lundahl*

INTRODUCTION

At the beginning of the 1980s the Tanzanian economy found itself in an acute crisis. The crisis was triggered by exogenous factors, such as deteriorating terms of trade and the war with Uganda. More important, however, is the fact that the crisis was also a logical consequence of the development strategy followed by the country after the 1967 Arusha Declaration. The latter laid down the principle of self-reliance as the path to be followed in the years to come. The country turned its back on the world market and embarked on a voyage characterized by stagnation, external and internal imbalances, commodity scarcity and deteriorating physical and social infrastructure.

The economic system that was created proved unable to adjust its structure to the new demands brought about by external shocks. The market and the price mechanism had to a large extent been destroyed, and scarce goods were allocated mainly via administrative decisions. Public enterprises were subsidized while private activities were discouraged. As a result of the famous *Ujamaa* programme, the farming population had been forced to concentrate in artificially-created villages. Since the peasants received prices far below the market-clearing level for their produce, the establishment of a black ('parallel') market was the inevitable result. The industrial strategy, based on import substitution, had failed, new capacity being built while the already existing capacity could not be utilized for lack of inputs, particularly imported ones. The public sector had been rapidly expanded into all parts of the economy through external and internal borrowing. The overall result of all this was a drastically reduced standard of living for the average Tanzanian, from the late 1960s to the mid-1980s (Bevan *et al.* 1988).

During the first half of the 1980s a number of efforts were made to overcome the economic problems. The results, however, were modest, partly because the injection of external funds that would have been necessary did not materialize, but also because the measures did not go far enough. More far-reaching efforts were necessary to bring about an agreement with the International Monetary Fund (IMF) in August 1986, which in turn also opened the door for an inflow of resources from the World Bank and bilateral donors. This chapter reviews the experience of the three-year economic programme launched in 1986, in terms of its impact on the economy, and discusses the remaining

problems, in particular the institutional rigidity.

THE ECONOMIC RECOVERY PROGRAMME

The agreement with the IMF was based on the so-called Economic Recovery Programme (ERP), 1986/87–88/89. The text of the agreement made it clear that the causes of economic decline were chiefly internal. It was not possible to blame external factors for the falling per capita income, rising inflation, increased lack of foreign currency, food scarcity and absence of consumption goods, as well as the deterioration of the physical and social infrastructure. Large budget deficits and large increases in the money supply had resulted in an upward pressure on the price level and a deficit in the balance of payments. Manufacturing had been favoured at the expense of agriculture. The incentives given to the producers were feeble. The marketing system did not work properly, and the government sector had grown too large.

The focus of the ERP was on short-term macroeconomic stabilization, and on structural adjustment and economic recovery in the medium term (URT 1986:14). Agricultural production was to be increased via more powerful incentives, improvements in the marketing system, and through channelling more resources to the sector. It was envisaged that capacity utilization within industry would be increased, through a more efficient allocation of foreign currency. A rehabilitation of the physical infrastructure, in particular in the fields of transportation, energy and water, was planned in order to support the other sectors. Tight fiscal and monetary policies and a more outward-looking trade strategy would be used to restore external and internal balance.

A number of quantitative targets were set. The envisaged annual growth rate of gross domestic product (GDP) was 4.5 per cent. Capacity utilization in industry would increase from 20–30 per cent to 60–70 per cent at the end of the programme period, while export earnings were planned to increase by 12–19 per cent annually. However, the planned increase in output required an increased import of inputs, to the amount of US $1,200–1,300 million per year. Producer prices in agriculture would have to be raised, either to 60–70 per cent of the f.o.b. price, or by 5 per cent per year in real terms, whichever produced the best result (Lipumba 1988:4–5).

In August 1986 Tanzania signed an agreement with the IMF. According to this agreement an ‘equilibrium’ rate of exchange would be reached in June 1988, via a crawling peg system whereby the Tanzanian shilling would be tied to a basket of foreign currencies. By the same time real rates of interest were to become positive. The expansion of the money supply was to be limited to 15 per cent per annum. The inflation target aimed at a reduction towards 20 per cent in the second year, and to 10 per cent by the end of 1989 (Lipumba 1988:3–4; Lipumba and Mbelle 1990:22). The budget deficit was to be reduced, both from the revenue and the expenditure sides.

The price control system was to be dismantled. Only twelve commodities were to be price controlled by June 1988 (IDA 1988:3). Trade liberalization, both internal and external, was to be gradually expanded. Thus, the ERP included not only economic policy measures, that is, measures to be carried out within the existing institutional framework, for example, price increases and devaluations, but also economic reform

measures, for example, price deregulation and trade liberalization, implying a change in the economic system itself.[1]

THE RESULTS OF THE ERP

To what extent have the targets of the ERP been reached, and what have been the economic consequences? In order to study the macroeconomic effects with some degree of precision a computable general equilibrium model would have been needed in order to simulate what would have happened if no shift in economic policy had taken place. No such model is, however, available. We must content ourselves with an examination of current developments, keeping in mind the dismal record of the past.

Implementation of the stabilization measures

The political willingness to act according to the programme appears to have been present within the government. The Tanzanian currency was devalued gradually, from 16 shillings per US dollar in March 1986 to 192 shillings per US dollar in December 1989 (TET 1989/90:76). Whether an equilibrium exchange rate has been reached or not remains a controversy between the government and the World Bank, but the gap between the black market rate and the official one has diminished considerably.

The expansion of both credit and money supply has been larger than foreseen in the recovery programme. The rate of expansion was twice the targeted one. During 1986/87–88/89 the money supply (broadly defined) increased by some 23–38 per cent per year, while domestic credits increased by some 28–55 per cent (TET 1989/90:80).

The monetary expansion was a result primarily of increased credits to government-controlled marketing organizations in the agricultural sector: co-operatives and marketing boards. The rate of interest does still not constitute an efficient instrument for allocating capital, but rationing continues in the financial sector. The parastatal companies, above all, the agricultural marketing organizations, have received priority in the allocation of credit, even though they leave a lot to be desired, from the point of view of efficiency and repayment, at the expense of more efficient firms.

Partly as a result of money and credit expansion, the rate of inflation has also remained above the ERP targets. In 1986 consumer prices rose by some 33 per cent, and in the following two years, the rate of inflation was 29 and 28 per cent, that is, well above the stipulated 20 and 10 per cent levels (TET 1989/90:74).

The government managed to restrain its borrowing from the banking system and the direct budget deficit was also kept within its projected limits, mainly by keeping expenditures at a lower level than the budgeted one. Government finances are still weak, however, and the budget deficit remains substantial at just under 10 per cent of official GDP. Total revenue covers only about two-thirds of total expenditure, and more than 80 per cent of the deficit is covered by foreign funds (Lipumba and Mbelle 1990:17–20).

Nominal interest rates were increased, but not to the envisaged point of becoming positive in mid-1988, due to the continued high level of inflation. By the end of 1988, however, the highest nominal rates of interest were increased practically to the level of

inflation, so that real rates were close to zero (TET 1989/90:80).

When it came to increasing producer prices in agriculture, the results were mixed. Nominal prices were increased substantially, both for food and export crops. During the ERP period the rate of inflation outstripped the increase in nominal prices of the major food staples, maize, paddy and wheat, however, so that real producer prices experienced a minor decline. Nominal increases in the prices of export crops were particularly high in the first year, ranging from 30 to 80 per cent. Despite inflation, real producer prices for coffee and cashew nuts increased significantly during the period, on average by some 14 per cent annually, and thus also led to improvements in relation to the official price of food crops. Real prices of cotton and tobacco, on the other hand, declined somewhat during the period, while that of, for example, pyrethrum remained more or less unchanged (TET 1989/90:81–4).

Structural adjustment and economic recovery

Not only the stabilization measures of the ERP, but also major institutional changes, were implemented in accordance with the programme. These reform measures have been of two major kinds: trade liberalization and removal of price controls.

During the ERP there was a continuation of the liberalization of both domestic and foreign trade that had been already initiated during the first half of the 1980s. With respect to domestic trade, internal barriers have been reduced, and private traders have been increasingly allowed to compete with the official marketing organizations in trade in food crops. Trade in export crops, however, has not been liberalized to the same extent, except for certain minor items.

In the external trade sector foreign currency continues to be partly allocated by administrative decisions by the Ministry of Finance and the Central bank (approximately half of the total foreign exchange available). However, systems that guarantee a freer allocation have also been introduced. Beginning with the 1984–5 budget, it became possible to import a number of consumption goods without having to declare where the foreign currency came from. These own-funded imports have been one of the propelling forces in the recovery process, since they have made it possible to increase the imports of incentive goods and various inputs. Exporters were also allowed to retain part of their foreign currency earnings. Finally, foreign currency has also been allocated via the Open General Licenses (OGL) system since February 1988, which more or less automatically provides currency for imports of a number of priority goods. Over time these schemes have generally been expanded to cover imports of more goods.

The removal of restrictions covering trade in certain goods has generally been coupled with decontrol of their prices. Prices have been deregulated for most goods. In 1989 only ten categories of price-controlled products remained (IMF 1990:15).

Turning to the effects of policy and institutional measures, we may begin with the production side. Official real GDP increased by between 3.6 and 4.4 per cent per annum during 1986–9, which implies annual real increases in per capita terms as well.[2] Growth was unevenly distributed, however. Important progress was made in agriculture, with output increases of 4.4–5.7 per cent per annum (TET 1989/90:73). Harvests have been exceptionally good due to favourable weather conditions. The increased supply of

consumer goods resulting from import and domestic trade liberalization has provided a stimulus to increased production as has the combination of increased producer prices and devaluations.

The performance of the industrial sector was more uneven. In 1986 manufacturing output declined by some 4 per cent. However, it has risen by 4.2, 5.4 and 5.1 per cent, respectively, during the subsequent three years. In absolute figures, however, production remained below the levels from the 1970s and early 1980s (TET 1989/90:73). Output growth differed significantly between various industries, and was negative in many cases. Capacity utilization also varied widely between different branches, and in the vast majority of cases it did not reach the set targets, but remained below 40 per cent on average (Lipumba and Mbelle 1990:28).

The performance of the supportive physical infrastructure has been poor, and little improvement, for example, in the transport system, has been recorded during the ERP. The bad state of the road and rail networks has seriously constrained other sectors, especially agriculture, despite an increase in the imports of vehicles and fuel during the period (Lipumba and Mbelle 1990:30–1).

The key to the entire recovery programme is to be found in the foreign trade sector. The situation looked very bad when the ERP was initiated. The volume of exports had been drastically reduced during the 1977–85 period. The overvalued currency, in combination with other discriminatory practices against agriculture and the failure of inward-looking industrialization, had restrained exports. That part of currency allocation which was based on administrative routines has proved to be extremely inefficient, and nothing indicates that it has improved during the ERP.

The incentives to export have increased strongly, not least as a result of the large real devaluations that were made in 1986 (61 per cent) and 1987 (32 per cent) (IMF 1988:30). In manufacturing the effective rate of protection fell and its spread was reduced. Thereby, the profitability of the protected import-competing branches fell in relation to that of the more labour-intensive ones, based on local raw materials. Moreover, in spite of the maintenance of the inefficient administrative foreign exchange allocation, and in spite of the fact that imports did not increase to the envisaged level, the various import liberalization schemes put an end to the severe scarcity of goods, and incentive goods and inputs have flowed into the country.

Nevertheless, the growth of exports did not match the ambitions expressed in the ERP. Tanzanian exports mainly consist of agricultural goods, coffee and cotton being the two most important products. In 1986 a 22 per cent increase in total official exports was recorded, but the following year saw stagnation. In 1988 and 1989 the figures increased again, by some 7 and 2 per cent, respectively. The value of traditional agricultural exports increased in 1986, but then declined by some 7 per cent annually during the next three years. The relatively weak progress of agricultural exports can partly be explained by falling world market prices, but also, for example, by deficiencies in the transport and marketing systems. The most positive changes on the export side refer to non-traditional commodities, including petroleum products, minerals, manufactures and 'other goods' (for example, pyrethrum, cotton-seed cakes and wattle extract). After a decline in 1986, non-traditional exports increased by almost 70 per cent during 1987. In 1988 the increase was insignificant, but the following year a figure of 12 per cent was achieved.

By that time the value of non-traditional exports had increased to some 44 per cent of total official exports (Bank of Tanzania 1990).

Registered exports during the ERP period did not suffice to meet the country's import needs. Official exports only covered about one-third of total annual imports during the period 1986–9 (TET 1989/90:75). Hence the balance-of-payments situation is still very fragile, and Tanzania remains highly dependent on foreign assistance. Moreover, the increasing size of the external debt, particularly the debt service obligations, impose severe restric-tions on the balance of payments, and on the import capacity of the country. The total debt increased from US $3.5 billion in 1986 to 5 billion in December 1988, basically as a result of the capitalization of outstanding interest payments (URT 1989b:4). Despite the rescheduling of the debt through the Paris Club, in 1986 and 1988, and despite bilateral donors writing off part of the debt, interest payments have increased during the ERP. Interest payments relative to official exports rose from 32 per cent in 1986 to 52 per cent in 1989 (TET 1989/90:75).

The liberalization of trade, both domestic and foreign, has significantly increased the role of the private sector in the economy. Private sector activities have grown, especially in trade and commerce, and to a certain, but lesser, extent also in production. As most private sector activities belong to the informal sector, official figures on, for example, production and exports, underestimate their real values. It is, for instance, generally recognized that own-funded imports, amounting to approximately the level of official exports, are financed by 'unofficial exports, parallel market foreign exchange transactions, and export retention schemes' (Lipumba and Mbelle 1990:15).

The manufacturing sector: problems of restructuring

The manufacturing sector was facing severe structural problems when the recovery programme was initiated. Value added in the sector peaked in 1979, and thereafter the trend was basically downwards until 1987 (Wangwe 1988:34). As soon as the ERP was implemented, production increased, presumably even more than indicated by official figures, since the latter neither include firms with less than fifty employees nor informal sector activities. The general impression is that a substantial output increase has taken place among small companies, producing such goods as radios, paint, soft drinks and crafts, many of which belong to the informal sector.

However, the manufacturing sector continues to have problems which it will take a long time to solve. The lack of raw materials and other inputs persists in many cases, as does the deficient infrastructure: electricity, water, transportation. Efficiency remains low in many branches, partly as a result of poor incentive structures and weak financial accountability in parastatal enterprises. It is mainly the large companies that are in trouble.

One of the main problems facing the large companies is their strong import dependence for inputs – around 70 per cent (Wangwe 1988:41). This fact easily makes the conditions on which foreign currency can be obtained decisive for their ability to produce. The administrative allocation of currency creates a number of problems and delays the necessary restructuring of the manufacturing sector by requiring that local currency be deposited in advance when an application for currency is made. This is also

the case within the OGL system. As a result liquidity rather than efficiency easily becomes the main determinant of the allocation of foreign currency. This process normally favours state enterprises. Thus, the lack of access to credit also makes for a lack of foreign currency, above all in the case of private companies. The financial system is poorly developed, and the inefficient parastatal marketing organizations in agriculture have captured a large share of the available credits.

However, the new policy has triggered a restructuring of the manufacturing sector. The industries that are able to compete in the international markets tend to see their output grow. Efficient producers have been able to increase their capacity utilization, since their ability to compete with inefficient firms for scarce inputs has improved as a result of the decrease of effective protection in the manufacturing sector.

Agriculture: marketing and transport problems

The new agricultural policy managed to improve the terms of trade of agriculture with the rest of the economy in relation to the situation prevailing at the beginning of the 1980s. Nominal producer prices were increased substantially, particularly for export crops, via the pricing policy and through the devaluations of the Tanzanian shilling, even though increases in real terms were difficult to achieve for most crops, since the rate of inflation remained above the figures envisaged in the ERP.

Nevertheless, the agricultural sector continues to be ridden by problems – problems that have important macroeconomic implications. The transport network does not function well, although minor improvements have been made since 1986. The deterioration that took place in the 1970s and early 1980s still takes its toll. The road network continues to be in a poor state and there is a lack of vehicles for produce transportation. Storage capacity for grains, and the capacity for ginning cotton, remains low.

The official marketing system is plagued with severe inefficiency problems. Deficient management, over-bureaucratization and, in many cases, outright corruption, all strongly contribute to inefficiency. Partly in order to overcome these problems, agricultural marketing has been reorganized several times. In 1984 the existing crop authorities, that had also worked at lower levels, were replaced by the present marketing boards, which were to concentrate on distribution at the national level. Co-operatives, which had been abolished in 1976, were reinstated. Primary co-operatives were to buy from the peasants and resell to co-operative unions which, in turn, were to forward the produce to the marketing boards.

However, the gains from the new system have been small, if any. Marketing costs rose rapidly between 1985–6 and 1987–8. During this period the prices paid by consumers for agricultural goods increased on average by 124 per cent, while the prices received by producers increased by a mere 56 per cent. The difference was due to the increasing costs of the marketing system (Banda 1988:13). The National Milling Corporation (NMC), the marketing board that deals in food crops, makes huge losses every year: 1.8 billion shillings in 1986–7 and 3.7 in 1987–8 (URT 1989c:40). The increases in consumer prices have not been large enough to cover the increased costs of the NMC.

The government has been reluctant to increase consumer prices of food, and it would

not be possible to increase consumer prices to the level necessary for the NMC to break even. The NMC is to a certain extent outcompeted by the growing number of private intermediaries that have been allowed since 1984. During 1987–8 these middlemen managed to deliver maize to urban consumers at a price that was 15–30 per cent lower than the one asked by the NMC (TET 1988:19). The NMC is currently undergoing substantial reorganization, and its market share has been reduced from some 25 per cent during the ERP to virtually nothing in the early 1990s (Banda 1988:13; World Bank 1991:60).

The efficiency of the parastatals that handle export crops is low as well. Long delays in processing and distribution have resulted in rapid cost increases. The most serious problems have been faced by the Tanzania Cotton Marketing Board, which ran a deficit of 1.5 million shillings in 1986–7 and one of 2.7 million during the following year (URT 1989c:40). The export parastatals have been 'better' off than the NMC in the sense that the price rises, made possible via the devaluation of the shilling, have been partly allocated to them instead of to the producers, thus providing room for further cost increases.

The main macroeconomic consequence of the malfunctioning of the official distribution network has been its inflationary impact. The possibility of covering the deficits through bank borrowing has generated a cumulative process that has fuelled inflation over time. The marketing organizations, for instance, have a transport problem which in turn makes it difficult to buy the crops for which money has been allocated. Nevertheless, the money is spent, and as long as loans can be obtained via the banking system, strong incentives are created to borrow for purposes that do not really exist. This raises costs even further, borrowing increases, and so on, with higher inflation as the ultimate consequence.

Certain steps in the direction of further liberalization of the marketing of agricultural products have been taken, however. Thus, large tea and sisal producers are allowed to export directly a larger share of their production, and the NMC, as of June 1988, must no longer purchase everything that the co-operative unions have bought. As a consequence, the latter are also free to sell to other buyers than the NMC – including licensed private intermediaries. However, these measures do not appear to have been sufficient to increase efficiency within the official marketing system.

Social aspects of structural adjustment

During the first two decades of independence Tanzania adopted a development strategy where a high priority was given to the development of social services and to an equitable income distribution. Ambitious programmes, especially for primary education, health care and freshwater provision, were started. During the economic crisis, however, the social infrastructure was neglected, and the services to the population deteriorated significantly. Simultaneously, while real incomes in general tended to deteriorate, those of the peasant population declined considerably more than those of the urban population (Bevan *et al.* 1988).

However, the ERP, like the previous economic programmes, did not include a strategy to prevent, or cushion, its possible negative effects on poor or socially weak groups of the

population. Neither were any explicit distributional considerations made. Moreover, little has been done to rehabilitate the deteriorating social infrastructure during the period.

With respect to income distributional aspects, it is difficult to determine the net effects of the ERP – for several reasons. A major factor is the increased importance of the informal sector for income generation and consumption, and informal sector data are scarce or non-existent. During the economic crisis the households adapted to the deteriorating performance of the official economy by diverting more of their activities to the informal sector which grew considerably during this period. Nevertheless, certain tendencies can be distinguished.

Real incomes within the formal economy, at least in the public sector, have probably deteriorated on average, mainly as a result of the continued high rate of inflation. However, formal sector income constitutes only a fraction of total income, and the effects of the ERP on the level of total incomes are unknown. It is not unlikely that reduced income possibilities in the formal sector have led to innovations in the informal sector, implying actual increases in real income. Preliminary estimates by the World Bank (1991:II:1) indicate that living standards may have increased considerably, on a national level, between 1983 and 1988. This is mainly due to increased consumption of food and other goods, the supply and availability of which has increased substantially. Thereby, the situation for most groups of the population appears to have improved, compared to the early 1980s, which saw an economic crisis without any measures resembling the ERP.

With respect to the relative distribution of incomes, the ERP has probably tended to reduce income differentials in certain respects, while increasing them in others. Although not explicitly stated, the programme has in fact addressed the issue of income distribution, by reversing the former discrimination against agriculture. Thus, the main equalizing effect ought to have been the income redistribution from urban wage-earners to peasant households in the rural areas, where the majority of the poor population is found. This redistribution in favour of the rural population has partly been accomplished through reduced discrimination against agriculture, as a result of, for example, the devaluations and the pricing policy. Liberalization of trade, both internal and external, has probably also had an equalizing effect. Food crops are now more easily transferred from excess supply to excess demand areas, and the supply of consumer goods, which used to be scarce and unevenly distributed, has increased significantly and is now more evenly spread across the country (Hyuha and Ndulu 1989). Tendencies towards increasing income differentials are most visible in urban areas, where a class of wealthy entrepreneurs is emerging, partly as a result of trade liberalization. Despite these trends, the equalizing effects on relative incomes may well predominate, since the vast majority of the population are peasant small-holders.

The deteriorating social infrastructure is due to a number of causes. A fundamental condition for the development of a sustainable social infrastructure is that the goals are realistically set in relation to the resources, internal as well as external, that can be generated. In the light of the poor economic performance since the early 1970s, one may seriously question the realism of the social ambitions of the government. Furthermore, the over-dimensioning of the public sector implied that financial resources had to be spread thinly. Expansion of the state sector into practically every kind of economic

activity inevitably had the consequence that the provision of basic social services was neglected for lack of resources. The 'over-optimistic' bias of the government, a common characteristic of developing countries with socialist ambitions (de Vylder 1990:4), and the overdimensioning of the state sector, made the social sectors vulnerable to the negative effects of the economic crisis.

The problems within the health care, education and water-provision sectors have largely a common origin.[3] Those caused by insufficient resources, directly or indirectly, have been expressed, for example, in a lack of materials, poor transportation facilities and a neglect of maintenance and repairs. Public expenditure, including that of local government, on health, education, water and electricity, stabilized, in real per capita terms, in mid-1980, after a dramatic decline in the early 1980s. Since 1986 it has even increased somewhat (World Bank 1991:114).

Shortage of foreign exchange has also affected the social sectors, but, for example, the supply of medicines improved significantly when the own-funded imports scheme was introduced in 1984 (Jonsson 1988), and is likely to have increased further during the ERP, as import liberalization has continued. This positive effect has, however, at least partly, been counteracted by the negative impact of the devaluations, making imported essentials relatively more expensive. However, drugs and consumption articles for the health sector have been given high priority in the administrative allocation of foreign exchange.

Certain attempts to improve the financial situation within the social sectors have been made during the ERP period. These have mainly implied the introduction of user charges, for example, within education and health care.

While economic growth and state sector involvement determines the volume of resources available to social infrastructure, organizational and other institutional conditions determine how efficiently they are used. One set of problems, related to both these aspects, has emanated from the weak incentive structure. All three sectors have encountered difficulties in attracting and keeping qualified staff. Low and declining real wages, limited opportunities for promotion and generally poor working conditions have reduced the incentives to remain in the public sector. Morale among public sector employees has declined and qualified staff have tended to divert their time to private sector and other activities, where earnings have been higher. During the ERP the government has taken steps to improve the incentives to public sector employees, by raising nominal wages and various allowances (URT 1988:29–30). In addition, teacher salaries were increased by an additional 25 per cent in 1987 (Andersson and Rosengart 1987:11).

A major part of the problem appears to have been of an organizational kind. The responsibility for health care, education and water provision is now shared between the central government and the local administrations. Local government was reintroduced in 1983, but has remained weak, both financially and administratively. The division of labour and responsibilities between central and the local authorities is unclear, however, and activities are often poorly co-ordinated. The extensive involvement of foreign donors in social sector programmes has further contributed to these organizational problems. In these respects, no major changes appear to have taken place during the ERP period.

The neglect of a social dimension in the ERP and the previous economic programmes

has been recognized and criticized in various contexts. Following the ERP, the government has adopted an Economic and Social Action Programme (ESAP), 1989/90–1991/92, also referred to as ERP II, where social aspects have been given explicit consideration. To improve the social infrastructure, significant emphasis is to be put on local participation, not only in raising funds, but also in initiating and administering various actions. User charges are to be employed to an increasing extent, and cost recovery and commercial considerations are to be used as guiding principles. Private sector activities are to be encouraged, for example, to supply drugs and school material, and in secondary education. In order to broaden the income base for poorer groups, informal sector activities, particularly in the urban areas, are to be promoted.[4]

Conclusion: partial success

The policy and reform measures of the ERP have been largely implemented. This is an indication of the sincere intentions of the government to accomplish change. The effects on the economy have been positive in many respects, even though most of the quantitative goals were not attained. However, the negative trend has been broken. The stabilization measures have had positive effects on both internal and external balance. However, they have only been partially effective. The increase in the rate of inflation has been halted, although the level remained high during the ERP period. In particular, monetary policy has failed. While the government has managed to keep the budget deficit within its projections, it has not been able to limit the monetary expansion which has contributed to maintaining the high rate of inflation. Moreover, the budget deficit remains large, and is almost entirely financed by external funds. The balance-of-payments position remains fragile. Officially recorded exports have increased only moderately, at least less than expected, and cover only about one-third of imports. Hence, Tanzania is likely to remain highly dependent on foreign aid for the foreseeable future.

Price distortions have been considerably reduced, mainly through price decontrol and a lower level of discrimination towards agriculture. Price signals are regaining their active role, that is, the market mechanism has been partly restored. This has alleviated the previous disequilibrium situation, since the excess demand for, for example, imports has been partly reduced.

Trade liberalization has created a greater role for the market mechanism in the allocation of resources. Furthermore, it has increased the scope for private activities, and thereby strengthened the role of the private sector in the economy. Consequently, the economic environment has generally become more competitive, which in turn has induced a shift from a seller’s to a buyer’s market. A stronger bargaining position for the consumer may be expected to activate countervailing forces – exit and voice – to the deteriorating performance in production, in terms of quality, efficiency and price and cost increases (cf. Hirschman 1970).

As a result of the liberalization of trade and the reduction of price distortions, structural adjustment has begun. Resource allocation is becoming more efficient. However, the process is slow. Economic recovery has certainly been initiated, although industrial performance remains poor and export performance is far from satisfactory.

The institutional changes imply that the role of administrative processes in the

allocation of resources has been reduced. A horizontal relationship – market co-ordination – has partly been substituted for a vertical relationship – bureaucratic co-ordination (cf. Kornai 1986). The changes have also led to a certain degree of decentralization of economic decision-making. The rules of the game facing the economic actors have been partly changed. Hence, by consolidating and extending certain earlier measures, the ERP has signalled a shift in both the emphasis and direction of government policy, towards a growing external involvement and a market economy.

INSTITUTIONAL RIGIDITIES

The institutional reforms of the ERP ought to have increased the flexibility of the economic system, making it more capable of responding to exogenous change. As it appears, however, flexibility has not been fully restored, but is held back by a lack of further institutional change.

While the increased competition and the shift towards a buyer's market puts pressure on enterprises to increase efficiency, the greater role for markets increases the incentives for enterprises to behave efficiently. How these changes in the economic environment affect the behaviour of economic institutions, however, depends on the ability of the latter to respond to changes. This will, in turn, be partly determined by the inherent mechanisms for decision-making within these economic institutions.

Institutional change during the ERP has only been partial. Major change has not taken place in important areas. The state sector remains essentially intact, and its rules of operation for decision-making are basically unchanged. Although the ERP has sought to improve the functioning of various state organizations, particularly agricultural marketing and industrial parastatals, the success criteria, the incentive structure, the degree of centralization versus autonomy, the softness of the budget constraint, and so on, do not appear to have changed to any significant extent (Eriksson 1991).[5]

The problem is well expressed in a World Bank report on Tanzanian parastatals (World Bank 1988:39):

> [W]hile the ERP provides strong incentives to parastatals – to the institutional entities – to improve performance, that fact does not automatically mean that board members, managers and employees of parastatals have comparably increased incentives. Since the Government, not any of these individuals, is the owner, no one with direct responsibilities is automatically and necessarily hurt by poor parastatal performance or rewarded for superior performance. . . . [I]n addition to being properly motivated, parastatals and their managers must have the capacity to respond in appropriate ways.

Thus, changes, for instance, in agricultural marketing, have taken place within a basically intact institutional framework. This has implied shifts in the functions of different organizations, or replacement of one organization by another, while the structure itself, and the rules governing it, have remained unchanged. In the case of industrial parastatals, the picture is somewhat unclear. There may be reasons to believe that pressure on the

parastatals to adapt their behaviour may have increased in sectors where the degree of competition has grown relative to other sectors where the lack of reform has prevented or delayed their adaptation to changing external conditions.

Decision-making within commercial parastatals in Tanzania, including agricultural marketing boards and co-operatives, has been highly centralized, with respect to both entrepreneurial and operational activities. Political interference, from the party and state bureaucracy, has been commonplace. Interference is closely related to the *nomenklatura*-like mode of appointment of enterprise managers, which has tended to create an incentive structure with its own logic, where loyalty has been an important success criterion.[6] Earnings have not been linked to financial performance indicators such as profitability (World Bank 1988:vi).

Intimately related to the weak parastatal autonomy and the *nomenklatura*-based loyalty is the soft budget constraint that faces parastatals. A soft budget constraint implies that there is no strict financial discipline on the firm, which, even if it is constantly making losses, can always count on being rescued by the state. In Tanzania industrial, agricultural and other commercial parastatals have been continuously bailed out by various mechanisms, mainly directly via the budget, for example, through subsidies, or via the banking system, which has granted them new credits in spite of accumulated losses, huge overdrafts and little or no prospects for future repayment.[7]

The soft budget constraint is, in turn, associated with the characteristics of the financial system, which in Tanzania resembles that of a monobank in the formerly centrally planned economies of Eastern Europe. The government budget is closely integrated with the banking system whose major task is to passively accommodate the financial needs of the state sector. This is precisely what the banks have done during the ERP. Even though government borrowing from the banking system was restricted, credit to the agricultural marketing institutions, in particular, was not subject to the same constraints. Marketing boards and co-operatives have not been financially accountable to the government, which has continuously stepped in to cover their losses, by ordering the banks to grant renewed credits, and by guaranteeing their accumulating debts.

Facing soft budget constraints, parastatal organizations have had little incentive to increase efficiency. Consequently their price responsiveness, particularly on the input side, has tended to remain weak. Thus, the soft budget constraint in the parastatal sector, in combination with the weak autonomy of the latter, contributes to the maintenance of a rigid economic system and may well explain part of the slow restructuring process in Tanzania. Adjustment to change takes time in the state sector. Instead of reallocating inputs, cutting costs, innovating, and so on, the firms tend to ask for compensation and protection. This has clearly been the case within agriculture, and possibly also within industry, albeit to a varying degree. The soft budget constraint and the weak autonomy of the parastatal sector may therefore explain an important part of its inefficiency.

The poorly functioning financial system has represented a major constraint in the adjustment and recovery process, not only for the state, but also for the private sector. The Tanzanian economy is financially disintegrated. There is no capital market, and financial resources are not channelled from excess supply to excess demand areas. Lack of financial sector reform may therefore limit price responsiveness in the private sector to, for example, devaluations. As a result of a lack of investment finance, private

enterprises have been prevented from setting up or expanding production in the now more profitable sectors. They have also been unable to shift to new, more cost-efficient production technologies. As firms are unable to reallocate their resources efficiently, the devaluations tend to spill over in price increases, fuelling inflation, while the restructuring of the economy proceeds slowly.

Thus, the absence, or partial nature, of institutional change appears to have retarded structural adjustment and economic recovery, and to have rendered stabilization policy partially ineffective. The efficiency of the macroeconomic policies of the ERP has been reduced since these policies were not coupled with a comprehensive reform of the economic system itself. As a result, incentives for efficient microeconomic behaviour have been partly lacking.

Weak confidence in official policies

When pursuing the ERP goals, the government has to some extent used market-oriented measures. It has consequently embarked on a process of systemic change. Whether the reforms will eventually lead to a change of the economic system still remains to be seen. In fact, the government and the party do not seem to know where the country is heading.

This has resulted in unclear and even ambiguous signals to the economic actors. While, on the one hand, the ERP has signalled a shift in the rules of the game, mainly by an extention of liberalization measures, the future role of the private sector is still unclear. Contradictory signals have been given. In the party programme for the 1987–2001 period, for instance, it is stated that the role of the private sector is limited to a transition period from capitalism to socialism, and that even during that period its role is to be secondary to that of the public sector (Simba and Mwapachu 1990:12,29).

Inconsistent government and party signals create uncertainty about the role of the private sector, for example, with respect to the future protection of private property. Private sector confidence in the government and its policy still appears to be weak, and uncertainty prevails as to the sustainability of recent policies. This acts as a major disincentive to private entrepreneurship, particularly long-term activities. Private sector activities have increased considerably in trade, although private investment has lagged behind. This has been the case within agriculture, where small-scale private trade predominates and there are few large traders, and practically no investment in, for example, storage. Thus, uncertainty about the rules of the game, due to partial or inconsistent changes, may also have contributed to the slow restructuring of the economy.

Conclusions: difficult reforms ahead

If economic growth is to be sustainable, and not a mere temporary phenomenon, further institutional change may be required. Since the major constraints to structural adjustment, macroeconomic stabilization and economic recovery seem to be located within the public sector, this is where change will have to come about. The issues that need to be addressed relate to the role of the state sector as a whole in the economy, with respect to both its functions and its size, as well as to its *modus operandi*, that is, its mechanisms for economic decision-making. In order to be able to provide social services and physical

infrastructure, for instance, a withdrawal of direct state engagement in activities, such as commercial trading, which could be performed by the private sector, may have to be seriously considered.

The current Economic and Social Programme (ESAP) continues the strategy of the ERP, using market-oriented measures to achieve the same macroeconomic goals. As mentioned above, however, the social sectors receive specific consideration. The institutional weaknesses within the public sector pointed to in this chapter are also recognized and addressed. Public sector reform, for example, with respect to agricultural marketing, parastatal enterprises and the financial system, is planned, and has to a certain extent been initiated. However, reform appears to proceed slowly.

In fact, the enhancement of public sector efficiency, for example, by increasing parastatal autonomy and introducing financial accountability, has been discussed and attempted during the whole of the 1980s, but little change in that direction has been accomplished (World Bank 1988:35–9). There are signs, however, that the government is more determined now. The 1990–1 budget speech (URT 1990) has, for instance, been considered as most radical and straightforward in this respect. The role of the private sector also appears to have been strengthened. In 1990 the government launched a policy for promotion and protection of private, including foreign, investment, which reflects what seems to be a changing official attitude towards the private sector, or at least an ambition to create faith among private actors.

The institutional changes ahead, that is, reform of the state sector itself, are likely to be far more difficult for the government to implement, whatever form they take, than the market-oriented reforms pursued so far. First, by questioning the role of the former priority sector, they are more controversial from a political point of view. The issue of privatization, for instance, appears to be so politically sensitive that it cannot be openly discussed. Second, and perhaps most importantly, strong resistance to reform can be expected from within the sector itself. This resistance may be particularly powerful, due to the large size of the sector and its specific mechanisms for decision-making.[8] Many lower-level employees risk losing their secure jobs. Moreover, those in higher positions, who have benefited from the *nomenklatura* system and its associated kickbacks, stand to lose their benefits if reforms that imply financial accountability are introduced or lead to privatization and an increased role for the private sector.[9] Public officials within the state and party bureaucracy as well as parastatal managers have strong incentives to maintain the status quo, and may therefore try to prevent successful reform from taking place. They may be successful, since they are in charge of implementing the reforms.

The economic system in Tanzania, that is, the institutions and mechanisms for economic decision-making, is to a large extent determined by the political system, expressed, for example, by party supremacy. As long as the party is supreme to all other state organs, there is a basis for *nomenklatura*, loyalty and kickbacks, and consequently a potential for effective resistance to state sector reform. Moreover, party supremacy is the basis for political interference in economic decision-making which contributes to weak managerial autonomy and soft budget constraints in parastatals. State sector reform, implying increased parastatal autonomy and financial accountability, may therefore prove ineffective – unless party supremacy is abolished.

To conclude, while we may on the one hand ask ourselves whether the success of

economic programmes of the ERP type in Tanzania may require institutional change in terms of fundamental reform of the economic system, we may, on the other hand, raise the issue of whether political reform is a necessary (although perhaps not sufficient) condition for such systemic change to take place.

NOTES

1 An economic system may be simply defined as the institutions and mechanisms for economic decision-making. These can be classified along a number of dimensions (Lindbeck 1973; Kornai 1986:1690). The simplest taxonomy is merely twofold: co-ordination mechanism and form of ownership of the means of production.

2 According to the 1988 Population Census, annual population growth 1978–88 was estimated at 2.8 per cent (URT 1989a:1).

3 See, for example, Larsson (1987); Maganya *et al.* (1988); and URT (1989d, 1989e).

4 See, for example, URT (1989b:23–7) and IMF (1990:21–4) for a brief presentation of the programme, and URT (1989f) for a more thorough one.

5 The concept of the soft budget constraint was coined by János Kornai and will be explained below. See, for example, Kornai (1979, 1986, 1990) for a more extensive treatment of the subject.

6 *Nomenklatura* implies the right of all levels of the party apparatus 'to "recommend" and "approve" appointments for all managerial positions in the economic (and public) administration and all managerial positions in enterprises' (Winiecki 1990:198).

7 The donor community has also contributed to the softening of the budget constraint, by continuing to support loss-making parastatals with, for example, foreign exchange. See Eriksson (1991:26–33) for an exploratory study of the soft budget constraint in Tanzanian parastatals.

8

> The public sector continues to be the largest employer in Tanzania, accounting for more than 80 percent of total wage employment. The civil service alone constitutes just under half of total public sector employment with the rest being employees of the parastatals.
>
> (URT 1989b:12)

9 Kickbacks are favours and returned favours, in terms of goods and services, from managers of mainly industrial enterprises, to 'those who appointed them, and to other superiors and colleagues who may advance their careers' (Winiecki 1990:200).

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15
ETHIOPIA: AWAY FROM SOCIALISM

*Göte Hansson**

INTRODUCTION

After seventeen years of military rule, Marxist-Leninist socialism, growing economic problems, and escalating civil war, the Ethiopian president, Mengistu Haile Mariam, fled the country on 21 May 1991. One week later, on 28 May, after unsuccessful peace negotiations in London, The Ethiopian People's Revolutionary Democratic Front, (EPRDF), took power by walking into a largely undefended Addis Ababa. In the first week of July the new leaders called for a National Conference on Peace and Democracy where the institutional frame for the immediate future of Ethiopia was discussed with representatives from the various liberation movements. It was decided that the United Nations Universal Declaration on Human Rights should be applied in Ethiopia. Furthermore, it was decided that a transitional government, consisting of a council of representatives and a council of ministers, should rule the country for the two coming years of transition. This transitional period is to be terminated when there has been a democratic election of a new parliament and a resulting new democratic government. By the same time the Eritrean people are to be given the right to decide on their country's future status of being a sovereign state or continuing to be a region within Ethiopia.

It is worth noting that the transitional parliament, the Council of Representatives, with eighty-seven representatives, consists of members from various ethnic groups, regional movements and political organizations. Thus, in a sense, Ethiopia today is a country that has taken a leap from being a one-party state led by one person, Mengistu Haile Mariam, to become a multiparty state which has entered on the path towards democracy.

The above-mentioned political change has resulted in expectations for changes in the Ethiopian economic system. As will be shown below, during the past seventeen years of socialist rule the Ethiopian economy has developed from a problematic but relatively stable and balanced macroeconomic situation to an economy in heavy distress. As in most other socialist countries, economic realities have led to the conclusion that economic systemic changes have to be introduced. In Ethiopia, announcements of economic reforms have been presented since the end of the 1980s.[1]

The aims of the present study are, first, to make a brief analysis of the current Ethiopian economic system in order to get a better understanding of the causes behind the past seventeen years of economic degradation, and second, to make a critical assessment of the intended economic reforms that are included in the transitional economic policy paper, *Ethiopia's Economic Policy During the Transitional Period* (TEP), that was decided upon by the council of representatives in November 1991. The new political situation and the intentions of the transitional government have improved Ethiopia's

position as a candidate for foreign assistance. Thus, the present study will also analyse the overall orientation of increased foreign assistance as a supplementary means in making the TEP successful. First, however, the next section will discuss the concept of economic systems and its various dimensions.

ECONOMIC SYSTEMS – DEFINITION AND DIMENSIONS

During the last couple of years the debate on the importance of economic systemic factors in explaining differences in economic performance among countries has increased in intensity (see, for example, Koopmans and Montias 1971; Prybyla 1969; Morris and Adelman 1989; Krueger 1990).

An economic system can be defined as the institutional, that is, the legal and political, framework that determines how the scarce resources of the economy are used.[2] Thus, the economic system defines the way economic decisions are made. A very topical issue is the question of how to design an economic system to achieve maximum efficiency, growth and economic development. In order to get a more complete picture of the concept of economic system and to get a framework for comparing the economic systems of different countries, Assar Lindbeck has defined the main dimensions of economic systems (Lindbeck 1973) (see Figure 15.1).

The first dimension describes on what level economic decision-making takes place. Are economic decisions made by a central authority, for example, the government, regional or local authorities, or are they made by individual

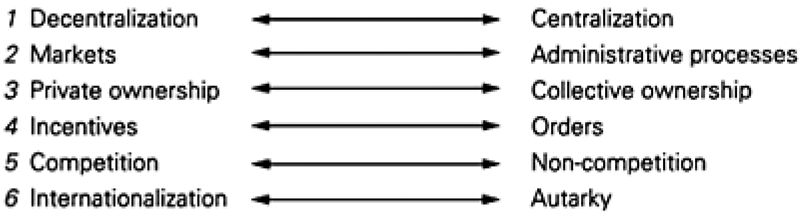

Figure 15.1 Main dimensions of economic systems

economic actors, that is, consumers, producers, capital owners, landowners, and employees? It is obvious that in real economic systems some economic decisions (for example on issues like the design of macroeconomic policy and the size of the public sector) are taken on the central level, while other types of decisions (for example, decisions on how to spend the major share of a household's income) are decentralized down to the household level. However, decisions on such activities as investment, production, employment, and on the division of consumption between public and private consumption are of a type which can be taken on the whole range of the *decentralization—centralization* scale. It should be noted that, as a rule, the higher the degree of centralization the more information is needed for efficient decision-making and the higher will be the costs related to implementation and control also.

The differences in the need for information and in the costs of control during

implementation also carry over to the second dimension, which describes whether markets or administrative processes are used as means in the allocation of resources. When markets are used, the income distribution, the prices, consumer preferences, and the production possibilities determine the allocation through the interaction of individual economic actors, whereas in a system with administrative processes, other information-intensive, and thereby also more costly, processes are used to decide and co-ordinate the resource allocation.

The third dimension relates to the structure of ownership. As a rule, it is assumed that private ownership requires much less control for efficient long-run utilization of capital and land than is the case when capital or land are publicly-owned or are owned collectively by individuals in various types of co-operatives.

The fourth dimension, which relates closely to the third, deals with the issue of how to make economic actors efficient. It is well known that incentives tend to be more efficacious than orders because they give the individual a feeling of being more free to act than is the case with orders. This, in turn, tends to increase the involvement, responsibility, and efficiency of individuals in their economic activities.

The fifth dimension, *competition—non-competition*, also emphasizes the efficiency aspect of economic activities. The higher the competition the more efficient will be the individual actors, for example, producers. Lack of competition tends to lead to higher costs and in time, to lower quality in production also.

The final dimension, *internationalization—autarky*, is closely related to the issue of competition but relates also to the possibilities of increasing the total income of a country by opening up its economy to trade and foreign investment. Through internationalization the degree of competition increases and foreign capital, raw material and foreign technology are made available for the country.

Finally, from the above brief discussion of the various systemic dimensions it follows that an economy's flexibility and ability to adjust to external and internal shocks are heavily dependent on the characteristics of the economic system. The further to the left along the scales of the six dimensions in Figure 15.1, the more flexible the economy tends to be.

It is obvious that, in the real world, we will not find economic systems that fall to the extreme left or right end of the scale in the schedule of systemic dimensions. Existing economic systems fall somewhere in between these extremes for each and every dimension. This creates consistency problems that easily reduce the efficiency in the allocation of resources. One of the most important consistency problems is related to the ownership dimension and the co-ordination (*market—administrative processes*) dimension. To achieve a market economy that functions efficiently, well-defined and protected property rights are of crucial importance. Recent research has shown that proper institutions are critical determinants of the nature and speed of development and that initial institutions seem to be more important than resources, capital, technology, or demography in the process of economic development (see, for example, Adelman 1991 and Oshima 1991).

THE ETHIOPIAN ECONOMIC SYSTEM

It is not an easy task to make a unique classification of existing economies into the schedule in Figure 15.1. Notwithstanding the difficulties, this section will try to characterize the economic systemic development in post-revolution Ethiopia in terms of the above-mentioned six dimensions.[3] The past seventeen years of economic policy in Ethiopia can be summarized under the following headings:[4]

(a) Nationalization
(b) Land reform
(c) Collectivization programme
(d) Villagization and resettlement programmes
(e) Distorting domestic incentives
(f) Heavy controls of international trade and foreign exchange.

Nationalization, in brief, moved the Ethiopian economy away from private to state ownership, that is, a change along the third dimension in Figure 15.1. The nationalization programme during the first years after the revolution in 1974 covered almost all large- and medium-scale manufacturing industries, mines, commercial farms, banks, insurance companies, transport companies (except road transports), wholesale trade, and a large share of construction companies.[5] To this should be added that all land was nationalized (see, for example, Clapham 1989:10f; 1990:46ff; Schwab 1985:26f). As a result, Ethiopia experienced a severe loss of entrepreneurs and thereby also of private capital and know-how. This resulted in reduced efficiency in more or less all non-peasant economic activities, for example, industries, trading and large-scale farming, where nationalization turned export-oriented profit-making commercial farms into state farms with poor management, thus wasting resources.

The **land reform,** on the other hand, was an important step with great potential in relation to efficiency in the peasant sector.[6] The ultimate aim of the land reform was, according to Ståhl to 'substitute the state for the landlords as the prime appropriator of agrarian surpluses' (Ståhl 1990:20). Thus, the land reform meant nationalization of land. But the major economic potential of the land reform was in its effects on the incentives in the dominant peasant agricultural sector, for example, dimension four in Figure 15.1, since it meant increased economic freedom for the individual peasants. This was the case in the southern parts of the country in particular, whereas in the northern provinces traditional Ethiopian feudalism was less frequent (see, for example, Cohen and Weintraub 1975:30ff; Brüne 1990; Pausewang 1990a).

However, the socialist ambitions soon outranged the potential positive effects of the reform. The **Collectivization** efforts (dimension 3), the **Villagization and resettlement programmes** (dimension 1), and the **Distortive domestic incentive system** with the Agricultural Marketing Corporation's (AMCs) monopoly in agricultural trading and compulsory grain delivery quotas for peasants and producer co-operatives (dimensions 2, 4, and 5), the heavy discrimination against individual private peasants with its emphasis on producer co-operatives and state farms in the allocation of resources (fertilizers, credit,

and extension services) (dimensions 2 and 4) undermined the agricultural sector at large.[7] In particular, the individual peasants suffered heavily from the distortive policy and the uncertainty in land tenure; even though the collectivization efforts failed, only 4 per cent of the peasants joined producer co-operatives.[8]

Other factors that have contributed to, and aggravated, the Ethiopian problems are the Ethiopian trade policy, with quantitative restrictions, trade taxes, and centralized allocation of foreign exchange, and the overvalued exchange rate due to the neglect of an active exchange rate policy during the entire socialist period. In terms of Figure 15.1, the development of Ethiopia's trade and exchange rate policy during the past seventeen years can be characterized as a change towards the right along the **internationalization—autarky** dimension. Thus, the trade and exchange rate policies have contributed to the depression of potential export production, both in agriculture and industry, and thereby undermined the potential for trade to work as an engine of growth in Ethiopia (see, for example, Hansson forthcoming).

In brief, in terms of the systemic dimensions presented in Figure 15.1, the economic system that has developed during the seventeen years of socialist rule in Ethiopia can be characterized as follows:

1 Highly-centralized resource allocation.
2 Administrative processes dominate the allocation of resources of production. Non-market prices on inputs and outputs. Orders, not prices, are the chief basis for industrial production and investments. Thus, by mid-1991 Ethiopia could be classified as being close to a command economy with growing parallel markets for consumer goods and some inputs.
3 Widespread state ownership in non-agriculture; state-owned land, mainly used and worked by private (individual) farmers.
4 Lack of incentives for individuals and companies. Insecure land tenure for peasants and an emphasis on state farms and, up to March 1990, on producer co-operatives in agriculture.
5 Lack of competition.
6 Heavy trade and exchange rate controls. Overvalued exchange rate and increasing illegal trade and parallel markets for foreign exchange.

This classification indicates that Ethiopia in 1991 falls quite far out on the right-hand side in relation to more or less all dimensions in Figure 15.1, thus indicating not only a very inefficient but also a very inflexible economy.

THE PERFORMANCE OF THE ETHIOPIAN ECONOMY

The economic development in Ethiopia since the revolution in 1974 has led to a situation even worse than the one leading up to the revolution. Figures 15.2–15.5 present the development in an economy with low economic growth, relatively high population growth; thus there is a negative trend in per capita income, per capita agricultural and food production as well as in per capita food availability. Furthermore, Ethiopia has experienced rapidly-increasing inflation during the last couple of years and a very rapid

deterioration of her fiscal and current accounts.

In times of economic crisis, in particular when there are growing trade deficits and balance-of-payment problems, it is very popular and attractive for governments to blame factors that fall outside their control, that is, external factors. This has been the case particularly in the less developed countries, where terms of trade development, unfavourable interest rates, dependence on the international business cycle, trade and exchange rate policies in the industrialized countries are often advanced as *the* major causes of the prevailing problems in the Third World. In an integrated world, dependence and interdependence are major characteristics. For countries whose economies are small in the international perspective (Ethiopia, for example) the outer world defines a framework within which the small country has to operate and try to optimize its performance. In such a world, external factors always have an influence, for good or for bad, on the economic development. However, the government in the respective small country has a great responsibility also since it is the government that defines

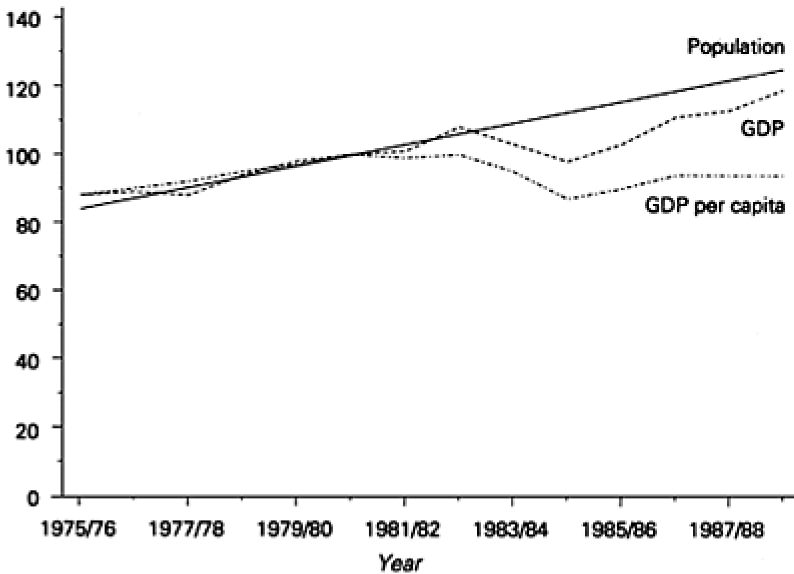

Figure 15.2 Ethopia: development of population, GDP and GDP per capita (index, 1980/81 = 100, GDP at constant 1980/81 market prices)

Sources: Central Statistical Authority, *Statistical Abstracts*, various issues.

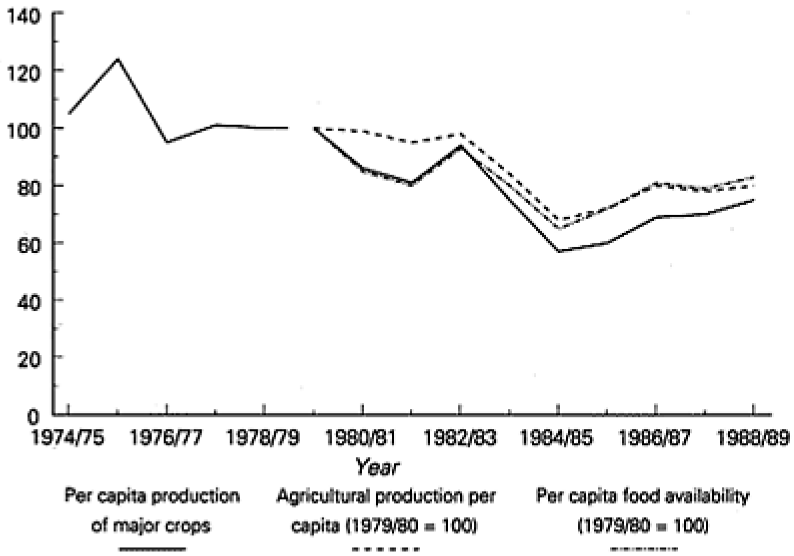

Figure 15.3 Ethiopia: agricultural production and food availability (volume, per capita, index, 1978/79 = 100 for 1974/75–1978/79; 1979/80 = 100 for 1979/80–1988/89)

Source: Central Statistical Authority.

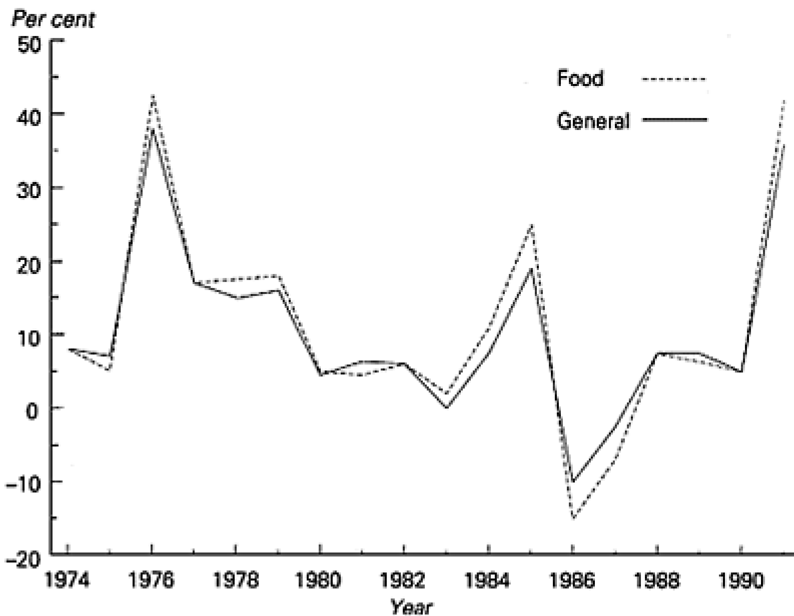

Figure 15.4 Ethiopia: inflation rates (annual average percentage changes in Addis Ababa retail price index)
Source: Central Statistical Authority.

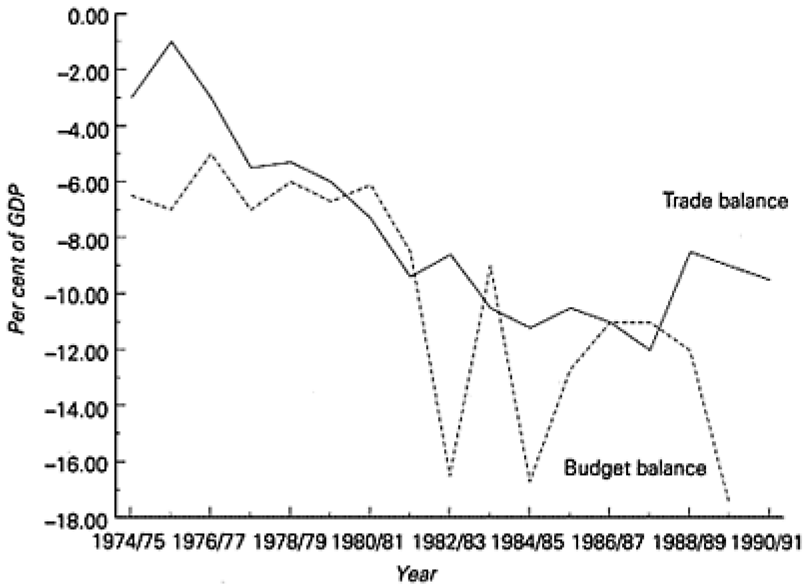

Figure 15.5 Ethiopia: trade and budget deficits (per cent of GDP)
Source: National Accounts Division, National Committee for Central Planning (NCCP).

the degree of openness and thus the extent of the international influence over the development in the country. The national government has the responsibility for the domestic economic policy also.

Looking at some of the major external factors affecting the situation in Ethiopia, Figure 15.6 shows the terms of trade development since the early 1970s up to 1988. From this diagram it is clear that even if terms of trade have deteriorated during the last couple of years, the development of terms of trade over the whole period cannot be blamed for the continuous deterioration of the trade balance and the overall economic situation. The same is true for the coffee quotas allocated to Ethiopia. For various domestic reasons, mainly lack of incentives, Ethiopia did not succeed in filling her quota during the 1980s when the deterioration of the economy was very fast.

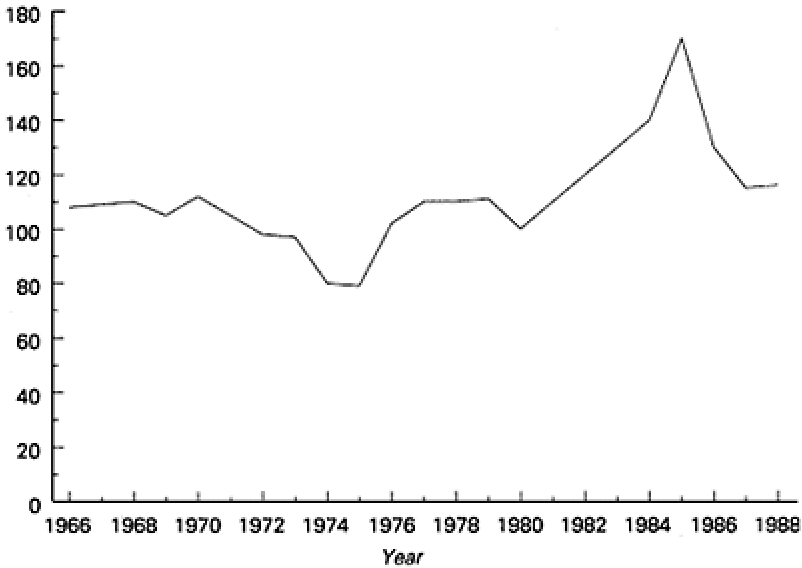

Figure 15.6 Ethiopia: net barter terms of trade (index, 1980 = 100)
Source: World Bank (1990: Annex Table 3.13).

The trade policy of the industrialized world, members of the Organization for Economic Co-operation and Development (OECD), is an obvious obstacle for trade-led growth and development in the Third World. Through the Lomé agreement the European Community (EC) gives preferences to trade from many countries in Sub-Saharan Africa, including Ethiopia. However, the agricultural policy in the EC, with its dumping of surplus agricultural production on the world market, is an important obstacle to lessdeveloped countries' trade in agricultural products. Even so, given the terms of trade development during the past seventeen years, together with the fact that Ethiopia has not succeeded in filling her quotas for her major export product (thus, the problem has been a problem of export supply rather than of the external demand and international price), the external factors cannot be claimed to be one of the major causes behind the negative economic development during the period of socialist rule.

The external economic policy, for example the trade and exchange rate policy, of Ethiopia is of crucial importance for her economic performance, in particular for the development of her foreign trade account. As mentioned above, the exchange rate policy during the socialist period has been passive. Since the revolution, the Ethiopian birr has been in a completely fixed relationship with the US dollar. From the above description of the growing trade deficit it is obvious that the Ethiopian birr is overvalued. Thus, there has long been an urgent need for a devaluation. Furthermore, since early 1973, when the Bretton Woods monetary system with fixed exchange rates came to an end, there are no a priori motives for a country to peg its currency completely to the US dollar or any other specific currency. Considering that the European countries, not the US, are the major

trading partners of Ethiopia, the birr should not be pegged to the US dollar but to a basket of currencies where the European currencies have a heavy weight.[9]

It is worth noting also that the current exchange rate policy is not a policy of fixed exchange rates. The case is rather the opposite. One consequence of the lack of a proper exchange rate policy is shown in Figure 15.7, from which it can be concluded that after the revolution and up to 1985, the real effective exchange rate for Ethiopia increased at the same time as the trade deficit increased. By the same reason, the real effective exchange rate has decreased (however, not enough to compensate for the pre-1985 development) during the last couple of years when the US dollar has depreciated in the foreign exchange market. The clear-cut correlation between the two curves underlines the importance of pursuing an appropriate exchange rate policy.

The civil war has contributed to the problematic economic situation in many ways. Besides its devastating effects on human capital, it has destroyed physical means of production also. By its negative effects on the infrastructure, and by occupying a large proportion of the means of transport, the war has contributed to the poor production and trade performance. Because of the need for low-cost food for the soldiers, the prices on agricultural produce have been kept down, thus reducing the incentives for efficient agricultural production. Furthermore, the civil war has increased the need for imports of fuel and military equipment and thus contributed to the rapid development of the trade and budget deficits.

The population growth, at present 3 per cent annually, has been, and still is, another problem in Ethiopia. This high growth rate makes the Ethiopian population heavily biased towards people in economically non-active age

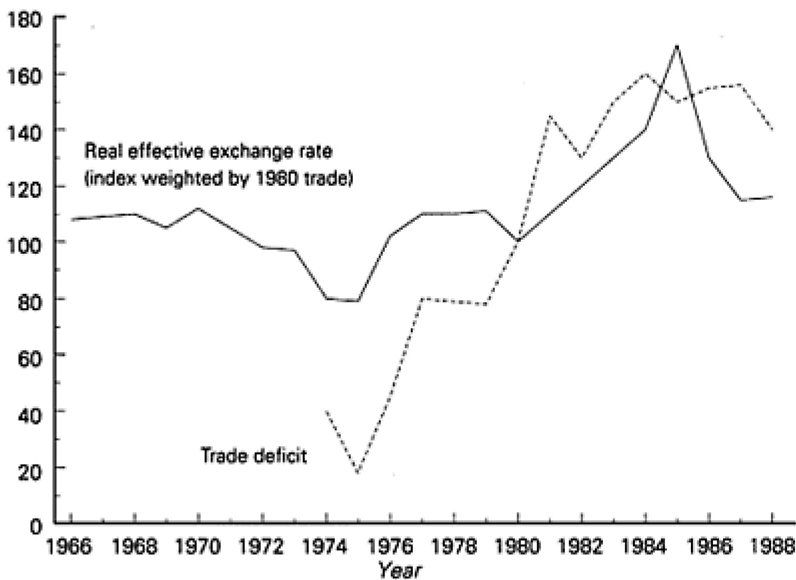

Figure 15.7 Ethiopia: development of real effective exchange rate and trade deficit (index, 1980 = 100)

Sources: World Bank (1990: Annex Table 3.12); National Accounts Division, NCCP.

groups; around 50 per cent of the population is below the age of 15, which places a heavy burden on the economically-active population.

The population growth, together with the poor performance in production, has led to a low per capita income, production and export. Figure 15.8 shows how the official per capita export volume of the major Ethiopian export commodities has decreased during the years of socialist rule. In fact, total official Ethiopian export per capita has decreased to one of the very lowest among the countries reported in the World Bank's *World Development Report* (1991). In 1989 Ethiopian per capita export amounted to around 20 per cent of the average per capita export for low income countries and to less than 15 per cent of the average for Sub-Saharan Africa.

As a result of the poor economic performance, the concomitant increasing fiscal and trade deficits, and the continuously over-valued Ethiopian birr, Ethiopia has changed from being a country with an insignificant external debt and debt service ratio in the 1970s to becoming a heavily indebted country, where the accumulated debt amounts to 58 per cent of gross domestic product (GDP) and debt servicing accounts for 76 per cent of the export revenues (TEP:8). This in turn has made international reserves very scarce. In 1991 the stock of international reserves was more or less totally depleted (see Figure 15.9).

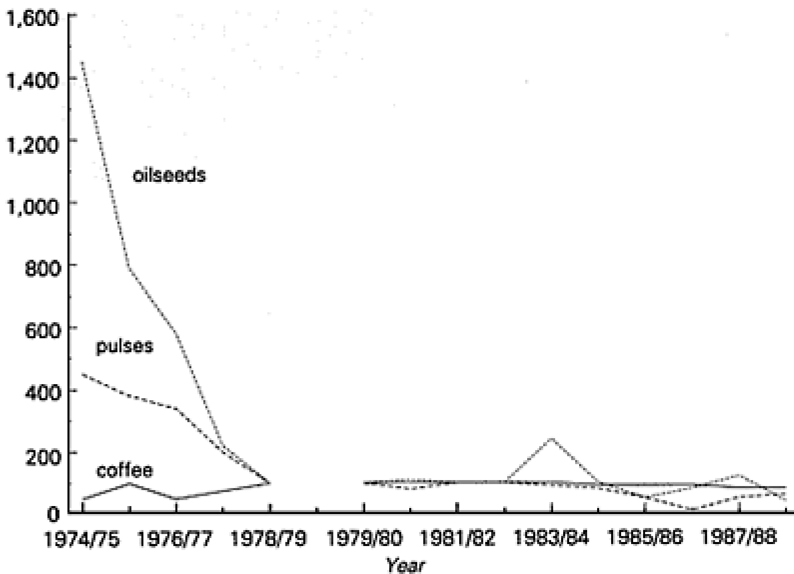

Figure 15.8(a) Ethiopia: per capita crop exports (volume, index, 1978/79 = 100 for 1974/75–1978/79; 1979/80 = 100 for 1979/80–1987/88)

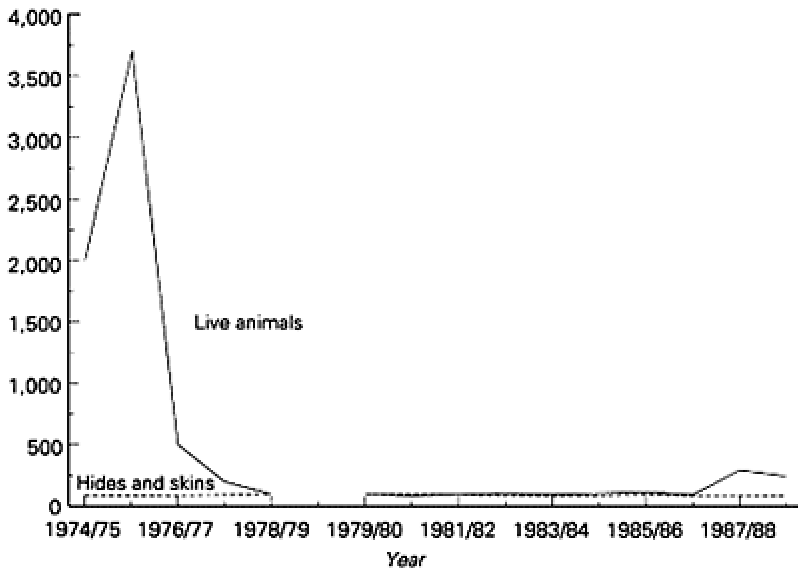

Figure 15.8(b) Ethiopia: per capita exports of hides and skins and live animals (volume, index, 1978/79 = 100 for 1974/75–1978/79; 1979/80 = 100 for 1979/80–1987/88)

Source: Customs Office.

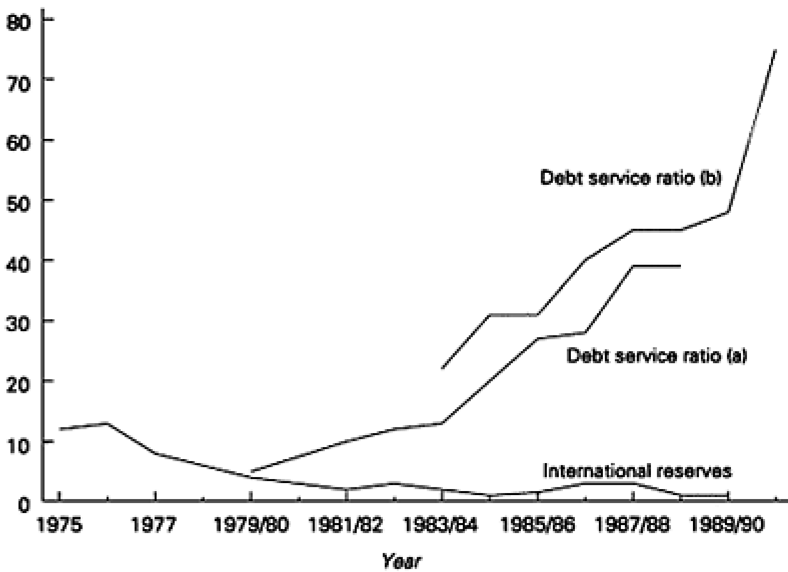

Figure 15.9 Ethiopia: debt service ratio (per cent of exports) and

international reserves (months of import cover)
Sources: Debt service ratios: series (a): World Bank 1987:5; 1989: Table 21; 1990:4; IMF 1988:iv.
Debt service ratios: series (b): Ministry of Finance unpublished data and *Ethiopia's Economic Policy During the Transitional Period,* Addis Ababa, 1991:8. International reserves: *National Bank of Ethiopia.*

POST-MENGISTU ETHIOPIA – AWAY FROM SOCIALISM?

The survey of the performance of the post-revolutionary Ethiopian economy points to a number of problems. Today there is close to complete agreement on the view that in economies with an economic system like that in Ethiopia there is much to be gained from an economic systemic change that reduces central planning and gives more weight to the market mechanism and thus more autonomy to the various individual economic actors. Is, then, such a change under way in Ethiopia after the overthrow of the Mengistu government, and if so what are the potentials of and obstacles to such a systemic change?

By the end of the 1980s, in November 1988, at the Ninth Plenum of the Central Committee of the Workers' Party of Ethiopia, the Mengistu government for the first time sent some signals that some changes in the economic system were being considered.[10] However, the signals were far from clear cut and they were not followed by the introduction of any important policy initiatives or measures, nor by any new signals supporting the initial ones, with the exception of a joint venture proclamation in June 1989. Instead, the emphasis on the old socialist policy continued.

By early 1990 the economic and political (read military) situation had reached a stage where some far-reaching initiatives were called for to keep up the fighting spirit of Ethiopians and to make the International Monetary Fund (IMF), the World Bank and bilateral aid donors more positive to the Mengistu government. Thus, in a speech on 5 March 1990, President Mengistu Haile Mariam announced a far-reaching economic reform programme and also introduced important changes regarding land tenure and agricultural marketing, and a legal possibility to dismantle producer co-operatives.[11] These changes had an immediate impact on the agricultural sector, even if the changes in land tenure were not followed up by legislation by the Mengistu government. Notwithstanding the content of the 5 March announcement and the above-mentioned reforms, the flow of external resources did not increase as expected or hoped for by the Mengistu government. Instead, the criticism from the aid donors continued, in particular they focused on the ongoing civil war.

The result of the weak response from the donor community was that the implementation of the reform programme began to meet with internal opposition within the Ethiopian government. Thus, the implementation in terms of introducing changes in policy and legislation, except for those mentioned above, become very slow.

When the tasks of the transitional government were defined in July 1991, not much was said on the issue of economic reforms. However, this did not mean that there were to be no changes in the Ethiopian economic system during the transitional period. In August 1991 Prime Minister Tamrat Layne prepared a draft paper on the economic policy of

Ethiopia during the transition. The major objective of the economic policy during the transitional period was stated to be relief and rehabilitation. After a public debate, where the public and various political, business and other organizations were invited to give their views and suggestions for changes, decisions on the transitional economic policy (TEP) were taken by the Council of Representatives in November 1991.

Although the decision on the TEP is so recent, the draft policy paper and the process of developing an economic policy through a public debate make both the declaration and the forerunning draft policy paper interesting policy documents. Considered together with personal interviews and discussions with civil servants and members of the new government on the economic situation and on the content of the draft policy paper, the TEP and the draft policy paper can be used as quite reliable sources on the intentions of the new government in terms of economic policy and systemic changes.

The changed role of the state

In socialist Ethiopia the state played a dominant role. In the 1990 reform announcement there were no explicit changes of the role of the state, with the exception of a change in the attitude to state enterprises. The transitional government, on the other hand, immediately started to question the role of the state. However, the draft policy paper was quite confusing with regard to this issue. In particular the motives behind state involvement in economic activities were unclear.[12] In the TEP, however, the role of the state is much more clearly defined. There it is explicitly stated that ‘it is evident that in the past state control over the entire economy was the major cause of economic decline’ (TEP:17). Therefore, in transitional Ethiopia, the role of the state is to be changed to be as follows (TEP:17ff):

- To design economic policies and map out economic development strategies; to promulgate laws and regulations that foster economic development;
- To participate directly or through joint venture arrangements in activities that are considered essential and in which the private sector is not willing to participate;
- To design, implement and supervise the expansion of infrastructure, research and development, manpower training, etc. as a basis for economic expansion;
- To create enabling conditions that will encourage private capital participation and expansion and popular participation;
- To protect consumers and producers against price fluctuations and take regulatory measures to prevent shortages of basic commodities;
- To promote private investment. Therefore the State shall:

  (i) Create enabling conditions for the participation of both domestic and foreign private capital in various economic activities without any capital limitation;
  (ii) Remove all existing bureaucratic procedures and red-tape and introduce new laws and regulations and enforce them to enhance domestic and foreign private capital participation;
  (iii) Provide incentives and encouragements to promote domestic capital participation; encourage a wider participation of private foreign capital.
  (iv) Provide special encouragements to communities participating in economic

development free from state interference.

- To promote public involvement in development. Therefore:
  (i) Public involvement in discussions and implementation of the TEP should be encouraged and be free from state interference;
  (ii) Local administrative organs must be given the opportunity to play a greater role in the implementation of the economic policy as well as relief and rehabilitation programmes, not on the basis of compulsion but on a voluntary basis and in line with the interests of the public.
- To mobilize external resources;
- To involve national and regional administrative organs in economic management;
- To prepare macro-economic policies consistent with the new economic policy. Therefore, existing policies and laws must be revised and complemented by new policies and laws, e.g.
  (i) policies, laws and regulations regarding money supply, credit and interests, taxes and investment that encourage private sector participation and facilitate and encourage the efficient operation of existing establishments;
  (ii) a new labour law that promotes productivity and efficiency and that protects the rights of the workers;
  (iii) a population policy which ensures a balance between rates of population and economic growth;
  (iv) a technology policy to ensure the development of all sectors as a basis for sustained growth.

From this list it can be concluded that the intentions announced by the former president, Mengistu Haile Mariam, in his speech on 5 March 1990, that is, that the Ethiopian economic strategy will be that of a mixed economy where the private sector will be encouraged and strengthened in all ways, are followed by the transitional government. The TEP goes far beyond the 1990 reform announcement by not just declaring that there is to be a change over to a mixed economy, but by clearly defining the role that the state should play in a non-socialist economic system without creating systemic consistency problems. In particular, the last point in the list above dealing with legislation should be noted. The importance of revising institutions and legislation has often been overlooked in economic reform or structural adjustment programmes, but this is of the utmost importance if a systemic change from socialism over to a market-oriented economy with private enterprises is to become successful. Furthermore, in the TEP the role of the state in relation to private capital has been clarified, both compared to what was the case in the 1990 reform announcement and in the draft policy paper on the economic policy during the transitional period.

If implemented successfully, the changes in the role of the state will move the economy towards a higher degree of private ownership (dimension 3 in Figure 15.1) and a resource allocation based on market prices and incentives rather than on administrative processes and orders (dimensions 2 and 4 in Figure 15.1).

After having concluded that the TEP means a far-reaching reform of the role of the

state in the Ethiopian economy, now let us turn to the implications of the TEP for some specific sectors.

Changes for agriculture

The transitional government, like the Mengistu government, emphasizes the importance of a land tenure reform. Agriculture, since it is by far the most important sector of the economy, employing some 85 per cent of the labour force, accounting for 40–45 per cent of GDP and 85 per cent of exports, is the sector from which Ethiopia must take its point of departure for growth and development. The productivity of the agricultural sector must be improved so that a growing agricultural surplus can be produced in order to reduce the need for food imports, but also in order to produce an exportable surplus and thus make agriculture produce the 'fuel' for Ethiopian trade to work as an engine of growth, industrialization and development.[13]

Among the factors that have led to the poor economic performance in Ethiopia the various types of discrimination and uncertainties of individual peasants should be given special attention. This was done already by the Mengistu government, which in March 1990 stopped the drive for collectivization, allowed for the dismantling of producer co-operatives (today there are no producer co-operatives left), and liberalized the grain trade. However, there are still important uncertainties about the land tenure system, in particular regarding the property rights defining the operational framework of peasant farming in the long run. In the reform programme of 5 March 1990, it was stated that the land should be owned by the state. It should be noted that the issue of land ownership is highly controversial. In fact, it is so controversial that in the TEP the question of land ownership is postponed until the end of the transitional period (TEP:21). However, both in the draft policy paper and the definitive TEP it is stated that the individual peasant's right to use a specific plot will be indefinite in time and can be transferred to his or her legal heirs who also derive their livelihood from farming. One problem in imperial as well as in socialist Ethiopia has been the frequent redistributions of land, which have made long-term investments in land conservation, fertilizing and planting of perennial crops risky activities with the individual peasant bearing the whole risk. Already the March 1990 reform announcement dealt with this issue, and besides the guarantee given for indefinite user rights, it was declared that trees and other perennial plants grown on the land will be owned by the respective peasants. Finally, according to the reform announcement, individual peasants are to be given the right to hire workers for farm work. On all these issues the TEP continues the initiatives taken by the Mengistu regime in March 1990.

As regards other incentives, the TEP sets out to eliminate the special contributions imposed by the Mengistu government on the agricultural sector. The farmers shall, accordingly, be liable or accountable only for payment of normal taxes. Furthermore, the policy introduced in March 1990 on agricultural marketing, meaning that agricultural producers will be allowed to sell their produce in the free market, will be continued by the transitional government also.

The supply of extension services, fertilizers, improved seeds and farm implements, were all concentrated heavily to state farms and producer co-operatives during the Mengistu regime. In the TEP it is declared that a major part of the budget and manpower

will be allocated by the state to agriculture in order to rehabilitate and develop peasant agriculture (TEP:22). The support to peasant agriculture will take the form of, for example, an expansion of the rural roads, and an increased availability of improved seeds, fertilizers and agricultural experts in peasant agriculture.

It goes without saying that the policy reorientation regarding peasant agriculture will have important positive effects on the performance of this dominating sector of the Ethiopian economy and will strengthen the tendency to economic systemic change in relation to ownership, incentives and resource allocation in general. That peasants are responsive to changes in the conditions related to their production can be seen in the reactions that followed upon the March 1990 reforms of peasant agriculture. One year after the speech by the president, peasants had increased the cultivated area by 12–20 per cent and agricultural production was estimated to have increased between 5 and 7 per cent.[14]

However, Ethiopian agriculture is not only peasant agriculture. In imperial Ethiopia commercial farms played an important role. In socialist Ethiopia these farms were turned into state farms. Later on there was an expansion of the state farms also, in some cases by means of forced labour. It is widely known that the state farms are frequently highly inefficient, sometimes even producing a negative value added.

In the 1990 reform announcement, President Mengistu declared that private investors should be allowed to establish modern large farms. The importance of making private investors enter into agriculture is underlined and strengthened in the transitional government's policy documents, according to which private commercial farming will not only be permitted but will be promoted and encouraged and no capital limit will be set on investments. Thus, in the TEP the role of state farms is largely reduced. However, it is stated that: 'When necessary, the state may operate those state farms that are strategic to the economy jointly with domestic or foreign private capital' (TEP:26).

Finally, in terms of agricultural policy it is interesting to note that the highly-debated, resisted, criticized, and costly villagization programmes and forced resettlement schemes, that were introduced by the Mengistu regime, will not continue during the transitional period (TEP:23f).

Changes for industry and services

With regard to non-agricultural sectors, the draft policy paper and the TEP are both much more explicit and detailed than was the economic reform announcement of 5 March 1990. In the latter there were quite general statements on state enterprises and private sector encouragement. The 1990 reform announcement also included a paragraph according to which private traders should be given the right (after registration) to compete without any restrictions with the state-run enterprises in all sectors of the economy. In the grain trade this change was implemented immediately.

The draft policy paper and the TEP, on the other hand, go explicitly into deeper details in relation to the above-mentioned fields of policy. This does, however, not automatically mean that, from the point of efficiency and growth potentials, the draft policy paper was superior to the 1990 reform announcement. In fact the draft policy paper contained a number of confusions and contradictions, in particular regarding the role of the state in

the Ethiopian industry and service sectors. However, as noted in the section on the role of the state, adjustments have been made in the TEP which eliminate most of these weaknesses.

The 1990 announcement was already quite clear in stating that private companies will be allowed to compete with state companies in all fields of economic activity without any restrictions. However, between March 1990 and May 1991 not much implementation of this policy was seen. Turning to the transitional government's policy papers there is no such clear-cut statement on private companies. Instead, according to the TEP, a very limited number of establishments that are essential for the development of the economy will continue to be either public or jointly-owned by the state and private capital owners. Furthermore, according to the above list on the role of the state, the state can also be active as the sole or joint owner in establishments in which the private sector is not willing to participate.

From the point of economic efficiency, there is no general a priori reason for having state-owned industrial establishments, with the possible exception of energy establishments (read electricity). Thus, the normal thing should be to have them run by the private sector. Here the transitional government has to develop an even clearer strategy in choosing where to remain, or step in, as owner than that which is stated in the TEP.

It is interesting to note also that, according to both the draft policy paper and the TEP, the remaining establishments under state, or joint state-private, ownership are to have full autonomy and be governed by a board where the workers are to have one-third of the votes (TEP:28). The governing criterion for these enterprises should be profitability. Furthermore, it is stated that during the transitional period the focus is to be on attaining full capacity utilization, higher efficiency and profitability. It is important to note the obvious risk of inconsistency in aiming at all these objectives. In a country like Ethiopia, where investments have been determined through administrative processes, profitability is likely to be maximized at a level of production that falls below full capacity utilization. From an efficiency point of view, in a market-oriented economy with profitability as the governing management criterion, it is important to define clearly the role of managers and the management boards. It is likewise important to make a clear distinction between this role and the role of workers and their representatives. Thus, the proposed one-third of the votes to the workers can be expected to be a barrier to making state enterprises profitable and efficient. The objective behind the heavy worker representation in management boards, namely, to achieve harmony between managers and workers, can be achieved in other ways, for instance, by various types of information channels with regular meetings where, however, the manager and the management board, not the workers, take the overall responsibility for the decisions and the operation of the establishment.

Like the 1990 announcement on economic reforms, the transitional government gives private capital a very central role in industrial development. However, as far as the relationship between domestic and foreign capital is concerned, the TEP contains a problem by stating: 'Domestic investors should always receive preferential treatment unless it is established that a given activity is beyond their capacity' (TEP:29f). It is of the utmost importance that the role of, and rules for, foreign investors and entrepreneurs

and their treatment relative to domestic investors and entrepreneurs are clearly defined and supervised if the greatly needed net flow of private capital into Ethiopia is to become a reality.

A crucial sector for economic recovery in Ethiopia is the transport sector. In the 1990 reform announcement the transport sector was not explicitly dealt with. However, in the draft policy paper and the TEP, the transport sector is given due attention. This sector, also, will be opened up for private capital. Since, according to the transitional government, there is at present not enough capacity in the private sector to run air, sea and rail transports, such operations, with the exception of medium-sized air and rail operations, will be under public control during the transitional period (TEP:37). Regardless of this, for the operation of these services, profitability and thereby efficiency, is to be the governing principle (TEP:39).

For road transports, the road transport administration, transport corporations and companies are to be dissolved. Instead, private capital is to be encouraged to play a major role (TEP:39f). Thus, government road transport companies are to be sold or be turned into joint ventures. Furthermore, the government is to promote the formation of private transport associations. It is not specified what type of promotion will be used in this respect. In order to avoid unnecessary state involvement it is important to leave it to the private operators to decide on how to co-operate and to base these decisions on efficiency and profitability considerations. To offer short-term management education to private road transport operators is probably the type of promotion that is most efficient.

Furthermore, in the future government regulation of road transport is to be carried out through the Road Transport Authority. It is interesting to note that existing controls of private-sector transports are to be removed. However, it is also stated in the draft policy paper that a new tariff structure 'is a must' and the TEP declares that a new tariff structure will be issued. In negotiations with the World Bank on an Emergency Recovery and Reconstruction Project, in February 1992 the transitional government agreed to raise the freight tariffs immediately by 70 per cent and to remove them before the end of 1992.

One of the points of the 1990 economic reform programme that was implemented immediately was the reform of domestic trade, dismantling the AMC monopoly and dissolving the grain control stations. The transitional government declares that it will continue this policy. Accordingly, the state monopoly in wholesale trade is to be broken up and this trade is to be left to the private sector. According to the TEP, the future role of the state in wholesale trading will be to 'pave the way for domestic private capital to play the dominant role in wholesale trade' and to issue laws and policies to regulate private sector activities in the sector (TEP:30). Furthermore, it is stated that the only case that motivates state trading in wholesale trade will be when there is a need to stabilize prices on basic consumer goods (TEP:31). In the case of retail trade it is clearly declared that this should be left completely to the private sector and that the government is to perform only its regulatory functions. Thus, in the field of domestic trade the intentions of the transitional government, if implemented successfully, mean a very drastic and, from the point of view of economic efficiency, a very positive change from the present situation.

According to the draft policy paper, foreign trade is to be left to the private sector. Having said this, however, the draft policy paper states that 'Although the private sector

will play a major role in foreign trade, the Government may also engage itself in the imports and exports of major commodities such as petroleum and coffee.'[15] No explicit reason is given for this intervention into foreign trade activities and it is difficult to see any economic or efficiency reasons why, in an economy such as that aimed at by the transitional government, the state should be involved as a trader in foreign trade. In the TEP it is stated that 'the state will end its monopoly over foreign trade, and instead, limit its control to areas that cut across sectors, in consideration of the problems that may be encountered if left to private capital' (TEP:32). Even if this looks like a step towards a policy more in line with the overall objectives of the TEP, the precise meaning of this statement is not clear.

In contemporary Ethiopia financial institutions, that is, banks and insurance companies, are not very well suited to play the important role that the intended economic system demands from them. Notwithstanding this fact, in the 1990 reform the financial institutions were completely neglected. In the draft policy paper it was stated that the financial institutions are to continue to be under public control and state ownership during the transitional period. No explicit motives for this view were given. Like other companies in the economy, the financial institutions are to be given greater autonomy to design their operations in accordance with the profitability criterion. In the public debate on the draft policy paper there were demands for letting private banks and insurance companies operate in Ethiopia. This would increase efficiency in the allocation of capital, provided that proper legislation that gives protection to the customers of the financial institutions is introduced also. However, no change in the government's attitude on the ownership issue in relation to financial institutions is presented in the TEP.

Changes in foreign trade and exchange rate policy

In economic reform and structural adjustment programmes, as a rule, changes in foreign trade and exchange rate policy are very crucial components. However, in the March 1990 reform programme these issues were completely neglected. The policy documents presented by the transitional government, on the other hand, announce clear and positive changes in both trade and exchange rate policies. In order to promote exporters, quantitative restrictions will be replaced with tariffs (TEP:32f). This is a positive change, not only in relation to exports but also for the overall allocation of resources in the economy. Furthermore, it is stated that bureaucracy related to foreign trade is to be minimized and investments in export-oriented activities are to be stimulated. Thus, in the field of foreign trade, the TEP means a clear-cut positive reorientation.

Furthermore, regarding trade policy, the TEP states that 'the state will ensure prudent utilization and allocation of foreign exchange' (TEP:33). Therefore, all exporters are to deliver all their foreign exchange earnings to the state in exchange for local currency, some of which, after approval by the state, can be exchanged back into foreign currency for business expansion.

The above procedure is understandable in a country that has long been governed, not by markets, but by various regulations and administrative procedures, and where, at the time of making the statement, the trade deficit has long been a real and growing problem; international reserves are more or less completely depleted, while debt and the need for

foreign exchange to service this debt grow very fast. However, in spite of this acute economic situation, the suggested procedure of foreign exchange allocation may easily turn the economy back to a situation of central planning. Of course, there are types of government needs that should be given priority, but when it comes to allocation within the private sector and also between the major share of public sector activities and the private sector activities, there are no efficiency gains to be made from such central allocation procedures.

Furthermore, it should be noted that foreign exchange that has been obtained in other ways than official exports (for example, through the Ethiopian franco valuta system, which allows holders of foreign exchange to import without declaring the source of the foreign currency) can be used freely for imports. Naturally, this possibility means an important incentive for illegal trade. It is a well-known fact in Ethiopia today that there is a considerable illegal trade (for example, smuggling of coffee out of the country to Kenya); some estimates point to illegal exports amounting to as much as 40–45 per cent of the official exports. This in turn not only takes away foreign exchange from control and allocation by the state, but also reduces the tax basis of the country.

It was noted above that there has been an exchange rate misalignment in Ethiopia. The birr has been completely pegged to the US dollar since the revolution at a constant exchange rate, US $1 = 2.07 br. That this has not been the optimal policy is obvious from the previous analysis of the performance of the Ethiopian economy. The transitional government is clearly aware of this. Unlike the Mengistu government, the transitional government declares that corrective measures should be taken (TEP:35). However, regarding when and how to make the adjustment, it is stated in the draft policy paper that in the short run,

> devaluation is bound to result in inflationary pressures, aggravate problems of unemployment and lead to further decline in output, thereby endangering the processes of peace and democratization. . . . Therefore, unless devaluation is handled carefully and introduced on a phased basis, based on progress in economic recovery, it is bound to have adverse consequences on the economy.[16]

The same view is presented in the TEP where it is concluded that ‘exchange rate adjustment should be a gradual process to be undertaken in tandem with improvements in the performance of the economy. . . .’ (TEP:36).

The above views are not motivated at length but interviews conducted in ministries during October/November 1991 and January 1992 have identified the high import contents of inputs into domestic industry as one major reason behind the fear that a devaluation will give rise to increased inflation and unemployment. However, if this link really exists it can be expected that the effects would be of short duration. The reason is that domestic input production can be expected to start when prices rise as a consequence of reduced competition from abroad, which will make imported inputs more expensive. During the start-up period the negative effects can be compensated for through donor-financed import support. However, this may not be necessary other than in some specific branches. The reason is that, in many cases, smuggling and trading at the parallel exchange rate seem to have increased to quite high levels during the second half of 1991

as a consequence of lack of control and the above-mentioned franco valuta system. The higher this share, the less inflationary and problematic will be the change in exchange rate. The smaller, also, will be the real or total effect on exports even if the official figures can be expected to increase significantly. If the correction of the exchange rate makes the official rate come close to the parallel one, smuggling, and so on, may cease to be profitable.

Balancing the state budget

Finally, as regards the important issue of improving the state budget balance, which is generally a component feature in much criticism of economic reform or structural adjustment programmes, the transitional government goes beyond the former Mengistu government by announcing a tax reform. However, no details are presented but it is declared that 'the state should take urgent measures for achieving fiscal balance' (TEP:36). Thus, the Government seems to be fully aware of the problems of achieving fiscal balance but still the measures have to be worked out. Besides the reduction of military expenditure, no major reductions in public spending can be foreseen. On the contrary, the government has declared that, during the transitional period, it must take action and use resources to reconstruct war-devastated regions and infrastructure and to rehabilitate soldiers. Thus, during the transitional period Ethiopia has to continue to rely on external sources to fill her fiscal gap.

Summary

The draft policy paper can be seen as a continuation of the reform process that was initiated already by the Mengistu government. During the autumn of 1991 there has been a debate on the issue of whether the economic draft policy paper should be seen as a step forward or backwards compared to the reform programme that was announced by President Mengistu in March 1990.

Below, the transitional government's economic policy papers are compared to the March 1990 reform announcement. The points of comparison selected are those that are normally included in structural adjustment programmes initiated by the World Bank.

From the above analysis of the content of the policy documents produced by the transitional government, and the summary in Table 15.1, we conclude that the transitional government's intentions, both as expressed in the draft policy paper and in particular as expressed in the TEP, go far beyond the intentions of the Mengistu government. The content of the TEP lies close to the content of a traditional structural adjustment programme, even if one should keep in mind the critical remarks made above on some specific issues. In particular the hesitance about introducing an exchange rate reform during the transitional period can be claimed to be a severe weakness.

In terms of Figure 15.1, the transitional government's policy intentions, if translated into real policy, will mean a movement towards the lefthand side of the scale for more or less all economic systemic dimensions.

Table 15.1 Ethiopia: a comparison of economic reform announcements

	The March 1990 reform announcement	*The transitional government's economic reform intentions*	
		Draft policy paper	*TEP*
Privatization	x	x	x
Liberalization of product markets	x	x	x
Liberalization of factor markets	x	x	x
Trade liberalization			x
Devaluation		x	x
Expenditure reductions			x

Decision-making will be decentralized and markets, rather than administrative processes, will determine the allocation of resources in an economy where private ownership will increase in industry, trading and agriculture, the exception being the ownership of land. Incentives, like prices, will increase in importance in the Ethiopian economy where profitability and competitiveness will be some of the major characteristics. The only dimension where there still are big question-marks is the *internationalization – autarky* dimension. Even if there are intentions to liberalize foreign trade, the problems related to foreign exchange policies and foreign exchange allocation are far from solved.

THE PROSPECTS FOR A SUCCESSFUL ECONOMIC REFORM

Compared to many other less-developed countries that have agreed to introduce economic reform programmes, the Ethiopian case is both more promising and more problematic. It is more promising due to the fact that it is a new government that is to introduce and implement the reform programme. The transitional government does not have the historical responsibility for the previous regime and its policy. Thus, the new government faces a unique challenge to break the negative economic development by a well-designed reform programme. Furthermore, for the same reason, the new government has already met increased interest from the donor community and increased external resources can be expected to flow into the country. In particular this will be the case when the government starts to implement the TEP. If properly designed, the increased flow of external resources will reduce the transitional problems and help Ethiopia to break the negative economic development.

The major problems for the new economic strategy in Ethiopia lie in the political risks. It is important to remember that during the transitional period Ethiopia is to take the step into a representative democracy. Thus, during the next couple of years two very dramatic systemic changes are to be carried out. The political risks are of three types, first, internal political risks arising from the implementation of the economic reform programme

parallel to the democratization process, second, internal political risks inherited from the former government, and third, the risks of losing international support in terms of foreign assistance.

The first type of internal political risks is closely related to the effects on living conditions that can be expected to arise as a consequence of an efficient implementation of the economic reform programme: what are the risks that the reforms will bring about such negative effects that the people will question the legitimacy of the policy and the transitional government? What then, can be said about the likely effects on various groups?

A successful implementation of the reform programmes presented since March 1990 will have a number of effects on the living conditions. First, people in the peasant sector, that is, the majority of the Ethiopian population, can be expected to gain from a successful reform that stops the negative discrimination of individual peasants. As a rule the peasants will gain from the deregulation of the agricultural marketing by receiving better prices for their products. The allocation of non-labour agricultural inputs will also improve through the reform, thus improving the situation of peasants also. Some of the most positive effects for the individual peasants are the changes introduced already in 1990 in the marketing of grain and the land tenure system. These effects will increase when infrastructural improvements, like reconstruction and rehabilitation of roads, have been completed.

The group in society that is often claimed to lose from economic reform programmes is the urban poor, and in particular urban women and children. As a rule the urban people are also the most politically active. Therefore, it is of interest to focus on this group. In the short run the implementation of the TEP, inclusive of an adjustment of the exchange rate, can be expected to hit the urban poor through increased unemployment and increased inflation. However, given the rapidly-growing illegal foreign trade and the parallel market in many areas, one may question whether the market has not adjusted to a more realistic exchange rate already.[17] Thus, investigations must be made before one can claim that a devaluation will give rise to severe price increases and thus be a threat to the whole reform package. As far as food availability in urban areas is concerned, this can be expected to increase, provided that infrastructure and transports are rehabilitated so that the production areas come closer to the consumption areas, especially the cities. Thus, after infrastructure rehabilitation, the open market prices, that is, the prices outside the 'kebelle shops' (co-operative urban shops with controlled and subsidised prices on food), can be expected to fall also. It is uncertain whether the reduction of prices will be great enough to make the kebelle shops unnecessary. If not, and provided that the government will provide poor urban groups with subsidized food in the future also, this must take place through direct subsidization of these groups or of the supply to these groups in the kebelle shops. Such subsidization means increased public spending, *ceteris paribus*, and may easily run into conflict with other macroeconomic objectives, for example, cutting down on public spending, that can be required by the World Bank or the IMF. Here, foreign assistance can play an important role.

Another important aspect of the economic reform, in particular for the urban groups, is the effects on the rate of unemployment. If the reform is carried through, a number of people involved in the planning process, the marketing corporations, and the state

companies, may become unemployed. However, in a medium- and long-run perspective, the efficient implementation and continuation of the TEP can be expected to give rise to increased economic activity outside the public sector. With this increase there will follow increased employment also. In the long run, therefore, the urban population also can be expected to be positively affected by the reform. How long it will take to increase the private commercial activities depends on how fast the government changes the legislation in order to liberalize the economy and improve the incentives to invest, but also on the availability of managerial skill, skilled labour and investable capital. Thus, foreign assistance in terms of management education and vocational training can play an important role in speeding up the adjustment of the Ethiopian economy. Therefore, even if the first types of internal political risks related to the economic reforms should not be overlooked, it may likewise be a big mistake to overstate them without closer analysis.

The second type of internal political risks relates to the issue of ethnic conflicts, regional liberation, independence and nation building. In the Charter of the Transitional Period, and its adoption of the UN Universal Declaration of Human Rights, there are groups in Ethiopia that find support for regional independence and nation building. In Article 2, the right of nations, nationalities and peoples to self-determination is affirmed (*Negarit Gazeta* 1991: Part One). Here it is important to note that even after the new regional division decided upon by the transitional government in 1991, Ethiopia consists of quite a large number of regions with great ethnic differences and different historical backgrounds, but also with great differences in terms of population, economic resources and standards of living. Ethiopia has still a long way to go before all regional conflicts have been solved, demands for regional independence and self-determination have lost their attraction, and Ethiopia can face the future as a united nation.

The draft policy paper and the TEP discuss the policy towards regional imbalances. Drought areas and areas hit by the civil conflicts will be supported. Soil and water conservation activities will be initiated where soil degradation is critical and off-farm employment will be created. A successful implementation of these policies will be of crucial importance for the avoidance of devastating regional conflicts and demands for regional independence. On the other hand, there are regions, in particular Oromo, that are relatively richly endowed with natural resources, and so on, and where many people today demand independence along similar lines as Eritrea. Even if the transitional government declares that there are no such heavy demands and that the solution for Eritrea is a special case where thirty years of war resulted in a victory for the Eritrean people, the decision to let Eritrea become an independent country after a referendum in 1993 implies an obvious risk that other regions will follow and demand the same right.

Finally, the prospects for a successful economic systemic change in Ethiopia are heavily dependent on the availability of foreign assistance. Given the intentions of the Ethiopian government regarding economic systemic changes, the donor community's attitude towards Ethiopia is in turn heavily dependent on the transitional government's policy on the questions of democracy and human rights, and its ability to handle regional conflicts in a peaceful manner. One problematic issue concerning human rights in Ethiopia today is the uncertainty created by the grievance committees that evaluate the leadership in more or less all workplaces. Today the work of these committees seems to have stopped a lot of management work. Here the legal process must be speeded up and

completed before those who are to be managers and chief executives in the new Ethiopia's economic life really can be expected to dare to work as efficient managers, and so on. Thus, the current work by the grievance committees has a negative effect both on the possibilities of implementing the economic reforms efficiently and the possibilities of obtaining increased inflows of external resources.

However, let us assume that human rights are protected and regional conflicts are solved, what type of foreign assistance is needed to assist Ethiopia in the process of economic systemic change?

In many countries, donors have been very active in supporting industrialization or other commercial sector projects. The new economic strategies require a reorientation of foreign assistance. Foreign assistance must be much more active in the building of infrastructure, knowledge and proper institutions, so that the freed market forces can work in a way that is efficient from the point of view of long-run growth and development (see, for example, Adelman 1991 and Oshima 1991).

It should be noted that the issue of institutions is largely overlooked, both in the foreign assistance debate and in the reform programmes that emphasize increased reliance on markets and private activities. In fact, there is an obvious risk that the efforts to reduce the public deficit may lead to a contraction of the public sector. It is obvious that many existing institutions should be closed down, but it is of the utmost importance that new institutions, for instance with the task of defining and implementing property rights, are developed for securing the working of markets and increasing private investment. A country like Ethiopia with a parallel implementation of a complete political reform and an economic systemic reform, cannot by herself mobilize enough resources, political capacity, and competence to build efficient institutions at the same time as she tries to satisfy the World Bank, the IMF and individual donors in their demands for economic reforms and improved performance. To assist in building such institutions is a real and very important challenge for external donor agencies.

Closely related to the above issue is the need for donors, the World Bank, and in particular the IMF, to increase the time span of the reform programmes. It is important to remember that politics and economics are closely related. In particular this is the case in the process of economic systemic changes where political decisions define the route, degree, and speed of the systemic change. In the process of change from centralized socialist economic system over to a decentralized market economy, decisions have to be made in relation to all of the dimensions defined in Figure 15.1. As a rule, decisions are taken in steps, each step taking only one rather than all dimensions into explicit consideration. It is also common that changes along single dimensions of an economic system, like the *internationalization – autarky* dimension, take place in steps, for example, gradual trade liberalization and gradual devaluation. This is due to the political difficulties that are assumed to arise as a consequence of the changes *per se* in terms of transitional problems, for instance, increased inflation and/or increased unemployment. In particular, these problems tend to be great in a country like Ethiopia, that stands on the threshold to democracy. However, step-wise reforms also involve a risk in terms of running into self-made problems due to inconsistency in the gradual reform process (see, for example, Edwards 1989; Krueger 1986; Mussa 1986). This is not to say that a one-step strategy is superior to a gradual approach. In Table 15.2 some problems related to

economic systemic changes are compared from the point of view of gradualism versus a one-step change.

Table 15.2 Gradualism versus one-step strategy

	Gradualism	*One-step strategy*
1 Consistency (efficiency)	–	+
2 Credibility	–	+
3 Political risks due to transitional problems (size of negative immediate effects on politically strategic groups)	+	–
4 Risk of reform disruption	–	+
5 Creating appropriate administrative resources and knowledge of market economics	+	–
6 Initial situation characterized by a large budget deficit or a banking system with imperfect supervision	+	–

Note: + sign (– sign) means superiority (inferiority) to the other strategy.

As is clear from the table, the situation in each country that is about to introduce systemic changes has to be taken into consideration before one or the other strategy is chosen.

Even if it is a risky task to extend the time for implementation of reform programmes, due to the initial economic situation, the political situation, and the lack of available competence, it is in many cases necessary to adopt a gradual approach. In such cases it is possible, and preferable, to link this approach and the increased time span to the issue of debt relief.

In the case of Ethiopia, the debt service ratio has now reached a level of more than 75 per cent. It is debated in Ethiopia whether the transitional government should be responsible for all loans that the Mengistu government has taken. In particular, this is the case with the debts to the former socialist countries, especially the former Soviet Union, which supported Mengistu by giving loans for military expenditures. But even if these debts are neglected, the debt to other donors will be a heavy burden for Ethiopia. Debt reductions must be seen as a long-term issue. Furthermore, it is not so much the level of debt as the debt service that is of interest. Thus, in order to protect the reforming government, instead of giving massive debt relief at one specific point in time, debt relief should be linked to the continuation and performance of such programmes by giving a massive relief of debt service combined with a gradual debt relief as long as the political and economic reform programmes continue.

Finally, in Ethiopia the political and economic transformation demands knowledge at various levels, in management, administration, but also in the form of industrial and agricultural skill. Given the low level of education of the average Ethiopian, in particular of Ethiopian women, foreign assistance has a very important role to play in improving all levels of education: basic education, manpower training programmes and university education. In addition to basic education, the female adult education in particular needs support since the women, along with the children, are the urban group that in the short

run can be expected to be most severely hit by the economic reforms.

CONCLUDING REMARKS

In the history of Ethiopia 1991 was an important year. On 21 May 1991 President Mengistu Haile Mariam fled the country. Some weeks later the civil war came to an end, and in early July the new leaders, representing various regional liberation movements and political organizations, adopted a charter for the transitional period and introduced the UN Universal Declaration of Human Rights into the Ethiopian society. Furthermore, they declared that a democratic election should take place before the end of 1993. During the autumn of 1991 an economic reform programme was worked out. If implemented, it will mean an economic systemic change away from a socialist command economy over to a market-oriented or mixed economy with private economic actors at the forefront and with the state performing mainly regulatory functions.

Ethiopia faces severe political and economic problems, but it has started on a road away from socialism that can lead to sustainable growth and development, provided that remaining internal problems are solved and that external resources are transferred to the country.

NOTES

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1 See, for example, Hansson (1989) and (1990) for a critical assessment of the reform intentions up to 1990.

2 The economic literature contains a number of, in general largely overlapping, definitions of the concept *economic system*. See, for example, Eidem and Viotti (1978:1), Lindbeck (1973:3), and Prybyla (1969).

3 For a similar study of the economic system and the systemic changes in Laos, see Bourdet (1991).

4 For a more complete analysis see, for example, Hansson (1989, 1990).

5 According to the *Census of Manufacturing Industries in Ethiopia, 1990*, 49.8 per cent of all industrial establishments were private establishments but these were on average very small and employed just 6.8 per cent of all industrial employees.

6 See, for example, Dessalegn Rahmato (1984) and Pausewang (1990b) for an analysis of the Ethiopian land reform.

7 On agrarian socialism see, for example, Cohen (1987:16ff); Cohen and Isaksson (1987); Clapham (1990: Chapter 7); Alamayehu Lirenso (1990); Brüne (1990:27ff); Dessalegn Rahmato (1990); Alemneh Dejene (1987: Chapter 4 and 1990); Pankhurst (1990); Pausewang (1990b); and Ståhl (1989). On agricultural surplus extraction, see, for example, Befekadu Degefe and Tesfaye Tafesse (1990) and Eshetu Chole (1990).

8 The objective of the collectivization programme was that 50 per cent of arable land should be transferred to producer co-operatives during the plan period 1989–94.

9 See, for example, Hansson (1990) for a more detailed analysis. The US share of Ethiopian exports has varied between 10 and 33 per cent (average 21 per cent) during the period 1975–88, while the corresponding variation of the 12 European Community countries' (EC 12) share is between 24 and 54 per cent (average 36 per cent). The corresponding shares of Ethiopian imports are 4–16 per cent (average 10 per cent) for the US and 32–46 per cent (average 38 per cent) for EC 12.

10 See, for example, Hansson (1989) for a critical assessment of the resolutions of the Ninth Plenum of the Central Committee of the Workers' Party of Ethiopia.

11 For a presentation of the March 1990 reform see, for example, Mengistu (1990). A critical assessment of the March 1990 reform announcement is presented in Hansson (1990).

12 After having discussed the draft policy paper at the 'EMI Workshop for Cabinet Members on the future of the Ethiopian Economic System and Macroeconomic Management', November 1991, and on the 'Inter-Africa Group Symposium on Rehabilitating the Ethiopian Economy', January 1992, it is my view that the reasons behind this problem were, and to some extent still are, based on a natural scepticism towards the potentials of the market mechanism and a lack of knowledge of the functioning of a market economy after seventeen years of socialist rule. In particular, the scepticism relates to the short-term effects of economic reforms where there is an obvious risk of running into rapid unemployment problems and price increases and thus increased poverty before there is a supply response. To some extent the scepticism is also based on the experiences from nearby countries that have introduced economic reform programmes (see UNECA 1989 and UNECA 1991:2f).

13 For a discussion of the past role of Ethiopian exports as an engine of growth see, for example, Hansson (forthcoming).

14 The higher figures are from *Africa Confidential* (1991) and the lower figures are from interviews in Addis Ababa in March 1991.

15 *Draft Economic Policy of Ethiopia During the Transition*: 6.

16 *Draft Economy Policy of Ethiopia During the Transition*: 7.

17 The parallel and quite openly offered exchange rate varied around 6–7 birr per US dollar in January 1992. Furthermore, in Eritrea, Eritreans (but not foreigners) can change US dollars at an official exchange rate of 6 birr (January 1992).

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16
MACROECONOMIC STAGNATION AND STRUCTURAL WEAKNESSES IN THE SOUTH AFRICAN ECONOMY

Mats Lundahl and *Lena Moritz*

INTRODUCTION

The South African economy is facing difficult times. For almost a century it was characterized by a growth rate which was among the highest in the world. Gold remained an engine of growth until after the Second World War when, gradually, manufacturing took over, stimulated by the import-substitution process which had been begun in the 1920s. This growth process also rested on an efficient use of low-paid African labour. Racial discrimination in the labour market served to create an 'unlimited' supply of unskilled labour on which the modern sectors of the economy could draw.

In the 1970s, however, the growth machine began to stall. A series of international shocks, notably the oil price rises and the hardened resistance to apartheid, put pressure on the economy. Even more important was the fact that the apartheid system no longer acted as a driving force, but as an obstacle. A skills bottleneck had formed in the labour market. As the technology of the South African economy grew more complex, and as manufacturing increased its share of GDP, the demand for skilled labour increased. However, the existence of a colour bar in the labour market made it impossible to match supply and demand. Also, the rate of capital formation had begun to slow down, among other things as a result of capital flight after the independence of the Portuguese colonies and the Soweto riots in the mid-1970s. To some extent, however, this was remedied by high gold prices towards the end of the decade.[1] Finally, the import substitution process showed signs of being exhausted as the existing domestic market for consumer goods was saturated.

Thereafter, the picture has gradually become one of stagnation instead of dynamism. South Africa is suffering from an economic crisis which is further compounded by the fact that the country is in the middle of an uneasy political transition to majority rule. The present chapter will survey the macroeconomic problems facing South Africa at present and in the immediate future. We will begin by sketching the macroeconomic performance during the last five-year period, with particular emphasis on investment and savings problems. Thereafter, three of the most important sectors of the economy – agriculture, mining and manufacturing – are dealt with in some more detail. Then the attention is turned to foreign trade and balance-of-payments problems, employment, prices and wages. The chapter ends with a survey of South African economic policy and a look at the future.

MACROECONOMIC PERFORMANCE

During the 1980s the performance of the South African economy was poor. As shown in Table 16.1, growth rates in the 1986–90 period averaged a mere 1.5 per cent per annum. This should be compared with the corresponding figures for the 1960s and 1970s: 5.8 and 3.1 per cent respectively (Nattrass 1981:25). The growth of the economy in the 1980s has not kept up with the population growth, with the result that gross domestic product (GDP) per capita has fallen on average by 0.8 per cent per annum.[2]

Table 16.1 South Africa: macroeconomic indicators, 1986–90 (growth rates, per cent, constant 1985 prices)

	1986	*1987*	*1988*	*1989*	*1990*
GDP	0	2.1	4.1	2.1	–0.9
GNP	0.2	2.7	5.2	–0.7	–1.7
GDP per capita	–2.2	–0.1	1.8	–0.1	–3.2
GNP per capita	–2.0	0.5	2.9	–2.8	–3.9
Private consumption expenditure	0.2	3.9	5.2	2.4	1.5
Consumption expenditure by general government	2.3	3.7	1.7	3.5	1.0
Gross domestic fixed investment	–18.2	–2.4	8.9	5.4	–1.4
Personal disposable income	–3.8	6.2	3.7	0.7	1.3
Personal disposable income per capita	–5.9	3.9	1.4	–1.5	–1.0

Source: South African Reserve Bank 1991:113

In 1990 the economy was contracting at an estimated rate of 0.9 per cent (SARB 1991:3), and the outlook for the future is not very bright. According to the Minister of Finance, Barend du Plessis, figures of hardly more than 1.5–2 per cent may be reached in a couple of years' time (Waldmeir 1991). Private consumption constitutes by far the largest component of the expenditure side of GDP. Its share of GDP was around 60 per cent in 1970, but less than 50 per cent in 1980, because prices rose faster than wages and because the income tax burden increased during the 1970s. By 1989 private consumption had increased again, to more than 56 per cent, because of the decline of gross domestic fixed investment and the fall in personal savings to an insignificant level (cf. below) (EIU 1990a:21). Adding government consumption, the share of consumption in GDP increased from 65 to 76 per cent over the 1980s.

Before the political turmoil in the mid-1980s, South Africa was a net importer of capital. However, during the first half of the 1980s, a foreign debt had begun to accumulate and when, in August 1985, President Botha declared that the government would not be pressured into abolishing apartheid, and foreign banks began to call in their loans, the country was turned into a net exporter of capital instead. In order to be able to service its foreign debt, South Africa has thereafter had to run a surplus on its balance-of-payments current account. This situation has been also aggravated by a significant net

outflow of capital through the Stock Exchange. Above all, however, business confidence has been low in recent years as a result of political instability (cf. Lundahl *et al.* 1990:35–41).

Thus, capital formation has been held back during the 1980s. Net investment declined from 17–18 per cent of GDP during the first half of the 1970s to 3–4 per cent 1985–8. Gross domestic fixed investment rose in 1988 for the first time since 1981, by 8.9 per cent, and in 1989, by 5.4 per cent, but from a very low base and its value at constant (1985) prices was lower in 1989 than in 1982 (EIU 1991a:19). Moreover, most of the gross investment has been replacement of old equipment (over 85 per cent in 1987, compared with 58 per cent in 1982) (EIU 1990b:24). During 1990 gross investment fell (EIU 1991a:19).

The reasons behind the reluctance to invest vary from sector to sector. One of the most important explanations, however, is the political uncertainty that prevails in South Africa at the present time. This is obvious in areas such as construction of private residential buildings. In addition, general business confidence in the future has been weakened by both the increasing violence and the question marks with respect to what economic policy will look like in post-apartheid society (SARB 1991:10–11; EIU 1990b:24, 1991a:19).

The corollary of low investment is a low level of personal savings; no more than 0.6 per cent of disposable personal income in 1990, that is, practically zero. This figure represents a tremendous drop in comparison with the 1970s when the savings propensity was regularly above 10 per cent, or even 1985, for that matter: 6.1 per cent (EIU 1991a:19). This decline is not surprising, given the fact that disposable personal per capita income has been declining during the 1980s, by 0.5 per cent 1984–8, while at the same time real interest rates were low or even negative (SARB 1989:14–15, 17). Moreover, income has been redistributed during the past decade in favour of organized African labour – who should have a lower savings propensity than middle- or high-income groups.

The extremely low level of personal savings is compensated by corporate and government savings which bring total gross domestic savings to 21.5 per cent in 1990 (SARB 1991:13). However, the depreciation of the rand over the 1980s has led to a huge increase in the cost of replacing imported capital equipment. Hence the figures have to be interpreted with some caution (EIU 1991a:20). Corporate and government savings had begun to fall already during the last half of the 1970s, and by the mid-1980s government had become a net dissaver, a situation which has been remedied only from late 1988 on (SARB 1991:13).

As has already been pointed out, South Africa is no longer a net importer of capital. In spite of the recent easing of sanctions it is difficult to believe that any dramatic rise in the inflow of foreign capital will take place in the foreseeable future. Political uncertainty in combination with the present recession makes this a long-term issue at best. By the same token, domestic savings are likely to remain low for some years to come.

AGRICULTURE: A SECTOR IN TRANSITION

The sectoral distribution of GDP is shown in Table 16.2. Manufacturing is by far the

most important sector, followed by public administration and defence, financial services and real estate, commerce (widely defined) and mining, in that order. However, the overall importance to the economy of the particular sectors is not just a question of their respective contributions to GDP. Thus, mining and agriculture are crucial because they are the main export sectors and agriculture is furthermore one of the most important employers. Consequently, in the following we will single out agriculture, mining and manufacturing for a more detailed examination.

Even though first mining and then manufacturing have been the most dynamic sectors of the South African economy, agriculture has continued to

Table 16.2 South Africa: sectoral origin of GDP, 1984 and 1989 (percentage of total, current factor cost)

Sector	*1984*	*1989*
Agriculture, forestry and fishing	5.4	5.8
Mining and quarrying	13.4	12.3
Manufacturing	23.8	24.2
Electricity, gas and water	3.9	4.3
Construction	3.8	3.1
Wholesale and retail trade, catering and accommodation	12.4	13.2
Transport, storage and communications	9.3	8.3
Financial services and real estate	13.4	13.7
Public administration and defence	12.6	13.8
Services and other[a]	1.9	1.3

Source: Economist Intelligence Unit 1990a:21.

Note:

a Less imputed financial charges.

play an important role, accounting, for instance, for some 30 per cent of non-gold exports. A wide variety of food crops are grown and the growth of output during the post-war period has more or less kept pace with the growth of the population.[3] This has in the main been the result of mechanization and an increased use of capital in the sector as the wage level rose and the sector started to shed workers.

South African agriculture is organized along racial lines: a white, modern, capital-using sector on the one hand, and an African subsistence-oriented segment concentrated on the low-quality soils of the bantustans on the other. The differences between these two types of agriculture basically derive from the Natives Land Act of 1913 and the Native Trust and Land Act from 1936 (both recently abolished) which concentrated 86 per cent of the land in white hands (Unterhalter 1987:6–9), and from the creation of the bantustan system from the mid-1950s onwards. As is well known from other parts of the world (Griffin 1969, 1974), this type of concentration of landed resources tends to create two completely different sets of factor prices. In the South African case this means that white farmers would be able to obtain credits at a much more favourable rate of interest than their African counterparts, using their land as collateral. This would generally in turn lead

to a much more land- and capital-intensive production on white farms than on African farms. However, in the South African case the process has gone even further. The government has also discriminated against the African majority in relation to credits, other financial support, infrastructure and marketing services.

Thus, the two types of agriculture operate under completely different conditions. In 1985, commercial (white) agriculture occupied 87.8 million hectares and produced an output value of 1,000 rand per cultivated hectare. The corresponding figures for the subsistence (African) sector were 16.7 million hectares, and 21 rand per hectare (Feynes, van Zyl and Vink 1988:187).

Today agriculture is a sector facing transition. Marginal white farmers have gradually been squeezed out. The subsidized credit to white farmers during the past decades resulted in heavy indebtedness, to the point where in 1990 the total debt of the sector amounted to 16 billion rand, to be compared with a contribution to GDP in the order of 10.8 million rand. Almost 5 billion of the former figure may refer to loans taken for non-agricultural purposes (cars, holiday homes, town-houses, and so on) and to make matters worse, bad decision-making – cultivation of marginal land, paying too high prices for land, employing short-term loans for financing long-term ventures – has put a squeeze on white farmers. With real interest rates being above 5 per cent per annum during the past two years, the ratio of debts to assets in white agriculture increased from less than 13 per cent in 1979 to more than 23 in 1990 (Gawith 1991a).

The credit problem is serious. Increased productivity in commercial agriculture will require investments that increase yields per hectare and per worker: mechanization, fertilizer, herbicides, pesticides, employee training, and so on. Even more serious problems, however, lie ahead for white farmers. Traditionally, the latter are accustomed to receiving something like 20 per cent of their income in the form of subsidies (Odén 1991:4). However, this appears to be a thing of the past. The government is determined to implement a more market-oriented approach. In 1988 the sector received 583.4 million rand in subsidies and rebates, but in 1990 this figure was down to 198 million (Gawith 1991a). Import controls and price controls were in the process of being phased out. Structural readjustment is a fact in agriculture.

On top of this agrarian reform is imminent. The recent scrapping of the 1913 and 1936 Land Acts is clearly a step in the right direction, since these laws constitute the legal cornerstone of apartheid in the land market. However, merely doing away with these laws will not produce agrarian change. A *de facto* redistribution in favour of the African majority is one of the top priorities, for example, for the African National Congress (ANC), which claims retribution for those 3.5 million Africans who were evicted from their homes during the erection of the bantustan order during the past three decades, as well as land for the agricultural workers who in the past have been working for white landowners. Until very recently the South African government has not been ready to accept these demands. Instead, it was entertaining the idea of offering favourable loans to Africans who wished to acquire land in the market (Mallaby 1990:21). However, in May 1991 it was announced that an all-party commission would be set up to adjudicate the land claims (Waldmeir 1991).

What the exact procedure will look like remains to be seen. At any rate, fear of a large-scale redistribution (underpinned by the Conservative Party) has spread among white

farmers. As the Minister of Agriculture, Kraai van Kiekerk, has noted,

> Farming in South Africa finds itself in the midst of a profound crisis that has all the elements of personal tragedy, communal disruption and an uncertainty common to the state of mind which prevailed during the Great Depression.[4]

MINING: PRICE AND COST PROBLEMS

From the discovery of diamonds in 1867 and gold in 1886, the South African economy was mineral-led for at least three-quarters of a century,[5] and to this very day its fate to a large extent continues to be determined by how gold production fares. Accordingly, during the entire post-Second World War period, South Africa has experienced balance-of-payments problems, whose severity has been closely associated with the international gold price. A trade surplus is vitally necessary if South Africa is to manage to pay interest and amortization on its foreign debt. Whether or not this trade surplus will materialize is crucially dependent on the state of South African gold exports (cf. Lundahl, Fredriksson and Moritz 1990:35–9). Gold has regularly accounted for some 30–50 per cent of total merchandise exports during the last few years.[6]

However, the gold-mining industry is in a difficult position at the present time. Output has declined almost continuously since 1970, when an all-time high of around 1,000 tons was reached (EIU 1990a:32–3). The root of this problem is to be found in the increase in production costs. Since the beginning of the 1980s, they have risen by around 15 per cent per annum (Riddell 1988:256–7; Gawith 1991c). For a while, the devaluation of the rand after 1983 neutralized the rise in costs, but in 1989 approximately one-third of the gold mines had been turned into loss-makers as a result of a lower gold price from 1988 (EIU 1989:30).

The gold price has continued to fall to the point where observers are beginning to draw the conclusion that the gold-mining industry is ‘suffering the worst crisis in its history’ (Gawith 1991c). In 1990, under pressure to increase its foreign earnings, the Soviet Union started to sell gold (Boliden KAR Ädelmetall 1990). The resulting excess supply in the world market led to a decline in the price of gold from around 384 dollars per ounce in 1990 to around 358 dollars in February 1991 (SARB 1991:20–1). At the same time the SARB has attempted to maintain the strength of the rand to combat inflation, with the result that the falling dollar price has not been compensated for by any depreciation of the domestic currency.

Production costs have also continued to rise. Hence, South African gold-mining is squeezed both from the output and the input price side. This has led to an estimated 36 per cent decline in the real rate of return over the past three years (Gawith 1991c). Production fell from 603 tons in 1989 to 592 tons in 1990 (SARB 1991:21). No less than 40 per cent of the output is now being produced at a loss, in mines employing around 190,000 workers. Employment in the industry shrank from 534,000 to 400,000 between 1986 and 1992 and, with uneconomic mines accounting for about 15 per cent of the sector’s employment, further layoffs are to be expected (Gawith 1992).

Exploration of new ventures is down as well, since most of the future prospects are in

very deep mines that would require the price of gold to double before production can become economically viable (Gawith 1991c). Thus, not surprisingly, there are strong voices in the mining industry advocating state support, mainly in the form of a devaluation to boost the rand price of gold, but this is hardly likely to materialize in a situation where the government is employing exchange rate policy to break inflation.

The declining importance of gold is revealed in the fact that in 1989, for the first time, profits from non-gold mining exceeded those from gold mining (Gawith 1991c). Problems exist for other minerals as well, however, even though they are not nearly as serious as in the case of gold. South Africa has around 90 per cent of the world's known platinum reserves and accounts for close to 50 per cent of world output (Boliden KAR Ädelmetall (no date), Odén 1988:46). Thus, the world market price of platinum is highly sensitive to the level of production in South Africa. At the beginning of May 1991 the platinum price dropped to a level of around 400 dollars per ounce, compared with 525 dollars in February 1990. However, this seems worse than it actually is, since the demand for rhodium, a platinum by-product, has quadrupled in four years as a result of the increased demand for car exhaust catalysts. This trend is expected to continue as emission control is tightened, not only in the United States but also increasingly in Europe.

The diamond industry is also facing price problems. Even though de Beers controls the Central Selling Organization, it has not proved possible to do anything about the decline in demand that resulted from the world recession in the 1980s. Sales fell to their lowest level since 1979 during the second half of 1990 (EIU 1990a:30, 1991a:23). This led to a 16 per cent drop in de Beers's profits during the latter year (Gawith 1991c). Continued low growth in the world economy, particularly in the United States, caused continued decline throughout 1992 (EIU 1992a).

Coal is the second largest export product, after gold. The outlook for this mineral is modest at best. Demand is being restrained both by low growth in the world economy, by growing concerns about the environmental effects of emissions from coal-powered power-stations and by a general reluctance to switch from oil to coal only to find that temporarily high oil prices will fall again (EIU (1990a:29). On the other hand, the coal industry has enjoyed better prices in its European contracts as a result of an increased confidence in the South African political reform process.

To sum up, the South African mineral industry is facing difficult times. Costs have risen and the price has fallen in gold-mining. Diamonds have to cope with sluggish demand. The prospects for coal are slightly better, and platinum, finally, is saved by a high demand for its by-product, rhodium. Even though mining is no longer the driving force in the South African economy, the industry's high sensitivity to external factors and exchange rate changes creates severe problems for the economy as a whole via the balance of payments. This calls for measures to ensure survival in the future. Accordingly, investment is required to strengthen the links of the mining industry with the rest of the economy. Increased domestic processing of minerals would both increase value added and create employment. Production of gold jewellery is a case in point.

MANUFACTURING: PRODUCTIVITY PROBLEMS

With 24 per cent of GDP, manufacturing is by far the largest sector of the South African economy. Production is well diversified, ranging from food-stuffs to investment goods. The sector began to be developed in the 1920s, following the introduction of tariffs. Right up to the present, protectionism and import substitution have been its main characteristics.

Growth was more or less uninterrupted right up to the beginning of the 1980s (Hobart Houghton 1976:121–9; Nattrass 1988:164–6; Fransman 1982; Moll 1989). Thereafter, however, the sector has had problems. The growth rate (value added at 1975 prices) was 5.1 per cent per annum 1974–80 (which was lower than the figure for the preceding twenty-year period) (Moll 1989:146). However, the sector went into decline in the first half of the 1980s. In 1985, output was 12 per cent below the (peak) 1981 level (EIU 1990a:37). A recovery set in during the second half of the 1980s, but in 1989 manufacturing again stagnated and a decline took place during 1990 and 1991 (EIU 1991a:23; 1992b:30; SARB 1991:7).

The manufacturing sector is struggling with a number of difficulties: low labour productivity, lack of capital, skill shortages, a small domestic market, a high rate of inflation pushing up costs and international sanctions. With the partial exception of inflation, all of these factors are one way or another related to either the import-substitution process or the apartheid system.

Beginning with the productivity issue, a comparison of South Africa with some of its major trading partners (Japan, France, Germany, Britain and the United States) reveals that output per man-hour in 1986 was only 19 per cent higher than in 1975 in South Africa, while the corresponding figures for their trading partners ranged from 36 per cent (Britain) to 92 per cent (Japan). Labour costs in rand had increased by 282 per cent over the same period. (The maximum figure for the trading partners was 152 per cent for Britain (pound sterling) (Du Plooy 1988:84).) Thus, the development of wages bore little relation to that of productivity and had it not been for the depreciation of the rand over the period, South African manufacturing – which was already a high-cost sector – would have suffered a further loss of international competitiveness. During the first half of the 1980s profitability in manufacturing could only be maintained by raising the product prices (Du Plooy 1988:86, 88).

Clearly, the above tendencies indicate that manufacturing is not a healthy sector. It is hardly possible to maintain competitiveness by depreciating the currency over longer periods, while raising output prices in the manufacturing sector feeds inflation, which in turn is tantamount to a real appreciation of the rand. In addition, in recent years the government has pursued an exchange rate policy which has been designed to keep the value of the rand up, to combat inflation. Thus, there is no way around increasing productivity if the manufacturing sector is to maintain its ability to compete with imported goods.

Increasing productivity, however, is difficult in a situation where, on the one hand, as a result of protection (tariffs and import quotas), the price level is too high to put pressure

on the producers to cut their costs, and on the other hand, skilled labour, capital and modern technology are lacking as a result of apartheid and apartheid-induced international sanctions.

Import substitution in the South African manufacturing sector has by and large followed the standard pattern (McCarthy 1988:9–12), beginning with light consumer goods, proceeding backwards via intermediate products, and finally into heavy industry as well. This sequence has required that protection should be gradually extended to more and more branches, but as import substitution was pushed 'backwards' in the production chain in this manner, the consumer goods industry experienced problems, because tariff protection of its inputs raised its production costs and hence lowered the sector's ability to compete. What is required is growth of the domestic market, since most products cannot compete abroad. However, this market has in the past been severely limited by the failure to raise African living standards.

Turning to the supply side, we may begin by noting that the import substitution strategy has not been successful when it comes to reducing the dependence of the manufacturing sector on imported inputs. While it managed to curtail imports of consumer goods (Odén 1988:47), for example, chemicals, fabricated metals and a variety of other goods produced by the heavy industry continue to have a high import content (McCarthy 1988:14). To the extent that South Africa became self-sufficient in consumer goods from the 1950s on (Moll 1989:143), this is also true in terms of technology. As long as international sanctions on investment in South Africa continue to be enforced, the capital equipment of the manufacturing sector will become increasingly obsolete. Between 1985 and 1989, as international sanctions tightened, the average age of machinery and equipment in private manufacturing rose from less than three and a half years to almost four years and eight months.[7]

Capital formation in the manufacturing sector (real gross domestic fixed investment), declined during the entire 1980s, by an estimated 4.5 per cent per annum (Nedbank Economic Unit 1990:4), much as a consequence of disincentives to investment in order to avoid balance-of-payments problems in a situation where the inflow of foreign capital had been cut as a result of sanctions. Hence the capital stock in manufacturing was reduced from 49.2 billion rand in 1984 to 44.9 billion in 1989 (at constant 1985 prices) (Nedbank Economic Unit 1990:4). The gross addition to the capital stock in the sector is not large enough to compensate for rapid depreciation. Hence, in spite of a gross increase of almost 20 per cent in 1988, total production capacity fell (EIU 1990a:37).

The manufacturing sector has also suffered badly from a lack of skilled and semi-skilled workers. The combination of a statutory colour bar and apartheid in the educational system made South Africa dependent on white immigration to fill vacancies in skilled and semi-skilled occupations. This worked relatively well until the early 1970s but thereafter, as the influx of whites slowed down, and technology in manufacturing became increasingly complex, a skill bottleneck gradually developed. By the early 1980s the demand for skilled labour, not only in manufacturing, but in virtually every sector of the economy, was by far outrunning the supply (Lipton 1985:237–8), and this disequilibrium persists a decade later as well.

As the apartheid system is being dismantled, and sanctions are gradually being lifted, the supply constraints on manufacturing output are also likely to disappear. Via formal

education and on-the-job training, Africans will acquire the knowledge necessary to hold skilled jobs and capital will once more be free to flow into South Africa. However, this does not solve the demand and cost problems. Of course, African incomes will increase and the market for consumer goods will be gradually extended. However, as long as the manufacturing sector remains protected, it will continue to produce inefficiently, at a cost which exceeds the internationally-competitive level.

Although the need for a more outward-looking industrial strategy has been recognized for quite some time, protection has been retained, and only selective promotion of export-oriented production was undertaken until the late 1980s (McCarthy 1988:19). At that point South Africa began to make a more concerted effort to reduce the extent of protection of the manufacturing sector.

However, to continue this policy may not be easy. Switching from an inward-oriented to an outward-oriented industrial strategy will necessarily entail the shrinking of certain branches – those that will fail to become competitive at international prices. In a situation where unemployment is already rampant and the African trade unions are pressing strongly for wage increases, this will inevitably increase the pressure in the labour market in a socially already very explosive situation. Thus, the movement towards free trade is likely to be slow and setbacks are likely to occur on the journey, as when the textile industry received increased protection at the beginning of 1990 (EIU 1991a:16). On the other hand, import substitution fuelled by protection amounts to producing domestically those items that could be obtained cheaper from abroad, while discriminating against products where the country has a comparative advantage. In the case of South Africa, the former type of products are likely to be capital-intensive while the latter are labour-intensive. Hence, if durable employment is to be created, the road goes via an export-oriented strategy. There is thus a conflict between employment in the short and the long run.

THE EXTERNAL SECTOR

South Africa is an open economy, where foreign trade (exports and imports) amounts to about 50 per cent of GDP (1989) (EIU 1990a:22). Exports consist mainly of primary products, notably minerals and metals, with manufactured products, whereas on the import side, machinery and transport equipment dominate the picture (Nedbank Economic Unit 1990:4). Gold is the single most important export product (around 40 per cent in 1988) (EIU 1990a:48). This creates a special problem in that export proceeds tend to fluctuate as the international gold price varies.[8] (Other minerals face the same problem.)

The growth of exports varied during the 1980s. During the 1981–3 period, slow growth of world trade, and a decline in the demand for primary commodities, restrained export growth. However, in the following two years a recovery got underway which was very much due to the upswing in the western economies (cf. Table 16.3).

Table 16.3 South Africa: exports and imports, 1984–9[a] (million rand)

	1984	*1985*	*1986*	*1987*	*1988*	*1989*
Exports	24,591	35,925	41,767	42,938	51,094	58,783
Imports, fob	21,471	23,045	25,514	28,320	39,170	44,133
Balance	3,120	12,880	16,253	14,618	11,924	14,650

Source: Economist Intelligence Unit 1990a:48.
Note:
a Figures include Namibia.

After the creation of the racially-segregated tricameral parliament in 1984 and the ensuing outbreaks of political violence and repression, trade sanctions were imposed by most western countries, to varying degrees. According to *The Economist*, these sanctions have cost the South African economy around 8 billion rand (*The Economist* 1990:12). However, by the end of 1988 it appeared that they had not had much of an impact on total export volumes, although individual companies and subsectors had been hurt. The value of exports continued to rise and the ratio of real merchandise exports to real GDP climbed from 17 per cent in 1987 to 20 per cent in 1989 (EIU 1990a:48).

On the import side, the picture is dominated by import substitution within manufacturing. For a long time machinery has been the most important single item, followed by transport equipment and chemicals. Oil products, although not shown in official statistics, constitute another important category of imports, the value of which was reported to be around 1.5 billion dollars in 1988 (EIU 1991a:3).

In the mid-1980s South Africa found itself in the middle of an acute foreign debt crisis. During the first half of the 1980s the government and the banks had borrowed heavily abroad at low interest rates, with the result that the foreign debt increased rapidly. Much of the debt was short term. In 1985 no less than two-thirds of the country's outstanding liabilities had a maturity which was one year at most, totalling some 14 billion dollars (EIU 1990a:53). At this time the foreign banks decided to call in their loans, largely for political reasons. This forced South Africa to freeze repayments and to start renegotiating the foreign debt with its creditors. Successive rounds of rescheduling the debt and converting it to longer-term maturity reduced the standstill debt (the part where payment has not been agreed upon) to 8 billion dollars by mid-1990. Nevertheless, this required that an estimated 2 billion dollars had to be paid in 1990 (EIU 1990a:54).

The repayment of the foreign debt has forced South Africa to maintain a surplus on the current account of the balance of payments ever since 1985.[9] A current account surplus has been also necessary to rebuild South Africa's foreign reserve position. The gold and foreign exchange reserves were run down during the first half of the 1980s and, with the exception of 1987, the situation continued to deteriorate thereafter as well, until at the end of 1989 reserves were down to just five and a half weeks' imports (EIU 1990a:52) and at the end of June 1990 an abysmally low two weeks was reached (SARB 1990:13). However, since the current account surplus exceeded the net capital outflow in 1990, net foreign reserves increased by 2–9 million rand in 1990 and there have been subsequent signs of further improvements (Stals 1991a). The reserve position is, however, still weak

by conventional standards.

A key question, when it comes to foreign trade, capital movements and the balance of payments, is what will happen to the sanctions that have been imposed by most western countries? The European Community has already begun to abolish its sanctions. In December 1990 the voluntary ban on new investment in South Africa was lifted and in 1991, the ban on imports of South African iron, steel and gold coins was also removed.[10] The United States has followed suit, claiming that South Africa has now met the conditions laid down for lifting the bans. After the repeal of the Group Areas and Population Registration Acts, however, only the release of the last political prisoners remained, and when in July 1991 it was deemed that this condition was satisfied as well, the US lifted most of its sanctions (EIU 1990a:18–19, 1991b:8–10). This act was opposed by many as being premature, an opinion which was fuelled by the ‘Inkathagate’ scandal which took place only a week after the decision. The most economically significant sanctions, notably the oil embargo, as well as the restrictions on World Bank and International Monetary Fund (IMF) lending, are, however, still retained. The sanctions imposed by the Organization of African Unity (OAU) also remain in place but, after a meeting in Nigeria in June 1991, it was clear that this position may be subject to change, provided that it is clear that the apartheid system is definitely abolished.[11]

EMPLOYMENT

Employment is one of the most severe problems facing the South African economy today. Unemployment rates soared in 1982 and 1983 as a result of economic recession. Thereafter the situation has continued to deteriorate. The labour force is growing at an estimated 2.6 per cent per annum while employment in the formal sector during the past fifteen years has increased at an average of a mere 0.7 per cent (SACOB/SABEK 1990:9). The employment situation among the non-African segments of the population is good. For the Africans, however, the situation is completely different. Unofficial estimates point to figures ranging from 30 to 40 per cent for Africans with a steady upward trend ever since 1960 (South African Institute of Race Relations 1988:293; SACOB/SABEK 1990:31).

To reach full employment would take an annual real growth rate of GDP of 8.4 per cent in the 1990s (SACOB/SABEK 1990:32). Negative growth was recorded in 1992 for the third subsequent year and, even if an improvement is expected in 1993, growth will not be large enough to improve the situation in the near future, but unemployment is expected to grow in the 1990s (SACOB/ SABEK 1990:32).

The alarming unemployment figures among Africans are a result of the apartheid policy. The creation of a racially-segregated educational system, where Africans have had to make do with low-quality schools,[12] in combination with the colour bar in skilled and semi-skilled occupations and the territorial segregation of races, with Africans being jammed into the bantustans, have made it very difficult to secure jobs in the formal sector of the economy. However, industrial policy is also to blame. Interest rates have in the past been low, at times even negative in real terms, and this has encouraged capital-intensive production methods at the expense of employment.

In the long run education is the key to the solution of the employment problem of Africans.[13] However, education is time-consuming and clearly short-run measures are needed as well, especially taking the current social unrest and violence into account. The general 'social upgrading' of the economy which will be a prime necessity in the post-apartheid society will offer employment opportunities in such areas as construction of low-cost homes. Production of consumer goods to meet the demands of the African population is also well suited to labour-intensive methods. In this context, the need to create a small business sector is often emphasized as this would not require any expensive investment and could make use of unskilled labour. Finally, improved standards of living among Africans may well have positive effects on labour productivity and this would in turn increase the attractiveness of labour in comparison with capital.[14]

PRICES AND WAGES

With an inflation rate of around 12–15 per cent during the 1980s, the South African price increases exceeded that of the country's main trading partners by about three to four times in this period. The result was a sharp depreciation of the rand over the decade, which in turn contributed to fuelling inflation even further.

From 1989 on, the main priority of South African economic policy has been that of combating inflation. Relatively restrictive monetary and fiscal policies from 1988 on and a more stable exchange rate from late 1989, combined with a reduction of import surcharges in March 1990, led to the curtailment of price increases up to July 1990. However, the crisis in the Persian Gulf which made oil prices rise sharply, cost-push effects emanating from wage claims, and adverse weather leading to increased food prices subsequently caused a setback (SARB 1991:17). With the fall of oil prices in 1991, the forecast for the consumer price index is a rise by 12.5 per cent, that is, lower than in 1990, particularly as the money supply also appears to be under control (EIU 1991a:21).

Partly as a result of the growing influence of African trade unions, wages have in general at least kept track with inflation. From 1985 to 1989 the rate of increase of nominal wages and salaries in the non-agricultural sectors rose from 11.4 per cent to 18.3 per cent, the highest rate since 1982, to fall somewhat during the first three quarters of 1990. For the non-agricultural sectors as a whole, real wages increased in 1988 and 1989, by 2.3 and 3.2 per cent, respectively. Real unit labour costs decreased from 1985 to 1989, and labour productivity increased, whereas costs rose the latter year by more than the labour productivity index. In 1990 it would seem that the cost increase continued while productivity declined (SARB 1991:15–16).

To a large extent the productivity problems are due to labour union militancy. Between 1988 and 1989 the number of workdays lost in connection with strikes and similar union activities increased from less than 500,000 to over 3 million, and during only the first quarter of 1990 the figure was 600,000 (EIU 1990a:27). The combination of work stoppages and wage increases may result in a substitution of capital for labour which would worsen the unemployment problem even further.

ECONOMIC POLICY

In recent years, the South African government has pursued a tight monetary and fiscal policy, with high real interest rates, a stable exchange rate and budgetary discipline as the key instruments. The main goal has been to bring inflation under control. The rate of growth of the broadly defined money supply (M3) was, however, brought down only in 1989. This continued in 1990, with M3 growing by a mere 12.4 per cent (Stals 1991b:37–8).

The government budget has been in constant deficit, but the deficits have been comparatively small: on average 3.6 per cent of GDP 1986/87–1989/90 (EIU 1990b:44). To an overwhelming extent budget revenue has come from income tax or general sales tax payments, that is, basically from taxes on individuals. In the hope of extending the tax base and cutting the rate of tax evasion (by the informal sector), the government substituted a value added tax for the general sales tax on 30 September 1991 (IMF 1992:27).[15]

Looking at the expenditure side, one of the most conspicuous items is public order and security (20.2 per cent of the total in 1990–1), to be compared with the social sectors: education (17.7 per cent), health, welfare and housing (18.8 per cent) and with public debt service (14.6 per cent) (EIU 1990b:45). In reality, however, part of the defence and police, and so on, expenditure appears under other items in the budget. In the post-apartheid situation it should be possible to cut these expenses, perhaps to an extent corresponding to more than 10 per cent of the total budget (Odén 1991:10–11). On the other hand this will be more than compensated for by the increases that will be necessary when it comes to improving the economic and social lot of the majority of the population.

The latter costs are likely to be huge. Azar Jammine at the Econometrix ‘think tank’ puts the cost of beginning to close the white-African gap in living standards (housing, education, health) to 20–30 billion rand per year over the next decade which, given the present expenditure, would require a 30–45 per cent increase in the budget.[16] With public expenditure representing around 35 per cent of GDP (Standard Bank 1991:3), this is hardly a feasible option. Nor is borrowing, since the interest cost on 20–30 billion rand per year would put an unrealistic burden on the economy (EIU 1990b:8).

To sum up, South Africa has pursued a fairly tight monetary and fiscal policy during the last few years and containing the rate of inflation remains the most important short-run goal. However, at the same time the economy is facing a long-run growth problem. South Africa is undergoing a process of structural adjustment. Substantial layoffs, particularly within mining (and construction), bad debts and bankruptcies, mainly among small businesses and farmers, have been unavoidable. Even worse, close to 40 per cent of the African population are either unemployed or have to make a living outside the formal sector of the economy, and the standard of living is unacceptably low among the Africans, especially among those living in the bantustans. This has created social and political unrest which makes for regular violent eruptions.

Hence it is imperative to bring the economy back to a growth path, but the present economic policy is hardly conducive to that. Even though the budgets of 1991–2 and

1992–3 have been slightly more expansionist than the 1990–1 one, fiscal policy can hardly be said to stimulate growth to any significant extent. Monetary policy will also remain firm, with a growth target for the money supply which is lower than the one for 1990. In addition, imports, and then mainly of investment goods, must be held back in order to make it possible to maintain the surplus on the current account of the balance of payments which is needed in order to service the foreign debt obligations. Negative growth prevailed throughout the 1989–92 period and, although economists are predicting a strong economic recovery in 1993 with a possible 3.5 per cent growth, the economy will remain too weak to support the social restructuration needed (EIU 1992b:5).

CONCLUSIONS AND A LOOK AT THE FUTURE

During the 1980s the performance of the South African economy was poor, and this situation remains at the beginning of the 1990s. The growth of GDP, in real terms, does not suffice to keep pace with that of the population. South Africa has turned into a net exporter of capital, and domestic investment has suffered accordingly. Personal savings are at a dismally low level.

Most important sectors of the economy are facing severe problems. Uncertainty looms large in 'white' agriculture with respect to the further distribution of land and subsidization of the sector has had to yield to a more market-oriented agricultural policy. Gold-mining is in the middle of a severe crisis, caused by a low international price, in combination with rising costs of production, and this, in turn, affects the balance of payments negatively. Finally, manufacturing is having cost problems as well, as a result of skill shortages, low capital formation and high inflation – in a situation where import substitution is grinding to a halt. An outward-looking industrial strategy is gradually becoming imperative.

South Africa has faced certain problems in the external sector, as a result of the sanctions that to a varying degree have been imposed by the western nations. At present, however, sanctions are gradually being phased out. However, the pressure to maintain the financial sanctions against South Africa has recently increased and this in turn reduces the prospects for capital inflow. Another balance-of-payments problem is caused by the foreign debt which was contracted during the first half of the 1980s and which now requires a surplus on the current account to ensure interest payments and amortization.

In the somewhat longer run, the most important macroeconomic problem of South Africa is that of unemployment – notably among the African population. Although South African employment statistics are notoriously unreliable, nobody doubts that the situation is troublesome. Even relatively high growth rates of GDP are not likely to be sufficient when it comes to solving this problem in the near future. At the same time, the rate of inflation is quite high and the government has opted for curtailing price increases rather than for an expansionist policy that could boost employment. To this end, a tight monetary and fiscal policy has been pursued in recent years. It would appear that there will be very little expansion in the economy during the next couple of years. South Africa thus has a long way to go when it comes to solving its structural adjustment and growth problems, and without solving these it is hardly possible to create viable economic

sectors that can guarantee gainful employment in the twenty-first century either.

The apartheid-driven growth machine of South Africa no longer works. On the contrary, apartheid has become the main obstacle to growth and development. As a result, the system is on its way out, at least in the economic sphere, where all laws have already been scrapped[17] and it is presumably only a matter of time before the African majority holds the decisive political vote as well. The rising political tide can hardly be stemmed, only delayed.

That political change will have an impact on the economy as well goes without saying, but the direction and extent of this impact remain unclear. Presumably the ANC will be the main political force in post-apartheid South Africa and thus very much hinges on what policy this organization decides to pursue. From time to time the desirability of nationalization, for example, of the mining and banking sectors, has been pointed out, but the ANC is split on the issue. Nelson Mandela and the 'old guard' have generally chosen to play it down while the younger generation of ANC leaders have come out in favour of a more deep-going redistribution of assets. Which of the two views will prevail in the end is not easy to guess. What appears fairly clear, however, is that agricultural land will somehow be redistributed to redress the present lop-sided situation.[18]

Thus, it is difficult to make reliable forecasts with respect to the more distant economic future of South Africa. The outcome very much depends on the assumptions that one is willing to make. Bearing this in mind, however, a few points may be noted. Provided that nationalization is not attempted on a broad front and provided that central planning is not introduced (both measures that are likely to have a negative impact on productivity), the removal of apartheid will be beneficial both from the point of view of efficiency and when it comes to narrowing the gap in living standards between whites and Africans.

Beginning with the efficiency issue, one of the most important effects of apartheid is that labour is not allowed to flow freely into those sectors and uses where its marginal productivity is highest. Also, apartheid obstructs the accumulation of skills among Africans, both formally and informally. An attempt to quantify these obstacles has been made by Murali Iyengar and Richard Porter (Iyengar and Porter 1990). Their simulations point to real GDP increases in the order of 6–9 per cent, depending on how fast Africans are allowed to accumulate skills and compete with whites for skilled occupations. The largest increases will take place in the sectors that are most skill-intensive, such as manufacturing and other urban sectors (excluding mining), while mining will be touched to a much lesser extent. Agriculture, on the other hand, which is the sector relying most on unskilled workers, will suffer as these workers leave for better-paid jobs elsewhere in the economy.

The second main effect of dismantling apartheid will be that of redistributing incomes from whites to Africans. While the total incomes of both groups are likely to rise as a result of the efficiency gains, the African increase calculated by Iyengar and Porter amounted to 7–34 per cent while white incomes would rise by 5 per cent if African skill development is slow and they would hardly be affected at all if it is fast. The main white losers are the unskilled (44–61 per cent) and the farmers (31–54 per cent) while the main gains are made by the capital owners (14–20 per cent).

Exactly what will happen among the African side is less clear. Wage levels in agriculture and mining will rise as labour leaves these sectors, while both skilled and

unskilled wages will fall in the recipient urban sectors. However, those who manage to either upgrade their skills or move to the high-productivity sectors (or both) will gain. The losers are only those who already hold urban jobs and fail to upgrade their skill level, also, to the extent that the abolition of apartheid results in an inflow of foreign capital to the urban sectors (those most likely to receive foreign investment).

Naturally, simulations like those presently referred to should not be taken too literally. They are no more reliable than the assumptions and simplifications upon which they rest. Still, in the case of South Africa, even though there may be reasons for handling magnitudes with care, the directions of change are clear enough. Both from the efficiency and the equity point of view, making apartheid a thing of the past is likely to bring positive change in the long run, provided that the transition can be made peacefully.

NOTES

1 Lundahl, Fredriksson and Moritz (1992) give the details of both the expansion process and the stagnation of the 1970s.

2 These figures may, however, be underestimates. The population growth figure employed is of the order of 2.2 per cent per annum, which may be on the low side. (EIU 1990a:14 estimates the population growth rate, including the bantustans, to be 2.6 per cent per annum and excluding these, 2.35 per cent.)

3 EIU 1990a:29. This figure includes processed agricultural products.

4 Quoted in Gawith 1991a.

5 For a discussion of mineral-led growth, see Mamalakis 1978.

6 1988:33.5 per cent, 1989:49.2 per cent, 1990:42.6 per cent (SARB 1989:27, 1991:19).

7 Figure from SARB, quoted by Gawith 1991b.

8 It should be noted that South African trade figures (exports as well as imports) do not provide a very accurate picture of either commodity or country composition. In order to increase the difficulty of detection of breaches of international trade sanctions, only broad, and fairly meaningless, aggregates are published. On the export side, platinum metals, individual so-called strategic metals and minerals, as well as military equipment, and so on, are hidden, and imports, for example, oil, military equipment and computer equipment, disappear (Odén 1991:6). In 1990 it was estimated that South Africa sold military equipment for about 1.7 billion rand abroad (EIU 1991a:24).

9 EIU 1990a:51. As indicated by Table 16.3 South Africa generally has a surplus on its balance of trade. On the other hand, invisible transactions are virtually always in deficit. Except for service of the foreign debt (36 per cent of the total in 1988), invisible payments include freight and insurance payments, travel, and remittances by migrant workers from the surrounding countries. On the credit side, transport is the most important item (tourism, passenger fares, freight, insurance, and so on), accounting for more than 40 per cent (EIU 1990a:51–2).

10 Holman 1991. This, in turn, has made South Africa relaunch the Krugerrand on the international bullion market (Gawith 1991d).

11 Quoted by Keeling 1991.

12 The school boycotts among Africans during the 1980s have, of course, also contributed to worsening the educational problem.

13 Wolpe (1991) discusses some strategical issues related to the planning of education for post-

apartheid society.

14 Cf. Wilson and Ramphele 1989: Chapter 5, for a discussion of hunger and health conditions among the African population.

15 It must also be noted that the revenue side of the budget is strongly dependent on the international gold price. Taxes on gold-mining yielded 18.3 per cent of the total revenue in 1980–1, but only 1.5 per cent in 1989–90 (Loots 1991:43).

16 Quoted by *The Star*, 13 February 1991.

17 Lundahl (1989) and Lundahl, Fredriksson and Moritz (1992) analyse the change of composition of the white polity and the implications of this for the apartheid system.

18 The most important official documents stating the economic strategy of the ANC are 'The Freedom Charter' (1988), 'Recommendations on post-apartheid economic policy' (1990) and African National Congress (1990).

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