Private Enterprise in Africa
Creating a Better Environment

Keith Marsden
Thérèse Bélot
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Keith Marsden is an operations adviser in the Industry Department of the World Bank; Thérèse Bélot is a consultant to the Bank.

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ABSTRACT

This paper addresses four issues. First, what are the main constraints to private enterprise and competitive markets in Africa? Second, how can African governments remove those constraints and foster the development of an efficient private sector in the future? Third, how can foreign aid donors best contribute to this goal? And fourth, in the light of past and current experience, will the economic performance of African countries be improved if the role of private enterprise is enhanced and market forces are allowed to operate more freely?

The assessment draws upon a variety of evidence and sources: cross-country studies; country economic and sector reports; lending operations experience; analysis by independent observers and development specialists; attitude surveys conducted among private investors; and special missions to review the business environment and investment climate in several African countries.

Chapter I examines barriers to entry faced by private investors in the agricultural marketing, transport and industrial sectors. Chapter II reviews obstacles to foreign investment. Chapter III discusses financial constraints. Labor regulations and price controls are analyzed in Chapter IV. The relationship between trade policies and the level of competition is traced in Chapter V. Chapter VI considers the role of foreign aid donors in promoting private enterprise in Africa.

An Annex summarizes five cross-country studies which have estimated the impact of government and the private sector on economic growth.
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EXECUTIVE SUMMARY AND RECOMMENDATIONS

1. What can governments do to create a better environment for private enterprise in Africa? Development in many countries throughout the world has shown that the initiative and drive of private investors and entrepreneurs can be important agents of economic growth. Many African countries would therefore like to make greater use of the potential benefits of private entrepreneurship. Economic analysis suggests that private enterprises contribute most to the generation of high economic returns (as opposed to just financial rewards to the investor) in a liberal environment characterized by few constraints on access to inputs and markets, autonomy in investment and operating decisions and a common framework of incentives applied consistently and uniformly to all actors. Likewise, a well-educated and motivated labor force and well-functioning capital markets are important ingredients of a stimulating business environment. While these conditions are rarely fulfilled in African countries, they are important targets to strive for in the interest of development.

2. This paper addresses key issues affecting private sector development in Africa. It is based on several missions to a number of countries and generalizes, to the extent possible, findings of weaknesses and constraints in key policy areas. Five areas are examined which typically have been neglected by governments in the past but are of crucial importance to a healthy development and performance of the private sector: (i) barriers to entry, (ii) treatment of foreign investment, (iii) financial constraints, (iv) labor policies and price controls, and (v) trade policies and competition. This Executive Summary outlines the main findings and recommendations; the full paper is attached.

Barriers to Entry

3. The granting of monopolies to state agricultural marketing boards has resulted in inefficient operations, misuse of funds, and depressing effects on farm output. These monopolies should be eliminated and private traders of agricultural produce of all kinds should be allowed to operate without obstruction. If existing state marketing boards are able to co-exist without subsidies, they will widen the choice of both producers and consumers and perform a useful role in preventing the emergence of private monopoly or collusion in restraint of trade.

4. In urban transport, small-scale, private operators have decisive advantages over public sector producers and over large-scale operators generally. Yet in many African cities, expensive and inefficient public
bus monopolies endure. And what is true of urban bus systems is true also of over-the-road passenger and freight systems. Private operators offer better, cheaper alternatives to public trucking companies. Yet they are often bypassed. Entry restrictions should be lifted if African countries are to open up their interiors, move people and goods to work places and markets faster and more efficiently and remove bottlenecks which are holding back progress in other sectors.

5. In many African countries a variety of policies also restrict private access to and participation in the mining, manufacturing and public utilities sectors. Sometimes activities reserved for state enterprises (or joint ventures with majority government ownership) are specified in Investment Codes or other legislation governing industrial investment. In other cases, public sector control has been acquired by nationalization of existing privately-owned enterprises. More frequently, selective use of industrial licensing authority preserves state monopolies in sectors considered to be politically sensitive or where the pursuit of social goals is made paramount. These barriers have deprived African economies of the benefits of private investment (both indigenous and foreign) and the skills, know-how and initiative which would have accompanied such investment. They have removed the competitive stimulus to efficiency which public monopolies have so obviously lacked in some key areas. Governments would achieve their goals more effectively if they eliminated these barriers and used broader economic policies and market incentives to guide private decisions in the desired directions—such as employment creation, training of nationals, reinvestment of profits, etc.

Obstacles to Foreign Investment

6. Apart from specific restrictions on entry noted above, foreign investors are often deterred by various bureaucratic procedures, policies and practices which create an unfavorable climate for foreign firms. Obstacles cited in a survey of European investors include:

- internal political pressures leading to price controls
- failure to respect contractual obligations
- restrictions on employment of expatriate staff
- requirements to use local inputs of poor quality
- restrictions on location
- government preferences for large prestige projects
- legislative insecurity, including increases in taxation after a project has been implemented
- corruption resulting from red tape and a multitude of authorizations required to do business
- excessive legalism and lack of precision in legal texts
- slow and arbitrary decision taking

7. African governments which wish to promote foreign investment should take more vigorous action to change these perceptions or else change the underlying reality. Mechanisms to allow a continuing dialogue between government and the private sector would lead to a better understanding of each side's needs and attitudes and a broader consensus on reforms required. These mechanisms include regular meetings with Chambers of Commerce and tripartite National Economic Councils and missions by prospective foreign investors arranged by such organizations as the U.S. Overseas Private Investment Corporation.

Financial Constraints

8. Shortage of investment funds and working capital is holding back development of the private sector, particularly small and medium enterprises (SMEs), throughout Africa. In part, this scarcity is simply a reflection of low income levels and the persistence of large subsistence (non-monetized) segments of their economies. But it also springs from weaknesses in policies and institutions which hamper resource mobilization and restrict the private sector's access to available finance. Serious constraints were found in six areas. First, financial market regulations reduce savings deposits and discourage banks from lending to SMEs. Second, stock markets and merchant banks able to mobilize equity capital are generally absent. Third, foreign exchange allocation systems restrict the supply of foreign currency to private firms. Fourth, the private sector is crowded-out of financial markets by excessive borrowing by government and public enterprises. Fifth, heavy taxation squeezes corporate profits and entrepreneurial incomes and therefore limits the private sector's capacity to generate internal investment funds. And sixth, foreign loans and grants are being monopolized by public investment programs.

Financial constraints on private enterprise can be relaxed by:

- allowing interest rates to reflect the state of the credit market and the foreign exchange market, plus differentials in risks, maturity and administrative costs of servicing different types of customer and sizes of loan;

- removing anti-equity biases in financial and fiscal policies such as interest rate subsidies, double taxation of dividends, and official bail-outs of loss-making enterprises;

- creating specialized equity-financing institutions and funds;

- adopting legislation to promote the disclosure of corporate and market trading information and the registration of stockbrokers;

- dismantling foreign exchange controls and import and export licensing, leading to free convertibility of currency;
- reducing the need for government and public sector borrowing in domestic credit markets by eliminating budget deficits, restraining the expansion of public sector employment and wages, seeking savings in recurrent costs in such fields as education and housing, reducing losses of public enterprises by restructuring, stricter monitoring and divestiture and scrutinizing public investment programs more rigorously to prune potential "white elephants";

- lowering high marginal tax rates to strengthen incentives and opportunities to save and invest and to decrease pressures for tax evasion and corruption;

- allocating a higher proportion of foreign aid funds to local development finance institutions and commercial banks for onlending to SMEs;

- encouraging private investors to take over inefficient state-owned enterprises and to undertake new projects currently included in public investment plans by guaranteeing long-term loans to match the investors' own equity contributions; and

- providing private sector development loans, financed by multilateral and bilateral aid donors, to meet the short- and medium-term foreign exchange requirements of private enterprises, linked to policy reforms that promote competitive markets and efficient resource utilization.

**Labor Policies and Price Controls**

9. Cumulative evidence suggests that over-regulated labor markets have generally resulted in bloated bureaucracies and hampered the profitability of enterprises in Africa. In particular, pressures upon employers to expand or maintain employment, for strictly social considerations, have proved to be counterproductive. Only economic growth can produce long-term expansion of employment.

10. Labor policies should allow firms more flexibility in negotiating wages, including the possibility of linking wages to employee productivity. Restrictions and penalties on laying off excess or unproductive workers should be relaxed, so that employers may take on and train new workers without excessive risks. Fiscal incentives should be given to encourage greater involvement of employers in the design and execution of training programs.

11. The short-term benefits of price controls to consumers have been far outweighed by their economic costs and destabilizing effects. Price controls have aggravated shortages and distortions. They have turned the terms of trade against agricultural producers, caused bureaucratic delays and market rigidities and restricted resource mobilization by squeezing profits. Several African countries have taken steps recently to remove
price controls completely or to retain them only for a few basic commodities. Measures to increase market competition, including freedom of entry, lower tariffs and removal of quantitative restrictions on imports, will help to ensure that price liberalization does not result in excessive rents for monopolists.

**Trade Policies and Competition**

12. Overvalued exchange rates are found throughout Africa and the situation has generally deteriorated relative to other regions over the past decade. Overvalued currencies make it more difficult for African farmers and manufacturers to sell their products abroad and reduce the returns in local currency received by exporters. They also result in foregone benefits in import-substituting sectors by making imports relatively cheaper. Thus, domestic resources are channelled into the production of non-traded goods and services. However, a growing number of African countries have begun to adopt more flexible exchange rate regimes which rely on demand and supply in the foreign exchange market to determine the exchange rate. Such measures as allowing exporters to retain a certain percentage of their foreign exchange earnings, and periodic auctions for trade-related foreign exchange transactions, can facilitate a transition to a freely convertible currency which is the most effective mechanism for ensuring that a realistic exchange rate is sustained.

13. The level of protection from imports afforded to domestic producers is highly variable in Africa, reflecting uneven tariff rates and selective quantitative restrictions. Effective protection tends to be high for activities with low domestic value-added such as component assembly industries, reducing competition and encouraging inefficiency. Low or even negative effective protection in other fields discourages the use of domestic raw materials and the development of intermediate and capital goods industries. Quantitative restrictions promote rent-seeking activities. Substantial rents can be obtained simply by having access to import licenses. Corruption almost unavoidably flourishes in such a situation. Politicization of the economic process is encouraged. High tariffs and quantitative restrictions on imports facilitate the emergence of private monopolies and "crony-capitalism" which yield few long-term benefits for society as a whole.

14. These distortions and weaknesses are being remedied in some African countries in the context of structural and sectoral adjustment programs. Tariff rates are being made more uniform and moderate. Quantitative restrictions are being lifted. These reforms are accompanied by a strengthening of customs administrations to improve revenue collection and to meet the legitimate complaints of domestic producers who are currently being undercut by fraudulent imports which evade many of the duties and domestic taxes imposed upon those who abide by the rules. These measures need to be replicated throughout Africa.

15. Biases against exports resulting from overvalued exchange rates and from high duties and quantitative restrictions on imports are reinforced in many African countries by explicit or implicit taxes on exports.
These taxes have retarded the growth and diversification of African exports, particularly in manufactures which account for only eight percent of total exports from low-income countries in Sub-Saharan Africa. Vigorous steps to counter the prevailing "export pessimism" in Africa are indispensable if more rapid and better-balanced economic growth is to be achieved. The private sector could provide the main driving force behind an outward-oriented trade strategy if export taxes were removed, realistic exchange rates adopted, duty draw-back schemes introduced and administered effectively, export credit facilities created, fiscal incentives offered and export promotion services strengthened.

Role of Aid Donors

16. The evidence reviewed in the main text of the paper and in the Annex indicates that there is no shortfall of entrepreneurial spirit in Africa. The most crucial limiting factor is not entrepreneurship, but weaknesses in the policy environment which inhibit effective investment.

17. Aid donors are already helping to remove debilitating restraints on private enterprise in many ways. Infrastructure development and project lending in productive sectors are important. Economic analysis and cross-country studies draw the attention of policy makers to measures which have been applied successfully. Structural adjustment operations help to minimize the short-term political and social costs of reforms and endow immediate financial benefits.

18. The impact of foreign aid on private sector development could be further enhanced by:

- involving the private sector more closely and systematically in the policy dialogue with countries;

- introducing Private Sector Development Loans aimed at reducing the financial and foreign exchange constraints on private firms and focusing on policy areas which have been somewhat neglected in past adjustment operations, such as eliminating statutory monopolies, applying growth-oriented fiscal policies, deregulating labor and financial markets, developing equity markets and fostering direct foreign investment;

- designing agricultural projects to ensure that private enterprises can participate fully in the provision of inputs and the distribution and processing of agricultural output, and are not preempted or undercut by subsidized public sector organizations;

- expanding the access of indigenous small and medium enterprises (SMEs) to credit, by lifting interest rate ceilings and other disincentives which deter financial institutions from undertaking riskier and more costly SME lending programs;

- strengthening market networks and subcontracting/franchising relationships which are more effective mechanisms for the
transfer of information and know-how to SMEs than public institutions and extension services;

- providing guidance and support to governments wishing to pursue the privatization option as a means of tackling the problems of their state-owned enterprises;

- shifting some of the burden of local cost financing from governments to the private sector by tapping the growing body of experience around the world with the private provision of public services;

- drawing upon donor's legal expertise for the drafting of new investment codes and redesign of commercial law to create a more stable, predictable and transparent business environment over the long run;

- assisting indigenous entrepreneurs identify, appraise and arrange financing for private investment projects;

- promoting direct foreign investment by providing insurance against noncommercial risks (MIGA), by organizing workshops and study tours for officials of African investment promotion agencies, by funding missions by potential foreign investors and subsequent feasibility studies, and by disseminating reports describing and analyzing the investment climate in Africa to organizations representing foreign investors.

Conclusion

19. A growing private sector providing a more diverse array of products and services is a formidable force for development. Opening the economy to more indigenous enterprises also provides increased opportunities for African women who, in many African societies, have a long tradition of commercial activity. For governments who have gradually realized the limits of public sector intervention, an enhanced role for the private sector is not a threat, but welcome relief. And the harsh rhetoric once heard in Africa against foreign investment is being replaced by a determined competition for the capital, technology, and employment which industrial country investors can bring to a developing country.

20. Attitudes and policies are changing rapidly in Africa. There is a growing recognition that, given the proper support, the enterprising energies of Africa's people have enormous development potential. Aid donors, industrial country investors, African governments, and African entrepreneurs themselves now have the opportunity before them to engage a powerful engine to help drive Africa's development forward. It is an opportunity which no one can afford to ignore.
INTRODUCTION

"It is now generally accepted that over time the majority of public sector enterprises or entities have not performed efficiently. Instead of accumulating surpluses or supplying services efficiently, a good number of these enterprises have become a drain on the national treasuries. Due to this poor performance, coupled with the growing recognition of the costs of ineffective public enterprises in terms of foregone economic development and the scarcity of domestic and external resources for public sector expenditure, reappraisal of the strategy of heavy reliance on the public sector has become imperative. From this reappraisal, a view has emerged—the need for enhancement of the role of the private sector in development. We in Africa are facing a great challenge. We believe that the creation of a conducive environment for the growth of the private sector, an important agent of economic growth, is essential."—Statement by Babacar N'Diaye, President of the African Development Bank at the International Conference on Privatization, February 17, 1986, Washington, D.C., U.S.A.

Similar official declarations promoting the role of the private sector as an engine of economic growth have become common in many African countries in recent months. This is in marked contrast from 20 to 30 years ago when African countries first gained their independence. The prevailing political philosophy at the time stressed the role of government in directing the development process. It was believed that resources could be allocated more efficiently by central planning than by haphazard market mechanisms. Market failures and distortions must be corrected by extensive government intervention through regulations and administrative controls. The strategic "commanding heights" of the economy must be owned by the state on behalf of the people, not exploited for capitalist greed.

Real political independence required economic independence, it was argued. Foreign companies and ethnic minorities dominated African economies during the colonial era. The new leadership had little faith in the entrepreneurial flair and managerial skills of indigenous entrepreneurs engaged in small-scale artisan and trading activities. Small-scale industry was thought to be a relic of the past and a barrier to the adoption of modern technology and economies of scale. So large-scale public investment had to take the place of foreign private investment as the main driving force behind a self-reliant development, it was believed. The battle for independence inevitably left many scars. Human resource development was low, and indigenous institutions were absent or very poor. Many countries
were not homogenous entities. Regional and tribal imbalances were important. In many African societies, the role of the government was seen by the population very differently from the way it is seen in more developed market systems.

These views were confirmed by some development economists and technocrats who were preoccupied with abstract models which reduced the process of development to the interaction of a few key variables, inevitably those which were most easily quantified such as capital investment. More intangible factors—entrepreneurship, risk-taking, innovation, incentives, motivation, opportunities, choice, mobility and liberty—tended to be left out of the equations. International suppliers and even Donor Agencies reinforced the emphasis on large capital-intensive projects.

Subsequent experience has led to a reappraisal of development strategies based upon these ideas and approaches. Growth of per capita income in Sub-Saharan Africa has lagged well behind that in other regions of the world. In low-income economies in Africa, average per capita GNP actually declined by 0.2 percent annually between 1965 and 1983, compared with an annual growth rate of 2.7 percent in all low-income economies. Per capita GNP in middle-income African economies rose by 1.9 percent annually over the same period, while the average growth rate for middle-income countries as a whole was 3.4 percent.

Experience has shown that the information and know-how available to government officials was generally less precise, and more often misused, than the information and know-how possessed by market participants (buyers and sellers). Failures of bureaucratic systems turned out to be more pervasive than market failures. Abuses resulting from state monopolies were more pernicious in their effects on people's welfare than entrepreneurs striving for profit in competitive markets. The managerial capacity of governments became overextended. Public enterprises were subject to political constraints and pressures from special interest groups. They were frequently set social objectives, such as preserving employment and restraining inflation, which were difficult to reconcile with efficiency. They were rarely allowed to go out of business, even if their products and plants were obsolete and incurring huge losses. Red tape and excessive bureaucracy undermined the effectiveness of government services. And government controls over private sector decisions, through licensing, rationing and regulations, distorted incentives and brought about a misallocation and inefficient utilization of resources.

Post-colonial experience has also demonstrated the reality of world interdependence. Poor countries can participate in world trade to their advantage and become stronger and more prosperous as a result. Foreign investors and commercial partners abroad can provide scarce, complementary resources that generate substantial benefits for the national economy, shared by all parties. Indigenous entrepreneurship is more prevalent than was thought, but needs a positive environment to flourish and time to gain stature and confidence.

What can governments do to promote efficient private enterprise and competitive markets? Country analysis suggests that private enterprise
tends to perform most efficiently (in the sense of generating high economic returns to the country, not just financial rewards to the investors) in environments with the following characteristics. Entry into any economic activity is unrestricted. Access to inputs and markets is assured. The labor force is well educated and motivated. Entrepreneurs are allowed considerable autonomy in their investment and managerial decisions. Property rights (including intellectual property) are protected by laws which are objectively enforced. Contractual obligations are respected. Government policies are applied consistently and uniformly, ensuring fairly equal treatment among sectors and firms, including non-discrimination between foreign and nationally-owned enterprises. Market distortions and rigidities are minimized, so that the prices of capital, labor, foreign exchange reflect their relative scarcity. Economic incentives are neither repressed by an excessive burden of taxes, nor feather-bedded by undue subsidies and protection from competition. Bilateral or multilateral agreements ensure independent arbitration of disputes affecting foreign investors and provide insurance cover against non-commercial risks. Government services are supportive, efficient and administered with integrity. Controls and red-tape are kept at tolerable levels. The infrastructure (roads, ports, power, telecommunications, etc.) is adequate. And independent institutions and competition in general are encouraged.

These conditions are seldom, if ever, united in a single country. Substantial deficiencies persist in most areas in many African countries. Nevertheless, they represent valid goals that can be pursued in national development strategies, even if they are unlikely to be fully attained in the real world. The following chapters discuss existing weaknesses and constraints in key policy areas, illustrated by specific country and sectoral cases, and review action being taken, or proposed, to further these goals. The paper does not attempt to be comprehensive. It focuses on issues which have been somewhat neglected in the past and on factors which have emerged from analysis and discussions as critical determinants of private sector performance.

Five broad policy areas are examined. The first covers restrictions on entry by private investors and the impact of statutory monopolies and nationalizations. The second comprises various obstacles to foreign investment, including bureaucratic procedures, corruption and inconsistencies in the way policies and laws are interpreted and applied. The third consists of financial constraints on private enterprise resulting from over-regulated financial markets, scarcity of equity funds, biases in the allocation of foreign exchange, "crowding-out" by excessive public sector borrowing, heavy taxation squeezing corporate profits and entrepreneurial incomes and the monopolization of foreign aid by governments and public investment programs. The fourth combines labor market regulations and price controls and considers their effects on labor mobility, employment creation and domestic resource mobilization. Last, but certainly not least, there is a discussion of trade policies and the role of the exchange rate, protection from imports and export incentives in determining the market opportunities available to private enterprises and the extent to which they are subject to a competitive stimulus to efficiency.
CHAPTER I. BARRIERS TO ENTRY

In almost all African countries, private entrepreneurs are prohibited from engaging in some economic activities which have been reserved for state monopolies. The range of activities proscribed varies from country to country but entry barriers are most prevalent in agricultural marketing (of inputs and outputs), transport and industry. Specific examples are cited below.

1. Agricultural Marketing

In the agricultural sector, the FAO List of Marketing Boards (1981) indicates the existence of more than 100 marketing boards in tropical African countries. The largest and most numerous are the monopoly boards for export crops and for domestic food crops. There are also boards that have monopolies of international trade in commodities for which they are responsible, but compete with private firms internally and do not have the power to fix prices. Initially the rationale for the creation of these boards was stabilization of prices and the management of the food supply for the growing urban populations. In some countries they were introduced by colonial administrations. However, it is now widely recognized that these state marketing boards have not only marginalized, distorted or destroyed highly functional indigenous traditions of "open" competitive agricultural marketing in Africa, but have also been wasteful and inefficient in their own operations.

Most marketing board analysts point out the disappointing performance of the majority of these boards. In a recent seminar in Leiden, the Netherlands, 23 case studies of farm marketing boards in individual African countries were presented. These papers provide revealing assessments made by marketing specialists.1/ There were few good words for any marketing boards and many harsh ones. Principal defects identified were misuse of funds, inefficiency of operations and the depressing effect on farm production of marketing board policies and practices.

Criticism of use of board funds concentrated on their diversion to political constituencies and on outright theft by public employees. The case studies gave the following illustrations. In Cameroon "an enormous amount (75%) of the funds accumulated from crop exports has been channelled from rural sector to manufacturing and service sectors, turning terms of trade against the rural sector." In Malawi "marketing board pricing policy has been used as an instrument favoring the development of estate agriculture at the expense of small holder expansion." "Nigerian marketing boards have been used to serve various interests and purposes, hardly any

of which have benefitted the producers." In Tanzania, "the grower ... is always voiceless and marginal in the system, and everybody's costs are considered except the farmers." Frequent embezzlement of money meant for the purchase of cocoa was reported in Ghana. Theft, embezzlement and collusion were said to be widespread in ONCAD (Office National de Coopération et D'Assistance au Développement) in Senegal. NMC (National Milling Company) personnel in Tanzania were reported to have "absconded with funds" and indulged in "clientage practices that made villagers tolerant of village officials syphoning funds." Gross abuse of weights and measures and adulteration of products by agents of marketing boards were found in Cameroon. In Sierra Leone there were complaints of frauds being practiced by licensed buying agents who "exploit" farmers by paying them less than the official price. Before the Sierra Leone Rice Board lost its exclusive right to import rice "half of its imports were being allocated to influential politicians to distribute at their discretion."

Related to the political determinants of how revenues extracted from farmers are allocated are the universally reported inefficiencies of marketing board operations. A FAO participant in the Leiden seminar concluded that "A most common complaint about grain marketing boards is that they "lose" money—heaps of it." Inefficiencies derive from a variety of causes, including the appointment to government positions of political supporters (the "spoils" system) with consequent burgeoning of staff numbers and deterioration of staff competence. A number of other circumstances contribute to costly and inefficient operations. An official of the West African Rice Development Association listed the following: "Inadequate funding and untimely release of funds; non-competitiveness of government producer prices; inadequate governmental facilities for transporting, storing, packaging and poor location of buying center; unqualified personnel; and operational bureaucracies that inhibit on-the-spot decisions by field staff." Furthermore, there are "deliberate efforts by management to reduce purchases so as to reduce costs of subsidies, and marketing margins of public marketing institutions are usually very high compared to that of private traders because of high overhead costs, large permanent staff, expensive head office facilities, poor management." There are also "substantial physical losses of rice during marketing." Boards cannot enforce market regulations or "handle a large quantity of locally produced rice" and "cannot operate without government subsidy due to high costs of operation and government pricing policies."

Various participants at the Leiden Seminar spoke of the lack of economic information that is necessary for making decisions about buying, selling, storing and transporting produce. The National Cereal Board of Kenya did not know the size of the crop or the nature of demand. Market prices are not collected systematically or processed adequately and market forecasts are very unreliable. This ignorance of national crop and price statistics extends to the internal accounts of the marketing boards themselves. "Some agencies in the Sahel haven't presented regular financial statements for several years."

A management consultant to several marketing boards painted a grim picture of the awesome responsibilities of managers who may be responsible for 80 percent of a country's export earnings and are under heavy
political pressure while the infrastructure is collapsing around them. He spoke of farmer's incomes being reduced by as much as three quarters by board operations. High operating costs, incompetence, political favoritism, and corruption have handicapped boards in achieving their authorized objectives of stabilizing food prices and incomes and ensuring adequate supplies of domestic foodcrops to consumers at reasonable prices. It was suggested that Malawi's marketing boards actually destabilized producer prices and incomes.

Despite widespread dissatisfaction with the performance of state marketing boards, the Leiden Seminar noted powerful forces tending to perpetuate these boards. They were a prominent part of the government apparatus inherited by the newly independent nations of Africa and were highly regarded as engines of government by their officers and staffs. Board officers wield considerable political power, and staff at all levels can find ways to line their own pockets if they are so disposed. Clients of a board, too—large growers, produce buyers, shippers, handlers, and warehousers—may view their own activities as intimately bound up with those of the board and mistrust change. Another group of civil servants tends to accept things as they are and react defensively to criticisms. The staffs of marketing boards are not small and their kinsfolk may be numerous. For the party in power, marketing boards provide a strong instrument of political and economic pressure as well as a ready source of government funds, and probably of private funds as well. And the boards are weapons that can be used against private domestic monopolies and international trading companies.

African marketing boards also serve various conventional government functions beyond that of marketing farm crops. They have been an important source of funds that serve agriculture along with the rest of the country—roads, bridges, railroads, ports and communications. It is easier to collect taxes in the form of trading profits or operating expenses than as more visible excise taxes and customs duties, and excessive use of this device in Africa has come close to killing the goose that laid the golden egg. In Tanzania, for example, the total exports of the country's major commodities (cotton, coffee, cloves, sisal, cashews, tobacco and tea) declined by 34 percent between 1973 and 1980. In general this was the result of severe cut-backs in production which, in turn, was sparked by lower official prices paid to the producers. The marked drop in prices was not due to unfavorable world conditions, but rather to heavy "taxes" on farmers—export duties combined with ever-increasing marketing and administrative costs accumulated by the parastatal marketing boards handling the products. These bloated costs were important factors leading to a reduction in farmer's share in export earnings to below 50 percent. As a result, producers directed some of the crops (coffee for example) into unofficial channels, neglected and even abandoned some tree and bush crops (coffee, sisal, and cashews) and shifted resources into subsistence production.2/

The story is the same for Ghana. Ghana's share of the world production of cocoa shrank from one third in the 1950s to one-sixth in 1979. The main reason for this disastrous decline was the heavy "tax" imposed on farmers through the Cocoa Marketing Board's price policies. Producer prices for cocoa lagged behind other relevant prices--far behind in most cases. The price index for all consumer goods rose 22 times between 1963 and 1979; the price of cocoa in neighboring countries rose 36 times. In contrast, Ghana's farmers received only six times more for their cocoa. The government had become too dependent upon current revenues from cocoa marketing to take a longer-term view of the negative effects of its pricing policies on both output and revenues.

Although resistance to change arising from the factors indicated earlier persists, several African countries have taken steps to increase the efficiency of agricultural marketing by allowing private traders to enter into fields previously confined to state monopolies and in some cases have even closed down marketing boards. In 1981 the Somali government eliminated the monopoly power of the Agricultural Development Corporation (ADC) in the field of maize and sorghum marketing and of the National Trading Agency (ENC) for imported foodstuffs. Private traders rapidly took over the bulk of grain distribution. By 1984 ADC's share of total maize and sorghum purchases in Somalia had dropped to 1.6 percent. Total production of these crops increased from 251,000 tons in 1980 to 491,000 tons in 1984. ENC's imports of grains halved over this period and their imports of oil, tea, sugar and pasta also declined. They were able to compete with private traders in some areas only because they continued to monopolize food aid imports and sell at concessionary prices.

In Mali, cereal marketing was liberalized in 1982 and the responsibilities of the state cereal marketing agency (OPAM) reduced and its operating costs cut. Government price controls remain however. Groundnut marketing was liberalized in 1983 and a farm input supply agency liquidated. The distribution activities of the general import–export agency (SOMIEX) were curtailed and several sectors opened up to private participation.3/

In Madagascar a major liberalization of rice marketing has taken place. Several parastatal agencies, including GANPA, were abolished in 1983 and price ceilings removed in 1983. In Cameroon, MEDAVLVE has become defunct and private traders have taken over food crop marketing. In Niger, reforms were introduced in 1984 to reduce the operating losses of the cereal marketing agency OPVN and to allow the private sector to participate in retail trade. In Senegal a government circular published in January 1986 eliminates all restrictive measures other than common law measures relating to the circulation of grain, other than paddy rice, within the national territory. The privatization of the paddy rice market will depend upon the phased disengagement of the Senegal River Valley Authority SAED. Nigeria abolished all commodity marketing Boards on September 26, 1986. Subsequently there has been a surge of exports, also influenced in good measure by the exchange rate adjustment as of that date.

Some other African countries are hesitating to eliminate state marketing monopolies because of uncertainty about whether private traders can be entrusted with this function. Governments often have adopted a patronizing attitude to the private trader. They argue that if left on their own private traders will exploit small farmers and will collude to drive prices up to consumers. However, both historical and current experience should leave little doubt that an effective private response would be forthcoming if existing barriers were removed. It has been pointed out ⁴/ that Africa has long traditions of open, competitive marketing at flexible prices that vary predictably with the season, the level of scarcity, and with transport and storage costs. In some societies almost every family is involved, as both buyer and seller, in the food and agricultural trade. In smallholder economies marketing activities involve large numbers of transactions dispersed over wide areas in diverse and changing circumstances. They require rapid, decentralized decisions and responsibility. As in the case of farming, they are self-financing, so that the individual trader survives on his or her judgement, skill and efficiency. Firms in this area are typically small, often involving only one person or family. While market information is at a premium, and family, ethnic and other personal links may be an advantage, financial, educational or physical barriers to entry are few and marketing margins tend to be low. Where legal barriers to entry exist, and the authorities attempt to enforce them by punitive fines or imprisonment, the continued existence of "parallel" or "black" markets in many African countries demonstrates the vigor and persistence of private traders. Their "informal" activities even extend to export trade. In Zaire and Rwanda, substantial quantities of coffee are known to be smuggled through neighboring countries. In Ghana, it is estimated that 20,000 tons of cocoa were smuggled annually through the Ivory Coast and Togo during 1980-82.⁵/ If private trading activities were legitimized for both domestic and export crop marketing, the dual market structure would be merged and entrepreneurial energies directed towards improving the overall distribution system with benefits accruing to producers and consumers. Free private entry into export marketing would also result in a wider diffusion of foreign exchange earnings, providing the funds for diversification of the rural economy. In Somalia, for example, profits from livestock marketing, which has remained in private hands, are being channelled into the production of animal feedstuffs, fruits and vegetables, footwear and furniture.

The general conclusion that can be drawn from this experience is that state marketing monopolies should be eliminated and private traders of agricultural produce of all kinds should be allowed to operate without obstruction. If existing marketing boards are able to co-exist without subsidies, they will widen the choice of both producers and consumers and perform a useful role in preventing the emergence of private monopoly or collusion in restraint of trade.


2. **Transport**

In many African cities, legal prohibitions prevent privately-owned and operated small vans and minibuses from competing with the "modern" (usually state-owned) transit system. The results are almost invariably negative: poor services for consumers, operating deficits for the public bus monopoly, and the suppression of entrepreneurial potentials whose existence cannot be disputed.⁶/

Abidjan, for example, was served by a very active informal system of common carriers until 1974. The vehicles in question were known as a'bakas. Originally, they brought goods from outlying areas to city markets. They naturally evolved into "illegal" common carriers for the low income areas of the city. In 1974, Abidjan's bus systems SOTRA (Societe de Transport d'Abidjan), then controlled by Renault but now with majority government ownership, urged the Ivory Coast Government to ban the a'bakas in the city limits because of their "unfair competition." Government agreed to do so. The consequences were unfortunate—for the people of Abidjan, for the municipal and national budgets, and even for SOTRA. Before 1974, SOTRA was profitable, despite the competition of informal carriers. It had a well-managed 300 bus fleet. With the banning of the a'bakas, SOTRA launched a massive fleet expansion and capital construction program. By 1981 the fleet had 900 buses, and a rise to 1,000 was planned for 1985. SOTRA has been in deficit since 1975.

Experience in Dakar is similar. That city's public bus company SOTRAC dates from 1971. It is a majority state-owned company. It has a 15 year franchise (monopoly) on public transport in Cap Vert (the Dakar metropolitan area). In 1981 SOTRAC had 430 buses and 35 minibuses. The informal transport sector is dominated by Cars Rapides, organized in 1962 on a cooperative basis, later into a syndicate. In 1981, there were 650 minibuses in operation, a decline from the 1974 peak of 700 vehicles, which is due to government restrictions on fleet expansion. Cars Rapides do 40% of all passenger trips, SOTRAC 20%, taxis and private cars 40%. SOTRAC operates with a growing deficit; amounting to 25% of total operating costs.

Deficits notwithstanding, SOTRAC proposed to expand services so as to achieve effective monopoly of Dakar's public transport. It claimed it would need an estimated 492 additional buses and much expansion of facilities, at a probable cost of $61 million. This would entail the banning of the Cars Rapides, which carried twice as many passengers as SOTRAC buses, and did so without government subsidy and in face of government restrictions on fleet expansion or even replacement. However, until now the government has only retained SOTRAC's monopoly in the center of Dakar.

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In Kenya, a happier road has been followed. "Matatu"—the private minibus variant in that country—were made legal in 1973. Some 3,600 of them operate around Nairobi; about 1,000 provide purely urban service. (An estimated 30,000 "Matatu" are in use throughout Kenya). The "modern" transport provider is the Kenya Bus Service, Ltd. (KBS) which has 320 buses under a franchise with the Nairobi City Council. KBS is a foreign-owned private company. After 1973 it decided on grounds of "unfair competition" not to increase its fleet when the matatu were legalized. So while the population of Nairobi grew from some 500,000 in 1970 to almost 1 million in 1980, the KBS fleet stayed about the same size. The company's buses ply the main routes. The company covers its costs. Matatu meanwhile are the backbone of the transport system. They go where the business is, in low income areas and in peak periods along commuter corridors and charge roughly the same fares as the KBS. The management of KBS acknowledge that without the matatu they would be induced to undertake expansion at costs to them beyond likely returns.

There can be little question that in urban transport small-scale, private operators have decisive advantages over public sector producers and over large-scale operators generally. Yet in many African cities, expensive and inefficient public bus monopolies endure. And what is true of urban bus systems is true also of over-the-road passenger and freight systems. Private operators offer better, cheaper alternatives to public trucking companies. Yet they are often bypassed. Entry restrictions should be lifted if African countries are to open up their interiors, move people and goods to work places and markets faster and more efficiently and remove bottlenecks which are holding back progress in other sectors.

3. Industrial Sector

In many African countries a variety of policies restrict private access to and participation in the mining, manufacturing and public utilities sectors. Sometimes activities reserved for state enterprises (or joint ventures with majority government ownership) are specified in Investment Codes or other legislation governing industrial investment. In other cases, public sector control has been acquired by nationalization of existing privately-owned enterprises. Nationalization took place in several African countries during the 1970s, for example, in Sudan, Ethiopia, Somalia, Togo, Ghana, Zaire .... More frequently, selective use of industrial licensing authority preserves state monopolies in sectors considered to be politically sensitive or where the pursuit of social goals is made paramount.

In Ethiopia, the government took over ownership and operation of over 100 private manufacturing enterprises during the 1970s. Public enterprises now account for 96 percent of the total value added in enterprises with 10 or more workers. Over the past decade, significant limitations have been introduced on individual and corporate private entrepreneurship. Some industrial activities regarded as critical (such as petroleum, iron

7/ See, for many examples, Gabriel Roth and George Wynne, Learning from Abroad: Free Enterprise Urban Transportation (Transaction Books, New Brunswick and London, 1982).
and steel) are expressly limited to the public sector and others are designated to be undertaken by joint government/foreign enterprises (pulp and paper and plastics). Small-scale industrial activities in areas like grain milling, oil and seed processing, handicrafts, baking, weaving and tailoring are open to the private sector, but are subject to the general limitation that fixed assets in private firms should not exceed Birr 500,000 ($250,000). Further, a private entrepreneur may participate in only one venture. Private enterprises must either be sole proprietorships or partnerships not exceeding five partners, all of whom must be working partners.

There has been no new foreign equity participation in manufacturing in Ethiopia since the nationalizations due in part to protracted negotiations on compensation to foreign owners of nationalized assets. However, the Ethiopian government adopted a Joint Venture Proclamation in 1983 which invites foreigners to participate in joint ventures in which the Government holds at least 51 percent of the shares and "which introduce technology and know-how into the country or which have a positive foreign exchange impact or which otherwise make positive contributions to economic and social development and which, in addition create employment opportunities in the country." Private Ethiopian entrepreneurs are excluded from participating in joint ventures, however.

In Guinea, the period 1962 through 1975-76 was characterized by massive public investments and the proliferation of parastatal enterprises, activities largely financed through expansionary monetary policies. Over 100 public enterprises have virtual total control of the manufacturing, trade and service sectors. The only important enterprises outside the public sector are three mining companies (CBG, FRIGUIA and AREGOR) in which the government retains 49 percent of the shares. Though the source of only 28.5 percent of domestic production, the public sector employs most of Guinea's wage earners, uses almost all domestic and foreign credit, and consumes most of the country's net foreign exchange earnings and official imports. Public sector recorded deficits totalled 7.8 percent of GDP between 1976-81.

In late 1985, Guinea embarked upon a major reform of its economy. An essential element is returning productive activities to the private sector is a properly functioning banking system. The public enterprise sector will be streamlined by closing down those businesses that are not performing well. Others will be transferred, wholly or in part, to the private sector. A new investment code and commercial legislation will facilitate private investment in these and other activities that are economically viable. The handful of remaining public companies, largely in the public utilities, will be given financial and management autonomy.

Sudan is another country where extensive nationalization of private industrial enterprises during the 1970s was accompanied by high public investment in projects with low returns and heavy foreign borrowing. These parastatatal enterprises, with few exceptions, have eroded their equity base and accumulated vast losses financed through overdrafts with the banking system. At the Consultative Group meeting in Paris in December
1983, the Government announced its intention to produce a private sector action program. Some parastatals have been converted to private companies. But subsequent policy decisions have, if anything, worsened the environment for private investment. Private activities are in desperate state due to high cost levels and lack of credit, rigid price regulations, disruptions in the supply of utility services and imported inputs and uncertainty about the future business climate. Opportunities for private investment have been undermined by the creation of the Military Economic Board (MEB) that put several existing public enterprises under military control. MEB activities could be better performed by normal private firms and should be privatized or liquidated.

Following the indigenization decrees of 1972 and 1977 in Nigeria, which required divestiture of foreign equity holdings, public investment in manufacturing grew more rapidly than private investment. The public sector has been responsible for two-thirds of total manufacturing investment since 1975. A 1983 review of the public expenditure program found that a number of public sector projects suffer from inadequate project design, high initial project costs and cost-overruns following implementation delays, and excess capacity once completed. There had also been an overcommitment of resources across a large number of projects. In recent planning documents, however, the Nigerian government has indicated that the private sector is expected to be the prime agent for industrial growth in the future with the role of the government focused on infrastructure investment and establishment of an appropriate legal and regulatory environment. Priority is being given to facilitating private sector activity by simplifying existing regulations and dismantling the ones which are redundant or have undesirable distortionary effects.

Policy towards foreign private investment was broadly welcoming in Ghana until the early 1970s. However, the departure of the Busia government in January 1972 saw a sharp switch. The new regime, led by Colonel Ignatius Achaempong, reacted to the severe economic difficulties inherited from its predecessors with a program of economic nationalism. In 1975, legislation was passed allowing the state to take a majority stake in foreign-owned enterprises; some of the larger companies, including the United Africa Company (UAC) sold 40 percent of their local equity to the state. While others passed 55 percent to local hands. By 1977 an estimated 49 percent of manufacturing value added came from the state sector, as well as a substantial proportion of mineral output. Yet having merely stagnated from 1970–77, by the late 1970s manufacturing had slid into a precipitous decline. Poor management in the state sector was paralleled by shortages of foreign exchange, as the cedi became increasingly wildly overvalued. Many companies simply shut up shop; others struggled on, using local raw materials wherever possible and improvising repairs. It seemed initially that life would be made if anything harder for foreign investors by the arrival of the (second) Rawlings government at the end of 1981. "Workers Defence Committees" were set up in work places and some enterprises were taken over by the employees. In late 1982, for example, an announcement by UAC that it was laying off workers at two textile mills because of shortages of imported inputs sparked off a sequence of events
which resulted in a takeover by the workforce. The new government's platform harked back to earlier themes of self-reliance and mobilization, and was broadly hostile to foreign capital as a means of developing the country. The overall utilization was estimated to be down to 21 percent by 1982, while the output of the minerals sector continued to fall until 1984, when none of the major subsectors was producing more than 35 percent of output in the peak year of production. It is hardly surprising against this background that there has been little new foreign investment in Ghana since the mid-1970s.

However, after extensive policy analysis and dialogue with both the IMF and the World Bank, the Government launched its Economic Recovery Program in April 1983. This can only be described as a complete turnaround in economic policy. A central element was successive devaluation of the cedi. A new investment code published in July 1985 must also be seen as an integral part of the recovery program. It underlines a new openness to foreign capital. Approved companies are provided guarantees against expropriation with standard dispute procedures allowing arbitration under Unctad rules or within the framework of existing bilateral and multilateral treaties. Only net foreign exchange earning ventures can be fully owned by foreigners however. Ghana's Finance and Economic Planning Minister Kwesi Botchwey announced the code at an Industrial and Technology Fair in Accra in March 1986, stressing that foreign investment was a vital supplement to domestic resource mobilization.

Barriers to entry remain for domestic investors in Ghana. An industrial license is required for manufacturing production, regardless of the scale involved. Existing firms wishing to change the mix of output or to expand capacities must also obtain a license. The licensing authority rests with the Ministry of Industry and the Investment Center. The practice is meant to prevent too many firms from entering the same industry and to ensure the use of appropriate technology, but industrial licensing is not without risks. Private monopolies might be created. If the screening of projects is too restrictive, or if the authorities are mistaken in assessing market conditions, supply might fall short of demand, resulting in windfall profits. Free market entry increases competition and weeds out inefficient firms. There is little basis for believing that over-extended officials would be technically qualified to select technologies in a wide range of ever-changing industries. The ultimate test of appropriate technology is the choice of consumers who evaluate the price and quality of the final products.

Zaire is a further example of a country which has swung from hostility to private investment to actively wooing foreign investors. During the colonial period, the mining sector was dominated by a Belgian company, Union Miniere du Haut Katanga. Another Belgian conglomerate, the Societe Generale de Belgique (SGB) had interests in most sectors of the economy. There was a large Belgium presence in terms of personnel in the

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corporate sector and equally in small business. Independence brought little change until the nationalization of Union Minière and the creation of a state enterprise Gecamines in its place in 1967. However, in 1971 a new policy of economic nationalism was detailed in the Manifeste de la Nsele. With few exceptions, foreign businesses were nationalized or passed to private Zairean control (The matter of compensation is still an issue in 1986).

Foreign businesses were frequently handed over to members of the Zairean elite who had little idea of corporate management and a limited understanding of the distinction between company and personal accounts. The second major innovation of the "manifeste" was the establishment of a predominant planning role for the state, with the aim of converting Zaire into a major industrial power in the region. "La politique de grands travaux" involved a number of prestigious projects on an enormous scale, the largest being the Inga Hydroelectric complex, the Maluka metallurgical plant and the Sozir oil refinery. It was hoped that Zaire would become an important exporter of energy, a steel producer and a regional influence in the oil industry. The government expected to transform a primarily agricultural economy into a modern industrial economy on a western scale through centralized controls and selective, public investment.

It soon became apparent that the state was not qualified for the role of centralized planner. Departmental planning was generally of a low standard. No system of proper accountability was established. Budgets were made and quickly ignored. "La politique de grands travaux" was one main reason for regular deficits which were funded by borrowing and the printing of new money. The Banque du Zaire was unable to resist government pressures with the result that inflation, money supply, lending to the government and overvaluation of the fixed currency soared.

Where the "manifeste" had aimed to produce a stable economic environment with the guiding hand of the state, in practice the reverse happened as conditions became disordered and government intervention hindered rather than helped modernization. The Zairenization of the economy was no more a success than the centralized planning. The private sector suffered from non-replacement of stocks and machinery and the withdrawal of working capital. Real GDP declined in the 1970s and, far from becoming a major industrial power house, Zaire has remained an exporter of raw materials and an importer of machinery and equipment.

The reversal of these policies came in the late 1970s and 1980s. Many companies were denationalized and their former owners invited to return. This met with limited success as numerous former managers and shareholders declined the offer, not least because of the matter of compensation. The task of attracting fresh investment has also proved extremely difficult, despite liberalization measures which include the floating of the Zaire, an end to interest rate restrictions, the guaranteed right to repatriate profits, the abolition of certain monopolies, and the narrowing of budget deficits. Legal and other barriers to private sector investment may be removed, but it takes longer to change fundamental attitudes towards the overall business climate. They will be helped by the recent signing
of a bilateral investment treaty with the United States guaranteeing most favored nation treatment to U.S. investors in Zaire. A revision of the Investment Code is also underway and major positive changes are expected.\textsuperscript{9/}

Three overall conclusions can be drawn from this examination of barriers to entry. First, these barriers have deprived African economies of the benefits of private investment (both indigenous and foreign) and the skills, know-how and initiative which would have accompanied such investment. Second, they have removed the competitive stimulus to efficiency which public monopolies have so obviously lacked in some key areas. Third, Governments would achieve their goals more effectively if they eliminated these barriers and used broader economic policies and market incentives to guide private decisions in the desired directions—such as employment creation, training of nationals, reinvestment of profits, etc.

CHAPTER II. OBSTACLES TO FOREIGN INVESTMENT

Direct foreign private investment in Africa has declined in real terms in recent years. It averaged only $530 million annually in 1978-80. Net foreign investment represented less than 1 percent of total domestic investment in the Ivory Coast, Nigeria and Botswana during this period.\(^\text{10}\) The investment position of the United States, defined as the book value of U.S. direct investment in and net outstanding loans to their foreign affiliates, amounted to US$3.1 billion in Sub-Saharan Africa in 1983. This constituted 6 percent of U.S. direct investment in all developing countries.\(^\text{11}\) The share of Africa in the flow of Japanese investment in manufacturing industry in developing countries dropped from 3.3 percent in 1951-1971 to 0.9 percent in 1972-80.\(^\text{12}\)

The level of foreign private investment in Africa is affected by barriers to entry and the potential investor's perception of the prevailing business environment. A survey of 233 industrial firms in the Federal Republic of Germany found that the most important individual constraint is difficulty in dealing with government authorities (bureaucracy). Less than one fifth of the respondents rated the problem a minor one. Other factors of particular importance related to conditions regarding the ownership and return (transfer) of capital; the regulations governing local participation, financing conditions and transfer of the profits rank second to fourth in the list of individual obstacles. In fifth place investors put restrictions on the supply of raw materials and intermediates (import restrictions, cash deposits, customs and compulsory use of local products both for production and plant investment). Sixth on the list were "other" obstacles, those most frequently mentioned being corruption, the risk of extortion and problems with the local partner. Obstacles connected with the prevailing political system and the country's general economic and social policies were next in line. Seventh was uncertainty about whether legal and contractual rights would be upheld in the courts; eight being employment legislation, recruitment and dismissal, social regulations, the right to strike, training obligations, etc., nine taxation; tenth wage policy, for example statutory minimum wages; eleventh the danger of nationalization; and twelfth price formation, the fixing of minimum and maximum prices.\(^\text{13}\)

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\(^{10}\) See Transnational Corporations in World Development: Third Survey (United Nations, New York, 1983).


Similar attitudes were encountered in a study sponsored by the Commission of the European Communities.\textsuperscript{14} It concluded that "Africa is, overall, a zone which is far less sought after by investors in the developed countries." The study reports various reasons cited by European firms. These include the following points:

**Permeability of the Market.** This is something official statistics tend to ignore, and the authorities tend to be careful not to mention contraband which is, in fact, an economic reality of considerable importance in many countries, particularly in Africa.

**The Importance of Internal Political Pressure.** A classic example of this is the question of price approval. This is a problem which occurs frequently in Africa where the domestic prices of everyday goods have to be approved by the authorities. But although the authorities are committed to respecting the firm's financial balance, they sometimes, under pressure of public opinion, postpone or turn down price rises that rising costs have made inevitable. This issue is linked to the extent of competition in the market (see Chapters IV and V).

**Under-estimating the Effects of their Decisions.** The host Governments often under-estimate the effect of failing to respect contractual commitments. The decisions are taken by authorities which are not really \textit{au fait} with industry and its constraints and their consequences—which are badly assessed or not assessed at all.

**Restrictions on Employing Expatriate Staff.** These include quantitative restrictions laid down in absolute terms for each firm (as in Nigeria) or as a percentage of the total number of employees; complex exit visa procedures—there are 28 formalities to complete if an expatriate wishes to leave Cameroon, even on a temporary basis (for a business trip, holiday or sick leave); in almost all cases (Zaire, Nigeria, Kenya, etc.), firms complain about the extremely long time it takes to obtain the requisite authorizations. They think these procedures (or policies) are particularly ill-conceived as they already keep their expatriate staff to a minimum because of the very high costs involved.

**Protectionist Measures.** One classic measure is to ban imports of products that are "similar" to those made locally (as in, for example, Kenya). The interpretation of such a text is often subject to debate between the businessmen and the Government and it is not easy to furnish proof one way or the other. Generally speaking, investors complain about the poor quality of local input and equipment that people try to force on them (however, they also complain when countries want to open up to imports of goods competing with theirs).

**Restrictions on Location.** The national development plans often channel foreign investors into certain regions which the Government, for

\textsuperscript{14} See \textit{The Constraints on Industrial Cooperation Between Firms in the EEC and ACP Countries} (EEC, Directorate-General for Development, February 1985).
purely political reasons, considers to have priority, although, economically speaking, they offer only mediocre opportunities for development. This is a fairly common situation in the countries of black Africa where the President's village and the surrounding area are often privileged in defiance of any economic logic and foreign firms are sent regardless of any preference for another zone. In other cases, the opposite policy obtains and whole regions are virtually out of bounds to foreign firms (usually when they offer particularly attractive development prospects).

A Short-Term View. Industry usually demands short sacrifices for long-term benefits, but this is not always obvious to the developing countries, where there is a tendency to look for a quick profit in both public and private sectors. Their attitude is reflected in the criteria for approval of industrial projects at the national level. Most of the ACP countries (particularly those in Africa) have established an industrial project approval procedure which decides on the granting of advantages offered by the investment code. In most cases, approval is given or refused more in the light of a failure to bring in immediate earnings (particularly in the shape of customs duties) than of any long-term benefits to the economy. In the private sector all European operators regret that partners in the host countries tend to be investors (usually from the import trade) who are making quick profits with no risk and no effort—which is at variance with a proper industrial approach. These attitudes may result from political and economic instability and incentives biased towards short term gains and minimal fixed investment.

Preference for Prestige Projects. Workshops and small factories, which play an essential part in the industrialized countries, are rather looked down on in the developing countries .... When it was set up and for seven years after that, the Dakar industrial free zone lay down employment thresholds (200 and then 100 jobs for Senegalese) and minimum investment figures (CFAF 200 million and then CFAF 100 million) for people wanting authorization. In spite of the disastrous record of firms settling in the zone, it was difficult to convince the Government to do away with the thresholds because it did not want Senegal to become an industrial "flag of convenience." In many of the ACP countries, European investors have been led to build bigger factories than they needed under pressure from their partners or the Government of the host country. In Mauritania, for example, the investment code stipulates a minimum of FF 1.3 million, which often forces investors to overestimate their projects (and penalizes small projects too).

Instability. Legislative insecurity, largely due to institutional changes come second on the list of constraints for German businessmen in an IFO survey. European firms are unanimous in saying that, although they are willing to accept investment restrictions (provided they are clearly laid down in advance), they find it very difficult to cope with changes after their project has been implemented. The firms' main complaints here are about taxation. It is by no means rare to see the rate of tax in force when the firm sets up suddenly shoot up a few years later. When the profitability of many industrial cooperation projects is only marginal, few firms can cope with tax increases of this kind without endangering their financial balance.
Slow and Arbitrary Decision-Making. During the negotiating period, the talks, which are at a fairly high level, take place in good conditions, but the further people go into detail—and down the hierarchy—the harder the decisions are and the longer they take. The firms complain about the time the attendant procedures takes, as two or three years may often be needed to negotiate with different departments to get approval.

Corruption. Because of all the red tape, many decisions and authorizations cannot be obtained without "compensation," particularly since the civil service pay is often so poor. These illicit payments ultimately become the oil that is vital to the workings of any firm. While they may be unavoidable and able to be coped with on a small scale, they become a real millstone when failure to pay causes a firm to seize up because they have become, in a way, institutionalized.

Unsuitable Legislation. Generally speaking, the more a government restricts the freedom of the foreign investor, the less that investor will be attracted by the country-in-question. His degree of interest in a given country will depend on the balance between constraint and attraction. The more comparative advantages a country has, the readier the foreign firms will be to accept restrictions. The ACP countries as a whole have to be seen as not very attractive here, so the degree of constraints and restrictions ought by rights to be fairly small. But in many cases, it is, in the eyes of the businessmen themselves, out of all proportion with the interest of an industrial cooperation project.

Excessive Legalism. Because they very often lack the relevant technical knowledge, the authorities in developing countries deliberately hide behind a veritable barrage of laws and regulations destined to protect the host country from any abuses from the foreign firms. This attitude often leads to excessive legalism, resulting in a pointless observing of the texts or, in many cases, to a restrictive interpretation of them. Texts that are lacking in precision or difficult to understand are certainly open to any interpretation—which is fine for the authorities, which are calling the tune, but not for the firms. The texts are interpreted generously and favorably for the firms while the project is being promoted (so as to attract the investor) and restrictively once the investment decision has been taken. European firms involved in industrial cooperation thus often get the impression that they have been caught in a trap. The negative effects (counter publicity and a loss of good will) of this attitude are, clearly, sizeable and lasting.

The attitudes to foreign investment in Africa revealed by this EEC Study may be said to be one-sided. These attitudes are nevertheless often critical in determining the level and direction of direct investment flows from abroad. If they reflect serious misconceptions or distortions, African governments which wish to promote such investment may need to take more vigorous action to change these perceptions or else change the underlying reality. A mechanism to allow a continuing dialogue between the private sector and government is desirable. The Chamber of Commerce and Industry is performing this role in several African countries. In Zaire, for example, a dinner/debate was organized by ANEZA (the Zaire Chamber of
Commerce) in January 1986. This brought together leading Zairean entre-
preneurs and top managers of foreign-owned companies with ministers and
senior civil servants and provided the opportunity for a very frank
exchange of views.15/ The U.S. Overseas Private Investment Corporation
(OPIC) has also been invited to send a mission composed of prospective
investors to study the business climate and hold talks with the government
and local counterparts. In Mauritius, a National Economic Council was
established in December 1981. It acts as a forum for discussion of
economic policies with representatives of business and labor. Such mechan-
isms can lead to a better understanding of each side's needs and attitudes
and a broader consensus on reforms required to promote development.

15/ See Discours Du Citoyen Bemba Saolona, President de L' ANEZA (ANEZA,
Kinshasa, January 14, 1986).
CHAPTER III. FINANCIAL CONSTRAINTS

Shortage of investment funds and working capital is holding back development of the private sector, particularly small and medium enterprises (SMEs), throughout Africa. In part, this scarcity is simply a reflection of low income levels and the persistence of large subsistence (non-monetized) segments of their economies. But it also springs from weaknesses in policies and institutions which hamper resource mobilization and restrict the private sector's access to available finance. Six constraints are examined: first, financial market regulations which reduce savings deposits and discourage banks from lending to SMEs; second, the absence of stock markets and merchant banks able to mobilize equity capital; third, foreign exchange allocation systems which restrict the supply of foreign exchange funds to private firms; fourth, crowding-out of the private sector from financial markets by excessive borrowing by government and public enterprises; fifth, heavy taxation which squeezes corporate profits and entrepreneurial incomes and therefore limits their capacity to generate internal investment funds; and sixth, public investment programs which monopolize the use of foreign loans and grants.

1. Financial Market Regulations

A World Bank analysis of interest rate policy in a number of developing countries from 1970 to 1982 revealed that by and large nominal interest rates were set by government, rates changed little overtime, and hence real rates were primarily determined by variations in the rate of inflation. Real deposit rates over the period were negative; in many countries they were 3 to 6 percentage points below the real rates that prevailed in the developed countries in this period, thus encouraging outflow of funds. In countries with very high inflation, deposit rates were substantially negative, sometimes reaching levels below minus 20 percent. The variability of real rates, as well as the level affected resource mobilization. As a result, in many African countries total domestic credit that could be made available to borrowers (public and private) by the monetary authorities and banks expanded slowly in real terms over the past decade, and in some countries actually declined in relation to GDP.

In Kenya, for example, although its financial depth as measured by the ratio of money and quasi-money (M₂) to GDP compared favorably with other countries in the same income category, its financial depth was seriously eroded during the period 1978 to 1983. The ratio of M₂ to GDP fell from 32 percent to 25 percent. The resurgence of inflation and the ceilings on loan rates, along with the substantial reserves the Government required the banking system to hold, kept deposit rates low and weakened the ability of the commercial banks to mobilize deposits. The decline in the financial depth was accompanied by a slide in the domestic saving rates. The ratio of gross private saving to GDP deteriorated from a peak of nearly 27 percent of GDP in 1977 to a low of 11 percent in 1983.
Similarly, in Ghana the M₂/GDP ratio declined from 29 percent in 1977 to 12 percent in 1984. At the same time, there was a decline in the banking habit, an increasing preference for holding liquid funds outside the banking system, and an increasing velocity in money circulation as firms and individuals sought to move out of financial assets and into fixed assets as hedges against inflation. These trends were aggravated in 1982/83 by a substantial drop in public confidence in the banking system following the demonetization of ₤ 50 notes and the freezing of all bank accounts in amounts above ₤ 50,000. While the government has taken important steps to address these problems since 1983 as part of the economic reforms under the Economic Recovery Program, the process of reversing past trends is still at an early stage and public confidence in the banking system has yet to be significantly restored.

Low loan rate ceilings fixed by governments have also restricted the operating "spreads" of financial institutions and discouraged lending to smaller, riskier businesses. In Nigeria, for example, low interest rates applicable to agricultural credit makes lending to smallholders extremely unattractive given the high costs of administering numerous small loans and low recovery rates. In some countries, governments have tried to compensate for these financial market disincentives through direct credit programs aimed at disadvantaged groups. Most of these directed credit programs are not designed to reallocate financial resources per se, but to affect the allocation of physical resources through financial reallocation and to offset differences between economic and financial returns through explicit or implicit interest rate subsidies. Experience has shown that much of the subsidized credit programs went to wealthy individuals or those with political influence, while smaller borrowers had to pay higher interest rates in the informal credit markets. Directed credits often induced recipients to use overly capital-intensive methods.

Many governments have recognized that in the past they have overextended their capacity to manage the economy through intervention in resource allocation. A number of countries are moving toward greater reliance on market forces for credit allocation. Complex systems of credit allocation are being dismantled and interest rates are now being allowed to reflect the state of the credit market and the foreign exchange market, plus differentials in risk and maturity. In Ivory Coast, for example, the central bank has pursued a more realistic interest rate policy since 1981, keeping domestic rates more in line with international ones to avoid large outflows of domestic surplus funds and enable deposit money banks to attract large foreign depositors. Real rates of return on time and saving deposits became positive for large savers in 1981 and all savers in 1982. The private sector's financial savings responded positively.

Under the World Bank's Second Structural Adjustment Credit to Kenya in 1982, the Government proposed to keep the level and structure of interest rates under review to ensure that they continued to be appropriate, given the domestic rate of inflation and the structure of international interest rates. In Malawi, the government raised deposit rates by two percent in May 1983 and proposed to make adjustments, as need arises, to keep interest rates positive. In Senegal, as a step towards improving
mobilization of personal savings, a new social housing bank was established. In Guinea, the government has decided to completely rebuild the banking system. The central bank is being reorganized and strengthened. A new Banking Law has been adopted which creates an appropriate basis for the establishment and regulation of commercial banks and other financial institutions. And the six existing state banks are being liquidated and independently managed commercial banks have replaced them. The International Finance Corporation has put in $1 million equity for the establishment of a multipurpose bank—Banque Internationale Pour le Commerce et l'Industrie de la Guinee (BICI-GUI) as a joint venture with French commercial banks. IDA has provided $2 million for management and technical assistance to BICI-GUI and further equity has come from the German Finance Company for Investments in Developing Countries (DEG).

In late 1985, the Malawi government agreed during negotiations for a World Bank industrial and agricultural credit project to annually review and revise interest rates to ensure that the rates charged by INDEBANK (the Industrial and Development Bank of Malawi) and the commercial banks on their agricultural loans are positive in real terms, in line with the overall interest rate structure in the country, adequate to enable the institutions to cover their administrative expenses, provide for possible losses and earn adequate profit margins.

2. Lack of Equity Funds

Very few African countries have active equity markets, either in the form of stock exchanges or merchant banks which can provide a full range of securities related services: underwriting, brokerage, dealership, corporate financial advisory services, investment management, etc. The financial policies of many countries have inadvertently had an anti-equity bias. In the 1970s inflation with low interest rates deepened equity values through retained earnings, but retarded the growth of equity markets external to firms. A second source of anti-equity bias has been many government programs, which in one way or another reduced the cost and risk of debt, but not of equity, finance. Such programs include explicit or implicit insurance that covered not only small depositors but large sophisticated investors; lender-of-last-resort facilities that guaranteed the liquidity of financial intermediaries; special institutions (Development Finance Institutions, agricultural banks, etc.) and lending programs that provide debt at subsidized rates; aspects of tax policy that made equity financing more expensive, in particular by treating interest as a cost before calculating profit taxes and the double taxation of dividends; and lastly, bail-outs for corporations that diminished the danger of excessive financing with debt. Equally important, controls on output prices often reduce corporate earnings and hence their ability to raise equity funds. However, nascent capital markets do exist in some countries.

In Kenya, secondary trading in long-term securities is carried out by six Nairobi-based stockbroking firms whose association, formed in 1954, is known as the Nairobi Stock Exchange. This Exchange has no physical trading floor. Instead, brokers hold a daily call-over at which prices for concluded transactions and for securities still on offer are announced. The broker act only as agents for clients and typically match buy and sell orders in-house. New issues of long-term private-sector
securities in Kenya are controlled by Government through a Capital Issues Committee set up in 1971 under the Ministry of Finance and Planning. This Committee approves issue prices, the timing of sales and the allotment plan for shares. However, since the Committee's inception there have been very few new public issues of equity securities.

At the request of the Kenyan Government, an IFC mission undertook a study in 1984 which recommended several measures to facilitate the development of the capital market in Kenya. These measures included:

- establishment of a Capital Markets Development Authority to promote the disclosure of corporate and market trading information, registration and regulation of securities professionals and measures to provide adequate protection for investors;

- promulgation of a Capital Markets Law to provide the legal basis for the development activities of the Capital Markets Development Authority;

- review and amendment of other laws, such as the Companies Act and the Foreign Investments Protection Act, which may hamper the primary issue, investment in and trading of capital markets securities.

- setting prices of all equity and debt securities issues by negotiations between the issue and his underwriter(s) rather than by the Government through the Capital Issues Committee.

IFC followed up this study in 1985 by providing additional finance to Industrial Promotion Services (Kenya) Limited, a private venture capital company, to expand its program of equity finance for small and medium enterprises in Kenya.

Capital market studies should be undertaken in other African countries to ascertain the scope for similar action and to identify ways of eliminating their anti-equity biases. In general these measures are likely to include removing interest rate subsidies, eliminating double taxation of dividends, ceasing to bail-out loss-making enterprises, creating specialized equity-financing institutions and funds and adopting legislation to promote the disclosure of corporate and trading information and registration of stockbrokers.

3. Foreign Exchange Allocation Systems

At present, only Zaire, Guinea and members of WAMO allow their currencies to be freely converted into foreign exchange. Most African countries have adopted centralized systems of foreign exchange budgeting and allocation usually managed by the Central Bank combined with import licensing by Ministries of Finance and Trade. The systems are intended to limit aggregate imports to the amount of foreign exchange available and to regulate the structure of imports to maximize economic benefits. These are desirable objectives, but in practice the use of administrative systems rather than price as the allocative mechanism has resulted in distorted
incentives, cumbersome and drawn-out bureaucratic procedures and biases in the rationing process which favor those with political power or economic influence over the allocating authorities.

In Ghana, for example, the import licensing system was generally perceived by the private sector to be procedurally complex and overly rigid and time consuming, often resulting in substantial delays in arrival of imports, significant additional administrative costs and considerable uncertainties in production planning at the plant level (one firm indicated that it had taken 5 months and some 65 visits to different government offices to process an import license). Further uncertainty arose because issuance of an import license did not ensure a firm of access to foreign exchange cover, for which approval had to be obtained subsequently from the Bank of Ghana. This resulted in additional delays, as in the past import licenses have been issued in excess of foreign exchange availability. The system was said to focus principally upon the requirements of larger firms (mostly SOEs), and discriminated against small enterprises despite the fact that their products tend to be less import-intensive and could contribute to output at a lower unit foreign exchange cost. However, in recent months steps have been taken to phase out the licensing system and a foreign exchange auction introduced.

These weaknesses are now being recognized by other countries and action taken to minimize if not eliminate them. In Malawi, for example, the foreign exchange allocation system operated jointly by the Ministry of Trade and Industry and the Reserve Bank of Malawi came under considerable pressure due to adverse economic conditions that Malawi was then experiencing. This led the Reserve Bank to try to reduce imports through delays of foreign exchange allocations. These allocations also became concentrated in the established traders and discouraged the development of new, indigenous entrepreneurship. As part of a Third Structural Adjustment Program, the Government intends to pursue an active exchange rate management policy which will hopefully make an allocation system redundant. Nigeria also abolished its import licensing system in September 1986 and substituted a foreign exchange auction.

In June 1985, the Government of Zambia presented An Action Program for Economic Restructuring to the Consultative Group for Zambia. This Action Program spelled-out the defects of the existing foreign exchange allocation system in these words—"in order to cope with the severe shortages of foreign exchange that have characterized the economy during the past several years, a centralized system of foreign exchange budgeting and allocation has been instituted. It is necessary to have both an import license and foreign exchange backing prior to importing an item. The system has proved to be cumbersome and costly to administer; officials have to make foreign exchange allocation decisions on a firm-by-firm and product-by-product bases. Budgeting of foreign exchange has also been problematic, with the result that a considerable over-hang of import licenses issued without foreign exchange has developed .... The foreign exchange control and import licensing systems, by excluding a wide range of competing imports of consumer goods from the domestic market, has provided high protection to import substituting activities and tended to reinforce the protection effects of the tariff structure."
The **Action Program** went on to say that "GRZ is convinced that the allocative formula must eventually include:

(i) increasing the reliance upon market forces rather than administrative mechanisms for allocating resources. This implies the gradual dismantling of the foreign exchange controls, import and export licensing and interest rate regulations;

(ii) restoring balance and increasing the uniformity of the incentive system, particularly between exports and import substitutes, as well as between agriculture and industry. This implies a major reform in the trade regime with greater reliance on the exchange rate as a mechanism for allocating foreign exchange, elimination of import restrictions, rationalization of the tariff structure and review of investment incentives; and

(iii) introducing greater automaticity into the determination of the exchange rate consistent with the long-run prospects for exports and terms of trade.

The Government of Zambia took action along the above lines in 1986. They provide useful guidelines for other African countries to follow. The broad objective should be to dismantle foreign exchange controls and import and export licensing, leading to free convertibility of currency.

4. **Crowding-Out by Public Sector Borrowing**

Private firms' access to bank credit has been restricted in many countries because governments and public enterprises have been given first claim on financial resources, both foreign and domestic. The latest IMF data show that the public sector's share of outstanding domestic credit from the monetary authorities and banks topped 60 percent in 14 out of 35 countries covered by the statistics. The private sector's share was less than 25 percent in six countries--Burundi, Ethiopia, Ghana, Sierra Leone, Tanzania and Zaire. Only in Botswana and Cameroon were governments net lenders rather than borrowers of domestic financial resources.16/

Governments' demands for domestic credit increased for three basic reasons. First, the growth of expenditure on public investment and current services outpaced the growth of revenue, resulting in widening budgetary deficits. For example, deficits reached 10.6 percent of GDP in Kenya in 1980/81, 16.5 percent in Malawi in 1981, and 11.5 percent in Senegal in 1980/81. Second, the income of public enterprises did not cover their operating costs. The gap was filled by additional loans provided directly by the banking system or by government subsidies which, in turn, were financed by government borrowing. In Ghana, for example, the combined operating deficit of SOEs in 1982 amounted to 2,880 million cedis (net of their hidden costs and subsidies), equal to 3 percent of GDP and the same as total government expenditure on education, health, social security and welfare that year. Third, although foreign aid grants and concessionary loans from abroad finance a significant proportion of their public

investment programs, some African countries found it increasingly more difficult to borrow in international commercial markets. They therefore drew more heavily on private domestic savings to meet their residual financing needs.

However, there is evidence that African countries are becoming increasingly aware of the negative effects of budgetary deficits and heavy government borrowing on private sector opportunities and the efficiency of resource utilization in the economy as a whole. Steps are being taken, sometimes in the context of structural adjustment programs, to curb the public sector's financial appetite in several countries. These measures include:

- restraining the expansion of public sector employment and wages (for example, in Kenya and Senegal);
- reducing recurrent expenditure by cost savings in such fields as education and housing (Mauritius and Ivory Coast);
- reducing losses of, and subsidies to, public enterprise by restructuring, stricter monitoring of their performance and divestiture (Togo and Senegal); and
- subjecting public investment programs (PIPs) to more rigorous scrutiny and pruning potential "white elephants" (Kenya, Malawi, Mauritius, Ivory Coast, Senegal, Togo).

In many cases, African governments are also trying to eliminate their budgetary deficits by raising tax revenues. This may be achieved without negative repercussions by broadening the tax base or improving tax collection. But there is a risk that imposing higher marginal tax rates on individuals and firms which are already heavily burdened by taxes may be counterproductive: encouraging tax evasion and corruption; reducing the citizen's willingness to work, save and invest; and squeezing profits which could have been ploughed back into the business to expand capacity, raise productivity or diversify output. This risk is discussed more fully below.

5. **Heavy Taxation Squeezing Corporate Profits and Entrepreneurial Incomes**

All countries must seek a balance in their fiscal policies between the need to raise revenue to pay for essential government services and the need to create adequate incentives to work, save and invest. They must also aim for an equitable sharing of the tax burden, both within and between different income groups, and avoid undue distortions in the after-tax returns to different economic activities.

In many African countries it has proved to be difficult to reconcile these objectives. The rates of taxes on corporate income are frequently high by international standards. For example, they are 60 percent in Ghana, Zaire and Sudan compared with 30 percent in Taiwan and Korea and 18.5 percent in Hong Kong. And depreciation allowances are
usually based upon historical costs. So in countries which have experienced rapid inflation the effective tax rate on real net income has been significantly greater.

Rates of personal income tax also tend to be high in Africa. The top marginal rate is 80 percent in Zambia and Rwanda, 70 percent in Sudan and 60 percent in Zaire and Ghana. These rates are reached at relatively low income thresholds.

High corporate and personal income taxes have had four negative effects. First, they have reduced the private sector's capacity to accumulate reserves to finance expansion, modernization and diversification projects and reduced savings for initial investment in new enterprises. Second, they have deterred foreign investors (especially in "footloose" labor-intensive industries like textiles, clothing and electronics) who have found more hospitable fiscal environments in East Asia. Third, entrepreneurial efforts have been diverted from formal productive activities, where financial transactions are more readily audited, to real estate speculation, trading and "underground" activities where earnings can be more easily hidden from the tax authorities. Fourth, high tax rates have increased the pressures for corruption of lowly-paid tax officials. Widespread corruption has undermined the integrity of public administration and weakened respect for the law.17/

In some countries, the net result has been a contraction of the tax base and lower tax revenues. Government attempts to stem the fall in revenues by raising tax rates still further have only accelerated the decline. Ghana, for example, introduced a series of tax measures such as a special sales tax on imports, excise taxes and advance tax payments for selected manufacturing sectors and a substantially higher registration fee for retailers. Moreover, Ghana postponed or kept to a minimum crucial adjustments in the tax system such as the level of personal exemptions, depreciation allowances for corporations and personal income tax brackets. These adjustments were needed to take account of rapid inflation and devaluation of the exchange rate. Consequently the tax burden on those individuals and private enterprises which abided by the tax laws increased sharply, while the actual tax revenues dropped from 13.8 percent of GDP in 1975 to 6.5 percent in 1984.

Similarly, in Sudan the maximum tax rate on personal income was raised from 60 to 70 percent and new development and defense taxes were imposed, but the tax revenue/GDP ratio declined from 15.2 percent in 1976 to 12.5 percent in 1984. As GDP in constant prices also fell during this period, the real decline in government revenues was even greater. In Zaire, "bracket creep" has resulted in the top marginal income tax of 60 percent being applied on incomes as low as $1,200 per annum. An IMF study of the tax returns of a sample of 20 enterprises found that the average

17/ See, for example, David J. Gould, Bureaucratic Corruption and Underdevelopment in the Third World: The Case of Zaire (Pargamon Press, New York, 1980).
employee paid 39 percent of his gross earnings as income tax. Enterprises are subject to a turnover tax which increased from 13.5 percent to 18.0 percent of sales, and a development tax amounting to 7 percent of sales. Yet total government revenue in Zaire fell from 29.7 percent of GDP in 1974 to about 15 percent in 1984.

A reappraisal of tax policy is underway in several African countries. In Ghana, a recent IMF/World Bank fiscal mission has recommended that the corporate tax rate should be lowered to 45 percent. For personal incomes, the mission proposed a three-fold increase in the tax exemption level, and a reduction of the top marginal rate to 40 percent. The mission further recommended an adjustment in depreciation allowances to permit corporations to maintain their income generating assets in the face of exchange rate adjustments and other price escalations.

In Zaire, several studies are being undertaken to assess the incidence of current taxation practices on the competitiveness and investment behavior of industrial enterprises. These studies are financed under the World Bank's SOFIDE III Credit. The adoption of a tax reform program satisfactory to the Bank forms part of the conditionality for the release of the second tranche of the proposed Industrial Sector Adjustment Credit for Zaire.

Mauritius is an example of a country which has successfully used fiscal incentives to diversify its economy and create employment. Its Export Processing Zone Act (EPZA) of 1970 granted: (1) tax holidays on corporate profits for ten years (extended up to 20 years on a declining basis since 1980); (2) tax holidays on dividends for any five-year period during the first 10 years; (3) free repatriation of capital and dividends; and (4) duty free entry of capital goods and inputs. These incentives were available only to firms exporting all of their output.

Further measures introduced in 1984 included a reduction in the corporate tax rate on non-EPZ firms from 65 to 35 percent and a system of corporate tax benefits to non-EPZ exporters in which the rate is reduced by 2 percentage points for each 10 percent of output exported. The 1985/86 budget limited the corporate tax rate of EPZ firms to 15 percent over the whole life of the firm and exempted dividends from income tax for a period of 10 years.

Against this background, the share of manufacturing in GDP rose from 8.0 percent in 1970 to 15.9 percent in 1983 and its share of total employment went up from 6.4 percent to 19.0 percent over the same period. Manufacturing, which contributed only 2.2 percent of Mauritian exports in 1970, accounted for 38.6 percent in 1983. The period 1983-85 has witnessed a further industrial boom. Manufactured exports rose by 35 percent to reach US$156 million and in 1985 are expected to surpass sugar as Mauritius' main exports. The number of exporting enterprises increased by 118 to reach a total of 237 firms in mid 1985. Fixed investment in plant and machinery increased by 50 percent in 1983 and by nearly 130 percent in 1984, reaching about $12.2 million. Export firms created 22,300 additional jobs in 1983-1984.
Botswana, which has one of the fastest growing economies in Sub-Saharan Africa, has a corporate tax on capital gains and income of 35 percent. The Financial Assistance Program introduced in 1982 offers liberal grants and tax holidays for productive ventures by local and foreign investors producing goods for export or import substitution.

In Malawi, the Government is carrying out a study of its tax system. The study will investigate ways to improve the responsiveness of the tax system and its efficiency, i.e., to remove or reduce disincentives for savings and distortions in resource allocation. In Niger, the Government has recognized that the fiscal regime discriminated against private enterprises by exempting parastatals from the turnover tax. In its new Standby Program with the IMF, it is committed to introducing a value-added tax. The emphasis under its Structural Adjustment Program with the World Bank will be on improving the efficiency of the tax system. A reform of the Investment Code will be included in a broader study of fiscal incentives and taxes and duties on external trade. Such studies are called for in other African countries as a basis for much needed reforms of their tax and investment codes, including reducing the reliance on import duties as the major source of revenue and lowering high marginal tax rates to strengthen incentives and opportunities to save and invest and to decrease pressures for tax evasion and corruption.

6. Public Investment Programs Monopolizing the Use of Foreign Loans

Private domestic saving are low in many African countries, for reasons already indicated. Public savings have also declined because government current expenditure has risen faster than government revenue and many state-owned enterprises have incurred losses. Thus African countries have had to rely increasingly on foreign savings, that is financial flows from abroad, to finance their gross domestic investment. This is true particularly of IDA eligible countries (low-income countries) in Africa. In 1970-74 gross investment in these countries averaged 17.9 percent of their GDP. 84 percent of this investment was financed by domestic savings (public and private). By 1984, however, their investment/GDP ratio had dropped to 14.3 percent and foreign savings accounted for 55 percent of total investment.

Private enterprises have had very limited access to medium- and long-term loans from abroad, either directly or indirectly through domestic financial intermediaries. This is shown by an analysis of foreign debt data classified by type of debtor. At the end of 1984, outstanding and disbursed medium- and long-term debt to Sub-Saharan African countries amounted to $56.5 billion. Only 0.6 percent of this total represented direct loans to private enterprises, whereas state-owned enterprises (SOEs) received 13.9 percent and mixed public/private enterprises 1.6

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percent. These figures cover MLT lending in all forms—suppliers credits, bank loans, bonds and loans and credits from multilateral and bilateral aid organizations.

Loans to development finance institutions (DFIs) accounted for a further 0.8 percent of outstanding foreign debt. This is a very low figure considering that these DFI's were intended to be the principal source of investment funds for enterprises in the private sector. And the amount available for private enterprises was even less, because SOE's were also beneficiaries of DFI subloans in most African countries.

Governments provided most of the initial equity capital for development banks during the 1960s and early 1970s. But subsequently there has been little injection of loanable funds from public treasuries. Nor have DFI's been very effective in mobilizing domestic private savings. So they have been largely dependent on funds from abroad. The response from foreign lenders, both official and private, has clearly fallen far short of the African private sector's needs.

The responsibility for this neglect of the private sector may lie more with governments than with foreign lenders, however. Governments guarantee repayment of this debt. Governments therefore have the final say in how the funds are used. The data demonstrate that African governments have preferred to use foreign MLT loans for their own public investment programs and to cover their external and budgetary deficits on current account. Loans to central governments and central banks for these purposes accounted for three quarters of total foreign debt. Equally evidently, foreign lenders have acquiesced with these priorities and perhaps even encouraged them. Some official sources of concessional loans may have shared the preference of governments for public investment, because it allowed foreign donors more direct involvement in the selection of projects and in procurement. Some lenders may not have wished to challenge a government's choice of a public sector executant for a given project, on the grounds that overt support for the private sector might be regarded as interfering with a nation's political sovereignty. Whatever the reason, the net result is that foreign loans have reinforced the heavy public sector bias of African investments.

In the case of the World Bank, IBRD and IDA loans and credits for DFI's in Sub-Saharan Africa amounted to just $109.6 million in FY84 and FY85 combined, out of total Bank commitments to the region of $3,964.9 million in those two years. World Bank lending for small enterprise development in Africa reached only $41 million in this period. However, it should be pointed out that some agricultural and rural development projects include agricultural credit components intended for private farmers and smallholders. Bank and IDA cumulative agricultural credit operations represented 3 percent of total IBRD/IDA lending to Africa by June 30, 1985. Also, some proportion of non-project lending and sector loans has reached private firms to ease their foreign exchange constraints on raw material inputs and spare parts. Sector and non-project lending accounted for 10 percent of the cumulative total.

20/ See World Bank Annual Report 1985, Tables 4.2 and 4.5.
There are signs of a reappraisal of investment strategies on the part of both foreign lenders and African governments in recent months. Guinea and Togo, for example, have requested foreign aid organizations to help finance their privatization programs by providing loans to private enterprises willing to take-over, invest in or acquire the physical assets of state-owned enterprises. A USAID policy paper states that "AID resources should be channelled through the private sector rather than the public sector, when host country conditions make this possible. In many cases, it may be feasible to contract with a private sector firm to provide what might have been provided through a government ministry." 21/ The World Bank is expanding its sectoral and structural adjustment lending to provide quick-disbursing funds which can be allocated to a larger number of private enterprises through commercial banks. The issue of how to achieve a better balance in the distribution of aid resources between the public and private sectors should be included on the agenda of meetings of consultative groups and aid consortia. Priority consideration should be given to action in three areas: (i) allocating a higher proportion of foreign aid funds to local development finance institutions and commercial banks for onlending to SMEs; (ii) encouraging private investors to take over inefficient state-owned enterprises and to undertake new projects currently included in public investment plans by guaranteeing long-term loans to match the investors' own equity contributions; and (iii) introducing Private Sector Development Loans to meet the short- and medium-term foreign exchange requirements of private enterprises, linked to policy reforms that promote competitive markets and efficient resource utilization.

CHAPTER IV. LABOR POLICIES AND PRICE CONTROLS

1. Labor Policies

Cumulative evidence suggests that over-regulated labor markets have generally resulted in bloated bureaucracies and hampered the profitability of enterprises in Africa. In particular, pressures upon employers to expand or maintain employment, for strictly social considerations, have proved to be counterproductive. Only economic growth can produce long-term expansion of employment.

Botswana's labor legislation has tried to find a balance between protection of the rights, safety and welfare of workers, the needs of employers and the need for labor market flexibility. Minimum wages, the length of the work week, annual and maternity leave, hiring and termination procedures are laid down. There is no provision for sick leave although it is given in practice. Dismissal of workers is allowed if there is misconduct, willful disobedience, lack of skill, substantial neglect of duties or unexcused absence from work. While government does not set wages in the private sector, it does attempt to restrain wage inequality and insure that private and public sector wages are comparable.²²/

In Mauritius, basic wage rates, working hours, sick leave, annual leave, authorized absence from work and compensation on termination of service are all regulated by legislation. A compulsory national pension plan is also in force, with contributions required from employers and employees. Labor-management relations are relatively stable and strikes are uncommon. The interests of the employers are coordinated through the Mauritius Employers' Federation for the EPZ under the Mauritius Export Processing Zone Association (MEPZA). Mauritian employees are organized into several powerful federations comprising some 36 unions. These unions have a record of responsible behavior, and are improving their capability to effectively represent their 80,000 members.

However, under the Second Structural Adjustment Credit 1983, the Mauritius government recognized that the labor legislation and the mechanisms for wage negotiations were cumbersome, created wage inequities and prevented labor mobility among various sectors. Wage policy has become an important part of adjustment policies in Mauritius. The policy is implemented annually through a national wage award (the cost of living adjustment), which is based on the previous year's inflation rate. The cost of living adjustment for 1984/85 equaled about 3 percent, compared to the rise in the cost of living index in 1983/84 of 5.6 percent. The Government continues to view wage restraint as vital to improve the country's export competitiveness. It proposed to liberalize minimum wage rates for male workers in the Export Processing Zone in order to encourage the hiring of male workers.

²²/ Botswana: Foreign Investment Climate, USDC, August 1985.
In Burkino Faso, a source of modern private sector discontent with regulations is what is felt to be excessive control over hiring and firing decisions. Though the legislation may be reasonable, in practice it is extremely difficult for modern sector employers to cut back on staff, or even to reduce working hours. According to some managers, approval by CDR (Revolutionary Defense Committee) representatives is required. Hiring new people generally involves going through the government's labor exchange. Smaller and/or 100% private firms have fewer such problems. But most firms have some public sector participation, and this opens the door to the restrictions noted. One large firm has sought for months approval to fire 120 employees, without success.23/

The general conclusion that can be drawn from African experience is that labor policies should allow firms more flexibility in negotiating wages, including the possibility of linking wages to employee productivity. Restrictions and penalties on laying off excess or unproductive workers should be relaxed, so that employers may take on and train new workers without excessive risks.

A recent World Bank report on Senegal states:

"It is no coincidence that the fastest growth in employment over the past decade (outside the public sector) has been in those branches of the Senegalese economy that are least regulated, such as artisanal production. Small-scale firms that largely escape payroll taxes, social security charges, government pressures to take on unneeded workers, and stiff penalties in order to lay off excess labor in times of slump, have a rate of new employment generation far in excess (estimated four times as high) of that for large-scale enterprises.

The report recommended that the government should move strongly in the direction of more liberal employment policies for large-scale public and private enterprises.

The Senegalese Government responded in its Letter of Development Policy in December 1985. Its proposed action program included the following statement on labor policy:

"Easing of employment regulations and increase in flexibility in determining wages."

Easing of the operation of the labor market is an important condition for the success of the economic adjustment program. This will be done gradually and on several fronts: employment regulations, formulas for worker incentives, collective bargaining, etc. The following measures will be taken or considered after the necessary studies have been conducted:

(i) **Hiring, dismissal and employment contracts.**

- introduction of provisions enabling employers to recruit Senegalese workers directly or through employment agencies;
- sharp reduction in the time taken by public employment agencies to reply to job announcements by enterprises;
- enhancement of the resources and performance (quantitative and qualitative) of public employment agencies;
- introduction of new provisions designed to better take into account the economic difficulties of enterprises submitting requests for large lay-offs;
- introduction of provisions permitting unlimited renewals of fixed-term employment contracts.

(ii) **Compensation**

- study of the link between external competitiveness, productivity and nominal wages, and proposal of appropriate measures to be implemented;
- encouraging enterprises and trade unions to make increases in bonuses and wage supplements contingent on changes in productivity and the operating results of each enterprise. Greater attention to these criteria in possible government arbitration proceedings (in the event of disagreement);
- reduction of the social security costs borne by labor-intensive enterprises.

(iii) **New formulas for the determination and distribution of compensation**

- Study of the possibilities of a link between employee compensation and enterprise profits, and proposal of appropriate measures to be implemented.

This statement provides a framework for an approach to labor market reforms which could be usefully followed in other African countries.

Training is another important area where the needs of private enterprises are not being fully met by government institutions. Too often the instruction remains theoretical and unrelated to the specific job requirements of employers. Some countries are therefore encouraging greater involvement of employers in the design and execution of training programs by providing grants and tax incentives. In Botswana, for example,
training sponsored by new investors under the Automatic Financial Assistance (AFA) program at institutions licensed by the Botswana Ministry of Education is automatically eligible for full reimbursement, provided total costs do not exceed $1,750 per trainee per year. Half the cost of training outside Botswana, off-the-job training done with business and/or training costing over $1,750 per trainee per year is refunded if special permission is received in advance.\footnote{24} In Lesotho, the Lesotho National Development Corporation (LNDC) established a $150,000 Training Grant Fund in 1980. Under this program LNDC reimburses 80 percent of the costs incurred by new project promoters in training Basotho workers.

A narrow indigenous technological base and lack of skills have undoubtedly retarded industrial development in Africa generally. However, some African and Asian countries have achieved impressive growth of manufacturing output and exports despite low initial levels of educational attainment, as measured by enrollment rates, whereas other countries in these two regions with similar educational endowments have performed poorly. The table below illustrates this fact. In Morocco, Tunisia, Pakistan and Thailand, only 11-16 percent of the population in their age group were enrolled at secondary schools in 1965, on a par with Ghana's 13 percent. Their enrollment rates for higher education were just 1-2 percent. Yet the first four countries achieved an annual growth of manufactured output in the 6-11 percent range over the period 1965-84, whereas Ghana's manufacturing production declined in real terms. Morocco, Tunisia, Thailand and Pakistan were also successful in penetrating overseas markets. Their manufactured exports rose 30, 35, 68 and 10-fold, respectively, in current prices between 1965 and 1983. Ghana's remained negligible.

Cameroon, Ivory Coast, Zambia and Zimbabwe started out in 1965 with even lower levels of human resources development. A bare 5-7 percent of their populations of secondary school age were enrolled and less than one percent were enrolled in higher educational institutions. But again their industrial performances have been sharply contrasting. Despite a more rapid increase in secondary enrollment rates in both Zimbabwe and Zambia, their manufacturing output growth rates have lagged well behind those of Cameroon and Cote d'Ivoire.

Improvement in basic educational levels undoubtedly facilitates industrial development but clearly can be undermined by other factors. It seems also true that low initial educational levels are not an insurmountable obstacle to export success. You don't need a Ph.D from MIT to sew shirts and jeans, weave silk, process foodstuffs, assemble radios or make other labor-intensive product which constitute the bulk of the exports of Morocco, Tunisia, Thailand, Pakistan, Cote d'Ivoire and Cameroon. Skills and know-how that were lacking were obtained by hiring expatriates, through direct foreign investment or by collaboration with overseas customers and suppliers. Indigenous skills were developed progressively by on-the-job experience and institutional training. Export growth stimulated more rapid

\footnote{24} See USDC, Investment Climate in Foreign Countries, op. cit.
### EDUCATIONAL ATTAINMENT AND INDUSTRIAL GROWTH IN SELECTED AFRICAN AND ASIAN COUNTRIES

<table>
<thead>
<tr>
<th>Country</th>
<th>Secondary School Enrollment (%)</th>
<th>Higher Education Enrollment Rate (%)</th>
<th>Average Annual Growth of Manufacturing Output %</th>
<th>Manufacturing Exports (millions of dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cameroon</td>
<td>5.0</td>
<td>21.0</td>
<td>(.</td>
<td>2.0</td>
</tr>
<tr>
<td>Côte d'Ivoire</td>
<td>6.0</td>
<td>19.0</td>
<td>(.</td>
<td>3.0</td>
</tr>
<tr>
<td>Morocco</td>
<td>11.0</td>
<td>29.0</td>
<td>1.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Pakistan</td>
<td>12.0</td>
<td>16.0</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Thailand</td>
<td>14.0</td>
<td>29.0</td>
<td>2.0</td>
<td>22.0</td>
</tr>
<tr>
<td>Tunisia</td>
<td>16.0</td>
<td>33.0</td>
<td>2.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Ghana</td>
<td>13.0</td>
<td>38.0</td>
<td>1.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Zambia</td>
<td>7.0</td>
<td>17.0</td>
<td>n.a.</td>
<td>2.0</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>6.0</td>
<td>39.0</td>
<td>(.</td>
<td>3.0</td>
</tr>
</tbody>
</table>

Source: WDR 1986.

(. ) Less than 0.5 percent.

( : ) Less than $0.5 million.

Income growth, which in turn generated higher tax revenues which were used to expand the educational system. Skill formation is a dynamic, interactive process which is rooted in effective economic policies. A country's capacity to absorb technology and to generate a constant stream of process adaptation and improvement, raw material substitution and product design changes depends largely upon action taken at the enterprise level. Employees have to be motivated by appropriate remuneration systems. Effective organizational structures and management techniques must be adopted. Information reaching the enterprise through market networks must be effectively utilized. Enterprise decisions in these areas are taken in response to economic incentives and competitive pressures, both of which can be strongly influenced by government policies.
2. **Price Controls**

Most African governments have exercised controls over the prices of agricultural and industrial products and services such as electricity, transport and telecommunications. The rationale for price controls was three-fold: (1) to ensure that people with low income can afford to buy basic necessities; (2) to contain inflationary pressures fueled by rapid monetary growth; and (3) to prevent abuses by monopolists.

Experience suggests that the short-term benefits of price controls to consumers are generally far outweighed by their economic cost and destabilizing effects. Price controls have aggravated shortages and distortions and affected the profitability of many enterprises adversely. As the case of Ghana illustrates, the effects of price controls tend to be opposite from the one anticipated. A World Bank mission recently observed that consumer prices continued to rise, as small retailers were too numerous to monitor. Retail stores run by the Government were constantly short of supplies. Profits were shifted from large producers, who were closely watched, to small retailers, who could sell at whatever prices the consumers were able to pay. Large private distributors of food products were forced out of business, while consumers continued to pay high prices as food supply fell.

Pernicious effects of agricultural price controls have been observed in Zambia. Until 1982, the Government set prices for virtually all crops and livestock on the basis of estimated costs of production on commercial farms, and the bulk of agricultural products were sold to public sector marketing boards. For the most part producer prices for crops were below import/export parity prices. This pattern of holding domestic prices below international prices subsidizes consumers and industrial users of agricultural commodities at the expense of the agriculture sector. Price controls on raw material inputs raise the effective protection afforded downstream industrial users. A comparison of the changes shows that the latter increased substantially faster than the former. Thus, the terms of trade moved against agricultural producers who had to pay more in terms of agricultural output for commodities which they purchased from the industrial sector.

Price controls are particularly burdensome and costly and represent a major disincentive to private operators. There are often long delays involved between an enterprise's request for a price increase and the Government's ruling on the request. In Burkina Faso, a bicycle manufacturer had to wait for 18 months to increase prices while the price of imported spare parts increased substantially in the meantime. In addition, he had to spare weeks of scarce managerial resources to comply with the heavy bureaucratic requirements for the preparation of the file. This had a serious effect on the profitability of his company.

Price control enforcement requires large staffs, adding pressure to already strained budgets. In Ethiopia the price control administration employs 800 persons, but is is recognized that they are insufficient to perform this task effectively.
Price liberalization is a politically sensitive issue. While many governments in the region recognize the many adverse effects of price controls, liberalization usually takes place in a gradual manner.

In Senegal, the government began to gradually eliminate subsidies on basic foods with the adoption, in 1975, of the true pricing policy (verite des prix). By 1980, under the first World Bank Structural Adjustment Credit, the last subsidy was abolished. Some sensitive food products such as rice, bread and ground nut oil remained under a system of government fixed prices but the prices of other goods and services were entirely uncontrolled by the end of 1980, except for certain crops subject to preliminary approval and monitoring. The 1986 SAC for Senegal proposed the progressive elimination of all price controls.

In order to allow market forces to play a more important role in the economy, the Zambian Government abolished the control of all wholesale and retail prices in December 1982, except for three essential commodities: wheat flour, maize flour and candles. Since then, prices for a wide range of commodities have increased, thereby helping to restrain domestic demand, while increasing the profitability of firms. Most recently, the price of wheat flour and bread was also decontrolled. Over the last three years, producer prices for most agricultural crops have been increased considerably in real terms. Together with concessionary tax rates for agricultural income and freer marketing arrangements for the livestock sector, these measures have already led to increases in the area under cultivation and in the marketed production of various crops and livestocks.

In Ghana, price controls have been substantially liberalized since 1985. Except for textile products, tobacco and beverages, and some less important items which remain subject to controls, manufacturers are only required to report price changes, with no prior approval needed. The Ghana National Procurement Authority has removed most food items from its list, retaining only sugar, rice, flour and edible oil. The liberalization of price controls has been welcomed by private businesses, while the combination of higher prices and larger production volumes are beginning to turn former seller's markets to buyers' markets. A World Bank mission to Ghana in 1986 recommended abolishing the remaining price controls especially on textiles, and phasing out the government's procurement and distribution activities, except in situations needed to render monopolies ineffective, and to assure adequate supplies in the most disadvantaged areas.

Nigeria removed all controls on ex-factory prices in September 1986. Prices have not changed significantly since then. Until 1983, the Government of Malawi maintained a system of formal and informal price controls on a variety of items that were considered essential either as consumer products or production inputs. This system, which evolved during the 1970s, reached a level that was seriously hampering the industrial sector. By the early 1980s, with increased inflationary pressures, it was creating serious disincentives for producers, by failing to signal shortages and surpluses, causing inefficiencies and imposing a financial burden on those firms experiencing large increases in their input prices.
Under SAL II, the Government implemented a price liberalization program, reducing the number of items on the price control list from 56 in December 1983, to 9 in August 1985. The Government is committed to carry out the price liberalization program to its conclusion.

In Niger, the number of products and services subject to the fixed price ceiling system was reduced from over 50 items to 7 items in November 1985. The Government also proposed to reduce the number of products subject to controls over profit and distribution margins.

Again, these country examples indicate the path that could be followed by other African countries in which price controls cause excessive market rigidities and hamper resource mobilization. Measures to increase market competition, including freedom of entry and removal of quantitative restrictions on imports, will help to ensure that price liberalization does not result in excessive rents for monopolists.
CHAPTER V. TRADE POLICIES AND COMPETITION

The last broad policy area reviewed is trade policy. This topic has not been left to the end because it is the least important. On the contrary, sound trade policy is probably the key element in the promotion of efficient private enterprise and open, competitive markets. In its absence, many of the reforms discussed in this paper would be undermined and ineffective, or might even have perverse results.

Trade policy issues in Africa can be discussed under three headings: (1) exchange rate policies; (2) import policies; and (3) export policies.

1. Exchange Rate Policies

A country's exchange rate affects not only the market opportunities for all tradables but also the rewards of their producers. An overvalued exchange rate makes it more difficult for farmers and manufacturers to sell their products abroad and reduces the returns in local currency received by exporters. Similarly, an overvalued currency has the effect of subsidizing imports which undercut the producers of import substitutes, unless import restrictions are imposed. Thus, resources are diverted into the production of non-traded goods and services.

Loss of exports (actual or potential) deprives a country of some important inputs needed for growth and efficiency. Exports increase the availability of foreign exchange which is one of the main determinants of the overall level of economic activity. Exports broaden markets and allow economies of scale to be achieved. Exporting activities expose producers to new technologies, new products and new marketing techniques. Exports create jobs and raise incomes.

Overvalued currencies also result in foregone benefits in import-substituting sectors. By making imports relatively cheaper, overvaluation undermines incentives in natural resource-based activities such as agriculture, forestry, mining, agro-industries and basic industries. It further discriminates against the development of appropriate domestic technology, and through cheaper imports of capital goods, encourages relative capital-intensive methods of production, thus discouraging employment creation.25/

There is widespread evidence of overvalued exchange rates in Africa and the situation has generally deteriorated relative to other regions over the past decade. IMF indexes of real effective exchange rates (that is, nominal exchange rates adjusted for relative rates of inflation) show that the weighted average index for all Sub-Saharan Africa appreciated by 75 percent between 1974 and 1984; whereas, the index for Asia depre-

ciated by about 26 percent and for the western hemisphere by 30 percent over the same period.\(^{26}\)

However, the costs and losses arising from currency overvaluation are being recognized. A growing number of African countries, particularly lower income countries, have adopted more flexible exchange rate regimes which rely on supply and demand in the foreign exchange market to determine the exchange rate.

Nigeria, for example, introduced a foreign exchange auction in September 1986. Zaire devalued the zaire by 77.5 percent against the SDR in September 1983, and introduced a dual exchange rate regime as an interim measure prior to complete liberalization. By 1985 the real effective exchange rate had fallen by three-quarters and the premium on the parallel market was no more than 10 percent, roughly in line with the cost of bank commissions. In late 1985, Zambia also introduced an auction system for most trade-related exchange transactions. Although the government and selected public enterprises continue to receive an administrative allocation of foreign exchange, the value of the foreign exchange is determined by the auction. After the introduction of the new system, the nominal exchange rate fell by two-thirds in three weeks. Guinea and Gambia are establishing similar systems intended to lead to a unified, market-determined exchange rate. Ghana has made substantial devaluations but has maintained its administrative controls over foreign exchange allocations. The availability of foreign exchange to the private sector remains highly constrained, except for exporters who are allowed to retain 25 percent of their foreign exchange earnings. Hopefully, this Foreign Exchange Retention Scheme will facilitate a transition to a freely convertible currency which is the most effective mechanism for ensuring that a realistic exchange rate is sustained.

2. Import Policies

The structure of tariffs on imports is highly uneven in most African countries, with low rates on foodstuffs, raw materials and machinery, and high rates on luxuries and products in direct competition with domestic industries. In Zaire, for example, tariffs on intermediate inputs are at 0 percent or 3 percent; on finished goods, up to 150 percent. This tariff structure results in substantial rates of effective protection on activities with low domestic value-added such as component assembly industries. High effective protection in these cases reduces competition and provides a powerful incentive to inefficient import-substitution industries. Low or even negative effective protection in other fields discourages the use of domestic raw materials and the development of intermediate and capital goods industries.

These tariff-induced distortions are further accentuated in many countries by quantitative restrictions on imports. These are often introduced to correct trade imbalances arising from overvalued exchange rates. Quantitative restrictions promote rent-seeking activities (rents are

incomes generated because of an artificially created scarcity). Substantial rents are obtained simply by having access to import licenses. Corruption almost unavoidably flourishes in such a situation. Politicization of the economic process is encouraged. The attainment of political power becomes vitally important from a private economic point of view, and this, in turn, fosters divisiveness between those who have political power and can extract rent, and the rest of the population. High tariffs and quantitative restrictions on imports facilitate the emergence of private monopolies and "crony-capitalism" which yield few long-term benefits for society as a whole.

Another prevalent weakness in African trade regimes is the granting of import duty exemptions to government enterprises and foreign aid financed projects. This practice subjects private enterprises to unfair competition and retards the development of domestic industries capable of making the same products, especially when such exemptions coincide with currency overvaluation and heavy domestic tax burdens on local producers.

These distortions and weaknesses are being remedied in some African countries in the context of structural adjustment programs. In Kenya, for example, the government announced in 1980 that it would gradually phase out quantitative restrictions and make the tariff the major form of protection. Tariff rates would be made more uniform and moderate. Twenty percent of import items subject to quotas were given free import status in 1982; a further 20 percent were to be transferred to this list each year. In Mauritius, the government agreed in 1983 to eliminate the discretionary system of industrial protection by gradually shifting to a generalized, time-phased program of declining tariffs.

In 1983, the Ivory Coast government adopted an action program to harmonize levels of effective protection through a comprehensive reform of the Customs Code. Quantitative restrictions would be phased out and replaced by temporary import surcharges during a maximum period of five years. In Senegal, customs duties on all imports were raised to 15 percent in 1980, and the Government proposed to gradually eliminate some exemptions applied to imported capital and intermediate goods. In Togo, quantitative restrictions are limited and customs duties vary from 5 to 40 percent, but the tariff system is complex. In 1985, the Government requested IDA to undertake a study to simplify and standardize the system.

In Zaire, the government announced in 1986 its intention to implement a program of tariff rationalization which would lower the average level of protection offered to the manufacturing sector and reduce the dispersion of protection rates that currently exist. This would be done by introducing a basic minimum duty of 10 percent on all imports, including raw materials and intermediate goods, and by reducing tariffs on finished goods progressively, aiming to establish maximum nominal rates of protection of about 30 percent in three years. In cases where it is considered desirable to limit the consumption of luxury goods, for example, excise taxes would be applied—equally to imported and domestically produced goods—so as not to provide incentives for the inefficient domestic production of these luxuries. Similarly, in cases of "dumping" by overseas
suppliers, a temporary import surcharge might be indicated. In addition to reforming the tariff structure, the Government is taking measures to provide institutional support to these reforms. Thus, a tariff commission composed of representatives from relevant economic ministries and the private sector has been established. Furthermore, a program of specific actions to improve the functioning of the Customs Administration Authority (OFIDA) has already been launched. This program includes incentives for customs officers through higher salaries and participation in penalties, training, logistic support, improvement of data processing and better organization. Its aim is to improve revenue collection and to meet the legitimate complaints of domestic producers who are currently being undercut by fraudulent imports which evade many of the duties and taxes imposed upon those who abide by the rules.

3. Export Policies

The anti-export bias resulting from overvalued exchange rates and from high duties and quantitative restrictions on imports has already been noted. Unfortunately, in many African countries this bias is reinforced by explicit or implicit taxes on exports. During the late 1970s, revenue from export taxes reached 70 percent of total tax revenue in Uganda, 26 percent in Ethiopia, 24 percent in Ghana, 20 percent in Rwanda, 19 percent in Burundi and 17 percent in Somalia, for example.\(^{27}\) In addition, the heavy administrative costs and wide operating margins of state export marketing boards act as a disguised tax on the primary producers of export commodities, even if there are no direct transfers to the national treasury.

Several countries have laws on the books which provide for tax and duty rebates on imported inputs that are processed for export. But, frequently, the criteria of eligibility are so discretionary and the administrative procedures so cumbersome that potential exporters are deterred from making the effort required to break into export markets. In many cases, an export license is required for each export consignment, acting as a disincentive and reducing the flexibility needed to respond quickly to export opportunities and to meet the delivery requirements of overseas customers.

The combined effects of these biases and barriers confine African exports, by and large, to commodities in which African countries have pronounced comparative advantages due to climate (tropical foodstuffs and wood) or geology (various minerals). Potential comparative advantages in labor-intensive manufacturers are dissipated because lower wage rates (compared with major East Asian exporters) are more than offset by higher taxes and other excessive costs resulting from the various policy weaknesses discussed earlier. Most successful Asian exporters operate at least within a tax-free export regime and in many cases receive export subsidies to counterbalance the tariff protection provided for sales in the domestic market.

markets. Manufactures account for only eight percent of total exports from low income countries in Sub-Saharan Africa compared with 51 percent for all low-income countries.28/

Mauritius is one African country which has demonstrated that by creating appropriate incentives and a favorable business environment, it is possible to eliminate dependence on primary commodities and penetrate highly competitive foreign markets with an expanding range of manufactured products. In 1985 over 50 percent of Mauritian exports were estimated to originate in manufacturing industries other than sugar refining—the traditional export industry. Several factors are responsible for Mauritius' success: generous fiscal incentives (noted in Chapter III); a hardworking labor force (well-educated but with little previous industrial experience); sound labor policies; and a democratic, pluralist society which fosters racial harmony while encouraging entrepreneurs from varied ethnic and religious backgrounds.

Other African countries are trying to follow suit by adopting similar policies. Under the SAL III, Malawi will take a number of steps to promote exports. A three-year project financed with the assistance of UNDP will strengthen the staff of the Malawi Export Promotion Council (MEPC) in the area of export promotion policy, product and market development, and trade information services. A center to train exporters and government officials in export promotion will be established. To meet the credit demands of small- and medium-sized exporters and to encourage the export of non-traditional products, the government is to set up an export credit facility to provide pre- and post-shipment financing, export credit guarantee, and export credit insurance. The duty rebate system will be streamlined and made operative.

In Burundi, the government proposes to eliminate all export taxes on local manufactured products. It will also reactivate the drawback system which exists, but is not well known to exporters. In Ghana, the formation of an inter-ministerial Export Promotion Council gives official recognition to the importance of exports which will be facilitated by ongoing reforms toward a realistic valuation of domestic currency and a liberalization of the trade regime.

In Zaire, the 1983 devaluation and the adoption of a realistic market-determined exchange rate has already begun to provide a potent stimulus to exports. Under the terms of a World Bank Industrial Sector Adjustment credit approved in 1986, these measures will be followed up by the abolition of all export duties and other taxes on manufactured exports. It is expected that the loss of fiscal revenues will be negligible and far outweighed by the revenue increases resulting from tariff reform and the corporate taxes on expanding export activities. Furthermore, the government will eliminate all the administrative bottlenecks faced by exporters, retaining only what is necessary for statistical purposes. An export promotion program will also be established.

The Ghanaian Government has taken steps to remove procedural and policy impediments to non-cocoa exports with the support of a World Bank Industrial Adjustment Credit approved in March 1986. These steps include removal of export permits, increased flexibility in the use of export retentions, streamlining of import duty drawbacks and strengthening of the Export Promotion Council.

Nigeria has introduced several reforms in the context of a Trade Policy and Export Development Loan approved by the World Bank in 1986. Import tariffs are being harmonized and the average level reduced. Quantitative restrictions on imports are being removed. A scheme for rediscounting of short-term bills for exporters is under preparation. And a duty drawback/suspension system initiated.

There is ample scope in other African countries for similar measures. Vigorous steps to counter the prevailing "export pessimism" in Africa would seem to be indispensable if more rapid and better-balanced growth is to be achieved. A competitive, dynamic private sector could contribute the main driving force behind a new outward-oriented trade strategy in Africa if export taxes were removed, realistic exchange rates adopted, duty draw-back schemes introduced and administered effectively, export credit facilities created, fiscal incentives offered to exporters and export promotion services strengthened.
CHAPTER VI. THE ROLE OF AID DONORS IN PROMOTING AFRICA'S PRIVATE SECTOR

The evidence reviewed in the previous chapters demonstrates clearly that there is no shortfall of entrepreneurial spirit in Africa. The most crucial limiting factor is not entrepreneurship, but weaknesses in the physical and policy environment which inhibit effective investment. What can aid donors do to help create more favorable investment conditions?

1. Policy Reforms

A fundamental prerequisite to the growth of the private sector in Africa is a favorable policy environment. The reform of official economic policies can remove debilitating restraints on entrepreneurial activity. Devaluation of inflated currencies, removal of barriers to entry, liberalization and diversification of financial markets, widening of the private sector's access to foreign exchange, domestic credit and foreign capital, the decontrol of factor and product prices, the lifting of excessive bureaucratic procedures and requirements, an easing and more equitable sharing of tax burdens, a reduction and harmonization of import tariffs, removal of quantitative restrictions on trade, and creation of incentives for labor mobility and skill formation are all difficult but essential steps to improve the business environment. It may be necessary to implement such changes gradually so as to avoid shocks to a country's society and economy. But without such reform, the necessary confidence among investors will not materialize, and other more targeted measures to stimulate the private sector will be far less effective.

2. Involving the Private Sector in the Policy Dialogue

The reform process is underway in several countries in Africa, such as Guinea, Ghana, Senegal and Zaire for example. Aid donors can facilitate progress along this path in many ways. In their economic and sector analysis work they can help to identify remaining constraints and, through comparative, cross-country studies, draw the attention of policy makers to measures which have been successfully applied to overcome these constraints. Donors can strengthen both their own analytical capacity and the national machinery for the implementation of reforms by involving the private sector more closely in their policy dialogue with countries. Missions to review the business environment in selected countries have yielded some new insights because they had more extensive contacts with representatives of the private sector than is customary in aid missions. But if the private sector focus of aid donors were confined to special, one-off missions their impact would be limited. The assessment of private sector attitudes and needs could be made more systematic. Consultations with private entrepreneurs and managers, and with representative organizations such as Chambers of Commerce, could be built into the standard schedules of foreign aid missions. This would demonstrate donors' recognition of the fact that the private sector is a vital partner with government in the development process, and that effective reforms require its
collaboration and support. Participation of the private sector in policy discussions should lead to a stronger consensus on development objectives, a better understanding of policy options and less resistance to particular reforms (such as import tariff and quota reductions) which the private sector might feel to be against its interest.

3. Policy-Based Lending

The short-term political costs of reforms are minimized, and the benefits made more immediate, if reforms are accompanied by additional resources. This is the role of policy-based lending. Loans for structural and sectoral adjustment are assisting a growing list of African governments to devise economic policies and programs which are more conducive to private sector activity. The freeing up of marketing systems, the liberalization of imports, encouraging the mobilization of savings to ensure credit availability, restructuring the financial sector, and the stimulation of competition through the elimination of subsidies to state enterprises are some of the steps governments are taking with donor support. There may be a need to extend the use of commercial banks as distribution networks for the diffusion of these loans, and perhaps to change allocation criteria and procurement methods to ensure that the private sector, particularly small firms, has adequate access to these financial resources. For example, trading companies supplying imported equipment, materials, and spare parts to small firms, which often lack the experience and know-how to import directly themselves, should be eligible for credits and foreign exchange provided by donors.

Donors could also focus more attention on policy areas which have been somewhat neglected in past adjustment operations. Statutory monopolies should be abolished and restrictions on entry by both domestic and foreign investors lifted. Liberalized investment regimes should signal investors of a more stable, predictable and transparent policy environment over the long run. This will help not only to attract new foreign capital but also to reverse the flight abroad of domestic savings. Growth-oriented fiscal policies should be introduced, aimed at increasing incentives to work, save and invest, mobilizing resources for productive sectors and open legitimate activities and reducing budget deficits and public sector borrowing requirements. Reforms of wage systems and labor market regulations and institutions should promote skill formation, productivity improvement and more rapid labor absorption in areas of comparative advantage for African countries. The anti-equity biases of existing policies should be corrected and equity market institutions strengthened. And on the broad question of price determination, donors could encourage governments to place greater confidence in the knowledge and wisdom of market actors when making decisions affecting their livelihood as producers and their welfare as consumers. Rather than reinforcing government price fixing machinery or trying to simulate market behavior in elaborate models, prices should be left largely to the interplay of competitive market forces.
Introduction of a new lending instrument—Private Sector Development Loans—might be the most effective means of ensuring that the foreign exchange and credit requirements of the private sector are met at the same time as its policy environment is improved.

4. **Agricultural Development**

In agriculture, where small scale enterprises have played such a prominent role historically in Africa, adjustment lending has enabled many governments to either decontrol or raise the prices paid to farmers and thereby reinstate incentives long absent from the agricultural sector. Many aid donors have emphasized the introduction of better farming practices, the dissemination of new seeds and varieties, and the development of more efficient marketing and credit facilities. Donors are also supporting intensive research into new agricultural technology for the African environment and the transfer of new discoveries to the field where they can be applied in practice by the resourceful African farmer. But perhaps greater care should be taken in the design of agricultural projects to ensure that the provision of inputs, and the distribution and processing of outputs, are not dominated by subsidized public sector organizations which preempt or undercut the opportunities for private enterprise in these fields. Independent, competitive fertilizer and seed merchants, agricultural equipment suppliers, blacksmiths, welders, and carpenters, grain millers, small transport operators and traders of all kinds are vital actors on the rural scene. They create new jobs for surplus agricultural labor. They supplement farm household incomes. They mobilize rural savings for the diversification of rural output. And they oil the wheels of the rural economy more effectively than do centralized, bureaucratic organizations.

5. **Promotion of Small and Medium-Sized Enterprises**

The encouragement of small and medium enterprises (SMEs) in both rural and urban areas should be a high priority in Africa, not only for the development impact of a growing indigenous private sector, but also as a recruiting and training process for future entrepreneurs. Since the early 1970s, donors have assisted African countries in setting up development banks which then lend to local investors, help identify projects and provided technical assistance to new entrepreneurs. In recent years, an increasing proportion of this type of lending has supported "apex" institutions, such as central banks, which have channelled credits to a larger number of local lending institutions so as to reach a wider group of entrepreneurs. But, the total amount of foreign aid channelled through development banks and for SME programs has been relatively small.

Although the existence of unsatisfied demand for credit for the private sector is not denied, African Governments and financial institutions have been reluctant to expand these programs. Donors could make a greater effort to persuade governments that subsidized credit is not the answer. Efficient SMEs can pay the real costs of credit. But they are being denied access to credit because of the inevitable abuses of subsidized schemes. Commercial banks would be more willing participants in the
programs if governments and donors recognized the higher costs and risks of SME lending. Aid funds should be made available to these institutions at the same cost as their other sources of funds, principally time deposits. Deposit and lending rates should be determined by financial institutions in response to market forces.

In the field of technical assistance to SMEs, specialized government institutions have been wasteful and largely ineffective in Africa, and elsewhere. Market networks, built upon commercial relationships between suppliers and customers, are more efficient mechanisms for the dissemination of know-how and information needed by SMEs. Policy reforms of the type discussed in this paper will strengthen this transfer mechanism by removing price distortions and subsidies and encouraging cooperation among firms in complementary fields, and help to fill any gaps in the provision of services. They will also create incentives for subcontracting and franchising relationships between large firms and SMEs which have been shown (in Japan and Korea, for example) to be mutually supportive.

6. Restructuring of State-Owned Enterprises

The rationalization and restructuring of large state-owned enterprises (SOEs) is another important area where donor support benefits the private sector. Frequently the managers of these state enterprises respond more to official concerns than to economic ones. Short of skilled manpower and sometimes the victims of poor planning, many such entities are found to operate at a loss, to drain government resources, consume scarce foreign exchange, and employ a government granted monopoly to exclude any potential competitors. They also borrow heavily at home and abroad, using credit which otherwise would be available to more productive borrowers.

Some SOEs are viable and perform well, but many should be restructured, rehabilitated and managed more efficiently. Although privatization of public sector holdings can be difficult to carry out in developing countries, it is an option which governments should examine closely for a wide range of state enterprises. Donors guidance and support are likely to be called upon increasingly in this field.

7. Infrastructure and Institutional Development

In addition to more favorable economic policies, an improved physical and institutional environment is also essential to encourage the development of a nascent private sector. Industrial and agricultural entrepreneurs rely on a functioning road, rail, and port systems to obtain essential inputs and to market their products. Power and telecommunications must also be reliable; frequent power outages not only reduce capacity utilization and profitability, but often cause serious damage to costly plant and equipment. Advances in the institutional environment are essential as well so that legal systems, accounting rules, and taxes are uniformly applied and observed. In addition, entrepreneurs must be able to draw upon a healthy and literate labor force—the key input in any business.
In the vital area of infrastructure aid donors have supported such investments as roads, ports, communications, water supply systems, and energy installations for many years in Africa. More recently, in response to the African economic crisis, some donors have shifted their infrastructure lending from new investments to the urgent rehabilitation and maintenance of existing facilities. These investments are important and should be continued. But more innovative approaches are needed to shift some of the burden of local cost financing from government to the private sector. There is a growing body of experience around the world with the private provision of infrastructural services. This experience ought to be tapped more fully in Africa.

International legal expertise is being increasingly utilized in the fields of SOE restructuring and privatization. Assistance could also be extended for the drafting of new investment codes and the redesign of commercial law.

8. Promotion of Direct Foreign Investment

Direct foreign private investment will be promoted by the establishment of the Multilateral Investment Guarantee Agency (MIGA) under the auspices of the World Bank. MIGA will respond to the concern of foreign investors, from developed and developing countries alike, that their investments be protected against non-commercial risks and volatile economic conditions in developing countries. With that protection available from MIGA, investment conditions will be further improved in Africa. Other steps that could be taken by donors to actively promote direct foreign investment include:

- organization of workshops and study tours for officials of African investment promotion agencies to facilitate a cross-fertilization of ideas and experience;

- technical assistance for the revision of Investment Codes to ensure non-discrimination between domestic and foreign investors (the OECD "national treatment" principle);

- provision of funds to African investment promotion agencies to support visits by potential foreign investors and subsequent joint feasibility studies; to qualify, investors must demonstrate that they are seriously interested in undertaking a project as well as having the necessary capital and capabilities to do so;

- invitations to representative bodies of international private enterprise (such as the International Chamber of Commerce) to participate in economic and sector missions dealing with foreign investment issues and policies; and

- dissemination of reports prepared by aid agencies describing and analyzing the investment climate in African countries to organizations representing foreign investors; such reports (appropriately edited) could include economic and sector reports,
reports to consultative groups, reports on feasibility studies undertaken by aid consultants, reports on market surveys conducted by donor financed institutions (e.g., DFIs) and reports on public investment programs.

9. **Conclusion**

In conclusion, it should be emphasized that promoting private sector development is not an ideological necessity. It is sound policy. A growing private sector providing a more diverse array of products and services is a formidable force for development. Opening the economy to more indigenous enterprises also provides increased opportunities for African women who in many African societies have a long tradition of commercial activity. For governments who have gradually realized the limits of public sector intervention, an enhanced role for the private sector is not a threat, but welcome relief. And the harsh rhetoric once heard in Africa against foreign investment is being replaced by a determined competition for the capital, technology, and employment which industrial country investors can bring to a developing country.

Attitudes and policies are changing rapidly in Africa. There is a growing recognition that given the proper support the enterprising energies of Africa's people have enormous development potential. Aid donors, industrial country investors, African governments, and African entrepreneurs themselves now have the opportunity before them to engage a powerful engine to help drive Africa's development forward. It is an opportunity which no one can afford to ignore. Aid donors can help to create a better environment for private enterprise in Africa in many ways. Their existing programs make significant contributions. They should be reinforced by placing greater stress on the development of competitive markets, the easing of regulatory controls and closer collaboration with the private sector at all stages of foreign aid financed activities.
Were differences in economic performance among African countries related to differences in the relative size and respective roles of the government and the private sector? Five cross-country studies have examined this question, using statistical techniques to estimate the strength of the relationship, if any, between key economic variables and economic growth. These variables include the level of government expenditure on public services, public and private investment, taxation, the extent of government intervention in product and factor markets, the share of the public and private sectors in domestic credit, external public debt and government/private sector involvement in the provision of agricultural inputs.

1. Links Between Government Expenditure, Private Investment and Growth

The most comprehensive analysis was undertaken by Daniel Landau.1/ His data set included 65 developing countries, comprising all countries with populations of one million or more for which data were available for the period 1960-80. 24 countries in Sub-Saharan Africa were included. His regressions took the rate of increase in per capita GDP as the dependent variable and examined 37 explanatory variables grouped into ten categories: measures of government expenditure and revenue raising; regulation and other government impacts; the level of per capita product; international economic conditions; human and physical capital variables; the structure of production; historical political factors; resources and geoclimatic factors; population; and a time trend. Separate regressions were run for four sub-samples of the data. Two of these sub-samples were for annual observations of the growth rate, one was for four-year periods and one for seven-year periods. Most of the regressors were lagged values, which avoids problems of contemporaneous correlations between regressors and disturbance.

Landau found highly significant negative relationships between the share in GDP of general government current expenditure (except education and defense) and the growth of per capita GDP. In his smaller annual sub-sample, for example, an increase of 1 percent of GDP in this category of government expenditure was associated with a 0.25 percent lower growth rate of per capita product. When the variables for private investment, the share of taxes in GDP and the share of government budgetary deficits in GDP were held constant, the coefficients for government expenditures decreased

in absolute values but retained their negative signs. This result led Landau to infer that part, but not all, of the negative impact of current expenditures on government services were due to the need to raise tax revenue to finance this type of spending.

In the field of education, Landau compared the impact of government educational expenditure as a share in GDP with a direct measure of education output by weighted enrollment rates. The coefficients for government educational expenditure alone were positive but not statistically significant, whereas those for enrollment were both positive and significant. The finding implies that education contributes to economic growth, but government spending on education in the LDC's is not efficient at producing actual education. A substantial proportion of educational services is provided by the private sector in many LDC's but no data were available to estimate its impact directly.

Perhaps the most important regression results concerned government capital expenditure. The coefficients for the four sub-samples were all negative, but only one was statistically significant. Thus, on net, government capital expenditure seemed at best to be no help in growth and was perhaps slightly harmful. This surprising result was explained by introducing private investment and revenue-raising variables into the equation. The findings indicate that there was some return to government investment, but the return did not cover the opportunity costs in terms of higher taxes, larger deficits and the crowding out of private investment.

In contrast to government investment, Landau's analysis suggests that private investment did increase the growth rate. The coefficients for private investment were all positive and their significance levels ran from better than 1 percent to 17 percent in the four sub-samples. While the pay-off to private investment appeared to be much better than public investment, it was not what one would hope. That might be explained, Landau speculated, partly by deficiencies in the data. Many government enterprises which operate autonomously are counted as private. An additional factor was perhaps various government policies and regulations which, on the one hand, prevent private enterprise from entering the most profitable and productive activities and, on the other hand, make non-productive investment profitable. An example might be high protection of assembly-type industries. Government distortion of prices and other incentives may bring about a misdirection of genuinely private investment. A study by Ramgopal Agarwala, discussed below, lends support to this hypothesis.

Landau's main conclusion was that what is called development expenditure by governments had no positive impact on growth in developing countries during the period 1960-80. He offered a three-fold explanation: (1) government investments are often inefficient, generating on average a low return, (2) the taxation and borrowing needed to finance government capital expenditure slow growth; and (3) government investment "crowds out" private investment which does contribute to economic growth. The development budget, he argued, is considered to be the main tool for promoting growth in most LDCs, but the huge sums spent are not increasing growth.
2. Government Intervention, Price Distortions and Growth

A large body of theoretical literature has demonstrated how price distortions result in a loss of efficiency. Ramgopal Agarwala examined the empirical evidence, undertaking a statistical analysis of the relationship between price distortions and economic growth in 31 developing countries during the 1970s. These countries represented more than 75 percent of the population of developing countries excluding China. 10 countries from Sub-Saharan Africa were included.

Price distortions exist when the prices of goods and services, as well as of capital and labor, do not correctly reflect their scarcity. For goods that are internationally traded, scarcity is generally indicated by international prices. Price distortions may be caused by monopolistic tendencies in the private sector or by government intervention. It is possible for government intervention, if properly designed, to correct distortions. In most instances, however, price distortions are introduced by government directly or indirectly in pursuit of some general or economic objectives; sometimes deliberately, sometimes incidentally.

Agarwala's analysis concentrated on distortions in the prices of foreign exchange, capital, labor, and infrastructural services (particularly power). Distortions were not measured against some theoretical ideal, but were practical approximations commonly used in policy analyses. For example, the measure for foreign exchange focused on changes in real effective exchange rates from a base period, together with the effective protection or taxation of traded goods. Similarly, distortions in interest rates were judged by how far interest rates were negative in real terms; in wages, by movement in real wages relative to productivity adjusted for changes in the terms of trade; in the value of money, by high and accelerating inflation; and in infrastructure prices, by the rates of return in utilities.

The study found that in many countries with a large balance of payments deficit during the 1970s, the exchange rate was allowed to become overvalued in relation to the purchasing power of the currency. This lack of competitiveness became particularly serious in sub-Saharan Africa, where the average real effective exchange rate appreciated by 44 percent between 1973 and 1981. Several African countries found that producers of traditional export crops could not be paid enough to cover their costs of production, even though these were crops for which they have a strong competitive advantage (cocoa in Ghana is an obvious example).

Trade restrictions (import bans, quotas, and high tariffs) often led to high and variable rates of protection between different manufacturing industries. By contributing to an overvalued exchange rate, such

restrictions inadvertently discriminated against both exports and agriculture. In several countries (such as Ghana, Senegal and Tanzania) the bias against exports was supplemented by export taxes or even outright restrictions, sometimes leading to increased agricultural imports at the expense of domestic production. When import controls were intended to protect infant industries, they were rarely geared to promote an industry's long-run growth potential; nor were they reduced even after the industry had reached adolescence. The loss of efficiency resulting from such policies can be considerable. Apart from these losses, the system of protection in many developing countries has been a serious administrative burden, and by giving windfall gains to those who obtain import licenses, often made the distribution of income more unequal as well.

Overvalued exchange rates and low tariffs on imported capital goods encouraged capital-intensive techniques at the expense of creating jobs. These tendencies were strengthened when interest rates charged to borrowers (and paid to savers) fell short of the inflation rate. At various times in the 1970s negative real interest rates were almost a world-wide phenomenon. But they were particularly perverse and persistent in countries such as Ghana and Nigeria.

Capital-intensive investment was also encouraged where the price of labor was increased by unrealistic minimum wage laws and social security taxes. In many mineral-based economies in Africa, the drive for higher mining wages spread to other sectors. This pushed labor costs above those of competitors, and encouraged rural people to leave land in pursuit of the high wages paid to those lucky enough to find jobs in the urban sector.

In his statistical analysis, Agarwala used a composite index derived by calculating an average of price distortions in the six price areas covered. His regression results showed a significant relationship between the price distortion index and economic growth in the 1970s. The average growth rate of GDP of those developing countries with low distortions was about 7 percent a year—2 percentage points higher than the overall average. Countries with high distortions averaged growth of about 3 percent per year, 2 percentage points lower than the overall average. Among African countries, Malawi, Cameroon and Kenya were in the low distortion, high growth category, while Senegal, Tanzania and Ghana were in the high distortion, low growth category.

These findings suggest that Third World governments could stimulate economic growth by removing price distortions in three ways: (1) by reducing direct interventions in product and factor markets in the form of public sector monopolies and administrative and legislative controls; (2) by encouraging competition among public and private enterprises by lowering levels of protection from imports and allowing freedom of entry into domestic production sectors; and (3) by leaving pricing decisions largely to market participants subject to the laws of supply and demand.
3. **Alternative Development Strategies and Growth**

A subsequent study by Bela Balassa supports these conclusions in a specifically African context. Balassa examined the performance of 19 oil-importing African countries over the period 1973-79, using two classification schemes to differentiate between the development strategies adopted by these countries. Development strategies were defined in terms of the extent of public intervention in product, capital, labor, and foreign exchange markets. Balassa assigned countries according to their policies concerning relative incentives to manufacturing and primary activities; the determination of exchange rates; the extent of price and wage control; the setting of interest rates, the degree of credit rationing, and the licensing of private investments; the choice of public projects and their relative importance in total investments; as well as the size of the government budget deficit. In his first classification scheme, Balassa distinguishes between "interventionist" and "market-oriented" countries; in his second, he adopts three categories: etatist, intermediate, and private-market oriented. Etatist countries exhibit the most public intervention in economic life and are characterized by a high degree of state ownership and rapid Africanization of middle- and high-level jobs in the economy. At the other end of the spectrum are the private-market economies, with the rest in an intermediate group.

The results of Balassa's statistical analysis are revealing. In 1973-79, GNP growth rates averaged 6.2 percent in market-oriented countries compared with 1.9 percent in interventionist Sub-Saharan African countries. Private-market economies achieved a 6.8 percent rate, intermediate economies 3.5 percent, and etatist economies 1.5 percent. The results of regression analysis show a positive correlation between market orientation and the rate of economic growth, significant at the 2 percent level. Such a result was also obtained for private market economies; the variable for etatist countries was negative, but not significant.

Balassa suggests that differences in growth performance may be explained by differences in incremental capital-output ratios and in domestic and foreign savings ratios. During 1973-79 incremental capital-output ratios averaged 7.8 in interventionist countries and 4.4 in market-oriented economies. Domestic savings ratios averaged 10.1 percent in interventionist countries and 21.5 percent in market-oriented countries. Finally, foreign savings ratios (the net inflow of foreign capital expressed as a percentage of the gross domestic product) averaged 6.3 percent in interventionist countries and 5.1 percent in market-oriented countries.

The effects of the choice of development strategies on incremental capital-output ratios, taken to represent the efficiency of using incremental resources, and on domestic savings ratios, reflecting the success of efforts at domestic resource mobilization, are also indicated by

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the results obtained in the three-way classification. In 1973-79, incremental capital-output ratios averaged 23.2 in etatist countries, 4.9 in countries of the intermediate group, and 4.3 in private-market-oriented countries; the corresponding domestic savings ratios were 10.5, 12.2 and 21.1 percent. Finally, private-market-oriented countries experienced the smallest inflow of foreign capital (1.8 percent of GDP), followed by etatist countries (4.0 percent) and the countries of the intermediate group (9.9 percent).

Balassa argues that differences in incremental capital-output ratios and domestic savings ratios are largely explained by the policies followed. The application of protectionist policies, aggravated by export taxes, price controls and the large margin of parastatal trading companies discriminated against exports and against agriculture in interventionist countries. On the whole, discrimination increased during 1973-79 reducing the efficiency of investment.

A review of the experiences of the 1973-79 period further indicates, according to Balassa, that interventionist countries failed to devalue along with inflation. As a result, their real exchange rates appreciated, discriminating against both exports and imports substitution. The licensing of private investments and the implementation of high-cost capital-intensive public projects further reduced the efficiency of resource allocation in interventionist—particularly etatist—countries. By contrast, a higher degree of openness, greater price flexibility, more realistic exchange rates, a freer choice of private investments, as well as a smaller number and a more judicious selection of public projects favorably affected the efficiency of resource allocation in market-oriented countries.

Domestic savings ratios are affected by public and private decisions. By and large, the deficit in the government budget was larger in interventionist than in market-oriented countries, thereby reducing public savings. In turn, private savings were affected by interest rate policy. During 1974-78 real interest rates on the average were negative in all the Sub-Saharan African countries, but were most negative in two interventionist countries Zaire (24.3 percent) and Ghana (21.8 percent) and least negative in two market-oriented countries, Malawi (2.5 percent and Burkina Faso (2.3 percent). Market-oriented countries increased reliance on foreign capital to a much smaller extent than interventionist countries, thus avoiding increases in debt-servicing ratios, which more than doubled between 1973 and 1978 in etatist countries.

In conclusion, Balassa notes that in Sub-Saharan African countries incremental capital-output ratios tend to be higher while savings ratios and GNP growth rates tend to be lower than in developing countries outside the region. He suggests that the differences may be explained by the fact that public interventions are more prevalent in Sub-Saharan Africa than elsewhere in the developing world. The findings indicate the importance of policy choices in Sub-Saharan Africa and point to the need for policy reforms towards greater market orientation. The conclusions thus support the findings of Accelerated Development in Sub-Saharan Africa, the report prepared under the direction of Elliot Berg (World Bank, 1981).
4. Credit Allocation and Growth

A study by Keith Marsden throws further light on the performance of 17 countries in Africa and East Asia over the period 1962-82. The countries are Cameroon, Ethiopia, Ghana, Ivory Coast, Kenya, Korea, Madagascar, Malawi, Malaysia, Mali, Philippines, Senegal, Sudan, Tanzania, Thailand, Zaire and Zambia. They constitute all countries in East Asia and Sub-Saharan Africa for which financial data are available, with the exception of OPEC members (Indonesia and Nigeria, which are special cases) and countries with populations of less than 5 million. Their economic structures (predominantly agricultural) and income levels were similar at the beginning of the period. The study uses data on domestic credit provided by the monetary authorities and banks to government and public enterprises on the one hand and to the private sector on the other. Data on external public debt, that is, medium and long-term foreign loans to governments (or guaranteed by them) are also analyzed. The countries are classified into four groups—high growth, medium growth, low growth and negative growth of GNP per head. The table below summarizes the findings.

<table>
<thead>
<tr>
<th>Countries</th>
<th>Average Annual Growth of GNP Per Head (%)</th>
<th>Share of Private Sector in Domestic Credit (%)</th>
<th>Private Domestic Credit (% of GNP)</th>
<th>External Public Debt (% of GNP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>High Growth</td>
<td>4.5</td>
<td>65</td>
<td>85</td>
<td>13</td>
</tr>
<tr>
<td>Medium Growth</td>
<td>2.3</td>
<td>92</td>
<td>65</td>
<td>13</td>
</tr>
<tr>
<td>Low Growth</td>
<td>0.9</td>
<td>89</td>
<td>31</td>
<td>13</td>
</tr>
<tr>
<td>Negative Growth</td>
<td>-0.9</td>
<td>68</td>
<td>26</td>
<td>8</td>
</tr>
</tbody>
</table>


The results are striking. Regression analysis showed that economic growth was strongly correlated with growth of domestic credit to the private sector. A 1% increase in the real rate of growth of private credit was associated with an increase in growth of GNP per head of 0.34%.

The estimate is significant at the 99% confidence level. Economic growth was also positively related to the shares of private sector credit in total domestic credit and GNP. This suggests that the private sector used its financial resources more efficiently than the public sector. Countries which mobilized savings through financial intermediaries effectively, and ensured ample access to credit by the private sector over the twenty year period, achieved higher levels of gross domestic saving in relation to GNP. Saving ratios dropped sharply wherever governments came to dominate the demand for domestic credit. This was true for Africa as well as Asia. The differences among countries seem to be more related to differences in policy than to inherent characteristics of the two regions.

Marsden found that economic performance was not significantly correlated with financial flows from abroad. Foreign lending to African governments was generally substantially higher in relation to GNP than for their East Asian counterparts. But in most cases it failed to boost growth. In fact, the level of external public debt had a negative relationship with economic growth, although the association was statistically weak. This indicates that foreign loans do not, by themselves, guarantee higher output and may sometimes have an adverse impact. The risk is greatest when governments raise taxes or borrow heavily in the domestic capital markets to pay the local counterpart costs of foreign funded activities within the public sector, or to cover the operating losses of those financed from abroad in the past. However, the experience of the higher growth countries suggests that moderate foreign borrowing by governments can contribute to progress in the following circumstances. First, the projects are well selected. Second, the public sector's managerial capacity is not over-extended. Third, the policy environment is conducive to efficiency. Fourth, the debt can be serviced readily out of export earnings. And fifth, the private sector is given adequate incentives and opportunities to harness and develop domestic resources.

Another important finding is that, with one exception (Zaire), all countries began the period with active private sectors and domestic credit markets geared to their needs. The level of credit outstanding to the private sector was relatively low as a proportion of GNP, but was surprisingly uniform across country groups (8-13%). Africa and East Asia started off on a similar footing. It was only over the next twenty years that their paths diverged. But not all African countries took the same route. This can be shown by a closer examination of the country groups.

In the high growth group (Korea, Thailand, Malaysia and Cameroon), per capita incomes rose at an average annual rate of 4.5%. The share of the private sector in total domestic credit went up from 65% to 85%. Outstanding loans to the private sector increased from 13% to 41% of GNP. By adopting sound monetary and interest rate policies and by creating an economic climate which fostered private initiative, these countries raised their domestic savings rapidly and induced individuals and firms to deposit their savings in financial instruments and financial intermediaries. Private entrepreneurs in all sectors (including farmers) were assured continued access to investment and working capital funds because domestic borrowing by the government and public enterprises was kept at moderate levels.
Two factors in particular explain this moderation. First, relatively low tax rates stimulated economic incentives and economic growth. A rapid broadening and deepening of the tax base generated higher tax revenues to pay for essential government services. Second, these high growth countries were able to obtain external finance, often on concessional terms from development agencies like the World Bank, to build up their basic infrastructures. Again moderation was shown in this borrowing. Their external public debt increased from 14% of GNP in 1970 to only 22% in 1982. Market oriented trade policies boosted exports and brought in ample foreign exchange to service this debt. Exports averaged 36% of GDP in the high growth group in 1982. Average annual growth of exports ranged from 4% to 20% over the period 1962-82.

The medium growth countries (Kenya, Philippines, Malawi, and Ivory Coast) achieved an average annual rate of increase of GNP per head of 2.3%. Their financial systems were particularly private sector-oriented in 1962, with governments acting as net lenders in three cases. Over the next two decades, the volume of domestic credit channelled to private enterprise rose significantly, in both absolute terms and in relation to GNP. But governments absorbed a growing proportion of domestic financial resources, and the private sector's share dropped to 65% on the average. Governments' demands for foreign loans also increased dramatically. External public debt reached 46% of GNP in 1982 compared with 22% in 1970. The private sector retained sufficient access to financial resources to maintain a reasonably buoyant level of economic activity overall, but economic growth slowed considerably during the second half of the period. The shift was most abrupt in Malawi. Its budget deficit soared to 15% of GDP in 1980/81 and the government took 92% of the incremental credit extended by the banks. Income per head actually declined over the last five years.

The presence of four African countries alongside four East Asian countries in the medium and high growth categories demonstrates that entrepreneurship is not lacking in either region. Their private sectors have responded to incentives and opportunities created by appropriate policies and have generally used their resources effectively. But their experience also indicates that, even where private enterprise is well rooted, economic performance can be adversely affected if governments' fiscal and financial appetites grow immoderately and if government controls over prices, interest rates and foreign exchange allocations cause market distortions which provoke inefficient resource utilization in all sectors, public and private.

The risks of excessive government intervention are illustrated vividly in the low growth group (Ethiopia, Tanzania, Mali, Senegal and Sudan) and negative growth countries (Zambia, Zaire, Madagascar, and Ghana). Economic stagnation or decline coincided with a massive extension of government control over domestic funds. The private sector's share of domestic credit fell to 31% and 26% in the two groups respectively. External public indebtedness also increased sharply. Foreign loans were often used to increase public investment and to cover the current deficits of public enterprises in the main economic sectors, not just in infrastructure. But loss of confidence among foreign creditors in the domestic policies adopted by these countries restricted their access to overseas capital markets towards the end of the period.
The study also examined two other variables which are often cited to explain the poor performance of many African countries. The first is a deterioration in their terms of trade. This undoubtedly added to their difficulties. But apart from Ethiopia, Zambia and Zaire, the low/negative growth countries fared no worse than did the high/medium growth countries over the period 1970-82.

A second factor is said to be a growing dependency on imported foodstuffs, thus tying-up scarce foreign exchange. Periodic drought has affected agricultural output in Africa, but so have defective pricing, exchange rate and marketing policies. Long-run economic growth does not appear to be negatively linked to the level of food imports. In fact, the two countries with the highest levels of cereal imports per capita in 1982, Korea and Malaysia, are both in the high growth category. By promoting exports and diversifying their economies, they had no difficulty in paying for imported food.

Korea and Ghana provide the sharpest contrast in performance among the countries reviewed. In 1962 their incomes per head were almost identical, $491 and $490 in 1980 U.S. dollars. They also had other characteristics in common. 64% of Ghana's labor force was engaged in agriculture in 1962 compared with 66% in Korea. 90% of Ghana's exports were primary products compared with 86% of Korea's. Yet just twenty years later, the average Korean enjoyed an income five times that of the average Ghanaian. Korea did begin with higher levels of adult literacy, but Ghana's human resources were among the most developed in Africa in 1962. So, this factor alone does not explain the subsequent disparities. 90% of Korea's exports were manufactured goods in 1982 and it had become a major force in world markets in such fields as shipbuilding. Exports represented 39% of GDP. Private sector credit amounted to 49% of GNP and 87% of total domestic finance. Public enterprises contributed only 6% of GDP and they maintained a current account surplus. The total tax/GDP ratio averaged 14.2 percent during the 1970s. The burden of direct taxes on the top three income deciles (from which most entrepreneurs are drawn) averaged only 1.8 percent, 3.6 percent and 11.7 percent of their total incomes.

Ghana's rudimentary industry on the other hand, was working at below 25% of capacity because of inadequate demand and scarcity of foreign exchange for imported inputs. The entrepreneurial skills and resources of the Ghanaian cocoa farmer, which had produced one of the highest living standards in Africa at the time of independence, had been drained by state marketing boards to finance ill-conceived public investment and to maintain an inflated bureaucracy. By 1982 the private sector was so squeezed, and the public sector so inefficient, that tax revenue had fallen to 4% of GDP. Exports accounted for only 2% of GDP, down from 28% in 1962. Private sector credit was also merely 2% of GNP.

There is some evidence that official data may exaggerate the extent of Ghana's economic decline. Entrepreneurial energies have been channelled into an "underground" economy and a parallel market. Nevertheless, the Ghanaian authorities now recognize that the government's role had become too pervasive and had undermined a critical asset, the spirit of enterprise of its people. Ghana has recently embarked on a program of
reforms to strengthen market mechanisms and to restore personal incentives.

In conclusion, the record of the seventeen countries covered in this study, as well as broader international experience, supports the view that mobilization of domestic savings and access by the private sector to credit are key elements in development. The record also shows that rich countries can make important contributions to Third World progress in two ways. First, they can assist governments in their crucial functions—strengthening the infrastructure, diffusing technology and know-how and, above all, creating a policy environment conducive to enterprise and initiative. Second, continued access to developed country markets is vital if developing countries are to climb from poverty largely by their own efforts. International cooperation in these forms should prove to be more than enlightened self-interest for all parties.

5. Provision of Agricultural Inputs and Growth of Agriculture

Finally, in this review of cross-country empirical studies which examine the impact of government and the private sector from different perspectives, attention is drawn to the work of Richard Vengroff and Ali Farah who focus their analysis on agriculture. The main question examined is the relationship between government involvement in the rural sector, particularly by the provision of inputs, and agricultural modernization and productivity. The authors use data on 39 Sub-Saharan African countries. The independent variables chosen fall into two categories. The first concern the supply of agricultural inputs: (i) fertilizer, (ii) seeds, (iii) chemicals, and (iv) farm equipment. For each country, each input is classified as being provided entirely by the private sector, or by government, or by a combination of both. For each of these farm inputs, a 1 is assigned for private, a 2 for private-public and a 3 for government distribution. These values are then totalled for each nation, the result being a scale ranging from 4, indicating agricultural inputs provided completely by the private sector, to 12 for those nations in which all four agricultural inputs are provided by the state.

The second independent factor, government commitment to agriculture, is measured by two variables: the percentage of (i) the central government's functional expenditures allocated to agriculture (1978) and (ii) the share of the increase in the central government's expenditure going to agriculture (1972-78). These provide a good indication of the relative importance of agriculture compared to other areas of government spending and also whether the share devoted to agriculture is increasing or decreasing.

Three types of dependent variables were taken: (i) the first measures the growth in agricultural production (food, non-food and total), food production per capita and growth in agriculture production per capita;

(ii) the second measures the adoption of modern agricultural inputs, notably fertilizer and consists of average fertilizer consumption, use per hectare of arable land and growth in fertilizer consumption; and (iii) the final set measures food self-reliance/dependency by total and per capita food aid imports, and food as a percentage share of merchandise imports and exports.

Vengroff's and Farah's findings are instructive. In many African states agricultural inputs tend to be provided by governments. Specifically, as many as 64 percent and 61 percent supply fertilizer and seed, respectively. In only four out of the 36 states on which data are available are either of these two inputs provided entirely by the private sector. Chemicals are provided by the government in just under half (47 percent) of the sample. The comparable figure for farm equipment is slightly lower (42 percent), with the number of countries relying entirely on the private sector (22 percent) being higher than for any of the other agricultural inputs.

When the authors examined the rank correlation between their overall scale as regards the source of agricultural inputs and the measures of productivity they found that the relationships were negative in all nine instances and significant in five. The growth in food production, both total and per capita, and in agricultural production are all strongly and negatively associated with government involvement in the provision of agricultural inputs. That is, the more the government is involved, the lower the productivity.

Turning to fertilizer utilization, as an indicator of the adoption of modern techniques, the authors found evidence that the supply and distribution of fertilizer are more efficiently handled by the private sector. The countries that relied on the private sector used more than ten times as much fertilizer per hectare of arable land as did those that used a system of mixed public-private distribution, and 20 times more than those relying on government distribution.

Vengroff and Farah looked next at the degree to which government commitment to agriculture is related to productivity. The relationship between increases in a government budgetary allocation for agriculture, the percentage of total government expenditures devoted to agriculture and the measures of agricultural productivity were all negative although only one out of the 18 coefficients was significant at the 0.05 percent level. Hence, it seems that additional government support does not necessarily have a positive impact on agricultural productivity.

Finally, the study revealed a strong positive relationship between government inputs and food-aid imports. That is, the more government inputs in agriculture the greater the dependence on foreign food aid. However, the authors advised caution in interpreting the findings. The heavy government involvement in agriculture may be a strategy adopted by certain nations to help overcome their shortages rather than a cause of their food dependency. Nevertheless, they concluded by suggesting that several inferences could be drawn from their data:
1. The utilization of government services to distribute agricultural inputs in Africa, and hence to stimulate increased productivity, seem to have failed. Much of the blame can probably be attributed to the inadequate management of these resources by the public sector, and to many of the pathologies associated with third-world bureaucracies. Problems ranging from inadequate resources to poorly trained extension agents have also contributed to this failure.

2. Political factors have also played a significant role. Resources which have consistently been siphoned off from government-controlled agricultural inputs and marketing systems have rarely been reinvested in agricultural development or returned to the producers as profits.

3. Not only has government management of agricultural inputs proved to be less adequate than either private or mixed management, but it is also less effective in promoting the adoption of modern techniques. This may be tied to the difficult environmental conditions experienced by farmers in many African countries where the private sector is not well developed.

4. Those nations relying on governmental systems for the distribution of agricultural inputs appear to be more rather than less dependent on foreign food aid than those that use either a mixed or a private format. The temptations for governments to rely on foreign donors at the expense of local food production are immense and work against the long-range interests of food self-sufficiency.

5. Finally, it seems that many African governments are somewhat remiss in exploring the possibilities of stimulating private sector suppliers of inputs as a more efficient means of promoting their agricultural development.

6. Conclusions from Empirical Studies

The most constructive interpretation of the findings of these studies is that policies matter and do work in Africa in the same way as elsewhere. African economies have performed better when markets have been allowed to function relatively freely. Entrepreneurs do exist in Africa and have responded well to appropriate incentives in some countries, but have been repressed or discouraged in others. This is not theory, or hypothesis, or ideology. Real life experience lies behind these dry statistics.

The findings do not imply, of course, that governments should abandon their important functions of building basic infrastructures, providing social services, ensuring adequate security and justice for their citizens and correcting market imperfections through laws and regulations. The evidence does suggest, however, that many African governments have (i) overextended their financial, managerial and administrative resources by trying to do too much, particularly through direct public investment and state ownership in economic sectors where private entrepreneurship would be forthcoming and be more effective; and (ii) created market rigidities and distortions and discouraged private resource mobilization by excessive intervention in areas where decisions and choices could be left to producers and consumers.
The broad lessons that may be drawn for future strategy are that African governments could accelerate progress towards their national economic and social goals by doing fewer things better themselves, while at the same time widening the scope for private enterprise by removing barriers and constraints to private initiative and fostering open, competitive markets.
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