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Sub-Saharan Africa Strategy
for Sustained Growth to
Breakthrough in the
21st Century

Achille Toto Same

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**Sub-Saharan Africa Strategy for Sustained Growth to
Breakthrough in the 21st Century**

Revisiting the development literature and paving the way ahead

Achille Toto Same

World Bank Institute
Washington, D.C.

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Sub-Saharan Africa Strategy for Sustained Growth to Breakthrough in the 21st Century

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Abstract

This paper provides an analytical framework, a nonconventional thought and economic policy to get Sub-Saharan Africa (SSA) on a sustained growth path to breakthrough in the 21st century. The paper argues that in the context of a double gap constraint $(S - I) \equiv (X - Z)$, as is the case for most SSA countries today, countries are trapped in the vicious cycle of underdevelopment and poverty, given SSA's current economic structure. Therefore, only a structural transformation will expand the production base as productivity is improved. Because the country wealth is generated from the country economic structure, other things being equal, substantial additional income can be derived only from a structural transformation. Malaysia's illustration demonstrates that there is hope, but also daunting challenges to overcome. It is critically important for the subcontinent to forcefully start the process of climbing the value-chain ladder and swiftly move into more manufacturing activities. This can be done in the early stage of its structural transformation by adopting and adapting existing technologies, while adjusting to the global demand and international trade, for sustained growth and poverty reduction. In addition, a development behavior-oriented leadership is vital to catalyze the process.

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1 Introduction and Executive Summary

After the optimism and euphoria following the independence of most countries in Sub-Saharan Africa (SSA), the continent was well on track and at the same level of development as almost all other developing regions. Many African countries were even richer than their Asian counterparts in the 1960s, and their strong natural resources bases augured well for future trade, growth, and development. For example, in 1965, incomes and exports per capita were higher in Ghana than in the Republic of Korea. Korea's exports per capita overtook Ghana's in 1972, and its income level surpassed Ghana's four years later (World Bank 2000).

Today, SSA is the poorest and least-developed region in the world, and it is getting poorer with time. About three-fourths of the countries in the region are classified in the low-income category, and more than three-fourths of heavily indebted poor countries (HIPC) countries are in SSA. Furthermore, among developing regions in the world, the subcontinent is the most dependent on official development assistance (ODA) and has the worst record on social indicators. Therefore, consideration is being given as to how the subcontinent could embark on sustained growth for poverty reduction and eventually derive a strategy for sustained growth to breakthrough in the 21st century.

This paper is not aimed at analyzing SSA's economic history and missed opportunities. Voluminous studies have done that, particularly at the World Bank (World Bank 2005a)¹. One more study with the same purpose may be even less relevant, because most of the pertinent issues have already been raised in that context. But this paper aims at providing a modest nonconventional thought and an economic policy to get the SSA on the sustained growth path to breakthrough in the 21st century.

Indeed, inappropriate policies, combined with a narrow export base for many SSA countries, have left many countries extremely vulnerable to external shocks and to the vagaries of weather. The failures of many countries throughout the 1970s and early 1980s to accommodate the adverse effects of negative external shocks have compounded the negative impact of these shocks. Hence, by the beginning of the 1980s, many countries realized the urgent need for economic policy reforms to address short-term balance-of-payments crises and medium-

¹ I would like to acknowledge the excellent recent publication by Benno Ndulu et al (2007): Challenges of African Growth. Opportunities, Constraints and Strategic Directions. This important study was not mentioned in my paper before, because my paper was already finalized in September 2006. Furthermore, I shared this paper with Benno Ndulu, for his comments and provided detailed comments on the earlier draft of Benno Ndulu et al study in September 2006. We both agreed then that, my paper and theirs shared some key themes and I was pleased that we independently reached to the same conclusions. We were both delighted and encouraged by the rising focus on the growth agenda as a central pillar for SSA breakthrough. However our distinctive analytical approach leading to the policy recommendations remains different as well as the core issue to tackle, we agree though on the overall objective. The main argumentation of my paper is as follows: there is a persistent double gap constraint in SSA for the last three decades, unless there is a structural transformation to fuel a sustained growth and break the vicious circle of underdevelopment and low income hence poverty, the gap cannot be resolved in a meaningful way other things being equal; and because the country wealth is generated from the structure of the economy as productivity is improved. The erratic growth observed in SSA from 1960-2001 speaks volume. Agriculture remains the mainstay of SSA economies, and per capita of the sector declined during 1970-2003. Furthermore, the overall share of exports from SSA, including South-Africa and Nigeria, is yet less than 2 percent of the global trade.

to long-term productivity improvement (Elbadawi, Ghura, and Uwujaren 1992, 7–8). In spite of such auspicious actions, the African continent still lags behind in the world economy.

The fundamental issue is as follows: SSA's balance-of-payments and budget² difficulties are largely the result of its structural intricacy in the sense that there is a persistent structural-economic constraint and supply-side constraint which are the bottlenecks preventing the region from generating stronger and sustained aggregate income. Thus, external and domestic imbalances can hardly be resolved in a meaningful way without *a structural transformation*.

The SSA economy is based, in general, on traditional exports, mainly agriculture. The level of demand and prices for traditional products can be strongly affected by cyclical changes in global economic activity. These induced demand changes have been an important cause of instability in commodity prices (along with industrial economies' agricultural subsidies)³ and revenues that had serious adverse impacts on development planning and industrialization; to the extent that good export performances have proven to be a major source⁴ of growth and foreign reserves—thus, development financing.

Basically, the development requires economic structural transformation. Transformation from a developing country to a developed economy can be defined by the set of structural changes required to sustain a continuing increase in income and social welfare. It includes diversification of production, changes in policies and institutions, and social transformation. Entrepreneurs will invest in new machinery to produce new products and adopt new organization forms. Farmers will adopt new farming methods and change their product mix. Consequently, the economy as a whole will produce and demand different goods and services.

The structural transformation concern has been systematically addressed in a series of studies. Beginning in the 1950s, Simon Kuznets established a number of empirical generalizations about long-term changes in economic growth (1966, 1971). He has further shown that the association between the international process and the level of income, found in the long-term experience of the industrialized countries, could also be observed in cross-country comparisons for a given period.

Following Kuznets (1966), Chenery (1982) measured the principal dimensions of this transformation by the change in the composition of aggregate demand, production, international trade, and the use of capital and labor as the level of a country's income rises.

Chenery and Syrquin (1975) have further demonstrated the structural transformation process by choosing a large set of processes that characterize modern economic growth and

² The government revenues are negligible and cannot be increased in a meaningful way, given that they are based on the country fiscal base (and therefore economic structure).

³ Industrial economies provide extremely high levels of support to their farmers. The Organization for Economic Co-operation and Development (OECD) has calculated that total transfers from consumers and taxpayers to farmers averaged about 30 percent of gross farm income in 2001, cost more than US\$300 billion (1.3 percent of GDP), and amounted to six times overseas development aid. Although agricultural support benefits some farmers in industrial countries, it can actually hurt others by increasing the prices they pay for inputs and by depressing world prices for those who receive relatively little support (IMF 2002, 81).

⁴ Along with investment and consumption.

extending the approach in an econometric study of more than 100 countries⁵ for 1950–70. Their processes centered on those that are most likely to be included in a minimal definition of structural transformation: accumulation of physical and human capital and shifts in the composition of demand, trade, output, and factors used—including socioeconomic aspects, such as urbanization, demographic transition, and changes in income distribution, which appeared to be correlated with the level of development.

Changes in structure and performance are interrelated, they imply, and lead to changes in supply-side constraint capacities (therefore reinforcing growth), and thus more resources for the government and the economy as a whole. Uses of these resources are influenced in various ways by government policies and constitute the core of the strategy of development.

Two factors are responsible for deterring the development of Sub-Saharan Africa: (a) persistent structural constraint, which impedes the sustained growth, and (b) lack of good leadership—more explicitly, lack of development behavior-oriented leadership and good governance. In fact, good leadership envisions development and endeavors, sound public finance management (PFM); hence a Public expenditure management (PEM) as a tool to attain its development vision, with efficiency and discipline in the best interest of the country.

This paper revisits the development literature on Africa and complements Jeffrey Sachs et al (2004) who argue in “Ending Africa’s Poverty Trap” that Africa’s extreme poverty leads to low national saving rates, which in turn lead to low or negative economic growth rates. Low domestic saving is not offset by the large inflows of private foreign capital, for example foreign direct investment, because Africa’s poor infrastructure and weak human capital discourage such inflows. With very low domestic saving and low rates of market-based foreign capital inflows, there is little in Africa’s current dynamics that promotes an escape from poverty. Something new is needed. The paper also complements Aart Kray and Claudio Raddatz (2005), which focuses mainly on assessing the effectiveness of Aid to help countries escape from poverty traps. Their paper calibrates simple aggregate growth models in which poverty traps can arise due to either low saving or low technology at low levels of development. When put to the task of explaining the persistence of low income in African countries, the models require either unreasonable values for key parameters, or else generate counterfactual predictions regarding the relations between key variables.

This paper takes a critical look at the current Sub-Saharan Africa (SSA) economy and provides a theoretical framework and groundwork to pave the way for country economists in the region to help them support the efficient implementation of the Africa Action Plan (AAP). The paper takes a fresh look at SSA’s economic structure and growth in the context of SSA countries today and argues that SSA countries are not generating sufficient aggregate income to catalyze the process of rapid capital accumulation, indispensable for poverty reduction due to the structure of their economy; consequently, a structural transformation is required to catalyze and fuel the sustained growth process: Because the country wealth is derived from the country economic structure as productivity is improved.

⁵ The results confirmed the strong association of economic structure with the level of development.

2 Sub-Saharan Africa Growth Assessment

Recent studies have confirmed the major importance of growth in the process of catching up with developed countries in general, and in poverty reduction in particular (Moser and Ichida 2001; Dollar and Kraay 2001a). Economists have always been interested in the factors that cause different countries to grow at different rates and achieve different levels of wealth (Rodrik 2004). In 1776, the founding father of economics, Adam Smith, in his fundamental book was wondering what determines the wealth of nations. It happens to be the continual and sustained increase of output; in other words, the real gross domestic product (GDP) growth rate.

Historical records show a broad range of outcomes in achieving sustained economic growth. Some countries have achieved high income, while many remain at lower levels. Recent economic studies⁶ have emphasized this fact in some countries, particularly in East Asia. They have achieved very rapid rates of growth and are catching up already with industrial countries, whereas others, specifically in SSA, have achieved little or no growth. Addressing these differences is an important theoretical and empirical challenge. Thus, it is necessary to address (a) the growth theory and development, and (b) SSA's growth and saving performance assessment from 1961 to 2001.

THE GROWTH THEORY AND DEVELOPMENT

Since late 1946, two main growth⁷ models (the Harrod-Domar and Robert Solow models) remain at the core of theoretical thinking and growth policy for developing countries. How far are these models consistent with SSA economic structure? Let us discuss their fundamental hypotheses.

William Easterly (1997) did an accurate assessment of the Harrod-Domar model. In 1946, Domar issued a paper on economic growth entitled "Capital Expansion, Rate of Growth, and Employment." The paper discussed the relationship between short-term recessions and investment in the United States. Domar assumed that production capacity was proportional to the capital stock. In other words, the GDP growth rate will be proportional to the share of investment spending in GDP.

The challenge of balancing aggregate demand and supply was Domar's⁸ concern. Investment in new machines had a dual character, which is desired purchases of goods (demand)

⁶ China has been a major success story since the late 1970s, experiencing a stupendous growth rate of 8.0 percent. India has doubled its growth rate since the early 1980s, pulling South Asia's growth rate up to 3.3 percent in 1980–2000 from 1.2 percent in 1960–1980. Latin America's growth rate collapsed in the "lost decade" of the 1980s and remains anemic despite some recovery in the 1990s. Africa's economic decline, which began in the second half of the 1970s, continued throughout the 1990s (Rodrik 2004).

⁷ Although endogenous growth is the core of a new growth policy, we will not be discussing its policy implication here; so far, it is still the subject of various controversies (Amable and Guellec 1992). The models of endogenous economic growth have not yet been distilled into a standard empirical work. The existing empirical work has failed to provide solid answers on the sources of variation in economic growth across countries. "The new models of growth have not adequately addressed the issues of structural transformation and disequilibria in factor markets which seem to be important parts of the development process and may make data analysis at an aggregate level less useful" (Renelt 1991)—discussed with William Easterly, Ross Levine, and Sergio Rebelo.

⁸ Roy Harrod had published a similar paper in 1939.

and capacity (supply). Domar's fixed ratio of production to machine became a central analytical tool for growth in developing countries.

"The depression following the World War II and the large number of underemployed rural people in developing countries had motivated Arthur Lewis⁹ to suggest a surplus labor model in which only machinery was a constraint" (Easterly 2001, 48–49). Therefore, building factories would absorb that labor without causing a decline in rural production.

Lewis (1954, 49) argued that "the central fact of economic development is a rapid capital accumulation." Lewis's finding still holds; the most impressive evidence is in East Asian countries, which are already catching up with industrialized countries. Rapid capital accumulation through structural transformation¹⁰ as a result of sustained growth remains the core element of the development process.

According to Domar's model, to have a high growth rate, you need to increase the investment rate as well; however, how to get investment high enough without a good level of national saving? Therefore, there was a financing gap. Given the current and persistent economic structural constraint, SSA as a whole is still facing the difficult dilemma of a financing gap, and consequently, unless substantive changes happen in the economic structure, the continent is in a poverty trap.

Hollis Chenery addressed that need of national saving in a systematic way in his notorious application of the Harrod-Domar financing gap model. Chenery and Strout (1966) started off in the usual way with a model in which aid will fill the temporary gap between investment ability and saving ability. They called their model "the two gaps model": the investment-saving gap and the trade gap. This model ensures the consistency between the balance of payments and the national accounts through the resource gap. The two gaps model can be summed up using the equation:

$$(S-I) \equiv (X-Z), \quad (2.1)$$

where S = domestic saving, X = exports, I = investment, Z = imports, and where the left side is the domestic saving gap and the right side is the trade gap. The purpose of the two gaps model is to estimate the levels of investment, import, and external finance needed to achieve a targeted real GDP growth rate. How can the gap then be filled?

This issue has been the subject of the analytical and philosophical basis for development programs of the past decades, formulated in the early 1960s. In outlined form, it asserted the following (Chenery and Carter 1973a):

- External resources can be used by underdeveloped countries as the basis of a significant acceleration of investment and growth.

⁹ Economists had many theories as to how the newly independent developing countries could grow and catch up to the industrial countries. We will not be reviewing all of these theories; rather, we will focus only on the Harrod-Domar model and its implementation throughout developing countries.

¹⁰ In the context of Sub-Saharan Africa.

- The maintenance of high growth rates requires substantial changes in the structure of production and trade.
- External capital can perform a critical role in both resource mobilization and structural transformation.
- The need for concessional aid declines once these structural changes are well under way.

In spite of the enormous flows of aid to Africa since the 1960s, the African continent is still lagging behind in the world economy. There has been a variety of criticisms of both the performance of countries receiving aid and the basic ideas on which aid programs have been conceived. Yet the ODA remains absolutely indispensable for the large majority of countries in SSA.

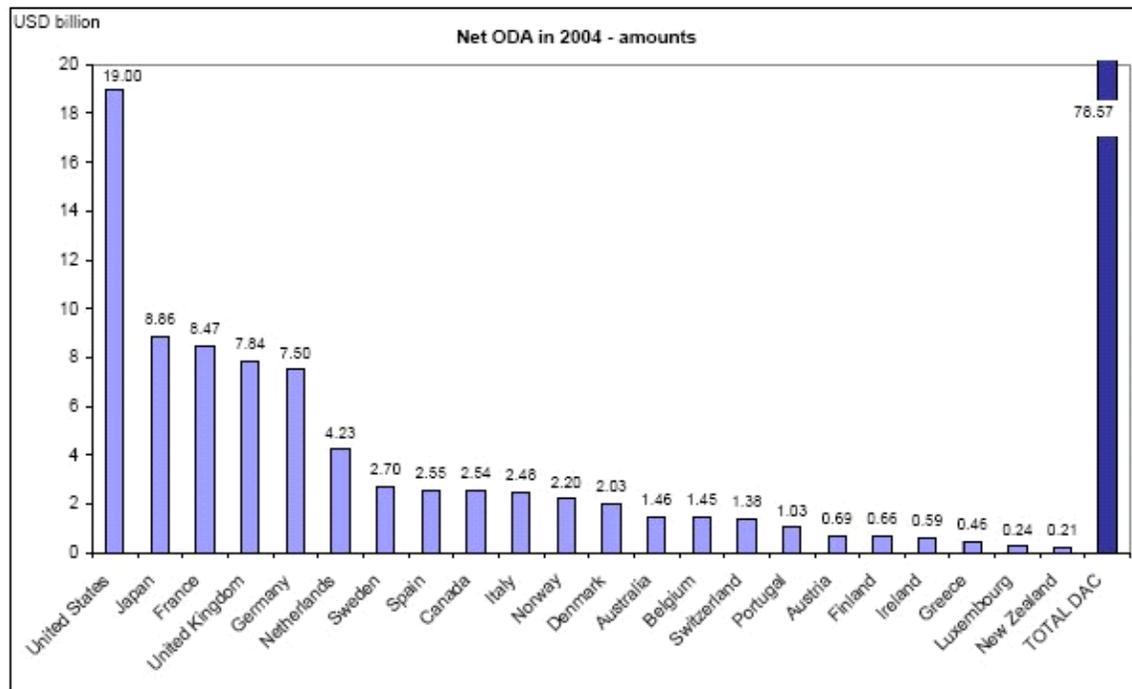
Recommendations made then by Hollis Chenery still square with SSA economic structure more than 40 years later. The diagnosis remains actual and consistent with SSA countries' economic structure. Structural transformation needs to be achieved, and the financing gap is still present. The structural transformation remains a necessary and fundamental condition of capital accumulation and, therefore, development takeoff.

The past decade was characterized by two major changes in the international environment: (a) the level of ODA on which the majority of the countries in the region have depended declined, and (b) the acceleration of economic globalization has been favorable to the development of capital markets, foreign direct investment (FDI), and private sector development. Meanwhile, Africa's economic growth was declining. There is a need for the continent to adjust, with the rest of the world, through structural transformations and improved productivity.

In the current globalized economy, it is widely accepted that the rate at which a country grows is substantially determined by three factors: (a) the country's ability to integrate the global economy through trade and investment; (b) its capacity to maintain sustainable government finances and a sound monetary policy; and (c) the country's ability to put in place an institutional environment in which contracts can be enforced and property rights can be established. This does not mean that the ODA is unnecessary for Africa; on the contrary, the subcontinent will still be in need of substantial levels of development assistance during the structural transformation process.

There is growing pressure for large increases of aid for Africa. In 2002, donors pledged at Monterrey, Mexico, to significantly increase aid levels to Africa. The Gleneagles Summit of the Group of Eight (G8) countries in 2005 renewed the commitment of the world's richest nations to support Africa's development and signaled the intention to move beyond the Monterrey pledges to additional development assistance (figure 2.1) and debt relief, amid aid effectiveness discussions. But it should be mentioned that the doubling of aid has to be carefully applied toward the structural transformation and the quest of sustained growth. This leads us to Solow's model of growth.

Figure 2.1 Net ODA in 2004



Source: OECD.¹¹

In the Solow¹² framework (Romer 1989), steady state growth depends on the exogenous technological progress. Without technological progress, output per capita does not grow and, economic policies cannot affect steady state growth. Using different words, only the technological changes could have an impact in the long run-growth rate. Policies can only affect the level of output or its growth rate when the economy is in transition from one state to another.

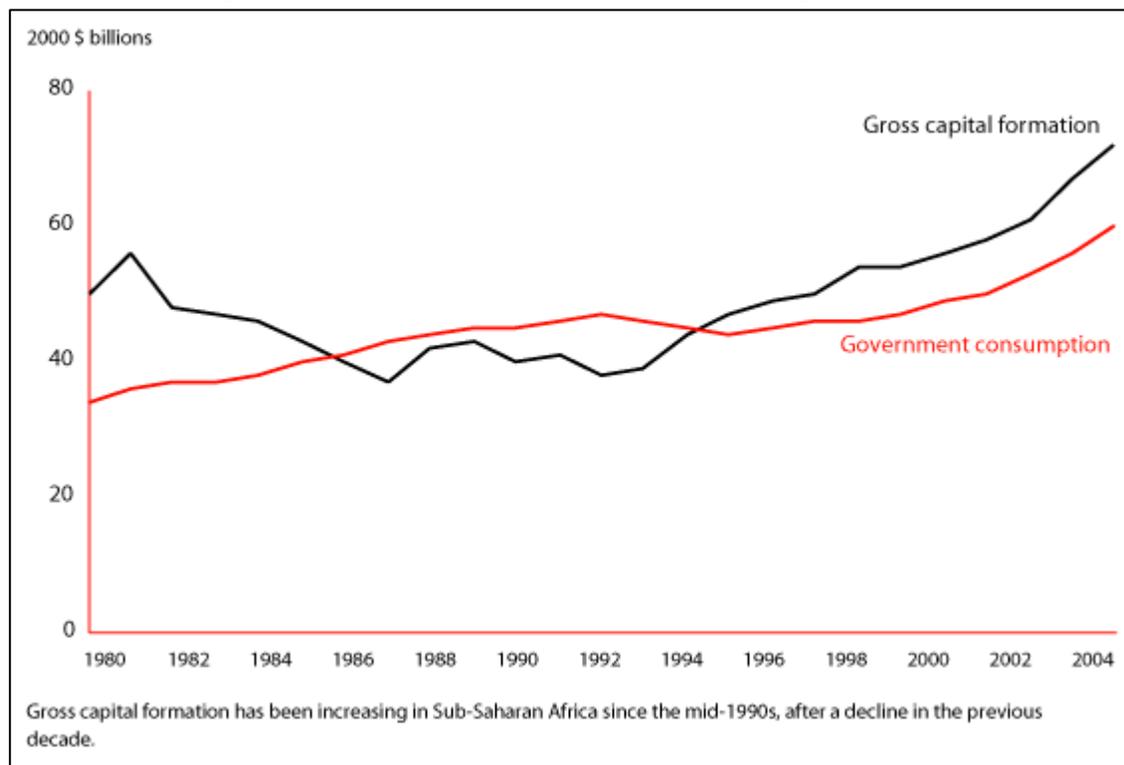
According to Easterly (2002, 54–55) regarding Solow’s growth theory, “increase in machinery per worker could not be a source of long-run growth, but it could be a source of growth in the transition period to the long-run path. An economy that started with very few machines—as is the case of most of SSA’s economies—would have a very high return for each additional machine. Because of these high returns, investment would temporarily bring high growth. Eventually, the economy will settle down to a comfortable existence at the growth rate of labor-saving technological progress.”

Solow estimated that technological change explained more than half of per capita output growth in the first half of the 1900s in the United States. World Bank (2005a) calculations indicate that it explained one-third of the increase in per capita income in East Asia up to the

¹¹ODA to developing countries increased to US\$78.6 billion in 2004, its highest level ever. Taking into account inflation and the fall in the U.S. dollar, this represents a 4.6 percent rise in real terms from 2003 to 2004 and follows a 4.3 percent increase from 2002 to 2003.

¹² The general properties of this model are well known. Solow’s fundamental hypothesis is that investment in machinery cannot be a source of growth in the long run; the only possible source of growth in the long run is technological change. Solow calculated in 1957 that technological change accounted for 78 percent of U.S. growth per worker over the first half of the 20th century.

Figure 2.2 Gross Capital Formation and Government Consumption in Sub-Saharan Africa



Source: World Development Indicators 2006.

early 1990s. Various other exercises reached a similar conclusion on the large role of productivity gains in growth. Figure 2.2 shows the indicators for SSA.

A United Nations Survey (UN 2006) recently confirmed that productivity growth in developed countries mainly relies on technological innovation, as is the case for the United States and the Organisation for Economic Co-operation and Development (OECD) countries. For developing countries, however, growth and development are much less about pushing the technology frontier and much more about changing the structure of production toward activities with higher levels of productivity. This kind of structural change can be achieved largely by adopting and adapting existing technologies, progressively substituting imports, entering into world markets for manufacturing goods and services, and rapid accumulation of physical and human capital.

In fact, SSA's economic structure is between a transition state for some countries and a poverty trap for others. Thus, a high level of investment is needed to break the structural and supply-side constraints. Hence, the SSA economy will settle down to a comfortable existence, through basic technology at the beginning and sustained growth. This is the natural transition to the next point: SSA growth and saving performance assessment from 1961 to 2001. The following section will underline how important national saving is in the case of SSA to sustain

**Table 2.1 Regional Composition of Net FDI Inflows to Developing Countries, 2002–2004
(US\$ billions)**

	2002	2003	2004
All developing countries	154.0	151.8	165.5
East Asia and Pacific	55.6	59.6	63.6
Latin America and Caribbean	45.7	36.5	42.4
East Europe and Central Asia	35.0	35.6	37.6
Sub-Saharan Africa	9.0	10.1	11.3
South Asia	4.8	5.2	6.3
Middle East and North Africa	3.8	4.8	4.1

Source: World Bank 2005b.

investment as a result of growth, given that the continent attracts very little FDI, not to mention portfolio¹³ investment (table 2.1).

SSA SAVING AND GROWTH PERFORMANCE FROM 1961 TO 2001

Investment is the centerpiece of growth. Ensuring an adequate level of savings¹⁴ should then remain a central policy concern, particularly for SSA economies, where foreign investors seem reluctant to invest. In general, perceived prosperity invites investment, actual investment supports growth, and savings flows are generated along the way as income rises. This virtuous circle cannot be achieved in SSA without structural transformation and good leadership.

We learned from traditional development theory since WWII that the long-run rate of economic growth is largely dependent on the saving rate. Saving determines investment, and they reinforce each other—technological change is implicitly taken as a function of investment—thus, the rate of capital accumulation, which is the basic determinant of long-run growth (Chakravarty 1993); Marglin and Schor (1990). The notion that raising the investment rate is a key parameter to increasing long-run growth has been at the heart of growth thinking since David Ricardo.

In addition, country empirical studies that include income growth as a determinant of saving report a significant positive effect of growth rates on the saving rate. This has been the case for Modigliani (1990) in a large study based on combined cross-country, time-series data, performed separately for 21 OECD countries and 85 developing economies. Jappelli and Pagano (1994) for OECD countries and Edwards (1994) for a sample of both OECD and least-developed country economies confirm this finding. The same result was found in a cross-country empirical work for developing economies (Collins 1991; Fry 1988; Giovannini 1983, 1985; Mason 1987, 1988; and Schmidt-Hebbel et al. 1992).

¹³ Out of US\$24.8 billion in portfolio investments in all developing countries in 2003, only US\$0.7 billion was directed to Sub-Saharan Africa (World Bank 2005b).

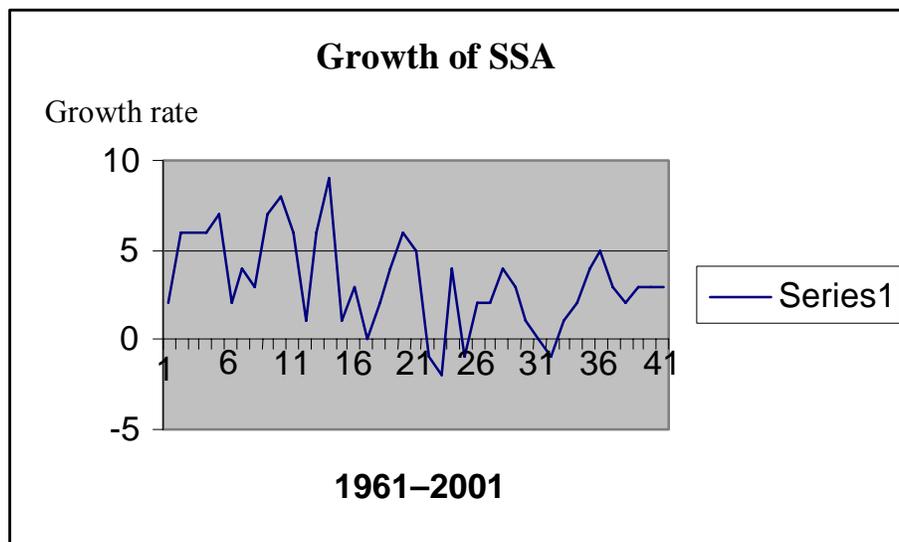
¹⁴ Regardless of whether saving is the main force driving growth, ensuring adequate levels of saving is fundamental to provide sufficient financing for investment and avoid balance-of-payments disequilibria and a heavy debt burden.

This is unlike the United States and other advanced countries, where domestic saving¹⁵ does not matter very much for investment. Because these countries are able to attract enormous flows of foreign direct investment and portfolio investment¹⁶ as such, they are capable of compensating for the weak level of national saving. This is not the case for SSA. The level of national saving needs to be increased to sustain investment in SSA and, although investment is not the sole engine of growth, notwithstanding, capital accumulation remains a centerpiece of that process. In general, it is difficult to find countries that have been able to grow at high and sustained rates for long periods without an important effort in capital formation or (using another word) sustained investment.

SSA countries experienced robust economic growth before the late 1970s and early 1980s, after which they collapsed (figure 2.3.) Inappropriate policies, together with lack of diversity in the export base for many SSA countries, have left many countries extremely vulnerable to external shocks and the vagaries of weather.¹⁷ The failures of many countries throughout the 1970s and early 1980s to accommodate the adverse effects of negative external shocks have compounded the negative impact of these shocks.

Hence, by the beginning of the 1980s, many countries realized the urgent need for economic policy reforms to address short-term, balance-of-payments crises and medium- to long-term productivity improvement. Important structural reforms have been implemented in many African economies in the 1990s (also see World Bank [2005a]): domestic price controls have been abolished—or at least liberalized—in several countries, some inefficient public monopolies have been dismantled, and a large number of state enterprises have been privatized.

Figure 2.3 Growth of SSA, 1961–2001



Sources: World Bank database and author's computation.

¹⁵ Although a certain level is required for basic macroeconomic fundamentals.

¹⁶ In aggregate, FDI and portfolio investment are nevertheless international saving.

¹⁷ The output in rural areas depends mostly on weather, given that (in general) agricultural production is not yet mechanized and modernized.

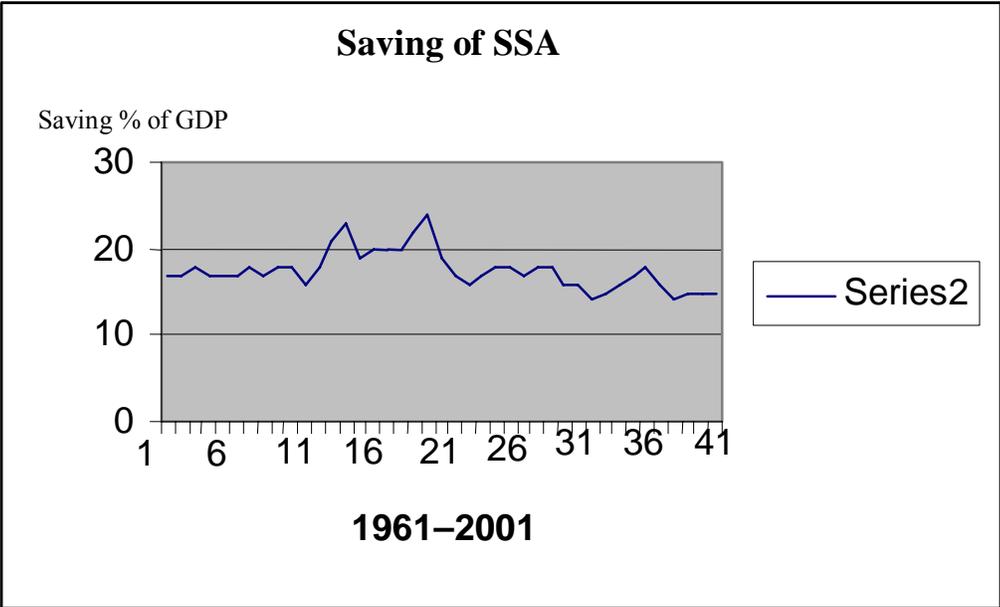
In the external sector, nontariff barriers have been eliminated in most SSA countries, and duties have been lowered in some; exchange rates have been freed and unified in most countries; and restrictions on payments and transfers for current international transactions have been eliminated in most countries. In addition, most countries have also eliminated direct controls on bank credit and have established market-determined interest rates.

In spite of these improvements, the economic situation of SSA remains worrisome. Per capita incomes are still low, poverty is deep and widespread, and external imbalances are very large in many countries. Most importantly, there has been no breakthrough to higher rates of capital formation, and the ratio of investment to GDP remains very low compared with that of other developing regions. Moreover, compared with other developing countries, SSA has not been very successful in attracting private foreign capital, although inflows have increased in recent years.

The continent remains the developing region still most in need of basic infrastructure and capital accumulation to sustain growth—hence, the development process; at the same time, both its domestic saving (figure 2.4) and investment are weaker compared with those of other developing regions (table 2.2). Without a structural transformation, the current situation cannot be addressed in a meaningful way, although foreign aid could play a significant role in the transition period, provided that there is a good economic policy and a development behavior-oriented leadership willing to implement the policy toward the structural transformation for sustained growth.

Legitimate concerns have emerged regarding the causal direction of the structural transformation and growth: in other words, whether the structural transformation sustains and fuels economic growth or the other way around, and whether the idea of a necessary structural

Figure 2.4 Saving of SSA, 1961–2001



Sources: World Bank database and author’s computation.

Table 2.2 Developing Countries: Saving and Investment Comparisons, 1990–2000

	1990–95	1995–2000
Investment (% of GDP)		
Sub-Saharan Africa	16.4	16.9
Latin America and Caribbean	20.2	20.5
East Asia and Pacific (excluding Japan)	27.2	28.7
Newly Indust. Economies of Asia	31.4	31.9
Private investment (% of GDP)		
Sub-Saharan Africa	11.6	12.3
Latin America and Caribbean	15.3	15.4
East Asia and Pacific (excluding Japan)	18.6	20.3
Newly Indust. Economies of Asia	24.4	25.2
Domestic saving (% of GDP)		
Sub-Saharan Africa	15.7	16.1
Latin America and Caribbean	18.2	18.2
East Asia and Pacific (excluding Japan)	30.9	33.2
Newly Indust. Economies of Asia	33.7	32.9

Source: IMF African Department.

transformation in SSA for a sustained growth can be tested or measured. Notwithstanding the lack of reliable data in many SSA countries to eventually test the causality, we can still observe that the structural transformation is yet to be undertaken in SSA, given the fact that the economic structure remains more or less in the traditional stage of production, with a preeminence of agriculture relative to the GDP.

The lack of reliable data to test the causal direction of the structural transformation and growth in SSA can hardly be a sufficient argument to invalidate or disregard the idea of the need for structural transformation in SSA if the continent is to achieve sustained growth to break through in the 21st century. Furthermore, the causality is well documented with robust empirical evidence in the economic development literature. The central concept of development that has emerged from comparative studies in the 1960s and 1970s is that structural transformation is required to sustain increased output and consumption.

The recent *United Nations World Economic and Social Survey* found that the SSA countries' economies show a lack of structural change. The countries in SSA included in the sample have not been able to break away from their low-growth development trap. This is also visible in the lack of structural change that took place in these economies. Agriculture remains the mainstay of these economies, and per capita of the sector declined during 1970–2003. In most countries, market-oriented structural adjustment policies, adopted in the 1980s and 1990s, failed to improve growth performance and, in fact, produced very little structural change.

The cornerstone underlining the analytical and philosophical basis of the aid and development programs in the early 1960s was the quest of structural transformation for sustained growth in developing countries, in general. It was asserted that external resources can be used by underdeveloped countries as a basis for a significant acceleration of investment and growth; however, the maintenance of a higher growth rate requires substantial changes in the structure of production and trade, and external capital can perform a critical role in both resource mobilization and structural transformation. Finally; the need for concessionary aid declines once these structural changes are well under way (Chenery and Carter [1973a]). The structural transformation was the main concern and the necessary condition to accelerate and to sustain growth.

As Chenery et al. (1974)¹⁸ point out; the field of development economics has been transformed by a rapid increase in empirical knowledge. Theories advanced in the 1950s have been tested, reformulated, or disregarded in the light of statistical analysis of their basic hypotheses. Out of this process has emerged a more comprehensive view of development as a set of interrelated changes in the structure of an economy.

The starting point for this reformulation can be found in Arthur Lewis's (1954) concept of development as a transition from traditional to modern forms of production and economic behavior. Over the period of transition, the supply of unskilled labor is elastic; profits, savings, and investment are rising; industries grow more rapidly than agriculture; and the pattern of international trade is gradually transformed, as the comparative advantage of a country changes.

In various forms, the concept of transformation from a traditional to a developed economy has provided the basic organizing principle for both empirical and theoretical analysis. Starting with the work of Kuznets and Lewis, the transition has been measured by the accumulation of physical and human capital and by the transformation of the structure of demand, production, trade, and employment, as the level of income rises. These phenomena were studied first in the historical experience of the advanced countries and from intercountry comparisons.¹⁹ Recently, it has become possible to extend these results by analyzing the experience of many developing countries over the past decades.

The dimensions of transition or structural transformation from a traditional to a developed economy can be defined in general terms as the set of changes in the economic structure required to sustain a continued increase in income and social welfare. This is what we repeatedly called structural transformation for a sustained growth. Because their requirements are dependent on social objectives, this implies the leadership aspect we have emphasized and possibilities for production and trade. They vary somewhat from country to country (Chenery and Taylor 1968; Chenery and Syrquin 1975; Diaz Alejandro 1976; and Syrquin and Chenery 1989a)²⁰.

¹⁸ Also see Chenery (1979).

¹⁹ Chenery et al. (idem 1979), Chap.1: *Economic Growth and Structural Change*.

²⁰ They provided more accurate measures of the dimensions of structural transformation during the process of development by estimating long-run patterns of development for 1950–83 (Syrquin and Chenery 1989a).

The central concept of development that has emerged from comparative studies is that *structural transformation* is required to sustain increased output and consumption. Kuznets' work demonstrates the usefulness of analyzing related shifts in resource allocation by measures such as the composition of demand, production, and employment. In addition, Syrquin and Chenery (1989b) brought to light some of the causes of the typical shifts in the composition of production and employment as incomes rise. They initially estimated the relation of a series of variables reflecting economic structure with the countries' income and population. (The available data set covers the period 1950–83 for 108 countries.)

As mentioned above, the variables selected reflect intersectoral demand, trade, production, factors used, and relative prices expressed as shares of GDP or, in the case of sectoral employment, as shares of the total labor force. Their results confirmed the strong association of economic structure with the level of income. They found that the changes in structure that accompany economic growth are a transition from a low-income agrarian economy to an industrial urban economy with substantially higher income. Technological changes and other exogenous factors influence the patterns of structural change. The main features of transformation identified by Kuznets as the core of modern economic growth, on the basis of long-term experience in advanced countries, have been clearly confirmed in the shorter time series of a large number of developing countries.

A similar approach was used in the UNIDO studies of industrial change (1979 and 1983), McCarthy, Taylor, Talati's work on trade patterns (1987), and the studies of 19th-century patterns of development by Crafts (1984) and by Adelman, Cynthia and Morris (1980, 1984). There is also a body of early studies on the related shifts and patterns conducted by Clark (1940), Kuznets (1957, 1966), Houthakker (1957), Temin (1967), and Chenery and Taylor (1968). These comparative studies of countries at different levels of income have revealed a number of common features of the process of development. One of the most pervasive and persistent is the transformation of the structure of production, from which the industrial sectors are typically growing more rapidly than the agriculture sector. Associated with the rise of industry are changes in the composition of demand, international trade, and the occupation of the labor force. These changes in the use of economic resources are influenced in various ways by government policies and constitute the core of a strategy of development (Chenery 1982). This also implies good governance in the case of SSA.

However, the issue is not to abandon the agriculture sector, but rather to improve the productivity (output per worker), given that the sector remains the main source of growth and income for the vast majority of SSA countries and rural poor; however, it is critically important for the continent to forcefully start the process of climbing the value-chain ladder and swiftly move into more manufacturing activities. This should be done by adopting and adapting existing technologies in the early stage of its structural transformation while adjusting to the global demand and international trade to obtain sustained growth and poverty reduction.

3 Development and Analytical Framework for Africa

The title of this section has been made as explicit as possible to suggest a nonconventional thought and an SSA development approach. It is obvious that, in general, economic theories and principles are universal; therefore, they could be applied without distinction across countries and regions. Nevertheless, the context of implementation does matter, and this means recognizing countries' specificities. We will therefore introduce the SSA macroeconomic structure to have a better understanding of SSA structural constraint, and suggest a proposed analytical framework.

INTRODUCING THE SUB-SAHARAN AFRICA MACROECONOMIC STRUCTURE

Agriculture²¹, one of Africa's most important sectors, is a very important sector for many SSA countries. African agriculture has two major components: food production and export commodities. Food production, including livestock, meat, and fisheries, is the livelihood for the majority of Africans; and export crops provide many African countries with their main source of foreign exchange and thus, their capacity to import for economic modernization purposes.

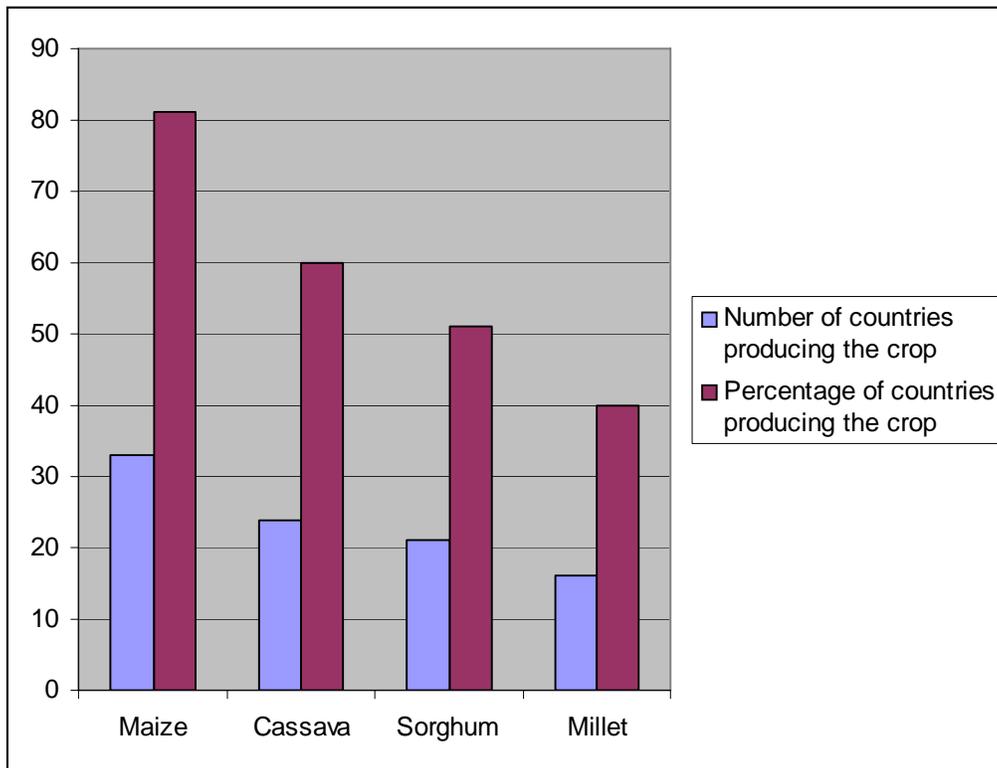
To capture the importance of SSA's economic structural constraint, it is important to draw a wide pattern of agricultural production. In addition, it is equally important to see whether the given agricultural production could be either expanded or become a source of foreign exchange earning. The same distinction will be kept as provided in the World Bank African Development Indicators: export production and food production.

Beginning in 1970 (World Bank 2000), Africa has suffered losses in its world market share for agricultural exports: 55 percentage points for groundnuts, 27 for cocoa, and 14 for coffee. But recent trends have been more favorable: the export shares for five of the region's nine main crops (bananas, cotton, sugar, tea, and tobacco) rose between 1980–89 and 1990–2000, although some increases were small. In addition, many countries in East and Southern Africa (Kenya, Tanzania, Zambia, and Zimbabwe), as well as in West Africa (Burkina Faso), have expanded into nontraditional export crops such as horticulture and floriculture, which is a very good start and needs to be improved to reach its potential significance.

Beyond the well-known productivity issue of SSA agricultural production and rural development, there is a need to assess the pattern of the continent's food production by major food crops to better understand the necessity of structural transformation and the challenge that the continent is facing to break the poverty trap. Figure 3.1 shows the pattern of food production of about 41 countries (excluding South Africa and Nigeria):

²¹ Agricultural land is becoming extensively degraded, and desertification is on the rise. In addition, water resources are being depleted and degraded, while deforestation continues.

Figure 3.1 Pattern of Food Production in SSA by Major Food Crops



Sources: World Bank African Development Indicators (2002) and author's estimations.

In the large majority of SSA countries, at least two of these food crops are among their major food production. It should also be noted that the nature and specificity of these food crops make their probable industrialization process less likely.²²

Cassava, sorghum, and millet are very specific SSA foods. Unfortunately, they cannot be exported²³ in sufficient quantity so as to become a new source of foreign exchange earnings. At the same time, agricultural exports that are supposed to provide many African countries with their main source of foreign exchange remain very weak. Nevertheless, recent trends (in some African countries) in export diversification toward nontraditional exports are encouraging (World Bank 2000).

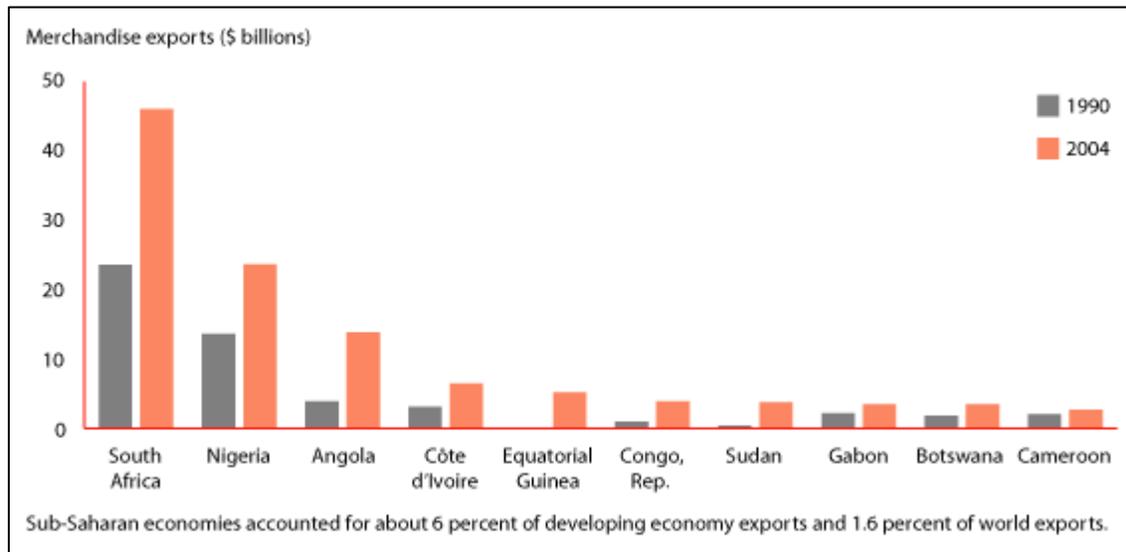
The necessity and urgency of structural transformation are even more crucial. The nine largest countries in SSA account for about 70 percent of the total value of agricultural exports in SSA (see figure 3.2), and the overall share of export from SSA, including South Africa and Nigeria, is still less than 2 percent of the global trade.

From 1990 to 1997, the value of SSA agricultural exports was an average of about US\$9 billion. To better understand this condition, this value should be compared with the direct and indirect support that industrial countries provide for their farmers. The OECD has calculated that

²² Except for maize, which could be exported.

²³ Except among SSA countries—they could be a source of growth.

Figure 3.2 Merchandise Export for Selected SSA Countries



Source: World Development Indicators 2006.

transfers from consumers and taxpayers to farmers averaged about 30 percent of gross farm income in 2001, totaling US\$300 billion (IMF 2002, 81), which is 1.3 percent of GDP).

Given that huge economic distortion, can SSA compete and launch its structural transformation? The evidence above suggests that SSA balance-of-payments difficulties are mainly the result of their patterns of domestic production and international trade. Consequently, this underlines the necessity of structural transformation to break the poverty trap.

The issue of the structure of SSA exports had been highlighted by Francis Ng and Alexander Yeats (2002). They observed that over the past decade, global trade in Africa's traditional exports grew at a rate of 1.9 percent, or about one-third the corresponding rate for all goods. The same trend had been observed for the 1980s. In addition, from 1990 to 1999, trade growth rates for more than 40 percent of SSA's traditional products were negative.

The second half of the past decade witnessed a major collapse in demand for many of these goods, with the most drastic decrease in 1995–99 in global exports of several traditional products. The reduction was more than 10 percent annually. This adverse international environment contributed to the erosion of SSA's global trade share, from 1.8 percent in 1990 to 1.5 percent in 2002 (IMF 2002, Statistical Appendix, 158). Thus, continued reliance on traditional exports will significantly extend SSA's marginalization in the world trade, and it will perpetuate the balance-of-payments difficulties and block the development process. Bloom and Sachs (1998) are even more radical. In their view, "SSA specialization in agriculture is not a viable development strategy." According to a World Bank report in 2000, if Africa had maintained the share of world trade it had in the late 1960s, its exports and income would have been some \$70 billion higher today.

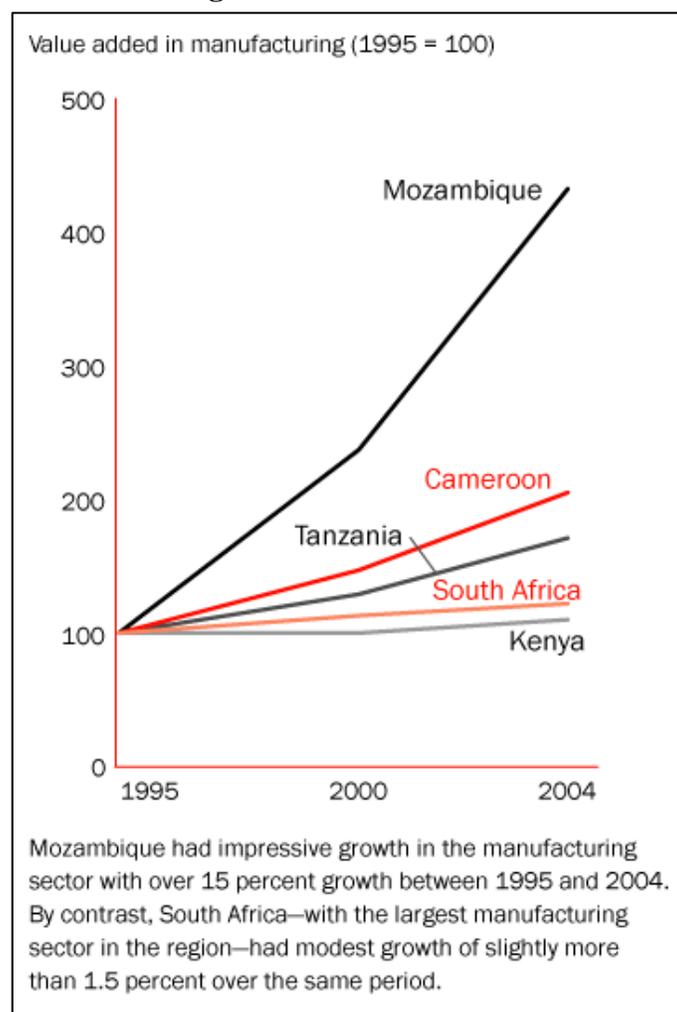
SSA's exports remain predominantly agricultural and natural resources based. Oil accounts for close to 50 percent of its export values (there are very few oil-exporting

countries),²⁴ and agriculture and other commodities account for about 36 percent. Manufacturing is only a meager 12 percent. This composition has not substantially changed during the 1990s (see figure 3.3).

The focus on structural transformation is the best process for poverty eradication because of the general wealth it could spread throughout the country. In that sense, it means transformation toward a modern economy with a set of structural and institutional changes aimed at sustaining a continuing increase in income and social welfare.

Chenery and Syrquin (1975) chose a large set of processes that characterize modern economic growth and extended the approach in an econometric study for more than 100

Figure 3.3 Manufacturing Growth Trends in Selected SSA Countries²⁵



Source: World Development Indicators 2006.

²⁴ Given that there are few oil-exporting countries in SSA, it suggests that the large majority of SSA is simply exporting agriculture and other commodities.

²⁵ The modest growth rate in South Africa is explained by the comfortable development that the sector already enjoyed compared with all other Sub-Saharan countries.

countries²⁶ for 1950–70. Their processes centered around those most likely to be included in a minimal definition of structural transformation: accumulation of physical and human capital and shifts in the composition of demand, trade, output, and factors used, including socioeconomic aspects such as urbanization, demographic transition, and changes in income distribution, which appeared to be correlated with the level of development.

Changes in structure and performance are interrelated and lead to changes in the supply-side constraint capacities to sustain further growth. This should result in more resources for the government and the economy as a whole. The use of these resources is influenced in various ways by government policies and constitutes the core of the strategy of development.

Looking back over the past 20 years of development, many developing countries have already witnessed significant structural shifts. The most noticeable is the decline of agriculture as a source of income and employment. In East Asia and the Pacific, agricultural value added has declined from a 28 percent share in 1982 to only 15 percent in 2002, while manufacturing, other industrial, and services have risen. China witnessed an impressive and rapid change in the sectoral composition of output. Between 1970 and 2003, the share of manufacturing and mining in overall output increased from 28 to 60 percent, whereas the share of agriculture dropped from 49 to 12 percent. A reform of rural institutions and aggressive investment policies induced infrastructure development in support of export industries and promoted this vast transformation of structural change and economic growth (Rada and Taylor 2006).

Structural transformation is a fundamental prior condition for the development process. The recent emergence of some Southeast Asian countries (China-Hong Kong; Indonesia; Korea; Malaysia; Singapore; and China-Taiwan) is relevant evidence; in Latin America, Chile has the most compelling achievement in recent Latin American economic history.

The SSA's economic structure reflected on macroeconomic aggregates and will further emphasize the necessity of structural transformation and sustained growth to drive the development process and poverty reduction (figure 3.4):

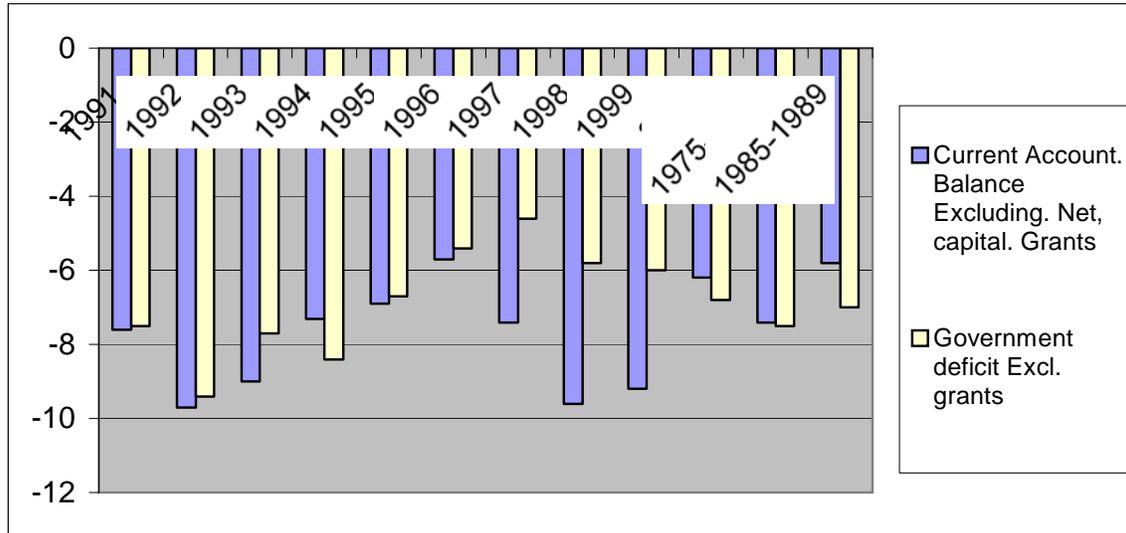
The continued balance-of-payments difficulties and sustained central government deficits for more than 20 years are additional evidence of the urgent necessity of structural transformation in SSA. It could be argued that excessive demand is the cause of the balance-of-payments difficulties; therefore, reductions in fiscal expenditures and money supply are expected to reduce the excess demand. This is absolutely consistent in theory.

In the case of SSA, the problem is structural; therefore, the continent is not in a position to further reduce expenditures that are already very low (in some cases, capital²⁷ expenditures are even meaningless or nonexistent—only the current budget is executed), compared with the gap that countries have to bridge and the development challenges they are facing. Furthermore, they

²⁶ The results confirmed the strong association of economic structure with the level of development.

²⁷ Capital expenditures depend exclusively (in some cases) on foreign aid for their execution.

Figure 3.4 Sub-Saharan Africa, excluding South Africa and Nigeria: Some Key Economic Indicators
Percentage of GDP



Source: World Bank database.

cannot expect to substantially increase²⁸ resources (excluding aid) under the current economic structure. What, then, could be the suitable analytical framework for Sub-Saharan Africa? Let me suggest a proposed analytical framework for Sub-Saharan Africa, bearing in mind growth as a prerequisite.

PROPOSED ANALYTICAL FRAMEWORK FOR SUB-SAHARAN AFRICA

This proposed analytical framework is based on the System of National Accounts (SNA), along with macroeconomic consistency, which obviously cannot stand alone. Consistency is simply the requirement that a budget constraint be observed for all participants in the economy. This, however, does not seem to have been the case in SSA, at least on the government side, for more than 20 years. Without structural transformation, the trend observed is likely to continue for many decades, unless SSA governments decide to further cut their expenditures and programmed investments. The consequence is likely to be systematic deep poverty and an underdevelopment trap cycle.

In principle, the budget constraint²⁹ appears at the economy wide level in the form of four macroeconomic identities. In addition, according to the national account identity, total income from domestic production equals total expenditure on domestic production (total consumption, total investment, and net exports). Therefore, total saving should be equal to total investment.

²⁸ Unless they all briskly become oil-producing countries or gold and diamond exporters. More seriously, structural transformation needs to be achieved to expect a substantial improvement in the government revenues and on the balance-of-payments side.

²⁹ The budget constraint is not specific to the SSA economy. The principle applies for all economies, including those of industrial countries. Nevertheless, it applies with a more pernicious aspect in SSA, because these countries are still in need of basic social services.

The fiscal identity equals the excess of public sector expenditure over income, with total public sector borrowing and money creation. The balance-of-payments identity similarly equals the excess of foreign exchange expenditure over earnings, with foreign borrowing and reserve changes. Finally, the monetary identity equals increase in the money supply, which corresponds to the increase in domestic credit and foreign reserves.

In this proposed framework, budget constraint and macroeconomic consistency are linked, and they determine government assets acquisition or investment from one accounting period to another. The domestic saving gap and the trade gap are derived from the formation of the gross domestic product, which means national income. Therefore, this highlights the need to expand the production base for more resources or the structural transformation necessary to achieve sustained growth for poverty reduction. Otherwise, the continent would be trapped in a blind alley, leading either to shrinking fiscal space, weakened fiscal revenues, and fewer resources available for poverty spending, or to severe macroeconomic imbalances and inflation if weakened government revenues are compensated through money creation, given that the continent attracts very few foreign direct investments and has weak export performances compared with those of other developing regions.

In principle, the national income accounting framework yields two important relationships that underpin macroeconomic analysis. These key relationships are derived from the identity linking GDP with spending. The first highlights the links between aggregate income and demand, and the external current account balance. The second focuses on the linkages between aggregate savings and investment, and the external current account balance.³⁰

The government assets acquisition or investment, in one accounting period to another in the macroeconomic consistency point of view, is obtained by the following identity:

$$I_g \equiv S_g + \Delta DC_g + \Delta NPB_g + \Delta NFB_g, \quad (3.1)$$

where I_g = government assets acquisition or investment, S_g = government saving, ΔDC_g = government borrowing from the domestic monetary system, ΔNPB_g = net lending to the government, and ΔNFB_g = government foreign borrowing.

Equation (3.1) expresses the saving, borrowing, and assets acquisition relationship. Government saving plus net borrowing is identical, in principle, to the assets acquired by the government during the accounting period.

It is assumed that the government investment or capital expenditure is being essentially used in the priority sectors such as education, health, economic, and social infrastructures (roads, energy, potable water, and so forth) and to some extent in the justice system. With good leadership and with just a very small budgetary effort, the justice system could be efficient and more effective.

Increasing the government assets acquisition or investment during one accounting period to another could be obtained through the following:

³⁰ These two important relationships are also the foundation of the IMF monetary model.

- Improvement in government resources, by increasing taxes³¹ or fiscal basis (mostly growth rate) and by improving tax collection
- Borrowing from the private sector, with the risk of crowding out the sector— private sector eviction (McKinnon 1973)
- Foreign debt³² or more development assistance in the form of donations or grants

The macroeconomic consistency of government assets acquisition could also be called “the government budget constraint.” Drawing from various analytical papers, the government budget constraint can be obtained by equating current government revenue (Yg) with current government expenditure ($CEXPg$) plus government saving (Sg) as indicated in (3.2)

$$Yg \equiv CEXPg + Sg \quad (3.2)$$

Substituting the expression in equation (3.1) for Sg gives

$$Yg \equiv CEXPg + Ig - (\Delta DCg + \Delta NPBg + \Delta NFBg) \quad (3.3)$$

and hence

$$Yg + (\Delta DCg + \Delta NPBg + \Delta NFBg) \equiv CEXPg + Ig. \quad (3.4)$$

The equation (3.4) states that government revenues plus borrowing is equal to total government expenditure, including investment. To address the budget constraint in a systematic manner, the equation (3.4) could be rewritten to unveil explicitly the source of government deficit financing in other words, the budget constraint as

$$(Yg - CEXPg - Ig) \equiv - (\Delta DCg + \Delta NPBg + \Delta NFBg), \quad (3.5)$$

where the left side of the equation expresses the overall budget deficit³³ and the right side is the source of financing the budget deficit. As emphasized in equation (3.5), the sources of deficit funding, bearing in mind macroeconomic consistency, are foreign borrowing and direct borrowing from the private sector or from the domestic financial system or capital market. The expression $(\Delta DCg + \Delta NPBg + \Delta NFBg)$ is also called “aggregate government borrowing” in the macroeconomic consistency framework.

The best way to improve or increase the government capacities to invest for poverty purposes and social development is to substantially improve its own revenues or its creditworthiness.³⁴ Once again for SSA, this hypothesis could not be realized without structural

³¹ However, this option has macroeconomic adverse impacts, except in some countries where the fiscal pressure is very low; nonetheless, the already very weak private sector in SSA needs to be protected from excessive fiscal pressure.

³² The impact on the balance of payments for heavily indebted poor countries is well known.

³³ As we are well aware, the government deficit in SSA is structural and has lasted for more than 20 years, whereas the level of poverty is worsening, particularly because of the lack of substantial investment in the priority sectors, a consequence of structural resources constraint and leadership deficiency.

³⁴ But we already know that is not the case: so far, almost all SSA countries are only IDA-eligible.

transformations and sustained growth (except in the new oil-producing countries. although it depends on the revenues that oil could generate compared with its development challenges).

We have addressed, in theory, the government budgetary constraint and laid out the source of funding within the context of macroeconomic consistency framework. The next step is to highlight, through an analytical consistency framework, the extent to which (both in theory and macroeconomic principles) the fiscal situation is the reflection of the macroeconomic structure. This attempt will be made through the accounting presentation of the gross domestic product (GDP) and will further emphasize the necessity of structural transformation³⁵ to fuel and sustain growth in SSA..

The GDP (or the value of goods and services that are currently produced by the domestic economy) can be derived from the basic macroeconomic relationship that states that the value of domestic production is equal to the value of incomes that are domestically generated. The national income identity can be then derived as

$$Ymp \equiv Cg + Cp + X - Z + Ig + Ip \quad (3.6)$$

or

$$Ymp \equiv C + I + X - Z. \quad (3.7)$$

Equation (3.7) can be rewritten as

$$Ymp + Z - X \equiv C + I. \quad (3.8)$$

The left side of equation (3.8) is the total availability of goods and services for the domestic economy; it is given by the GDP at market prices (Ymp) plus imports (Z) less exports (X). The right side is the domestic demand or domestic absorption; it is equal as stated to consumption (C) plus investment (I). Equation (3.8) can also be rewritten (thus revealing two of the guises of a trade deficit) as

$$Ymp - (C+I) \equiv (X - Z) \quad (3.9)$$

or

$$(Ymp - C) - I \equiv (X - Z), \quad (3.10)$$

where $(Ymp - C)$ is domestic saving (S), $(C + I)$ is domestic absorption (A), and $(X - Z)$ is the trade gap. Thus, a trade gap reveals itself in the forms of an excess of domestic absorption over production and of domestic investment over savings. Equation (3.9) also shows that if the GDP and exports are fixed in any accounting period, an increase or reduction in absorption will come through an increase or reduction in imports. These implications can obviously be seen from equation (3.10). This is also the core principle of Jacques Polak's³⁶ model, well known as the

³⁵ This section clearly underlines the analytical framework necessary to support the necessity of a structural transformation to fuel a sustained growth process in the case of SSA. Indeed, the double gap concept illustrates to the perfection, why the structural transformation is needed in SSA, if the continent is to break the vicious circle of underdevelopment and poverty and given the current SSA's economic structure.

³⁶ Jacques Polak was Director of the IMF's Research Department from 1958 to 1979. He is considered the founding father of the IMF monetary model.

“IMF monetary model,” and is the rationale for the IMF balance-of-payments assistance and structural adjustment credit. The model that IMF introduced in the 1950s is still very much alive today. The IMF Stand-By Arrangement and other financial support continue to be designed around the monetary target, serving as performance criteria or as benchmarks (Polak 1997):

$$Ymp - A \equiv (X - Z), \quad (3.11)$$

Equation (3.11) also says that the composition of *Ymp* or the *GDP* really matters to efficiently bridge the trade gap. In addition, to increase the domestic saving rate you need to substantially increase the domestic production or national income. In theory it could also be obtained through a significant contraction of domestic absorption other things being equal.

And equation (3.10) is the equivalent of

$$(S - I) \equiv (X - Z), \quad (3.12)$$

where the left side is the domestic saving gap and the right side is the trade gap, reflects the macroeconomic consistency framework’s “theorem” and, implicitly, the SSA’s underdevelopment trap, given the macroeconomic accounting principles and the current SSA economic structure. The³⁷ country’s wealth is generated from the country’s economic structure; other things being equal, substantial additional income can come from only structural transformation in the context of SSA or double gap constraint $(S - I) \equiv (X - Z)$. Only the structural transformation will expand the production base as productivity is improved.

Reduction in domestic absorption can generate a reduction in imports, and thus could resolve the trade gap $(X - Z)$, relieving the balance-of-payments difficulties. However, this cannot generate additional GDP growth rate, which is absolutely fundamental for any distribution policy, poverty reduction, and development process; on the contrary, reduction in domestic absorption could lead to economic recession or a contraction (slowdown) of the real GDP growth rate, and could also lead to poor fiscal performance.

What is needed in SSA is a structural transformation for sustained growth that is necessary to increase export performance and generate more resources in a sustained period to initiate a development takeoff. A sustained growth widens the fiscal space and provides the government with an increase margin to maneuver for poverty reduction without generating an excessive debt burden. The sound and sustainable way to resolve the domestic saving gap $(S - I)$ in a dynamic manner, while being mindful of the development process and poverty reduction as

³⁷ This footnote has been added in response to a last minute feedback which asserts that: “this Section proposes an analytical framework to foster structural transformation of SSA economies. Although the paper does not specifically discuss the implementation of such a framework in the case of SSA countries, it provides some illustrative information through the example of Malaysia leaving the reader with the burden of connecting the two sides (Malaysia/SSA)”. For this matter this section of the paper demonstrates in theory that the country wealth is generated from the country’s economic structure, therefore there is a need to expand the production base through the structural transformation in the case of SSA in addition; the composition of GDP matters to efficiently bridge the trade gap. Malaysia’s illustration is then used to support my theory. I further acknowledged in this section that Malaysia’s economic structure before the transformation was similar in many ways to that of most SSA countries today, hence explicitly connecting Malaysia and SSA.

the ultimate goals, is to substantially increase the GDP,³⁸ generate a sustained and high growth rate that embodies the structural transformation process, and consequently a sustainable fiscal space and base (figure 3.5). The stronger the growth rate, the more the fiscal space will improve.

According to Domar’s model, an increasing investment rate will also result in a high growth rate. But how does SSA get high investment without good levels of national saving, particularly when the subcontinent barely attracts foreign investment? Hollis Chenery addressed the need for national saving in his notorious application of the Harrod-Domar financing gap model. Chenery and Strout (1966) started off in the usual way, with a model in which aid will fill the temporary gap between investment ability and saving ability. But can ODA still be the in-between solution for SSA as a bridge toward its indispensable structural transformation?

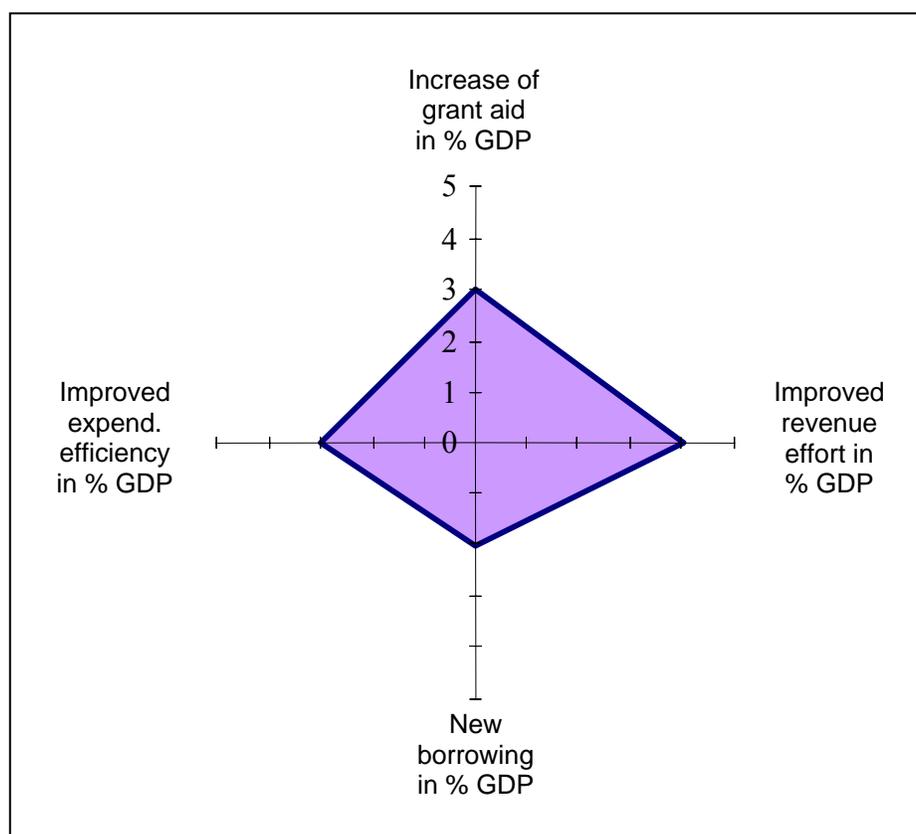


Figure 3.5 Fiscal Space

Source: World Bank, May 2006.

It appears that Malaysia successfully managed to break the vicious cycle of the domestic saving gap and the trade gap through its structural transformation. It is also important to mention that Malaysia’s economic structure before the transformation was similar in many ways to that of most SSA countries today: therefore, SSA countries could learn from the Malaysian model. This leads us to the Malaysia’s illustration.

³⁸ Or to attract more foreign direct investments.

MALAYSIA'S ILLUSTRATION

Mounting internal political and communal tensions led to the separation of Singapore from Malaysia on August 9, 1965, and the proclamation of Singapore as an independent country.³⁹ However, Malaysia, a multiracial country like many SSA countries, managed to drastically reduce poverty while achieving rapid economic growth. What transpired in Malaysia during 1970–2000 was an excellent illustration, underscoring the fact that a developing country with good leadership and development vision can achieve structural transformation despite enormous challenges.

Malaysia formulated a range of policies and plans to guide the management of national development during 1970–2000 comprising the New Economic Policy (NEP), 1970–90, and the National Development Policy (NDP), 1991–2000. The complement of these policies was Vision 2020, which was formulated in 1991 and projected a vision of Malaysia three decades ahead. The two core national policies were based on a philosophy of growth with equitable distribution. The policies saw national unity as the goal of development and followed a two-pronged strategy to achieve it: the eradication of poverty and the restructuring of the society, which were conducted within the context of rapid and sustained economic growth.

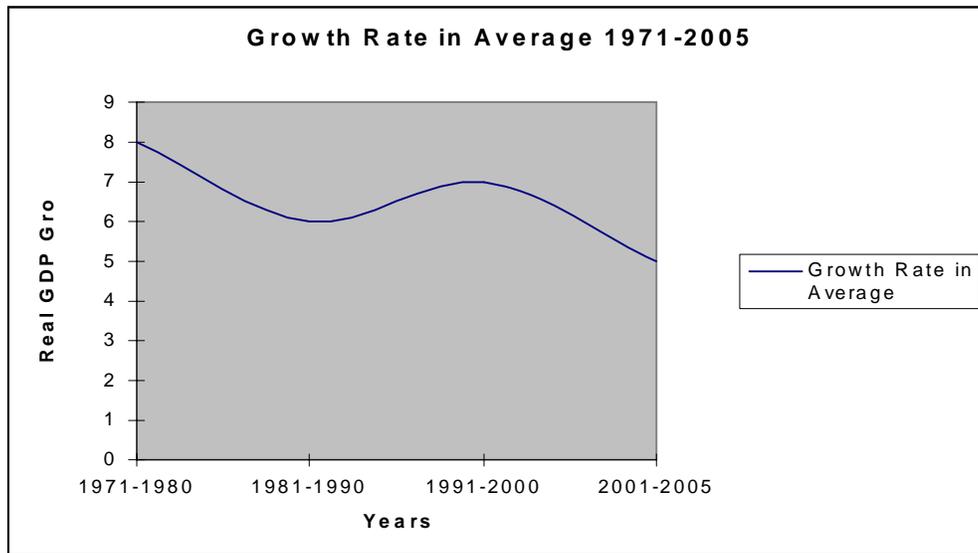
The institutional framework and work procedures for formulating development policies and plans were organized to produce (a) relevant, pragmatic, and politically acceptable broad national development policies; (b) more detailed socioeconomic development plans; (c) specific policies or plans for the development of important sectors of the economy, or for dealing with urgent and serious national issues; and (d) timely decisions on critical issues arising from the implementation of development policies and plans. The framework was broad in scope, encompassing all major socioeconomic groups, and its procedures were well detailed to promote discipline and systematic actions among participants in the process.

Malaysia experienced rapid and almost continuous year-to-year economic growth (figure 3.6) during the NEP and NDP periods, and achieved greater income by the end of each period. At the same time, there was a large reduction in the incidence of poverty and marked progress in meeting targets concerning the restructuring of the society's strategy. Malaysia's economic growth during the NEP and NDP periods was associated with many factors. Among the most noticeable is the supply side, through increased productivity and diversification of sources of income, in addition to the enormous flows of foreign direct investment (FDI) into Malaysia, particularly in the 1980s and 1990s.

³⁹ Preliminary Memorandum on Malaysia's Economic Position and Development Problems, September 1965, World Bank.

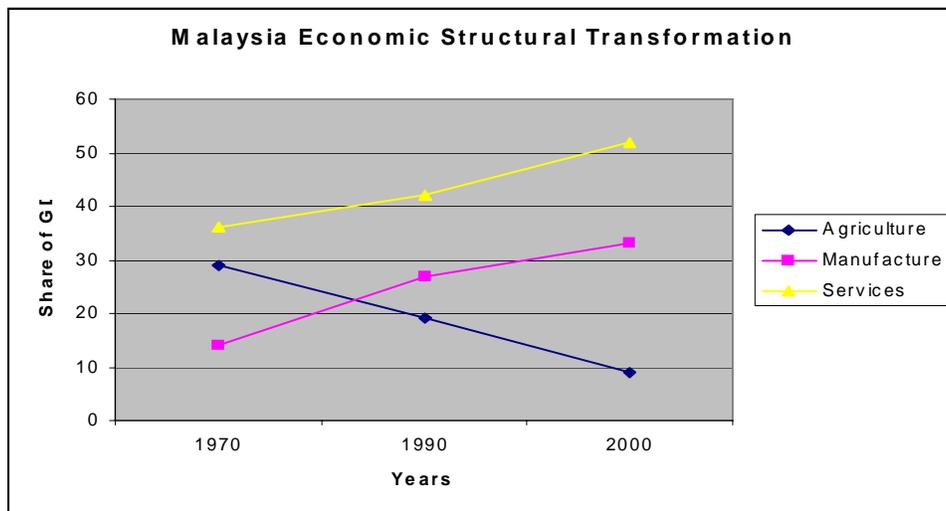
The principal characteristic of Malaysia's sustained economic growth was the transformation of the supply side, which makes this illustration particularly appealing for SSA. The sustained growth was associated with a structural transformation of the economy from a raw

Figure 3.6 Growth Rate in Average 1971–2005



Source: Malaysia's Economic and Planning Unit, May 2006.

Figure 3.7 Malaysia's Economic Structural Transformation



Source: Malaysia's Economic and Planning Unit, May 2006.

material production⁴⁰ to a manufacturing-based economy, in both cases geared to export markets. In 1970, the share from the agriculture sector of GDP was 29.0 percent. This made it the second-biggest sector after the broad-ranging services sector (36.2 percent). The share of the manufacturing sector was then 13.9 percent. By 1990, the respective shares of the three sectors

⁴⁰ Government of Malaysia, the Second Outline Perspective Plan, p. 41.

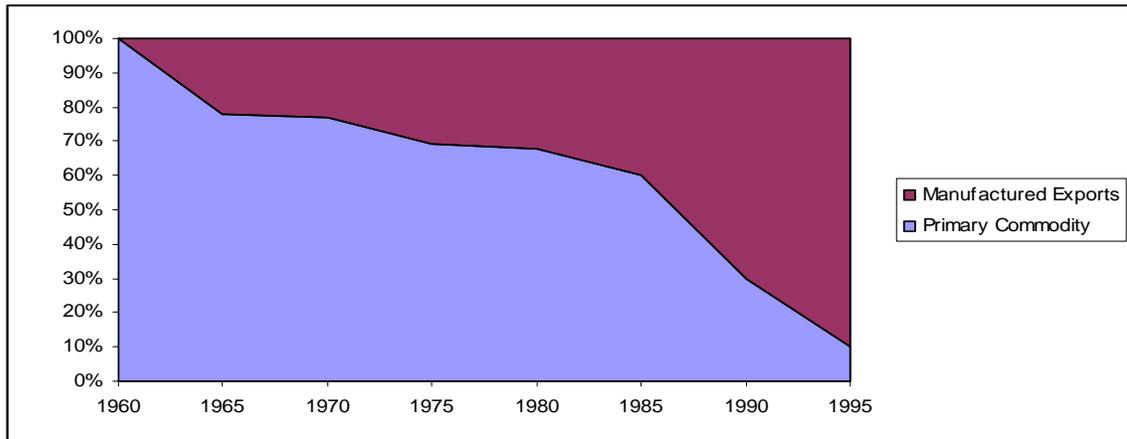
had been transformed to 18.7 percent agriculture, 42.3 percent services, and 27.0 percent manufacturing.⁴¹ In fact, the manufacturing sector had grown bigger than the agriculture sector. The transformation was further strengthened during the NDP period, and by 2000 the agriculture share had shrunk to 8.7 percent of GDP, while services expanded to 52.4 percent, and manufacturing reaffirmed its position with a bigger share of 33.4 percent (figure 3.7).

In the agriculture sector, rubber declined in importance, whereas palm oil, forestry products, and cocoa gained in importance in the NEP period. Palm oil and forestry products continued to be the priority subsector in the NDP period, but increasing food products gained importance as a strategy of limiting Malaysia's huge food import bill. Similarly, in the mining sector, there was a shift from tin, bauxite, and iron to petroleum and gas, beginning in the NEP years. The manufacturing sector shifted from import substitution industries to a mix of export-oriented and import-substitution industries. There was also a gradual, but noticeable change from labor-intensive to capital-intensive production methods, particularly in the electrical and electronics subsectors. Another shift began in the 1980s with the introduction of heavy industries, including the production of a national car, methanol, sponge iron, and pulp and paper (Malaysia 2004, 28). In sum, the most critical feature on the supply side of Malaysian economic growth was the transformation of the structure of the economy (figure 3.8), among and within sectors that diversified, modernized, and strengthened the economy.

The Malaysian development challenges, policy responses, and achievements were in many ways unique. For this reason, attempts to replicate the model fully in SSA may not produce

⁴¹ Government of Malaysia (idem), the Second Outline Perspective Plan, p. 49.

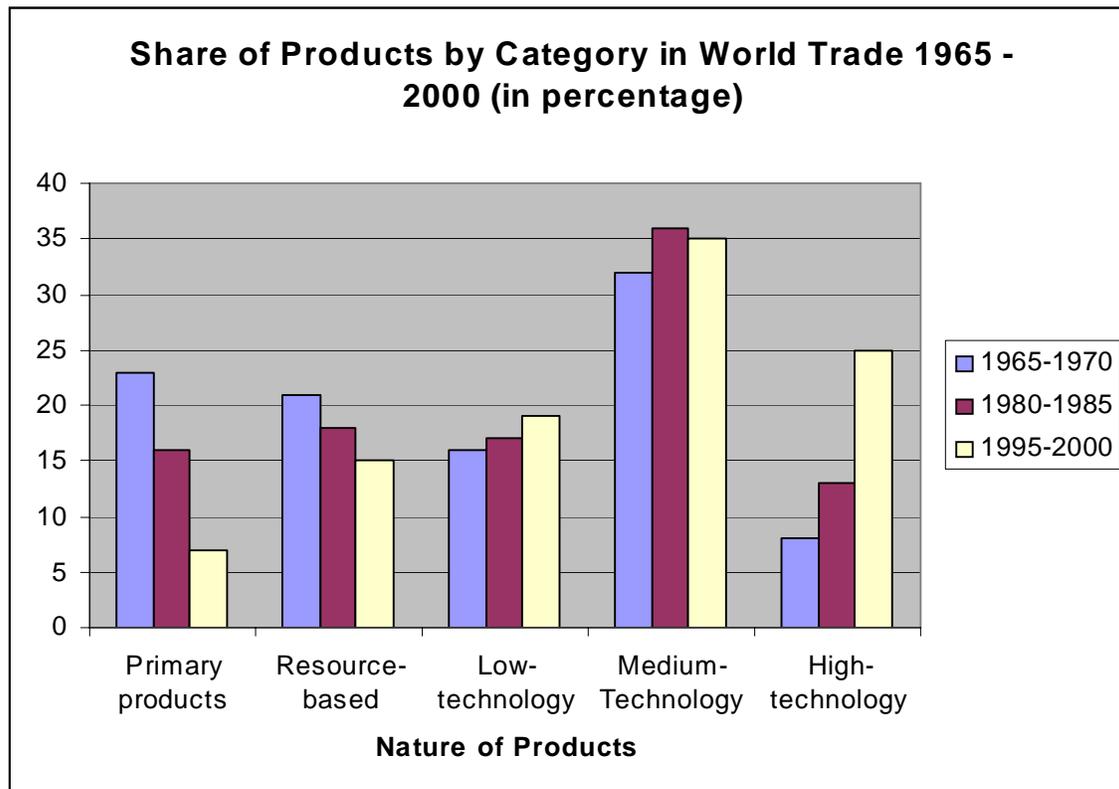
Figure 3.8 Malaysia's Share of Primary Commodity and Manufactured Exports



Source: IMF, May 2006.

the same results; nevertheless, generic lessons can possibly be adopted or adapted from the Malaysian experience. Indeed, lessons learned from the Malaysia model could also apply for a SSA strategy to breakthrough in the 21st century, particularly because many strong SSA countries are facing the same challenges as Malaysia in the 1970s.

Figure 3.9 Share of Products by Category in World Trade, 1965–2000



Source: UN/DESA, based on Freenstra et al. (2005)

4 Strategy for Africa to Breakthrough in the 21st Century

The main policy challenge that SSA countries are currently facing is a fight for the transformation of their economic structure, in other words the structural transformation aimed at improving their living standard in a meaningful way by increasing their level of income. The structural transformation process will fuel a sustained growth, combined with good governance and strong leadership, SSA will eventually breakthrough in the 21st century.

Indeed, in a series of studies beginning in the 1950s, Simon Kuznets (1966, 1971) established a number of empirical generalizations about long-term changes in economic growth. Kuznets has also shown that the association between the international processes and the level of income, in the long-term experience of industrialized countries, could also be observed in cross-country comparisons for a given period.

Following Kuznets (1966), Chenery measured the principal dimensions of this transformation by the change in the composition of aggregate demand, production, international trade, the use of capital, and labor as the level of income of a country rises.

Chenery and Syrquin (1975) chose a large set of processes that characterize modern economic growth and extended the approach in an econometric study for more than 100 countries for 1950–70. Their processes centered around those most likely to be included in a minimal definition of structural transformation: accumulation of physical and human capital and shifts in the composition of demand, trade, output, and factors used, including socioeconomic aspects such as urbanization, demographic transition, and changes in income distribution, which appeared to be correlated with the level of development.

Changes in structure and performance are interrelated as illustrated through Malaysia. This implies changes in supply-side constraint capacity so as to sustain further growth and, consequently, more resources for the governments. Indeed, a sustained growth would increase the fiscal space and the economy as a whole. Uses of these resources are influenced in various ways by government policies and constitute the core of the strategy of development. Therefore, governance and development behavior-oriented leadership are paramount.

In various forms the concept of transformation from a traditional to a developed economy has provided the basic organizing principle for both empirical and theoretical analysis. Starting with the work of Kuznets and Lewis, the transition has been measured by the accumulation of physical and human capital and by the transformation of the structure of demand, production, trade and employment, as the level of income rises. These phenomena were studied first in the historical experience of the advanced countries and from inter-country comparisons⁴². Recently, it has become possible to extend these results by analyzing the experience of many developing countries over the past decades.

⁴² Economic Growth and Structural Change – Chenery et al (idem 1979)

The central concept of development that has emerged from comparative studies is: the *Structural Transformation* is required to sustain increased output and consumption. Kuznets' work demonstrates the usefulness of analyzing related shifts in resource allocation by measures such as the composition of demand, production and in employment. In addition, Moshe Syrquin and Hollis Chenery in "The Three Decades of industrialization" issued in 1989, brought to light some of the causes of the typical shifts in the composition of production and employment as incomes rise. They initially estimated the relation of a series of variables reflecting economic structure with the countries' income and population. The available data set covers the period 1950-83 for 108 countries. Their results confirmed the strong association of economic structure with the level of income. They found that the changes in structure that accompany modern economic growth are a transition from a low-income agrarian economy to an industrial urban economy with substantial higher income. Technological changes and other exogenous factors influence the patterns of structural change. The main features of transformation identified by Kuznets as the core of modern economic growth, on the basis of long-term experience in advanced countries, has been clearly confirmed in the shorter time series of a large number of developing countries.

It is a fact that SSA is yet to embark on the structural transformation process and a recent *United Nations World Economic and Social Survey* found that the SSA countries' economies show a lack of structural change. The countries in SSA included in the sample have not been able to break away from their low-growth development trap. This is also visible in the lack of structural change that took place in these economies. Agriculture remains the mainstay of these economies, and per capita of the sector declined during 1970–2003. It is then critical for the continent to undertake the process of structural transformation to break the vicious circle of underdevelopment and poverty.

However, can SSA be considered as one country and as such, needing a unique strategy without any distinction although the structural transformation is needed for all SSA countries? It is important to make a categorization proposal and subsequently a proposed strategy per category of countries given that the strategy to achieve the structural transformation for sustained growth will depend on existing country potential and specificities. SSA still lags behind in the world economy, but within the continent, the levels of development and economic perspectives across SSA countries are often tremendously different.

PROPOSED CATEGORIZATION OF SUB-SAHARAN AFRICA COUNTRIES

The relationship between the transfer of foreign technology and economic growth in developing countries has long been studied by development practitioners and scholars. Chenery and Bruno (1962), McKinnon (1964), Bacha (1984), and Taylor (1990, 1993) focused on foreign exchange resources as the most important constraint on economic growth in developing countries. Their argument is based on the idea that most developing countries, because they cannot produce the needed technology-embodied capital goods domestically, must rely on imported capital goods in acquiring advanced technology; imported capital goods and intermediate goods are indispensable inputs. And if there is not sufficient foreign exchange to finance the desired technology-embodied foreign capital goods and intermediate goods, the economy cannot operate properly and achieve high growth.

Bochove (1982) argues that many imports are indispensable inputs in developing economies; therefore, imports should be treated explicitly as a factor of production in long-run growth models. Hence, the capacity to export, as a means to generate more foreign exchange resources, so as to finance the desired technology-embodied capital goods and to acquire advanced technology⁴³ from abroad, is fundamental for the structural transformation.

There is strong evidence that industrial productivity in Tanzania, for example, was hampered by the weak capacity to export (Ndulu 1986; Devarajan, Easterly, and Pack 1999). At Tanzania's independence, more than 80 percent of the manufactured goods consumed in Tanzania were imported, and manufacturing accounted for only 4 percent of GDP. A succession of government plans placed heavy emphasis on import-substituting industrial investments for basic consumer goods, construction, and related capital goods. Between 1965 and 1980, real investment in manufacturing grew by 21 percent a year. And in 1986–90, investment rose to the remarkable level of more than 100 percent of manufacturing value added. Despite this massive expansion, output per worker fell as production rose slowly and capacity use collapsed. The most important factor appears to have been a critical shortage of imported inputs and spare parts following the balance-of-payments crisis after 1974. Tanzania's industrial drive failed because investment could not generate enough manufactured exports to fund continuing imports of the materials needed to sustain production.

Tanzania's shortfall demonstrates that for economic modernization and efficiency, SSA may ideally first need to bridge the technology gap, even to the minimum standard, for better productivity and to increase exports performance so as to break the vicious cycle of supply-side constraint. This backdrop meant to emphasize the critical importance of good exports performance to fuel sound development financing as illustrated by Malaysia, which has been able to generate enough manufactured exports to fund continuing imports of the materials needed to sustain production. This backdrop provides the theoretical rationale for the categorization of SSA countries.

SSA countries have been subdivided into three categories: Group I, based on their capacity to export; Group II, oil-producing countries, if the value of oil is more than 40 percent of their overall exports; and Group III, conflict and postconflict countries. Within each group, nevertheless, it is possible to extract some subgroups, depending on their economic perspectives and the structure of their economies.

Capacity to Export: Group I

Under this category of countries, there are two subdivisions: Major Exporters with High Economic Expectations and Midsize and Low Exporter Countries.

⁴³ Some economists even claim that foreign technology imports are the most important factor in explaining the rapid economic growth of Taiwan (China), Korea, and other newly industrialized countries, by borrowing foreign technology rather than by generating new products or processes.

High Economic Expectations: Major Exporters

Botswana
Cameroon ⁴⁴
Ghana
Kenya
Mauritius
Namibia
Zimbabwe

Midsized and Low Exporters

Benin	Mali
Burkina-Faso	Mauritania
Cape Verde	Mozambique
Comoros	Niger
Djibouti	São Tomé and Príncipe
Eritrea	Senegal
Ethiopia	Seychelles
Gambia, The	Tanzania
Guinea-Bissau	Togo
Madagascar	Uganda
Malawi	Zambia

Oil-Producing Countries: Group II

The criterion for Group II is that oil exports make up more than a 40 percent share of overall exports. Given the lower share of SSA international trade (about 1.5 percent of the global trade), this trigger could reflect the importance and the contribution of oil revenues in the government budgets and in the balance of payments.

Since Adam Smith and David Ricardo, there has been a belief that natural resources are “a blessing”; therefore, countries that are richly endowed with natural resources have an advantage over countries that are not. Natural resources endowments have helped many

⁴⁴Sources: *La Zone Franc: Rapport Annuel 2000*; *Banque de France 2000*. Oil exports account for about 48 percent in Cameroon. Others: World Bank, *World Development Indicators 2006*.

Countries	Oil share of overall exports (%)
Equatorial Guinea	87.8
Angola ⁴⁵	85.2
Chad	80.0
Congo, Republic of	77.9
Gabon	69.0
Sudan	61.4
Cameroon	48.0

Sources: La Zone Franc: Rapport Annuel 2000; Banque de France 2000.
Oil exports account for about 48 percent in Cameroon.
Others: World Bank, World Development Indicators 2006 and IMF.

countries (for example, Botswana, Finland, Indonesia, Malaysia, and Norway) to grow and diversify, in part by providing a basis for developing associated technologies and capital goods industries.

The abundance of natural resources also carries a paradox that has inspired innumerable studies of mineral-rich countries in the developing world. Since the 1970s, they have consistently underperformed their mineral-poor counterparts on a variety of economic performance, good governance, and income equality measures (Eifert, Gelb, and Tallroth 2002; Gelb 1998; Sachs and Warner 1999; Auty 1998, 2001). This phenomenon has come to be known as the “resource curse,” which is the phenomenon whereby an export-driven natural resources sector in a country, generating large revenues for the government, leads paradoxically to economic stagnation and political instability. There is considerable evidence that nonrenewable natural resources revenue (especially windfall ones) can, if not properly managed, adversely affect economic growth and poverty reduction.

Weak economic performances and continued poverty in many oil-exporting countries continue to pose a challenge to scholars and development practitioners. The abundant existing literature explaining the poor growth performance in resource-rich countries⁴⁶ can be divided into two sets of issues: some focus on economic effects such as Dutch Disease and volatility known as booms and busts (Gelb 1988; 2003; Auty 1998, 2001); others focus on governance issues (Karl 1985, 1987 and 1997; Eifert, Gelb, and Tallroth 2002).

The resource curse is not unavoidable, however: a sound resource-led development strategy could make a difference. Therefore, it is important to learn from other resource-rich countries to understand the dynamic of structural changes that typically occur alongside large-scale mineral production. In the context of an oil boom, the structure of the economy is

⁴⁵ Angola could also be considered as a postconflict country.

⁴⁶ Sachs and Warner (1999), from a sample of 95 developing countries, found a clear negative relationship between natural resources-based exports and growth during 1970–90.

fundamentally transformed; these changes, together with the revenues from oil exports, could set the stage for sustained growth and economic development.

Conflict and Postconflict Countries: Group III

Repeated conflicts and wars have plagued many SSA countries, and these conflicts have had devastating effects on the populations involved: destroying infrastructure, dislocating families, increasing poverty, and generally raising the level of vulnerability of many groups (which often continues long after the cessation of hostilities). The risks and vulnerabilities facing such countries are often exacerbated by conditions of conflict and socioeconomic disruption, coupled with the creation of refugees and internally displaced populations. The impact of conflict is even worse when the country involved in the conflict is among the poorest countries in the world, with very limited economic prospects. Furthermore, meager resources available are often diverted to finance emergency humanitarian relief (spending that should have not existed in the first place), as opposed to more strategic sustained development.

Angola
Burundi
Central African Republic
Congo, Democratic Republic of
Côte d'Ivoire
Liberia
Rwanda
Sierra Leone
Somalia
Sudan

It is worth distinguishing conflict and postconflict countries with some favorable economic prospects and unexploited potential from conflict and postconflict countries with less favorable foreseeable meaningful economic potential. These two groups of countries require different development strategic approaches in the medium and long terms.

Conflict and Postconflict Countries with High Economic Expectations

Angola
Congo, Democratic Republic of
Côte d'Ivoire
Sudan

Conflict and Postconflict Countries with Low Economic Expectations

Burundi
Central African Republic
Liberia
Rwanda
Sierra Leone
Somalia

PROPOSED STRATEGY PER CATEGORY OF COUNTRIES

This proposed strategy is a comprehensive approach because SSA is not taken as a homogenous continent without differences in the degrees and levels of development, even though the basic structures of the SSA economies are more or less similar. This implies that it is, nevertheless, important to provide a generic strategy that could evenly be applied to all SSA countries and thereafter provide a specific strategy based on country category.

A Generic Strategy Response for SSA to Breakthrough in the 21st Century

As has been repeatedly emphasized, structural transformation⁴⁷ is the main challenge for SSA to attain sustained growth and growth is necessary for poverty reduction (Dollar and Kraay 2001a)⁴⁸ (Ghura, Leite, and Tsangarides 2002).⁴⁹ Meanwhile, growth by itself is not enough: good leadership is a central pillar toward the structural transformation in the sense that good leadership encompasses many features that are absolutely indispensable for SSA's economy to address its macroeconomic policy and provide the vision needed.

Good Leadership or a Development Behavior-Oriented Leadership

Leadership is such an abstract concept that it can hardly be defined and described with precision; moreover, its definitions and descriptions have changed over time. Definitions from earlier times tended to focus on the qualities of individual leaders (Burns 1978; Rosen and Brown 1996; Grint 1997; and Mintzberg 1998). Leadership also refers to the quality of the behavior of the individuals whereby they guide people or their activities in organized effort.

In the context of SSA, good leadership (GL) can be defined as development and communication of a vision of the desired future, and the direction toward which people ought to go. In other words, GL means developing a vision of the future and the strategies needed to

⁴⁷ A peer reviewer has expressed concerns regarding this section which is about the specific transformational strategy for SSA countries. The feedback argues that the section remains very weak which probably stems from the fact the paper does not build on a solid and robust quantitative analysis of the transformational process it contemplates. One does not see how the proposed strategic recommendations will lead to increase savings and ultimately more investments. The reviewer certainly overlooked the substantiated discussion related to the structural transformation process in the section II and the discussion in the section III introducing the SSA economic structure and; the proposed analytical framework, which sets the stage for the transformational strategy for SSA and where it is demonstrated that the economic structure remains more or less in the traditional stage of production, with a preeminence of agriculture relative to the GDP. Agriculture remains the mainstay of these economies. The changes in structure that accompany sustained economic growth are a transition from a low-income agrarian economy to an industrial urban economy with substantial higher income. Technological changes and other exogenous factors influence the patterns of structural change. Starting with Kuznets and Lewis, the transition has been measured by the accumulation of physical and human capital and by the transformation of the structure of demand, production, trade and employment, as the level of income rises. Regardless of the lack of reliable data in SSA, this process is yet to take place in SSA as it has been the case for Malaysia: This is a fact. It is also noteworthy to emphasize that the share of SSA in the global trade is less than 2% and the level of income is the lowest in the global stage.

⁴⁸ It is clear from this research that when average incomes rise, the average incomes of the poorest fifth of society rise proportionately. The research also shows that growth-enhancing policies and institutions tend to benefit the poor and everyone else in society proportionately.

⁴⁹ This paper investigates the existence of pro-poor policies that directly influence the income of the poor after accounting for the effect of growth. It also provides an estimate of the elasticity of the income of the poor with respect to average income. The study concludes that the current existing empirical evidence on poverty reduction and on human development strongly supports the primacy of the role of economic growth for poverty reduction.

achieve that vision, and creating coalitions that understand the vision and are committed to its achievement.

According to Williamson and Haggard (1994) leaders can be characterized as visionary when they are “executives with strong commitment, a vision of where they would like their countries to go, and a willingness to take risks.” SSA countries are in great need of a general discipline. That requires a strong executive who could effectively lead the country and align people by getting them to understand and believe the vision, and by leading as an example.

In fact, in SSA, good leadership has to be associated with a development vision and planning, as well as good public management in general as a tool to attain the development vision with efficiency and discipline. Chile, Malaysia, the “four dragons” in Southeast Asia (Hong Kong [China], Korea, Singapore, and Taiwan), and currently China are good examples in this respect. This process may not necessary happen under a democracy, but a fair amount of individual and (specifically) economic rights must be given to citizens.

A democracy is identified as a nation with regular, free, competitive multiparty elections, and is the best form of government to manage a country. It also happens that for SSA countries, it could be the source of paralysis and economic blockage when the “legally” elected party serves only its own interest and its elite members’ interests without accountability. This is the “*Democracy à l’Africaine*” or multiparty of unique party (President’s party), with some exceptions. The change in power is usually a change in economic oppression and the source of conflicts and political instability.

The subcontinent remains the only continent where the political competition leads to instability and even armed conflicts. Part of the explanation is that the ruling elite exclusively controls the country’s resources, and everyone else is excluded. The state is seen as a source of self-enrichment. In addition, any substantive private initiative outside the ruling-elite circle is seen as a threat⁵⁰—and undermined as such—instead of a growth opportunity and economic consolidation for poverty reduction. Consequently, it devastates the economy and discourages the fabric of a domestic independent private entrepreneurship,⁵¹ thereby undermining the potential of structural transformation, sustained growth, and job creation and, hence, the poverty reduction effort. Good leadership will promote sustained growth and will lead with vision.

Structural transformation and performance are interrelated. These two aspects imply and lead to changes in the supply-side constraint capacity, so as to sustain further growth and thereby generate more resources for the government and the economy. The uses of these resources are influenced in various ways by the government’s policies and constitute the core of development strategy. Therefore, good leadership is absolutely fundamental for the development process. Although a large part of the development process takes place through the private sector, the government is the key player, particularly in SSA.

⁵⁰ There is barely any new entry outside the ruling elite circle, or the entry cost is prohibitive and therefore dissuasive and discouraging for any new substantive independent domestic private initiative.

⁵¹ The classical instruments often used can hardly capture this phenomenon. Even an investment climate survey could hardly explain why opening a business could take a year instead of a few days—legally—or why access to the financing system to finalize a business *tour de table* or an investment opportunity is systematically denied unless there is a connection with the ruling elite circle.

The development process mostly takes place through the private sector, where most of the country's added value to the economy is formed. Without a vibrant private sector, there is no sustainable poverty reduction. Undermining the fabric of a sound private entrepreneurship means condemning the economy to a sustained poor performance, rampant poverty, and social unrest; this generates its own circle of political instability and poverty, leading to a vicious cycle of poor growth performance, if any, and poverty; in other words, the blockage of sustained growth and the development process.

Good leadership in SSA will be able to achieve what seems to be missing most: coordination, organization, and discipline. The main characteristic common to all industrialized countries is as follows: their country could easily be put on "automatic pilot" without jeopardizing the social cohesion, the administration's efficiency, and the economy as a whole, because of the organization and coordination structure agreed upon by everyone and observed with discipline by everyone. Social cohesion cannot be achieved without common discipline; good leadership will be able to bring people together for the same goal and in the overall interest of the country.

As we all know, leadership is presiding over institutions and therefore can influence its setting. And recent research and development economic literature has strongly made the case and provided evidence regarding the critical importance of economic institutions⁵² on prosperity and poverty (Acemoglu, Johnson, and Robinson 2003; Rodrik, Subramanian, and Trebbi 2002). A Nobel Prize in Economics was awarded to Douglass North in part for articulating the role of institutions in understanding economic development. In this section, we argue that development behavior-oriented leadership can overcome and correct the negative impact of weak institutions and catalyze the structural transformation process for sustained growth and a durable poverty reduction in SSA.

According to Acemoglu, Johnson, and Robinson (2003), although the geography hypothesis emphasizes forces of nature as a primary factor in the poverty or prosperity of nations, the institutions hypothesis is about manmade influences. According to this view, some societies are organized in a way that upholds the rule of law; encourages investment in machinery, human capital, and better technologies; facilitates broad-based participation in economic and political life by the citizens; and supports market transactions. Three crucial elements of these organizational settings of good institutions are as follows:

Enforcement of property rights for a broad cross-section of society, so that a variety of individuals have incentives to invest and take part in economic life

Constraints on the actions of elites, politicians, and other powerful groups so that these people cannot expropriate the incomes and investment of others in the society or create a highly uneven playing field

⁵² A poor country that is able to revise the rules of the game in the direction of strengthening the property rights of entrepreneurs and investors is likely to experience a lasting increase in its productive capacity (Rodrik 2004).

Providing some degree of equal opportunity for broad segments of the society, so that they can make investments, especially in human capital, and participate in productive economic activities

Acemoglu, Johnson, and Robinson (2004) and Rodrik, Subramanian, and Trebbi (2002) further demonstrated that economic institutions matter for economic growth because they shape the incentives of the key economic actors in society. In particular, they influence investments in physical and human capital and technology, as well as the organization of production. Although cultural and geographical factors may also matter for economic performance, differences in economic institutions are the major source of cross-country differences in economic growth and prosperity.⁵³ Economic institutions determine not only the aggregate economic growth potential of the economy but also an array of economic outcomes, including the distribution of resources in the future. That means they not only influence the size of the aggregate pie, but how this pie is divided among different groups and individuals in society. Therefore, we believe that development behavior-oriented leadership in SSA is critical to positively influence the rule of the game toward structural transformation, sustained growth, and poverty reduction because political power—hence, a country’s leadership—determines economic institutions and policies.

Most SSA countries operate under organizational settings where the state is the key economic player, controlled and run for the benefit of an individual or a small group of individuals who use power to transfer a large fraction of society’s resources to themselves, in a general environment where the private sector often relies on the state for business opportunities and government contracts.⁵⁴

Bates (1981) described the concept behind the inefficient transfers and policies in place in SSA. He argued that many of these inefficient policies are in place to transfer resources from the population to the ruling groups, while at the same time ensuring their political survival. In particular, the nexus of inefficient policies appeared to be useful for creating an environment where any group that became politically mobilized against the rulers or “so-called leadership” could be punished,⁵⁵ while those who remained loyal were rewarded.

Acemoglu, Johnson, and Robinson (2003) generalize Bates’s concept through a systematic reasoning they call “divide-and-rule strategy.” Divide-and-rule is a method used to maintain power in a weakly institutionalized environment while simultaneously pursuing policies costly to society. The logic of a divide-and-rule strategy is to enable the leadership, in place, to bribe politically pivotal groups off the equilibrium path, ensuring that rulers (leaders) can remain in power against challengers. To remove a ruler from power requires the cooperation of distinct social groups, which is made difficult by the collective action problem (Olson 1965). By providing selective incentives and punishments, the divide-and-rule strategy exploits the fragility

⁵³ For a detailed framework, please see Acemoglu, Johnson, and Robinson (2004).

⁵⁴ In Cameroon, for example, from a standpoint of principle, the institutional framework on paper is among the best in SSA; however, the so-called “elite” is allowed to make, as it pleases, ill interpretations of the rules of the game without further consequences.

⁵⁵ Given that in SSA the state is the main economic player, the people against the ruling party are excluded from the economic system, or deprived of economic opportunities and often pushed into bankruptcy as the way to force them to join the ruling party.

of social cooperation. When faced with the threat of being ousted, the ruler intensifies the collective action problem and destroys the coalition against him by bribing the pivotal groups.

This is happening in most SSA countries because of the lack of a powerful economic interest group and the absence of a well-structured independent private sector. The existing private sector is relying more or less on the state for business opportunities or for self-interest (for example, private entrepreneurs are not willing to pay their corporate taxes, preferring to pay an insignificant amount directly to the ruling party with which they are also affiliated). This shadow political-economic-based system is also responsible for the real decision-making process. Challenging the “shadow inefficient political-economic-based system” ultimately means bankruptcy through the system of retaliation⁵⁶ and economic exclusion; therefore, the incentive to keep the status quo is extremely high for the ruling elite. The end game is weak government revenues, lack of economic and social infrastructures, and—as a result—weaker government revenues. The allocative efficiency of the economy is very weak, and so is the growth rate, if any; therefore, it is not possible to put in place a credible strategy for the structural transformation process, because growth and development are not at stake. The rent-seeking political system’s survival is more important than the economic system and society’s interest as a whole.

In the shadow inefficient political-economic-based system, relationships of loyalty and dependence pervade a formal political and administrative system, and officials occupy bureaucratic positions less to perform public service than to acquire personal wealth and status. Despite the fact that civil servants receive an official salary, they also enjoy access to various forms of illicit rents and petty corruption, which constitute an entitlement of office.⁵⁷ The chief executive and his inner circle undermine the effectiveness of the nominally modern state’s administration by using it for systematic patronage and “clientelist” practices to maintain political order, although it is highly dysfunctional. This system is at the heart of Africa’s economic crisis and development failure (Bratton and van de Walle 1997; van de Walle 2001). Only a development behavior-oriented leadership can change the system and catalyze the structural transformation process needed in SSA for sustained growth. Indeed, “when a country is far below its potential steady-state level of income, even moderate movements in the right direction can produce a big growth payoff” (Rodrik 2004).

The shadow inefficient political-economic-based system is less likely to arise when there is a balance of power between the ruler (leadership) and a powerful economic group in society, or under a development behavior-oriented leadership (Acemoglu, Robinson, and Verdier 2003). This is consistent with the more successful economies in SSA, such as Botswana and Mauritius, which have both managed to become stable democracies and to refrain from the most distortionary policies. The political power of major economic groups, such as the cattle owners in Botswana and the sugar planters in Mauritius, have placed real constraints on the behavior of political elites (Leith 2000; Bowman 1991).

⁵⁶ Indeed, the system is organized as such, and it is almost impossible to survive outside the circle; in this type of situation, the administration will prove itself very effective and is particularly sealed against the challenger. Suddenly, refinancing opportunities through the banking system are shut out and so are business opportunities; the challenger slowly runs out of “treasury” (cash) and therefore faces bankruptcy.

⁵⁷ This is also the phenomenon that undermined the classic governance reform programs in SSA. The system is reluctant to reform itself.

Van de Walle (2004) argues that there is a positive synergy between the political and economic success in Botswana and Mauritius. In both countries, several factors, including visionary political leadership right after independence, helped establish democratic political systems with effective checks on the executive branch and empowered technocrats to make effective development policies, which soon resulted in economic growth (Acemoglu, Johnson, and Robinson 2001a). In turn, economic success reinforced these political choices, helped to consolidate democratic governance, and created domestic constituencies that had a stake in the continuation of the same patterns. Botswana's independent leader, Seretse Khama, appears as a relatively traditional African "big man," except that most of the choices he made proved to be the right ones. He used his power to fashion effective state institutions and a stable democracy, rather than for self-enrichment. This is a very good illustration of development behavior-oriented leadership—and the path that SSA countries may wish to follow for structural transformation and sustained growth for poverty reduction.

In Mauritius, there is no prominent leader comparable to Seretse Khama of Botswana; however, several leading politicians seem to have been able and wise. Mauritius shares with Botswana the presence of a political elite that was able to put the country on the right course from the beginning. There is a consensus around the idea that the political compromise crafted by politicians across the ethnic divide right around independence has paved the way for political stability and long-term economic growth in Mauritius. Here again, the development behavior-oriented leadership has proven critical for the development process in Mauritius.

The Botswana and Mauritius success stories can be understood as resulting from several factors. Enlightened leadership helped create an auspicious start in both the economic and political realms, which allowed the development of positive synergies between the two that served to sustain and expand the success story. The emergence of parliamentary politics served to promote executive accountability. In both countries, fortuitous international factors supported the success stories. In the Mauritian case, success generated societal support and a supply response; in the Botswana case, the success has been sustained by a disciplined technocratic class that has continued to be motivated by long-term development goals (van de Walle 2004).

Botswana is an optimistic example of what a development behavior-oriented leadership can accomplish in the quest for structural transformation and sustained growth. It can be done with the appropriate actions toward institutional design or, if corrective actions are taken (given the current context of the subcontinent), even starting with unfavorable initial economic conditions. Botswana was able to grow rapidly because enlightened development behavior-oriented leadership helped create right institutions and implemented good policies. Despite being a small, agriculturally marginal, predominantly tropical, landlocked nation, in a very precarious geopolitical situation, Botswana nonetheless experienced rapid development, further sustained by the sound management of its natural resources and mineral wealth.

Many SSA countries are also well endowed with natural resources and mineral wealth, but have not been able to achieve the performance of Botswana or Mauritius, simply because they lack a fundamental asset: a development behavior-oriented leadership to clean up their institutions and, mostly, the mind-set of political elites. In fact, most of the time, the legal economic-institutional framework on paper is excellent, particularly in francophone countries; and the legal framework and economic institutions in place in English-speaking countries are

often inspired by the British influence. This backdrop further emphasizes the critical need for a development behavior-oriented leadership in SSA, and also to loudly and clearly point out a fundamental missing pillar in SSA—the need to put the continent on the path of structural transformation for sustained growth and poverty reduction. The continent will have to deliver on this account if it is to break through in the 21st century.

Finally, let us conclude this leadership section with another encouraging illustration and well-known success story: Singapore. Upon achieving self-rule in 1959,⁵⁸ Singapore was saddled with severe poverty and chronic unemployment within its poorly educated population. Singapore's traditional economic activities were already in decline as a result of the development of direct trade between Southeast Asia and the developed world markets. Mounting internal political and communal tensions led to the separation of Singapore from Malaysia on August 9, 1965, and the proclamation of Singapore as an independent country. Separation from Malaysia meant that Singapore was left with no natural resources, a small population, and some manufacturing capacity, which never really took off under import-substitution policies, particularly because the small 2-million-person domestic market could not sustain an import substitution policy (Eng, Tan, and Robinson 2006a).

Singapore chose to turn to the global market that was available without privileged access. Hence, export orientation became the logical choice of a growth paradigm, with firms manufacturing goods and creating jobs for a market far larger than what Singapore's domestic consumption alone could sustain.

The main reason for Singapore's widely acknowledged success is leadership. Singapore's founding leaders were visionary, committed, and competent; in other words, they displayed the main features of development behavior-oriented leadership. They eschewed potentially divergent politics that threatened to divide people along racial and ideological lines and dealt fairly with rising communal tensions. Under the leadership's guidance, the people of Singapore were galvanized into a resilient and hardworking people, determined to fight for their own survival. They rallied to the leadership's reminders that the "world does not owe us a living" and "we cannot live by the begging bowl." Thus, the people became committed to Singapore as an independent country in which they had a stake (Robinson et al. 2006b). A development behavior-oriented leadership matters to the development process, and is needed in SSA for the structural transformation challenge and sustained growth.

Good Governance as an Efficient Tool for Poverty Reduction

There is increasing international consensus on the critical necessity to strengthen governance, transparency, and accountability for poverty reduction. Evidence has shown that with good governance, large revenues generated from extractive industries enjoyed by some SSA countries can foster economic growth and reduce poverty; similarly, efficient management of government revenues and spending—public expenditure management—can have a profound impact on poverty reduction.

⁵⁸ The people of Singapore cannot make it alone, and a majority voted by referendum for merger with Malaysia (Malaya).

Until now, the governance issue has been dealt with through the lens or entry point of public sector reform and management, and the World Bank has implemented hundreds of public sector reforms,⁵⁹ yet the governance issue remains and is more critical than before for poverty reduction in Africa, despite the enormous efforts that have been undertaken. Literature (Shah 2005) increasingly shows that many of the traditional and new reform types have failed to have lasting and effective effects on recipient countries. Unresponsive, unaccountable, inefficient, and ineffective bureaucracies seem impossible to change with the current tools; therefore, the governance issue requires a new approach.

The new approach needed for Africa is a focus on public finance management (PFM) and, more specifically, on public expenditure management (PEM) if the continent is to make good use of meager government resources for poverty reduction and development. Efficiency in PFM/PEM will also increase the fiscal space as allocation and resources management for poverty reduction are rationalized, in addition to structural transformation and sustained growth.

In general, growth is partly translated into social spending and therefore service delivery, based on efficient revenue management and collection of taxes. The manner in which the government channels its poverty spending and manages the budget is then critical to service delivery, and hence poverty reduction. Transparent and accountable budget executions are key and indispensable to a modern public finance management and, by extension, for efficient public sector management and service delivery to the poorest people of Africa. Governments should be encouraged to put in place a credible system of budget monitoring and implementation, given that the governance issue appears to be among the main impediments and bottlenecks for poverty reduction in Africa.

Transparency and accountability in budget execution (spending side) and tax collection, including external assistance funding (revenue management side), together with credible oversight structures, are the heart of the governance agenda. Tackling these issues will ultimately and drastically reduce corruption and therefore increase the resources available and government efficiency for poverty reduction. The governance issue in the PFM lens is critical for the continent. In fact, in most of the African countries, governments remain the main economic player through their budgets. Therefore, a strict budget-monitoring system, together with a credible oversight structure, including media, will definitely reduce corruption and increase efficiency in government spending.⁶⁰

In the past 20 years or so, the fundamental problem of budgeting in SSA has been the tendency of parallel budgeting procedures or outlaw budgeting processes. The deterioration of governance engenders budget indiscipline, the deterioration of budget institutions, and the increasing lack of coherence between government policies and the budget, which, together with a notorious lack of transparency and accountability, are made worse for resources allocation and poverty reduction, particularly in the current situation of resource scarcity. Therefore, it is

⁵⁹ The fundamental reasons underscoring mixed performance of public sector reforms in SSA are discussed in the Leadership section of this paper.

⁶⁰ Focusing on PEM will increase the scrutiny of government spending, where part of the poverty reduction effort is implemented. The spending side of the budget is also where the most mismanagement and corruption arrangements occur in general.

fundamental to improve governance through the PFM/PEM entry point for more efficiency in resources management and poverty reduction.

It is paramount to emphasize the importance of public expenditure management (PEM) for SSA, given that PEM is instrumental in nature. As a central instrument of policy, it pursues three overall economic policy goals: (a) fiscal discipline; (b) economic growth; and (c) poverty reduction, are pursued partly through allocation of public resources to the various sectors. These three goals require efficient and effective use of resources. Hence, these overall policy goals are translated into three key objectives of good public expenditure management: expenditure control (fiscal discipline), allocation of resources consistent with policy priorities (strategic allocation), and good operational management. It is then important for SSA to address forcefully the governance issue and to adhere to international PEM standards, although successful PFM/PEM reforms will still be country-specific.

Market Access to Sustain a Strong Growth

SSA's integration into the international trade is the most important tool to achieve its structural transformation. Evidence has already been accumulated linking openness with higher growth (Chenery, Robinson, and Syrquin 1986;⁶¹ Edwards 1989⁶²). Increases in openness to international trade seem to cause increase in the rate of technological changes. Romer (1989) has shown that countries that expand their degree of integration with world markets seem to have a higher marginal product of capital. Countries that are more open to trade have a higher level of investment and growth.

This backdrop suggests that, trade will not only support growth but will also support the changes in aggregate demand structure because of its collateral or catalytic effect on the technological changes it can generate. In other words, better integration with the world market is associated with an increase in technological changes; therefore, it is a powerful engine of structural transformation for SSA. Better world market integration can be a catalyst for economic diversification and sustained growth.

There is now agreement among a large proportion of scholars and practitioners that countries that have relied on "outward-oriented" development strategies have done better over the medium and longer term than those countries that have adopted "inward-looking" strategies (Dollar and Kraay 2001b; Edwards 1989). Recently, even the Economic Commission for Latin America/Comisión Económica para América Latina (ECLAC/CEPAL) has recognized that the excess of import substitution has been very costly for Latin America (Bianchi et al. 1987).

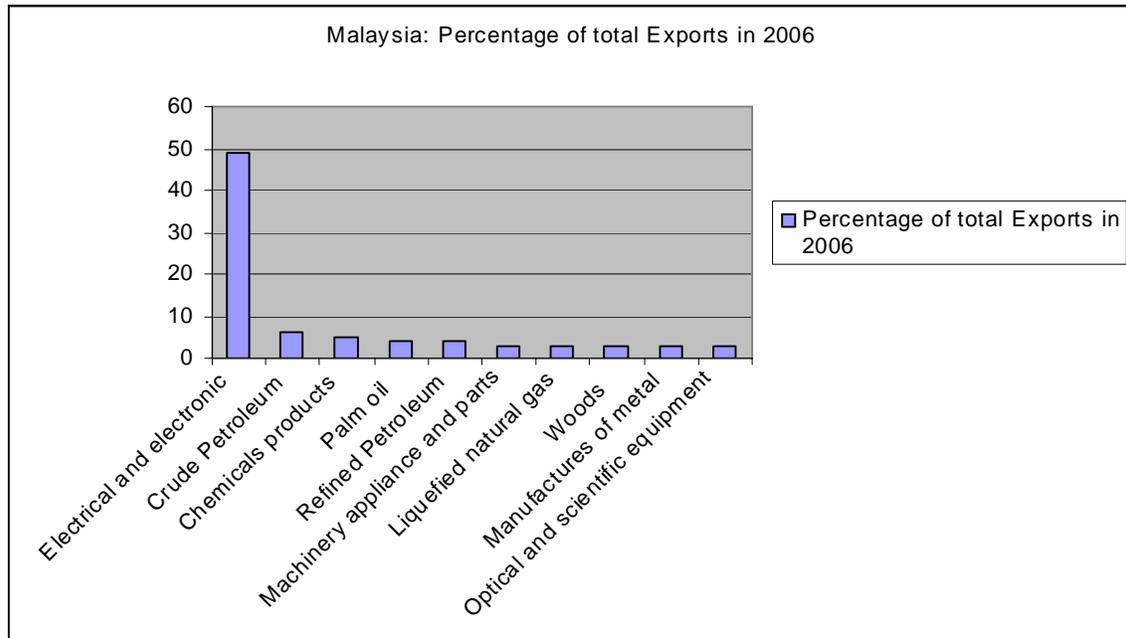
Better market access alone is not enough; SSA countries will also have to change their exports composition. The differential in trade and growth performance reflects the fact that certain regions have been better placed, through the policies they adopted, to take advantage of new technologies and changes in the nature of world trade. The continent will have to adapt to the new structure of the world trade if it is to benefit efficiently from better market access. The concept of market access is meaningless if there is nothing to trade or if the supply side does not meet the demand. Again, this backdrop is positively illustrated through Malaysia, which has been able not only to generate enough manufactured exports to fund continuing imports of the materials needed to sustain production, but also to adjust to continuous changes in world trade, as illustrated in figure 4.1.

Market access is such an important issue and development tool that it is absolutely necessary to discuss below the Multilateral Trade Agreements (MTA) that govern the international trade system. A favorable trade system for developing countries (and particularly for SSA) in the areas where they can justify a comparative advantage will forcefully contribute to and sustain their development effort.

⁶¹ Approached this question from the point of view of development economics.

⁶² Approached this question from the perspective of the trade theory and the effects of liberalization.

Figure 4.1 Malaysia: Percentage of Total Exports in 2006



Source: Government of Malaysia, Department of Statistics, 2006.

Digression on Multilateral Trade Agreements for SSA Development

Developing countries do have a comparative advantage on agriculture, textiles, and clothes, but they are facing many export restrictions by developed countries. The same developed countries are promoting more liberalization for key sectors and favor market-opening policies, but not on agriculture.

The General Agreement on Tariffs and Trade (GATT), which took effect in 1948, sets rules for international trade and provides a forum for multilateral trade negotiations. The original intention was to create a third institution handling international economic cooperation and to join “the Bretton Woods” institutions known as the “World Bank” and the “International Monetary Fund.”

So far, eight rounds of “multilateral” negotiations under the GATT have succeeded in reducing average tariffs in the industrial countries by more than 40 percent in the early 1950s to less than 5 percent today.⁶³ The latest and largest round was the Uruguay Round from 1986 to 1994, which led to the creation of the World Trade Organization (WTO). Whereas GATT mainly dealt with trade in goods, the WTO and its agreements cover trade in services, trade inventions, creations, and designs (intellectual property). The current Doha Round is trying to address development issues.

The WTO⁶⁴ is the unique international body dealing with the rules of trade between nations (that is, the multilateral trading system). WTO agreements are negotiated and signed by

⁶³ U.S. Department of State dispatch, “GATT and International Trading System,” Washington, DC, Aug. 1993.

⁶⁴ WTO has existed since January 1, 1995.

the bulk of the world's trading nations. These documents provide the legal ground rules for international commerce. They are essentially contracts binding governments to keep their trade policies within agreed limits. (The following paragraphs will introduce the principle of the multilateral trading system through the WTO agreements.)

The first principle of the WTO agreements is that the trading system should be *without discrimination*. A country should not discriminate between its trading partners: they are equally granted "the most favored nation (MFN)"⁶⁵ status. The WTO's cardinal principle governing trade in goods is that no member country should discriminate between its own products and the foreign products or services of others.

The second principle governing the Multilateral Trade Agreements through the WTO is *freer trade*. When the trading system is allowed to operate without the constraints of protectionism, firms are encouraged to adapt gradually and in a relatively painless way. They can focus on new products, find a new niche in their current area, or expand into new areas.

The third WTO principle is *predictability through binding*. The multilateral trading system is an attempt by governments to make the business environment stable and predictable. In the WTO, when countries agree to open their markets for goods or services, they "bind" their commitments.

The fourth WTO principle is *promoting fair competition* by discouraging unfair practices such as export subsidies and dumping products below cost to gain market share. Nevertheless, the WTO agreements provide some provisions on export subsidies under the domestic support.

The fifth and last principle is *encouraging development and economic reform*. More than three-quarters of WTO members are developing countries and countries in transition to economic markets. The GATT, which deals with trade in goods, has a special section (Part IV) on trade and development that includes provisions on the concept of nonreciprocity and trade negotiations between developed and developing countries. When a developed country grants trade concessions to developing countries, it should not expect the developing countries to make matching offers in return.

GATT also enables countries to grant special concessions to developing countries without having to do the same for the entire membership. This provision is known as "special and differential treatment." The General Agreement on Trade in Services (GATS) similarly allows developing countries some preferential treatment under the heading "Economic Integration" (Article V of GATS).

Very briefly, these are the fundamental pillars that govern the multilateral trading system through the WTO agreements. *The purpose is greater market access for all*. The rule is trade without discrimination: grant someone a special favor and you have to do the same for all members. However, the WTO agreements provide special provisions for developing countries and least-developed countries (LDCs).

⁶⁵ Under the WTO, each member treats all of the other members equally as "most-favored" trading partners, which means that if a country improves the benefits that it gives to one trading partner, it has to give the same "best" treatment to all other WTO members. However, some notable exceptions are given to developing countries.

Indeed, the parties to this agreement have recognized that their relations in the field of trade and economic endeavor should be conducted with a view toward raising standards of living; ensuring full employment and a large and steadily growing volume of real income and effective demand; and expanding the production and trade in goods and services, while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development. When functioning effectively, members seek both to protect and preserve the environment, and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development.

The member countries also further recognized a need for positive efforts designed to ensure that developing countries, especially the least developed among them, secure a share of growth in international trade commensurate with the needs of their economic development. The purpose is noble, and so far it is intended to promote more growth. But it does not work for all countries, especially developing countries. This is particularly true if we consider the Agriculture Agreement and, to some extent, the Textiles and Clothing Agreement, two areas in which developing countries have comparative advantages. Markets for agriculture in the world's richest economies remain highly distorted by import restrictions and export and production subsidies. Subsidies to agriculture in OECD countries average about 1.5 percent of GDP.⁶⁶ The Uruguay Round made important advances in this area, which should be followed by further ambitious reforms in the Doha Round.⁶⁷ Textile is another area subject to restrictive trade policies, where developing countries have justified comparative advantage.

The principal idea here is to make Multilateral Trade Agreements work for all (in other words, "win-win" Multilateral Trade Agreements to sustain the SSA development process). Indeed, SSA can naturally compete in agriculture and textiles. These areas could support its efforts toward structural transformation, through more exports and progressive economic diversification; therefore, more global opportunities and fewer trade barriers, including the abusive or distorted use of the Agreement on Sanitary and Phytosanitary⁶⁸ Measures, the Agreement on Technical Barriers⁶⁹ to trade, and the Agreement on Safeguards.

⁶⁶ "Trade and Development," address by Shigemitsu Sugisaki, Deputy Managing Director of the IMF, at the WTO High-Level Symposium on Trade and Development, Geneva, March 17, 1999.

⁶⁷ The Doha Round has collapsed.

⁶⁸ This agreement concerns the application of sanitary and phytosanitary measures (in other words, food safety and animal and plant health regulations). The agreement recognizes that governments have the right to take sanitary and phytosanitary measures, but that they should be applied only to the extent necessary to protect human, animal, or plant life or health and should not arbitrarily or unjustifiably discriminate between members where identical or similar conditions prevail. Its application is currently largely distorted; thus, it is becoming a new type of trade barrier.

⁶⁹ This Agreement will extend and clarify the Agreement on Technical Barriers to Trade reached in the Tokyo Round. It seeks to ensure that technical negotiations and standards, as well as testing and certification procedures, do not create unnecessary obstacles to trade. However, it recognizes that countries have the right to establish protection at levels they consider appropriate (for example, for human, animal, or plant life or health or the environment) and should not be prevented from taking measures necessary to ensure that those levels of protection are met.

In fact, Article XIX of the General Agreement allows a GATT⁷⁰ member to take a “safeguard” action to protect a specific domestic industry from an unforeseen increase of imports of any product that is causing, or likely to cause, serious injury to the industry. The abusive or distorted application of these Agreements should be addressed with energy so as to make globalization work for all—and particularly for SSA, as a continent where global market integration is most needed. Having underscored a generic strategy, what could be a specific strategy per category of countries?

Strategy per Category of Countries

This section aims at providing a specific strategy response based on the economic structure of each group of countries. Although SSA countries share a common ground, considering the general economic structure, there are some important differences regarding economic perspectives among countries and groups of countries that justify different approaches and different strategy responses.

Group I: Capacity to Export

Imports are considered as indispensable inputs in developing economies generally and SSA particularly, toward the structural transformation; therefore, imports should be treated implicitly as a factor of production in long-run growth models. Thus, the capacity to export as a means to generate more foreign exchange resources is required to finance the desired technology-embodied capital good. The capacity to acquire advanced technology from abroad is fundamental for the structural transformation.

Major Exporters with High Economic Expectations: Better Market Access for Strong Growth

In addition to development behavior-oriented leadership, better market access for strong growth is the main response for the major exporters with high economic expectations. With better PFM/PEM and better integration into the global market, this group of countries can compete with the rest of the world. In addition, they can break the supply-side constraint and modernize their economy.

Considering the economic structure and the overall pattern of their exports, these countries can easily get into the process of economic diversification with more exports and with better organization and discipline.

Should this group of countries exploit their enormous unexploited potential, including more oil, natural gas, gold, and diamond explorations and other valuable raw materials, combined with better market access and economic diversification, they are likely to attract more foreign direct investments for structural transformation and sustained growth.

⁷⁰ The Agreement breaks major ground in establishing a prohibition against so-called “gray area” measures and in setting a “sunset clause” on all safeguard actions. The agreement stipulates that a member shall not seek, take, or maintain any voluntary export restraints, orderly marketing arrangements, or any other similar measures on the export or the import side. Any such measure in effect at the time of entry into force of the Agreement would be brought into conformity with this Agreement or would have to be phased out within four years after the entry into force of the Agreement established with the WTO. An exception could be made for one specific measure for each importing member, subject to mutual agreement with the directly concerned member, where the phase-out date was December 31, 1999.

Attracting more foreign direct investment is good for the balance of payments because it would provide the overall economy with more foreign reserves. It would also be a great source of technological transfer through joint ventures and many other means. More foreign direct investment would be an additional and powerful engine for SSA structural transformation. This prospective scenario can materialize only if there political stability and good, strong leadership exist.

Midsized and Low Exporters: More Development Assistance and Better Market Access

The economic perspective and economic potential are not as good for the midsized and low exporters as for the major exporter group of countries with high economic expectations; therefore, their structural transformation could take much longer.

Basically, during the transition period, they will need more development assistance on a concessional basis from bilateral and multilateral institutions, and they should avoid, as much as possible, the cycle of unsustainable debt;⁷¹ thus, they would be able to invest in the priority sectors while reforming their economies.

They will also need to have better and freer market access, which could generate more resources and contribute to the modernization of the structure of production. This would consequently improve their productivity and accordingly lead to more export capacity and more resources for poverty alleviation. It is obvious that this will require political stability, strong public finance management, and strict public expenditure monitoring.

Group II: Oil-Producing Countries: Better Management and Flexible Country Capital Expenditure Program

Referring to Eifert, Gelb, and Tellroth (2002), most of the essentials for managing oil revenues well are the same as those for good budget management in general; however, there is an important difference as to how to deal with uncertain revenues and avoid boom-bust cycles.

When should countries save or borrow against anticipated future oil income to finance current consumption and investment, as Mexico did in 1979? In addition, oil prices have been highly variable, twice as variable as those of other commodities (Eifert, Gelb, and Tallroth 2002), even in the case where changes are measured as deviations from recent trends. Also, changes have been predicted poorly.

Although managing oil revenues is a tricky issue for governments, oil revenues are nevertheless a huge opportunity for the development process. SSA oil-producing countries need to have a better PFM/PEM and development planning to fully take advantage of this exceptional opportunity to accelerate their development process.

This group of countries absolutely needs a flexible country capital expenditure program every five years, together with strict implementation monitoring made possible through an improved PFM/PEM system. This requires excellent budget preparation, execution, and monitoring. The flexible development planning will be done in such a manner that the countries could integrate the volatility of oil revenues.

⁷¹ Given their poor export performance and with almost with no FDI, these countries can barely service their debts.

The proposed flexible country capital expenditure program can be done, using the lowest oil price-per-barrel forecast as a baseline scenario. In the worst-case scenario, these countries could nevertheless implement the flexible capital expenditure program. And in the case where the prices forecast per barrel are more favorable, additional revenues generated will be carefully invested in priority sectors or transparently set aside.

It is time for SSA's producing countries to change their current policy and understand that oil revenues are an exceptional opportunity and not a renewable source of development financing. Therefore, they should take full advantage of that favorable situation to strengthen their public finance management in general, and their public expenditure management in particular. They should also plan their development process effectively.

Group III: Conflict and Postconflict Countries

Many of SSA's internal conflicts are no longer short-lived ways to settle a political dispute (Michailof, Kostner, and Devictor 2002). Although it is good to emphasize that conflict remains an unacceptable way to settle a political dispute in the modern world, constant instability has become an acceptable way of life for some warring factions. The impact of such situations on regional and country development prospects is dreadful. The situation is even worse when countries in conflict are among the poorest in the continent.

Conflict and Postconflict Countries with High Economic Expectations: Better Market Access and Pacification

The economic circumstances of postconflict societies are distinctive in several respects (Collier and Dollar 1999). The need to restore infrastructure, juxtaposed against the collapse of revenues, makes official development assistance (ODA) a prerequisite for the stabilization period. This effort could sustain the peace process, which is fundamental for any serious and credible development strategy.

ODA will play a critical role during the transition period for a more stable environment. Thereafter, these countries will need better market access and better public management. Indeed, these countries are potentially wealthy: in the absence of conflict, they could have been among the countries with high economic expectations (namely, major exporters or oil-producing countries). Angola, for example, is the second-largest (to Nigeria) SSA oil-producing and oil-exporting country.

Conflict and Postconflict Countries with Low Economic Expectations: Strict Public Expenditure Management, Pacification, and More ODA

These countries will be in need of much more development assistance and strict PFM/PEM in a sustained period to assist them to stabilize their economies and support the peace process (Collier and Hoeffler 2002). This includes funding the demobilization process toward a peaceful environment and nation rebuilding. Once countries have been stabilized, the next stage will be to apply the same strategy as that of Group I, Midsized and Low Exporters, because they do have more or less the same pattern of economic structure and economic prospects.

These countries, with heavy debt burdens and very limited domestic resources, will need to have better and freer market access, which could generate more resources and contribute to the

modernization of the structure of production. This could improve their productivity and accordingly lead to more export capacity and widen their export base; hence, there will be more resources for poverty alleviation. It is obvious that this will require political stability, development behavior-oriented leadership, and strong public finance management, along with strict public expenditure monitoring.

The structural transformation will take much longer for this group of countries because of their very limited domestic resources and unproven economic potential, as is also the case for most Group I Low Exporter countries.

WORLD BANK AND IMF RESPONSES

Collier and Dollar (2000) have demonstrated how efficient allocation of foreign aid could increase the rate of poverty reduction in the developing world. They developed a model in which changes in developing-country policies and changes in underlying aid parameters would lead to changes in the rate of poverty reduction. Accordingly, there is no doubt about what could be the role of the sole universal aid institution, namely the World Bank, toward the SSA poverty reduction and development process.

Reiterate the World Bank's Partnership

It is useful to clarify a persistent misunderstanding among Africans, regardless of their education and background: Can the World Bank alone develop SSA? Or should the mandate aim at providing additional assistance and support to governments to complement their own actions and policies toward the development process?

The mistaken idea that the World Bank alone will develop SSA is so popular in Africa that the Bank is being blamed for the missed performances of the continent. It should be said that poverty reduction in the world or in a particular region or country depends primarily on the quality of economic policy, and therefore the government: in other words, the country leadership. Collier and Dollar (2000) demonstrated that where they find, in the developing world, good environments for households and firms to save and invest in, they generally observed poverty reduction.

“Foreign aid can accelerate the process. It can assist the government and the society to provide public services, including critical ones needed by poor households to participate in the market economy. Aid increases the benefits from good policy. Meanwhile, good policy increases the impact of aid; thus, the combination of good policy and aid produces especially good results in terms of growth and poverty reduction” Collier and Dollar (2000).

Recently, aid effectiveness literature has been developed that investigates quantitatively the criteria by which aid should be allocated. Burnside and Dollar (2000) found that aid is more effective in increasing growth when the macroeconomic policy is better. Collier and Dollar (2001) incorporated the differences in poverty in the analysis and solved for a poverty-efficient allocation of aid across countries. Such an allocation equates the marginal efficiency of aid in reducing poverty across recipient countries, with aid absorption being dependent on both the incidence of poverty and the level of policy.

The burden of evidence is conclusive; the World Bank partnership with SSA works through its mandate: provide for additional assistance and support to governments in complement to their own actions and policies toward the development process. The government is responsible for the country's development; thus, good leadership and governance are critical for an efficient development process, poverty reduction, and structural transformation in SSA. However, the Bank should play a greater advisory⁷² role in SSA, given its international expertise (which is really needed), toward structural transformation for sustained growth and durable poverty reduction.

IMF's Continual Assistance and Balance-of-Payments Support

The quest of SSA to achieve economic and structural transformation is an imperative necessity to break the poverty trap and progressively bridge the continent's development and social gap. This process will certainly take time and will not be a homogenized movement that could lift off at the same time in all SSA countries. Even in the event of such an unexpected occurrence, the International Monetary Fund (IMF) should continue to provide SSA with balance-of-payments assistance.

One of the IMF's purposes is to facilitate the expansion and balanced growth of international trade to promote economic prosperity for all countries and to give⁷³ confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards and thus to provide them with an opportunity to correct maladjustments in their balance of payments, without resorting to measures destructive of national or international prosperity.

The Fund would play an even more important role during the SSA structural transformation process, given the dynamic that could be put into motion in the transition period between (a) the necessity of more imports to modernize the production structure, so as to break the supply-side constraint, and (b) the improvement needed in export⁷⁴ capacity to relieve foreign exchange constraints. The structural transformation process could generate severe external imbalances if there is no substantial increase in foreign direct investments in the beginning of the process, or additional flows of external assistance including bilateral assistance. Therefore, the IMF will remain relevant in Africa in the foreseeable future.⁷⁵

⁷² In addition to financial assistance, which many of the poorest SSA countries depend on, and they will likely be in need of much more Bank assistance in the long period toward structural transformation for sustained growth.

⁷³ Section V, Article I of IMF's Articles of Agreement.

⁷⁴ And be able to generate substantive foreign exchange resources for balance-of-payments equilibrium and development financing, specifically.

⁷⁵ This can be supported by the important IMF intervention during the financial crisis in East Asia in the mid-1990s, during which even Korea, considered as a newly industrialized country, was resigned to the IMF intervention.

5 Conclusion

Agriculture remains the mainstay of SSA economies, and per capita of the sector declined during 1970–2003. Furthermore, the overall share of exports from SSA, including South-Africa and Nigeria, is yet less than 2 percent of the global trade and the continent has the lowest income level in the world. The volatility of the SSA economy from 1960 to 2001 and SSA's balance-of-payments and budget⁷⁶ difficulties for more than three decades are largely the result of its structural intricacy in the sense that there is a persistent structural-economic constraint and supply-side constraint which are the bottlenecks preventing the region from generating stronger and sustained aggregate income. Thus, external and domestic imbalances can hardly be resolved in a meaningful way without a structural transformation.

Two factors are responsible for deterring the development of Sub-Saharan Africa: (a) persistent structural constraint, which impedes the sustained growth and (b) lack of good leadership—more explicitly, lack of development behavior-oriented leadership and good governance to catalyze the process. In fact, good leadership envisions development and endeavors, sound public finance management (PFM); hence a Public expenditure management (PEM) as a tool to attain its development vision, with efficiency and discipline in the best interest of the country. It is then critical for the continent to embark on the process of structural transformation to break the vicious circle of underdevelopment and poverty.

Indeed, in a context of double gap constraint $(S - I) \equiv (X - Z)$, as is the case for most SSA countries today, countries are trapped in the vicious cycle of underdevelopment and poverty, given the current SSA economic structure. This is fundamentally a macroeconomic accounting fact, a reality and a reflection of fundamental macroeconomic mechanisms. A country's wealth is generated from the country's economic structure; other things being equal, substantial additional income can come only from a structural transformation. And only a structural transformation will expand the production base as productivity is improved.

It is critically important for the subcontinent to forcefully start the process of climbing the value-chain ladder and swiftly move into more manufacturing activities by adopting and adapting existing technologies in the early stage of its structural transformation. At the same time SSA must adjust to global demand and international trade, if it is to achieve sustained growth and poverty reduction.

SSA could embark on a sustained growth path and launch its economic takeoff if the subcontinent wins the battle of structural transformation and supply-side constraint; this would help to break its vicious cycle of enormous need of resources and the poverty trap. However, it will not be a homogenous lift-up, given the difference regarding the degree and the relative level of development among SSA countries and their economic potentials.

⁷⁶ The government revenues are negligible and cannot be increased in a meaningful way, given that they are based on the country fiscal base (and therefore economic structure).

As we have repeatedly highlighted, changes in structure and performances are interrelated. In many respects, the emergence of Malaysia is a perfect illustration in that regard. The central concept of development that has emerged from comparative studies is clearly the structural transformation required to sustain increased output and consumption. The dimensions of transition or structural transformation, from a traditional to a developed economy is defined in general terms as the set of changes in the economic structure required to sustain a continued increase in income and social welfare. The transformational process implies accumulation of physical and human capital and shifts in the composition of demand, trade, output and factor used; including socio-economic aspects, such as urbanization, demographic transition and changes in income distribution.

Malaysia successfully managed to break the vicious cycle of the domestic saving gap and the trade gap through its structural transformation. It is also important to emphasize that Malaysia's economic structure before the transformation was similar in many ways to that of most SSA countries today: therefore, SSA countries could learn from the Malaysian model.

Malaysia was a traditional commodity (tin, rubber, and palm oil)-based economy, as is currently the case for SSA. Then it turned itself into a manufacturing economy. Now it is changing again into a services-based economy, although manufacturing still accounts for more than 30 percent of the economy.

Malaysia has been able to combine the traditional commodities while building a strong manufacturing sector. Now it is climbing the value-chain ladder by trying to move its electronics industry up from commodity "chip making" to testing and even designing chips. Meantime, Malaysia will pay more attention to the traditional commodities⁷⁷ that made the country rich.

Malaysia's structural transformation has been made possible, in part, because of the country's leaders and the advantage they took of the wave of foreign direct investment (FDI) that rolled into Southeast Asia in the 1980s and 1990s. During those two decades, some US\$80 billion was invested in Malaysia.

Most of the SSA countries can become the next Malaysia, should they manage to have a development behavior-oriented leadership in place to catalyze the structural transformation process and to make better use of public resources; should they take advantage with discipline and systematically utilize all economic opportunities and potentials to attract more FDI; and should they have better market access to fuel the structural transformation. Unfortunately, it is not likely to be the case for all SSA countries at once. The less well-endowed among them will still be in need of much more ODA for a sustained period, although they would take full advantage of freer and better market access.

⁷⁷ Palm oil, rubber, tin, and (later) crude oil.

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