Heritage Lectures

Published by The Heritage Foundation

No. 858
Delivered November 6, 2004

December 20, 2004

Multilateral Economic Development Efforts in Sub-Saharan Africa

Brett D. Schaefer

The world can fairly easily be divided into areas of wealth and poverty. This has always been true, but only in recent decades has there been a concerted attempt by wealthier nations to assist poorer nations in becoming more prosperous. Starting with the Bretton Woods institutions (the International Monetary Fund and the World Bank) and extending to the subsequent creation of regional development banks and national development agencies, the developed world began to undertake this effort in the 1940s.

Several years ago Congress created the International Financial Institution Advisory Commission (IFIAC) to assess the impact of the International Monetary Fund (IMF), the World Bank, and other international financial institutions (IFIs) in achieving their stated goals—of which one of the most important is helping poor nations increase economic growth. The final report of the Commission concluded that the IFIs were not providing positive contributions toward development. It offered a number of fundamental recommendations to improve those institutions, most of which remains unadopted.

Development in Sub-Saharan Africa

No region of the world is in more dire need of development than sub-Saharan Africa. The 700 million people in this region face tremendous challenges, including the world's highest incidence of HIV/AIDS, deep poverty, unemployment, political instability, and a host of related problems. If the IFIs are to be measured, sub-Saharan Africa should be a key factor in that judgement.

Talking Points

- Despite development assistance (often at extremely subsidized interest rates and generous repayment schedules), sub-Saharan Africa has performed dismally on various economic indicators.
- Experience demonstrates that simply providing assistance will not magically spur economic growth. It is policies and institutions that matter for development.
- Developing countries must make their own internal reforms by implementing policies that promote economic freedom, which, in turn, are known to be associated with higher levels of economic growth.

This paper, in its entirety, can be found at:
www.heritage.org/research/tradeandforeignaid/hl858.cfm

Produced by the Center for International Trade and Economics (CITE)

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

The Heritage Foundation

The decades since the 1940s have seen an evolution in strategies to achieve the overriding goal of increasing economic growth in poor nations. With the support of the World Bank and other development institutions, most African nations embraced development strategies involving heavy state intervention, including nationalization of industries, property, banks, and control over key utilities and commodities. These policies proved disastrous, leading to poor growth, rampant corruption, and poor services. Despite a general rejection of state-led development beginning in the early 1980s, many countries in sub-Saharan Africa are still burdened with heavy state intervention.

Between 1980 and 2002, the World Bank's International Bank for Reconstruction and Development and International Development Association, along with the African Development Bank, have provided $77.5 billion (in 1995 dollars) in development assistance to the 48 countries in sub-Saharan Africa—nearly $1.5 billion per country—to spur development in the region. This is a huge investment, particularly when the relatively small sizes of the recipient countries' economies are taken into account. To put this into perspective, the total gross domestic product (GDP) in constant 1995 U.S. dollars for those 48 countries in 2002 was $296.6 billion (approximately the same GDP as Michigan). Using constant dollars, multilateral development assistance to the region from 1980 to 2002 was over 26 percent of the region's total GDP in 2002.

Despite this development investment (often at extremely subsidized interest rates and generous repayment schedules), sub-Saharan Africa has performed dismally. Of the 45 sub-Saharan African countries for which per capita GDP data are available from 1980 to 2002:

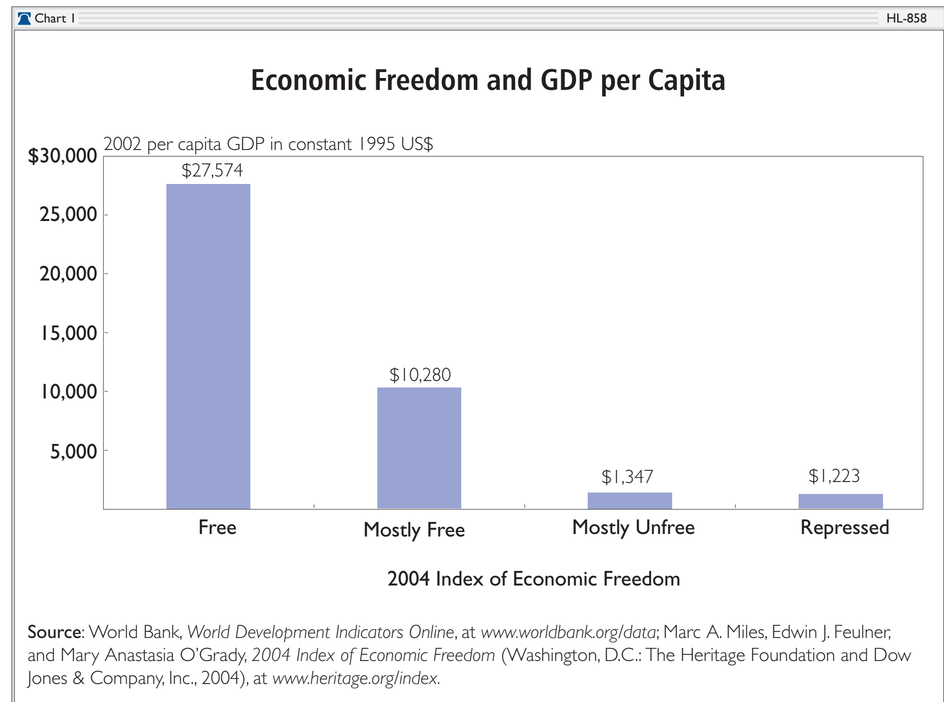
- Twenty-three experienced negative compound annual growth in real per capita GDP (constant 1995 U.S. dollars);
- Seven experienced marginal compound annual growth between 0 percent and 1 percent in real per capita GDP; and
- Fifteen experienced compound annual growth of more than 1 percent in real per capita GDP, but only three achieved per capita growth over 4 percent. The best performer was Equatorial Guinea, which experienced real growth of over 12 percent due to the recent discovery and export of oil.

Why is this important? According to the World Bank, the average 2002 per capita GDP in sub-Saharan Africa was $577.[1] To become as wealthy as the United States in per capita GDP, the average country in sub-Saharan African must experience real compound growth in per capita GDP of 5 percent per year for over 80 years. To reach upper-middle–income status (per capita income of $2,976), it would have to experience real compound growth in per capita income of over 5 percent for more than 34 years.[2] Instead of desperately needed economic growth, sub-Saharan African saw a decline in per capita GDP from $660 in 1980 to $577 in 2002 (in constant terms).[3]

Despite the modest gains in areas such as literacy and infant mortality,[4] which should be encouraged, improvement of human development indicators in sub-Saharan Africa has lagged far behind other regions of the world. For instance, sub-Saharan Africa is the only region of the world that is not on

1. All per capita GDP data are in constant 1995 U.S. dollars. World Bank, *World Development Indicators 2004*, at *www.worldbank.org/data/onlinedatabases/onlinedatabases.html* (November 12, 2004).
2. World Bank, "Classification of Economies," in *Global Economic Prospects and the Developing Countries* (Washington, D.C.: The International Bank for Reconstruction and Development/ World Bank, 2003), pp. 219–223.
3. World Bank, *World Development Indicators*.
4. In 2002, life expectancy had fallen from 48 years in 1980 to 46 years, largely due to HIV/AIDS. However, the adult literacy rate improved from 38 percent to 65 percent and infant mortality dropped from 116 per 1,000 live births to 103 per 1,000 live births. Still, these figures were among the world's worst—far below middle-income countries, such as Mexico, 20 years ago (where in 1980, life expectancy was 67 years, adult literacy was 81 percent, and infant mortality was 56 for every 1,000 live births). World Bank, *World Development Indicators*.

track to meet a single target of the Millennium Development Goals—including the goals to reduce poverty, hunger, and infant mortality or to improve secondary school enrollment for girls, immunization for measles, and access to potable water.[5]



Source: World Bank, *World Development Indicators Online*, at *www.worldbank.org/data*; Marc A. Miles, Edwin J. Feulner, and Mary Anastasia O'Grady, *2004 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2004), at *www.heritage.org/index*.

Unfortunately, even the few gains made by African countries may be short lived because without increases in economic growth, they are not sustainable. Without economic growth, countries lack the resources to support efforts to improve the lives of their citizens. Indeed, the World Bank estimated that halving severe poverty in sub-Saharan Africa by 2015 (a target of the United Nations' Millennium Development Goals [MDG])[6] would require annual growth of at least 7 percent. Meeting the other MDG—and more importantly, creating the ability for countries to continue progress made toward those goals—depends in great part on increasing economic growth. Foreign assistance by itself is not sufficient.

The Need for Economic Freedom

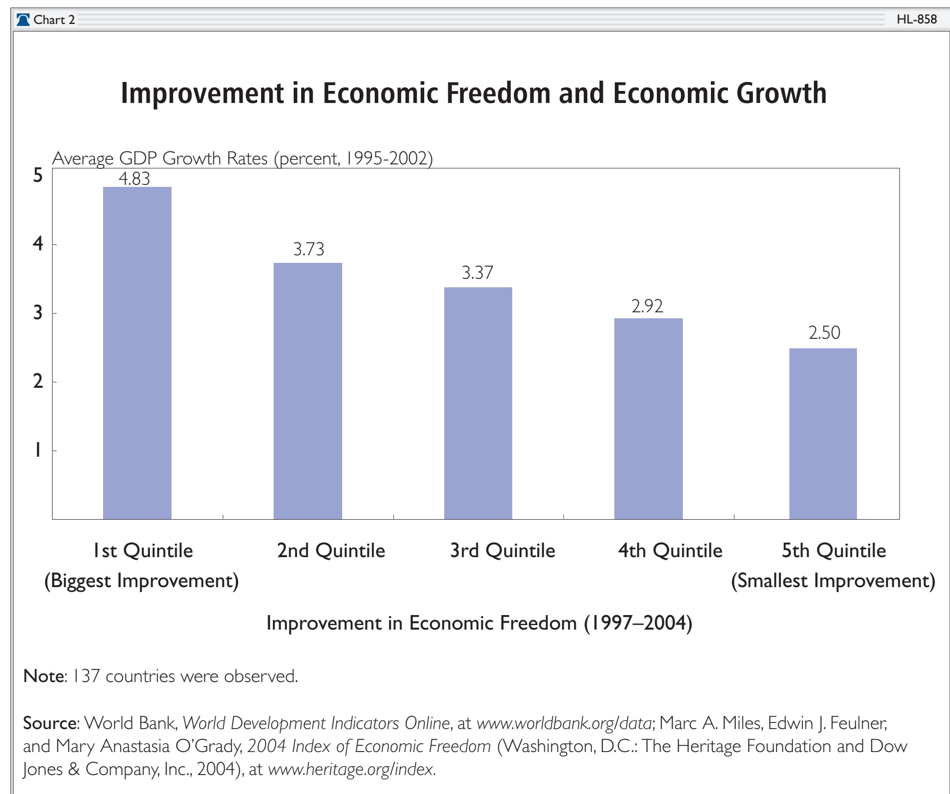
Achieving high per capita economic growth is possible, even in low-income countries. No doubt everyone is familiar with the respective histories of sub-Saharan Africa and East Asia. Per capita GDP in East Asia and the Pacific was lower than in sub-Saharan Africa in 1960, but has since far eclipsed sub-Saharan Africa. Most have heard about the dramatic success of Singapore, Hong Kong, and Taiwan. Yet even troubled nations like Indonesia have outpaced similar nations in Africa. In 1960, Indonesia had a per capita GDP of $249 and Nigeria had a per capita GDP of $224 (in constant terms). Nigeria has seen a $24 increase in per capita GDP—despite enormous oil resources—while Indonesia's per capita GDP climbed to over $1,000.[7] This disparity in growth occurred despite similarities between the countries, including oil resources, multi-ethnic populations, religious tensions, large populations, proximity to developed markets, large geographical size, and extensive corruption.

Perhaps one reason for the different development paths is these countries' respective approach to economic policy. While neither nation is a paragon of economic freedom, Indonesia generally has had a freer economy.

Research at The Heritage Foundation indicates that the best way for countries to increase economic growth is to adopt policies that promote economic freedom and the rule of law, which are measured in

5. "Ends Without Means," *The Economist*, September 11, 2004, p. 72.
6. United Nations, "U.N. Millennium Development Goals (MDG)," at *www.un.org/millenniumgoals/* (November 12, 2004).
7. Comparison taken from Raymond W. Copson, "Africa: Development Issues and Policy Options," Congressional Research Service *Issue Brief* IB95052, July 22, 2004, p. 3.

the *Index of Economic Freedom*. The *Index* analyzes 50 economic indicators in 10 independent factors: trade policy, fiscal burden of government, government intervention in the economy, monetary policy, capital flows and foreign investment, banking and finance, wages and prices, property rights, regulation, and informal market activity. Those 10 factors are graded from 1 to 5, with 1 being the best score and 5 being the worst score. Those scores are then averaged to give an overall score for economic freedom. Countries are designated "free," "mostly free," "mostly unfree," or "repressed" based on these overall scores.



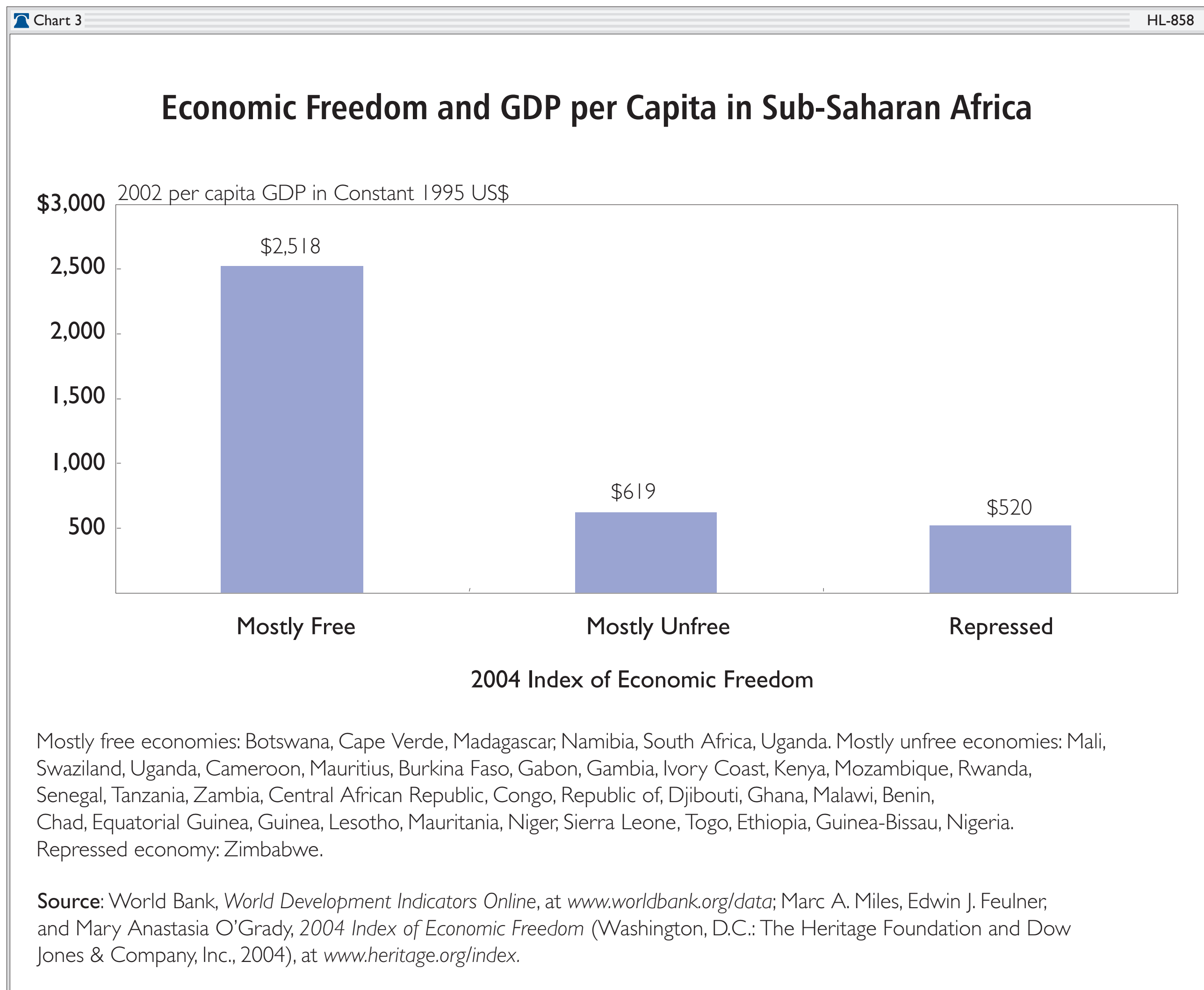
As shown in the *Index*, "free" countries, on average, have a per capita income twice that of "mostly free" countries. "Mostly free" countries have a per capita income more than three times that of "mostly unfree" and "repressed" countries. (See Chart 1.) This relationship exists because countries that maintain policies that promote economic freedom provide an environment that facilitates trade and encourages entrepreneurial activity, which in turn generates economic growth.

Not only is a higher level of economic freedom clearly associated with a higher level of per capita GDP, but higher GDP growth rates are associated with improvements in a country's economic freedom score.[8] Chart 2 ranks the graded countries according to the improvement in economic freedom between 1997 and 2004. The countries represented in the left-hand bar were most improved, and those in the right-hand bar were least improved. Average growth rates across the eight years of changes were then computed for the countries in each bar or group. Across the spectrum, the more a country improved its economic freedom, the higher the average economic growth it experienced. Countries that consistently march toward improved economic freedom enjoy the most progress towards prosperity.

This relationship holds, in general, for sub-Saharan Africa. As illustrated in Chart 3, "mostly free" economies in sub-Saharan Africa graded in the 2004 *Index* averaged a per capita GDP of more than three times that of "mostly unfree" economies, which in turn averaged a per capita GDP nearly 20 percent greater than "repressed" economies.

Similar to the trend for all countries, Chart 4 illustrates that sub-Saharan African countries that improved their economic freedom scores the most were associated with higher GDP growth rates. The relationship is not as linear in the African countries as it is among all countries, but clearly the countries improving the most saw the greatest improvement

8. Marc A. Miles, "Introduction," in Marc A. Miles, Edwin J. Feulner, and Mary Anastasia O'Grady, *2004 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2004), p. 21.



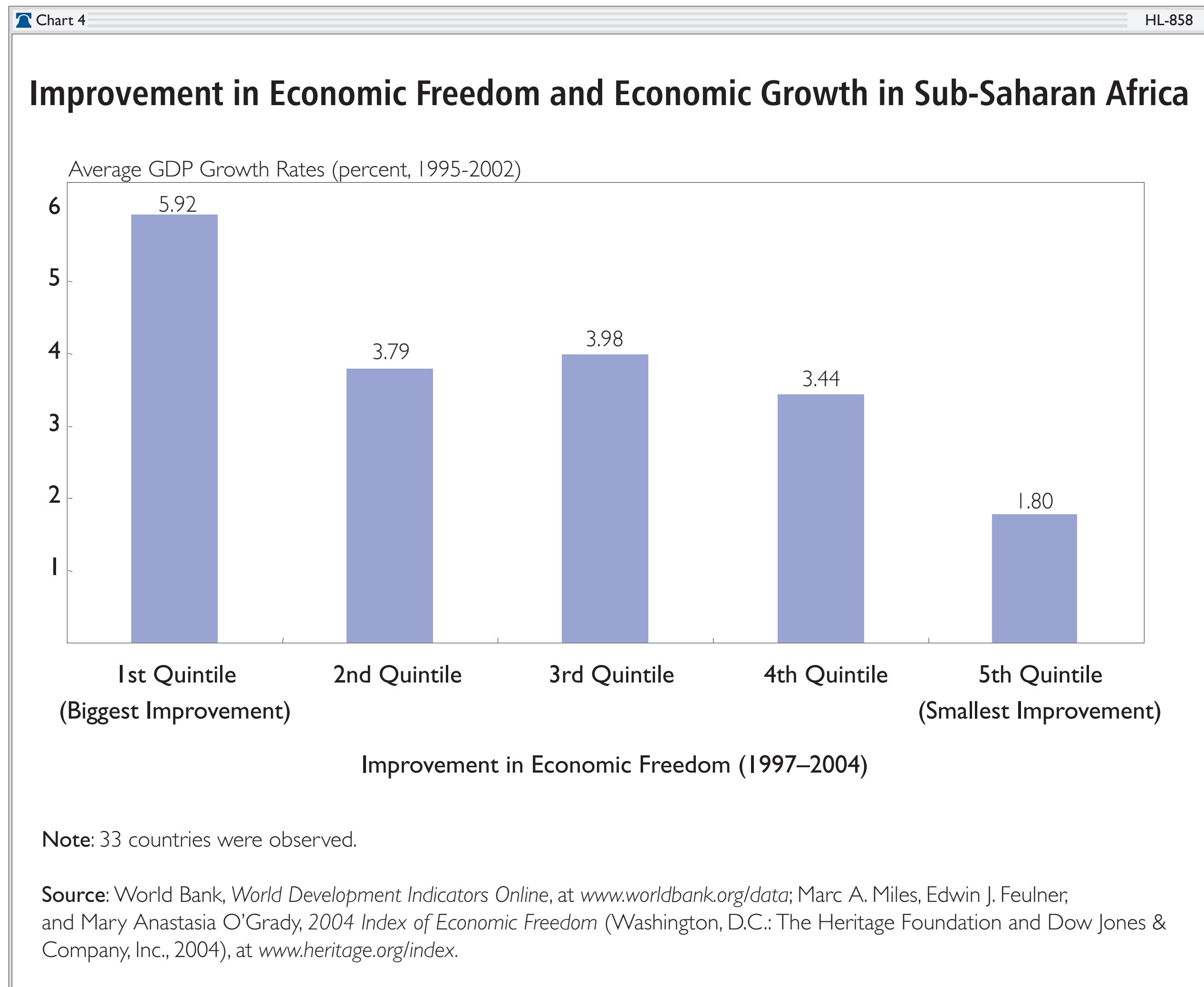
Mostly free economies: Botswana, Cape Verde, Madagascar, Namibia, South Africa, Uganda. Mostly unfree economies: Mali, Swaziland, Uganda, Cameroon, Mauritius, Burkina Faso, Gabon, Gambia, Ivory Coast, Kenya, Mozambique, Rwanda, Senegal, Tanzania, Zambia, Central African Republic, Congo, Republic of, Djibouti, Ghana, Malawi, Benin, Chad, Equatorial Guinea, Guinea, Lesotho, Mauritania, Niger, Sierra Leone, Togo, Ethiopia, Guinea-Bissau, Nigeria. Repressed economy: Zimbabwe.

Source: World Bank, *World Development Indicators Online*, at *www.worldbank.org/data*; Marc A. Miles, Edwin J. Feulner, and Mary Anastasia O'Grady, *2004 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2004), at *www.heritage.org/index.*

in GDP growth rates and the countries improving the least experienced the least GDP growth.

Why would economic freedom contribute to economic growth? Rigid labor policies, high regulation and bureaucratic red tape, high official taxation, corruption, and trade barriers are obstacles that create a drag on economic growth. The greater the level of government intervention in the economy, the lower probability that individuals, investors, and businesses will be able to prosper because costs of private economic activity become higher. This leads talented people to leave the country for more advantageous opportunities or to engage in activities that do not contribute to GDP (such as government service) and enrich themselves through rent seeking and corruption. It has also created a permanent informal economy in many countries that, while operating less inefficiently than it would if economic impediments were removed, fills demands left unmet because of the government's anti-market policies. The practical result is that economically unfree countries are more likely to be poor and find it more difficult to escape that poverty.

The evidence from the *Index* is that increasing economic freedom is a key element in creating a positive environment for foreign and domestic investment. Botswana and Mauritius are good examples of how, even in sub-Saharan Africa, countries that embrace economic freedom can reap



rewards in higher economic growth. From 1980 to 2002, both countries achieved a compound average growth in per capita GDP of 4.42 percent and 4.44 percent, respectively. Not surprisingly, these countries adopted economic freedom early and reaped the rewards. Both nations have been rated "mostly free" economies for most of the time that the *Index of Economic Freedom* has graded them.

Do International Financial Institutions Help Promote Economic Freedom?

The idea that economic freedom or economic liberalization is necessary for development is not a radical proposal. It is generally accepted by economists, even at the World Bank.[9] A 1997 World Bank analysis of foreign aid found that, while assistance has a positive impact on growth in countries with good economic policies (free market policies, fiscal discipline, and the rule of law), countries with poor economic policies did not experience sustained economic growth regardless of the amount of assistance they received.[10] Another World Bank study found that increased integration into the world economy from the late 1970s to the late 1990s led to higher income growth. These countries achieved average per capita income growth of 5 percent per year in the 1990s.[11]

By contrast, non-globalizing nations have seen poor economic growth of only 1.4 percent (on average) during the 1990s, and many saw negative growth. Moreover, a related World Bank study found that increased growth resulting from expanded trade "leads to proportionate increases in incomes of the

poor...[;] globalization leads to faster growth and poverty reduction in poor countries."[12] These studies simply confirm the "Washington consensus" of market-driven development that has supposedly guided IFI development policy during the past two decades.

In many ways, the policies upon which the Washington consensus is founded are consistent with free markets. Key features of that consensus include fiscal discipline, lower marginal tax rates, liberalization of interest rates, trade liberalization, privatization, deregulation, and secure property rights.[13] Indeed, IFIs make many rhetorical gestures toward a commitment to market liberalization. The problem is that this rhetoric is rarely adhered to in practice, and recipients often violate policy commitments made to IFIs without fear of repercussion. This situation is why the IFI strategy of "conditionality"—providing money to fund promises of economic reform—has failed. The assistance is provided, but reforms seldom materialize.

Take, for instance, the World Bank's record in encouraging recipients to adopt liberal economic policies in sub-Saharan Africa. Analysis of the correlation between changes in *Index* scores on economic freedom from year to year for sub-Saharan African countries and changes in disbursements of World Bank year-on-year assistance per capita for those countries reveals that the relationship between aid disbursement and improvements in economic freedom is not significant. Moreover, to the extent that there is a relationship, the World Bank has more often increased lending to countries that are retreating from economic liberalization.[14]

While the World Bank often states that lending is based on a commitment to policy change, it seldom ties lending to policy improvements. This lends credibility to charges that the Bank is more interested in processing loans than being a tough advocate of policies that would contribute to economic growth. This situation may serve the bureaucratic impulses of the Bank and the vested interests in recipient countries that profit from anti-market policies, but it clearly does not serve the interests of the people in poor nations whose governments

9. Other studies arrive at similar conclusions. For instance, economists Richard Roll and John Talbott support this conclusion with evidence that the economic, legal, and political institutions of a country explain more than 80 percent of the international variation in per capita real income (between 1995 and 1999) in more than 130 countries. Richard Roll and John Talbott, "Developing Countries that Aren't," unpublished manuscript, November 13, 2001, p. 3. Other studies include Paul Collier and Jan Willem Gunning, "Why Has Africa Grown Slowly?" *Journal of Economic Perspectives*, Vol. 13 (1999); David Dollar, "Outward-Oriented Developing Economies Really Do Grow More Rapidly: Evidence from 95 LDCs, 1976–1985," *Economic Development and Cultural Change*, Vol. 40 (April 1992), pp. 523–544; Robert J. Barro and Xavier Sala-i-Martin, *Economic Growth* (New York: McGraw–Hill, 1995); and Jeffrey D. Sachs, and Andrew Warner, "Economic Reform and the Process of Global Integration," Brookings Institute *Papers on Economic Activity*, Vol. 1995, Issue 1 (1995).

10. Craig Burnside and David Dollar, "Aid, Policies, and Growth," World Bank, Policy Research Department, Macroeconomic and Growth Division, June 1997.

11. Paul Collier and David Dollar, *Globalization, Growth, and Poverty: Building an Inclusive World Economy* (Oxford: World Bank and Oxford University Press, 2002), p. 5.

12. David Dollar and Aart Kraay, "Trade, Growth, and Poverty," World Bank, Development Research Group abstract, March 2001.

13. John Williamson, "What Should the World Bank Think About the Washington Consensus?" article written as a background paper for World Development Report 2000–2001, at *www.worldbank.org/research/journals/wbro/obsaug00/pdf/(6)Williamson.pdf* (November 23, 2004).

14. This analysis was from taken from the *Index of Economic Freedom* (1997 through 2004 editions). The correlation was the difference in *Index* score and change in aid per capita year to year (with the sign reversed for the *Index* data to account for the inverse scale of scoring, in which lower scores are better than higher scores). Because *Index* scores are based on data available prior to publication (for instance, economic data would be from 1994 in the 1997 *Index*), these scores were correlated with changes in World Bank assistance per capita two years prior to the first *Index* year—i.e. the change in score from the 1997 to the 1998 *Index* were correlated with the changes in assistance per capita from 1995 to 1996. For an online interactive tool to perform multi-year comparisons or to view *Index* scores from past years, see *www.heritage.org/research/features/index/search.html.*

routinely resist economic reforms more likely to result in economic growth—and who are ultimately responsible for repaying ineffective Bank loans.

How to Increase Economic Freedom Among Poor Nations

The failure of development assistance in facilitating economic growth has left many poor nations with a large debt burden. It is the small return on development assistance over the years and the justifiable belief that new loans were often approved to finance existing debt (creating a rising spiral of debt that does not contribute to growth) that fuels criticism of foreign assistance and lies at the heart of calls for debt forgiveness.

Many people recommend debt forgiveness and argue that payments on this debt would be better used if they were dedicated to domestic development needs. This may be true for some countries, but countries beset by poor policies, corruption, heavy state intervention, and other characteristics that retard growth will not benefit from the debt relief. It is not debt that is preventing these countries from addressing their problems, it is anti-market economic policies, corruption, and the absence of the rule of law. Debt relief cannot help the worst-governed developing nations, such as Zimbabwe, Sudan, and the Congo. In such countries, additional funds gleaned from debt forgiveness will be used to prop up bad governments or simply provide more resources for kleptocrats to pocket. Debt can be a carrot and a stick: We should use forgiveness to reward good performers, encourage policy change—and withhold forgiveness from countries that refuse to change.

An interesting recent development is the creation of the Millennium Challenge Account (MCA) in the United States. The MCA takes a new approach to foreign assistance by making assistance available only to countries "that govern justly, invest in their people and encourage economic freedom" as determined by their performance on 16 specific indicators.[15] If a country bests the average in at least half the indicators in three general categories, it becomes eligible to receive MCA grants. Failure to meet that standard excludes the country from aid consideration for that year.[16]

The idea of establishing preconditions in order to receive foreign assistance—rewarding good policies already in place, rather than providing money in hope of encouraging reform—was a central tenant of the IFIAC.[17] The evidence thus far bolsters

15. The six indicators for Governing Justly (followed by the source for the indicator) are: Civil Liberties (Freedom House); Political Rights (Freedom House); Voice and Accountability (World Bank Institute); Government Effectiveness (World Bank Institute); Rule of Law (World Bank Institute); and Control of Corruption (World Bank Institute). The four indicators for Investing in People are: Public Primary Education Spending as Percent of GDP (World Bank/national sources); Primary Education Completion Rate (World Bank/national sources); Public Expenditures on Health as Percent of GDP (World Bank/national sources); and Immunization Rates—DPT and Measles (World Bank/UN/national sources). The six indicators for Promoting Economic Freedom are: Country Credit Rating (*Institutional Investor* Magazine); Inflation (IMF); Three-Year Budget Deficit (IMF/national sources); Trade Policy (Heritage Foundation); Regulatory Quality (World Bank Institute); and Days to Start a Business (World Bank). In addition to passing a majority of the indicators in each category, countries must pass the "control of corruption" indicator to qualify. For more information about the Millennium Challenge Accounts, see *www.mca.gov/* (November 23, 2004).
16. The Millennium Challenge Account was created in response to the ineffectiveness of previous foreign assistance in promoting economic growth. President Bush called for "a new compact for global development, defined by new accountability for both rich and poor nations alike. Greater contributions from developed nations must be linked to greater responsibility from developing nations." See White House, "The Millenium Challenge Account," at *www.whitehouse.gov/infocus/developingnations/millennium.html* (November 23, 2004). To qualify for the MCA, a country must score above the median for half of the indicators in each policy area—that is, it must pass three of the six performance indicators that measure good governance; two of the four that measure investment in people; and three of the six that measure economic freedom.
17. Congress established the International Financial Institutions Advisory Commission (IFIAC), chaired by Professor Allan Meltzer, to assess the role and effectiveness of the World Bank, the International Monetary Fund, the regional development banks, the Bank of International Settlements, and the World Trade Organization. The full IFIAC report is available at *www.house.gov/jec/imf/meltzer.htm* (November 23, 2004).

this Commission recommendation. Although the MCA has not provided a grant to date, it has spurred reform among candidate countries. For instance, governments in some African countries have mentioned how they were reducing the time needed to register a business—one MCA measure. They were also very interested in how the *Index* measures trade policy (another MCA measure) and how they could improve their score.[18]

By creating incentives for reform, the MCA has led to policy changes even before the first grant has been extended. Its willingness to differentiate among potential recipients and deny aid to countries that fail to demonstrate a commitment to good policies has great potential for improving the effectiveness of foreign assistance. Hopefully, the Millennium Challenge Corporation will demonstrate success once it begins disbursing MCA grants and make further IFI reform easier.

The economic futures of developing countries lie predominantly in their own hands through the policies that they choose to adopt and enforce. If countries want to increase per capita GDP, they should adopt policies that are most likely to achieve that result. IFIs can contribute to this goal, but they must change their approach to foreign assistance.

Conclusion

Development assistance is not necessary for poor nations to develop. Experience demonstrates that simply providing assistance will not magically spur economic growth. It is policies and institutions that matter for development. Foreign assistance, through an international financial institution or otherwise, has the potential to help poor countries achieve specific goals, but it cannot replace the political will to implement policy change. The challenge is to create opportunities for growth and remove barriers to growth.

As noted in *The Road to Prosperity: The 21st Century Approach to Economic Development*:

> In technical terms it is not the level of poverty that is most vicious, but rather the absence of change or opportunity to escape that poverty. Where the 20th century approach produced a vicious cycle of aid, default, and dependency on foreign governments, the IMF, or the World Bank, the 21st century holds out the prospect that countries can generate growth and prosperity themselves, without foreign interference.[19]

The challenge is to make these countries' efforts positive rather than negative.

Developing countries must make their own internal reforms by implementing policies that promote economic freedom, which, in turn, are known to be associated with higher levels of economic growth. Unfortunately, in many cases foreign assistance has made development more difficult by encouraging corruption, abdication of responsibility for bad policies, perpetuation of bad policies, and by many years of recommending counter-productive policies.

The IFIs enjoy considerable support from both donor and recipient nations and are not going to be eliminated. However, the U.S should strive to reform these institutions along the lines of the IFIAC. Only then will developing countries be on the path to economic development and only then will multilateral assistance find fertile soil to aid development.

—Brett D. Schaefer is the Jay Kingham Fellow in International Regulatory Affairs in the Center for International Trade and Economics at The Heritage Foundation. This lecture was originally presented November 6, 2004, to the American Institute for Economic Research in Great Barrington, Massachusetts. *The author would like to thank Anthony Kim, Research Assistant in the Center for International Trade and Economics, for his valuable assistance.*

18. Author interview with various African country representatives, October 11–29, 2004.
19. Marc A. Miles ed., *The Road to Prosperity: The 21st Century Approach to Economic Development*, (Washington, D.C.: The Heritage Foundation, 2004) p. 8.