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## Response to Mkandawire

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## Response

Vasant A. Sukhatme

I welcome the opportunity to respond to the remarks of Thandika Mkandawire, although I confess at the start that I am not an Africa expert and do not have any special qualifications to speak on globalization issues. I will say, however, that I have long believed that many kinds of topics often benefit from the perspective of a novice, and I hope you will agree by the end of my remarks that “Globalization and Africa’s Unfinished Agenda” is one such topic. I am, by profession, an applied microeconomist with a research interest in economic development, so I shall bring the tools of that “trade” to address the topic at hand.

The ten poorest countries in the world, measured in terms of purchasing power parity estimates of income per capita, are in sub-Saharan Africa: they are Rwanda, Ethiopia, Mali, Tanzania, Madagascar, Malawi, Burundi, Sierra Leone, Chad, and Niger. The total combined population of these countries is about 140 million, which is about one third that of all of sub-Saharan Africa. Although these countries are all poor, they do not represent a homogeneous group. For one thing, they range in population from less than five million to more than fifty million. Compared to any other group of countries or any other continent — and in stark contrast to all of them — Africa as a whole has experienced economic decline, which began in the mid-1970s. This is what is beneath the refrain that Africa has been marginalized. Gross domestic product per capita in several large African countries has declined from the mid-1970s to the mid-1990s. In the last year or so, however, several African countries have experienced significant positive economic growth. Nonetheless, a larger fraction of the population in Africa as compared with any other major part of the world seems to be below the poverty line, regardless of how we define or draw that line.

This tragic state of affairs is a commentary on the lives of hundreds of millions of people. It is also the context in which I frame my remarks as I respond to Mr. Mkandawire. I believe it is important to understand, as best as we can, the fundamental reasons behind the state of affairs in Africa. If we can begin to understand the causes of Africa’s ills, we can better understand what economic steps must be taken to reverse the continent’s decline.

Among the many things African nations have in common are economies that are small in size, with low average incomes. However, Africa is a continent of enormous size and a great deal of diversity. There are major differences across the continent in terms of agroclimatic conditions and natural and human resources. There is considerable variation in economic performance across sub-Saharan Africa. For example, Niger and Togo experienced substantial declines of per capita income between 1985 and 1994, whereas in that same period countries such as Mozambique and Uganda grew more than 2 percent per year in per capita terms. Bear in mind the implication of this: a country growing at 5 percent a year will double its income every fourteen years, whereas a country growing at 1 percent a year will take five times as long, or seventy years, to double its income. I would be remiss, however, if I did not also note that Botswana and South Africa are relatively well-to-do, with average incomes seven times greater than the group I listed at the beginning of my remarks. Botswana and South Africa have roughly similar per capita incomes, but Botswana is only 1/25th the size of South Africa. Further, two other countries in sub-Saharan Africa (Gabon and Cameroon) are considerably better off than the average of the ten poorest countries I listed.

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After briefly summarizing the conclusion I reached from Mr. Mkandawire's essay, I will offer my own view of the causes of Africa's lagging economic performance. I understood Mkandawire to say that the international financial institutions in Africa have not served Africa's economic interests well. A corollary of this message is that the problems of Africa must be seen in a global context, which is to acknowledge that globalization is harming Africa. Mkandawire appears to argue that the globalization of Africa is largely driven by the international financial institutions, particularly the International Monetary Fund and the World Bank, and that the benefits of globalization have yet to reach Africa. Further, he argues that if African countries cannot fashion the right response to the external forces of globalization, then for Africa it will be an "immiserizing" globalization. Finally, he argues that internal institutional and political weaknesses and the particular way Africa is being integrated into the global system are likely to lead to this undesirable outcome.

My approach differs from the one Mkandawire adopts, but I believe it also complements his. I want to emphasize issues that are internal to the structure of African countries but I admittedly do not know enough about African nationalism to do justice to his comments on that subject. Instead, I will take the approach which I am most qualified to do, as an applied microeconomist.

Africa is the only part of the world where foreign economic assistance flows exceed by a large margin private-capital flows. In that sense, one can say that Africa is aid-dependent. In my view (and that of many other economists), aid has failed in Africa and so has aid conditionality. But I want to emphasize that development has not occurred in Africa because aid has failed. In fact, aid is not a key or even a major determinant of economic development. If anything, aid is but a small part of the explanation of why development has failed in Africa. Economists studying the economic impacts of foreign aid have generally concluded that aid is beneficial when the economic-policy environment of the aid recipient is conducive to economic progress. Where aid has flowed into environments with inferior economic policy, there have been, under conditionality, attempts to induce good policy environments. That is part and parcel of the business of foreign aid.

It appears to be generally accepted that, because Africa is so greatly aid-dependent, it is a pawn of the IMF and the World Bank. But surely this grossly overstates the situation. While aid conditionality sounds ominous on paper, it does not actually amount to much of a burden. In fact, as the economist Ravi Kanbur has recently noted, it is likely that the desk officer at the Fund or the Bank of an aid-receiving country that violates conditionality will look the other way rather than put a stop to the flow of aid funds.<sup>1</sup> If the loan officer at the Bank or the Fund does not keep aid funds flowing, then his own position at that institution is at stake. Because this is the heart of the agency problem that haunts the aid business, in practice, aid conditionality has turned out to be neither particularly onerous nor effective. In light of this, it is difficult to understand why the concept of conditionality raises the ire of so many people, but it explains, in large measure, why bad policy environments have persisted. Aid flows have not helped in the development of Africa and have not helped in the development of useful economic policies.

In spite of what many may believe, economists have learned an enormous amount in the last five decades about what kinds of eco-

conomic policies are necessary to stimulate economic growth and development. Rapid population growth in many countries and external constraints — such as adverse terms of trade for some countries and the slow growth of output in industrialized countries leading to decreased demand for primary products from Africa — have all contributed to Africa's faltering economic performance. The major culprits, however, have been domestic-policy failures, including the bias against agriculture in price policy, tax policy, and exchange-rate policy.

In an important recent volume, Thomas Tomich, Peter Kilby, and Bruce Johnston propose that a broad-based development strategy must involve the following: incentives, institutions, infrastructure, initiative, inputs, and innovations.<sup>2</sup> These strike me as particularly applicable to the African context. The structure of agricultural prices provides the incentive structure, which, in turn, affects the inducement to innovate and to invest in private and perhaps even in public irrigation. Attention to these fundamentals must be adequately paid if the agricultural potential of Africa is to be realized.

I dwell on the agricultural sector because this is where the bulk of the population of sub-Saharan Africa derives its livelihood, and this is the sector that contributes the majority of the region's aggregate measured output. I also want to address two very important sets of relative prices that play a crucial role in the economic-development process. Economists have learned much about the agricultural sector, and we know a lot about what it takes to foster rapid agricultural growth and what the consequences are of government intervention for agriculture. Governments have intervened in every aspect of agriculture in nearly all countries, from outputs to inputs, from domestic marketing to international agricultural trade, and from staple food products to fibers and livestock.

In recent years, the work of, among others, Krueger, Schiff, and Valdes has advanced our techniques for understanding agricultural-pricing policies by emphasizing that a comprehensive evaluation of the effects of pricing policies must incorporate both direct agricultural sector interventions and indirect interventions, primarily via the real exchange rate and protection to domestic industry.<sup>3</sup> Direct interventions include price policies that suppress output prices below world-market levels, taxes on the export of agricultural commodities, and tariffs and other restrictions on the importation of inputs such as fertilizer and machinery. Indirect interventions include economywide import-substitution policies, the overvaluation of real exchange rates

that arise from high rates of domestic inflation, and lags in adjusting the nominal exchange rate. According to the estimates of Krueger and his colleagues, direct interventions in agriculture result in a tax on agriculture that is only about one-fourth of the total tax on agriculture due to direct and indirect interventions. Despite the accumulated weight of evidence on the ill effects of such price interventions, however, many countries continue to intervene in the agricultural sector.

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I'd like to briefly address the two sets of relative prices I mentioned earlier. The terms of trade are defined as the ratio of the price of a country's export products to its import products. Mkandawire argues that changes in the terms of trade for African countries, particularly after the Asian financial crisis began in mid-1997, demonstrate the fragility of African economies and their vulnerability to external factors. Sub-Saharan Africa's principal exports are cocoa, coffee, cotton, copper, and oil, all of which are extremely vulnerable to price risk as well as exchange-rate and interest-rate risk. The terms of trade are particularly important to those countries whose foreign trade is large relative to national output, because changes in the terms of trade may have a large impact upon the balance of payments and national income.

The terms of trade for African countries show considerable fluctuation over the last three decades. There are frequent, often sharp increases in the terms-of-trade index, as well as frequent decreases. The prolonged debate about the long-term trend in the terms of trade for developing countries continues to this date. For some countries and periods of time, the trend in that variable is downward, and for other countries and periods of time, the trend has been upward. Whether upward or downward, the trend is not pronounced. For example, over the last twenty-five years in Ghana, the number of years when there was an upturn has been roughly equal to the number of years there was a downturn. The impact of movement in the terms of trade on the trade balance and the rate of growth of real GNP is also somewhat unclear. In the context of Africa, however, I want to link movements in the terms of trade to agricultural development. Suppose the terms of trade move adversely, and capital transfers, including foreign economic assistance, do not sufficiently increase to compensate for these adverse terms of trade, thereby reducing the import capacity in many countries. If imports of agricultural inputs, fuel, and spare parts for

trucks and transport equipment fall, this can adversely affect the rural sector. Further, the reduced imports of fuel and spare parts raise the internal purchasing and marketing costs of government agencies. As official agencies purchase fewer crops, the producer price of both food and export crops falls. Mkandawire is right, then, when he claims that these changes alter the terms of trade. However, his point is incomplete. Since the terms of trade can also rise, to the extent that government purchasing agencies prevent any rises in the prices that producers receive, governments prevent the benefits of globalization from reaching the farmer. A mix of macroeconomic policies and the use of stabilization funds and other financial-market instruments can ameliorate some of the impact of commodity price fluctuations on national economies.

Finally, let me comment on the exchange rate, which is merely the price of a unit of foreign currency in terms of local currency. A mispricing of the exchange rate distorts the price mechanism and will affect the allocation of resources and, in turn, the growth of income. For example, in the early 1980s, because of highly distorted exchange rates (which were, in effect, a tax on exports), huge amounts of cocoa were smuggled out of Ghana and into the neighboring countries of Togo, Burkina Faso, and the Ivory Coast. A rise in the world price of cocoa, unaccompanied by a corresponding rise in the internal price of cocoa, led Ghanaian producers to smuggle cocoa to the neighboring countries for sale abroad. Measured Ghanaian exports fell, as did GDP, even though actual exports, including smuggled exports, rose.

Obviously, there is no magical recipe for development that countries of varied historical, social, cultural, political, or economic backgrounds can follow. There is, however, a growing body of evidence arising from the experiences of a growing list of countries, that suggests connections between what policy-makers in those countries chose to do to their economies and the consequences of their actions. In country after country, government interventions have had unanticipated consequences and attempts to deal with those consequences ended with denials of the key role of markets and prices. Economic growth will occur even where some important policy lessons are violated, but it will not occur where there is wholesale violation of these lessons.

Overall, I am optimistic about Africa's future. A growing number of countries have undertaken policy reforms, and many appear ready to open up markets and grant the private sector a larger role in resource

allocation. The growth record has improved in several countries, as well. It must be remembered, of course, that economic policy reforms without any underlying political and social change will not bring about any significant improvement in the lives of millions of Africans.

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**Notes**

1. Ravi Kanbur, "Aid, Conditionality and Debt in Africa," unpublished manuscript, July 1998.
2. Thomas P. Tomich, Peter Kilby, and Bruce F. Johnston, *Transforming Traditional Economies: Opportunities Seized, Opportunities Missed* (Ithaca, N.Y.: Cornell University Press, 1995).
3. Anne O. Krueger, Maurice Schiff, and Alberto Valdes, *The Political Economy of Agricultural Pricing Policy* 1–5 (Baltimore, Md.: Johns Hopkins University Press, 1992).