Ordering information

To order copies of Accelerating the Pace of Development by the Economic Commission for Africa, please contact:

Publications
Economic Commission for Africa
P.O. Box 3001
Addis Ababa
Ethiopia
Tel: +251-1-44 31 68
Fax: +251-1-51 03 65
E-mail: ecainfo@uneca.org
Web: www.uneca.org

© Economic Commission for Africa, 2003
Addis Ababa
Ethiopia

All rights reserved
Manufactured in the United States of America
First printing July 2003

ISBN 92-1-125087-0
Sales number E.03.II.K.1

Material in this publication may be freely quoted or reprinted. Acknowledgement is requested, together with a copy of the publication.

Designed, edited, and produced by Bruce Ross-Larson, Meta de Coquereaumont, Joseph Costello, Elizabeth McCrocklin, Michael Molanphy, Christopher Trott, and Elaine Wilson of Communications Development Incorporated, Washington, D.C.
Cover photographs provided by the World Bank Photo Archives and Photodisc.
Contents

Foreword xi
Acknowledgements xiii

Overview 1

1 Recent Economic Trends in Africa and Prospects for 2003 25
   The global recovery—a mirage? 26
   Recent economic developments in Africa 30
   Poverty reduction—encouraging trends 46
   Combating HIV/AIDS, malaria, and tuberculosis 46
   More progress needed to deepen second-generation reforms 52
   Medium-term prospects—mixed 60
   Note 62
   References 62

2 Uganda—A Tale of Two Economies? 65
   Recent economic performance 66
   Monetary policy—targets achieved 69
   Fiscal policies and developments—pursuing prudent policies 73
   External sector policies and developments 76
   Social sector developments 84
   Unleashing the private sector—many challenges to surmount 91
   Medium-term outlook—promising 95
   Notes 96
   References 96

3 Rwanda—HIPC Contradictions Restrains Development 99
   Recent economic developments 101
   Institutional reforms 113
   Social sectors 116
   Policy challenges in key sectors 121
   Medium-term outlook—some slowdown in growth 124
   References 125
4 Mozambique—The Elusive Quest for Pro-poor Growth 127
   Macroeconomic developments 129
   Monetary policy—inflation on the decline 137
   External trade—new trading partners 141
   Human development 143
   Private sector—poised to benefit from regional markets 148
   Medium-term outlook—fairly favourable 151
   Notes 152
   References 153

5 Ghana—The Danger of Fiscal Exuberance 155
   Recent economic developments 156
   The enhanced HIPC Initiative 168
   Promoting export-led growth 170
   Social developments 173
   Institutional reforms—public service in crisis 180
   Medium-term prospects 183
   Notes 184
   References 184

6 Egypt—Economy Slows as Reforms Lose Steam 187
   Recent economic developments 190
   Macroeconomic policy and trends 195
   The external sector 203
   Structural reforms and impacts 210
   Developments in the social sector 215
   Medium-term prospects—clouded by external environment 220
   Notes 222
   Appendix 223
   References 223

7 Gabon—Struggling to Diversify from the Oil Sector 225
   Recent economic developments 227
   Sectoral performance—stunted by Dutch disease 229
   Macroeconomic developments 233
   Structural and institutional reforms—slow pace with mixed results 237
   Poverty and the social sectors 239
   Medium-term prospects and policy challenges 244
   Note 245
   References 245
8 Mauritius—Moving Up the Value Chain 247
Recent economic developments 250
Macroeconomic stabilization policies and impacts 261
Developments in the external sector 268
Ongoing structural reforms 273
Developments in the social sector 275
Medium-term prospects are good 278
Notes 280
References 280

Boxes
1.1 Ethiopia—famine in a growing economy 34
1.2 Doha development round falters 41
1.3 Socioeconomic impact of HIV/AIDS, malaria, and tuberculosis 49
1.4 The costs of HIV/AIDS to an employer 51
1.5 Expanded Policy Stance Index 53
2.1 Successful resolution of the Uganda Commercial Bank 73
2.2 Linking the Poverty Reduction Strategy to the budget 75
2.3 Liberalizing the capital account: a lesson for other countries? 81
2.4 Public funds finally reach schools 85
2.5 The untold side of the success story 87
2.6 Poor governance widespread in the public sector 94
3.1 Rwanda’s Vision 2020 100
3.2 How conflict affects development 101
3.3 HIPC Initiative’s flaws and the post-conflict context 106
3.4 Fiscal policy after conflict 107
3.5 Gacaca mechanisms for social reconciliation 114
3.6 Strengthening institutional quality—the key to stability 115
3.7 Institutions, ethnicity, and reform 116
3.8 The sectorwide approach in education 117
3.9 Rwanda’s Poverty Reduction Strategy 122
3.10 Institutional mechanisms to put poverty-oriented expenditures in place 123
4.1 What do residents want the government to know and do? 130
4.2 When economic reform goes wrong: cashews 135
4.3 Sugar production has great potential for poverty reduction 136
4.4 Privatizing major banks to avert a financial meltdown 139
4.5 Could fees increase enrolments? 145
4.6 Threats to poverty reduction in Mozambique 152
5.1 Better economic management in 2001—the new government’s first year 157
5.2 Will Ghana benefit from monetary union? 164
5.3 Ghana’s HIPC Initiative relief triggers 169
5.4 The false seduction of protection 170
5.5 The dangers of using tariffs for income redistribution 171
5.6 Key pillars of Ghana’s Poverty Reduction Strategy 176
5.7 A tradeoff between child labor and school attendance? 177
5.8 Numeracy and literacy decline 178
5.9 Mutual health insurance scheme in Ghana 180
5.10 Why so little to show for 20 years of reforms? 181
6.1 The ebb and flow of reforms in the last decade 188
6.2 Egypt—an emerging modern economy 189
6.3 Monetary policy reform—towards more liquidity 197
6.4 Double-edged reforms 200
6.5 Strengthening the financial sector’s institutional framework 200
6.6 Exiting from a fixed rate regime 205
6.7 Capital account liberalization: lessons from Egypt 208
6.8 Measures to support the private sector 214
6.9 Potential high-growth emerging sectors 215
6.10 Key challenges facing higher education 219
7.1 Fiscal reforms—agenda and recent progress 238
7.2 Gabon’s Poverty Reduction Strategy 241
8.1 The Mauritian miracle—can others emulate it? 248
8.2 Venture capital funds—supporting economic diversification 256
8.3 Mauritius Stock Exchange 257
8.4 Reducing waste with a medium-term expenditure framework 265
8.5 Privatizing Mauritius Telecom 276
8.6 Set to achieve the Millennium Development Goals 277
8.7 A medium-term macroeconomic framework 279

Figures
1.1 Annual GDP growth, OECD, EU and G-7 countries, 2000/Q3–2002/Q3 26
1.3 Aid flows to Africa from Development Assistance Committee donors, 1990 and 2000 31
1.4 Real GDP growth rates for the top 10 and the bottom 5 African countries, 2002 32
1.5 Annual economic growth, 2001 and 2002 33
1.6 Zimbabwe: drought and inexperienced farming hurt agricultural production 36
1.7 Getting the trinity right—more savings, investment, and growth 38
1.8 Privatization transaction values, cumulative for 1991–2001 40
1.9 Proportion of population in poverty 47
1.10 HIV prevalence in adults ages 15–49, 2001 50
1.11 Expanded Policy Stance Index, 2002 54
1.12 Qualitative Poverty Reduction Policy Stance Index, 2002 58
1.13 Qualitative Institution-Building Policy Stance Index, 2002 59
2.1 GDP growth, 1998/99–2001/02 67
2.2 Gross domestic savings, private savings, and public savings, 1999/2000–2001/02 68
<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.3 Gross domestic investment, Uganda and Sub-Saharan Africa, 1998–2000</td>
<td>69</td>
</tr>
<tr>
<td>2.4 Inflation in December 1999/2000–2001/02</td>
<td>71</td>
</tr>
<tr>
<td>2.5 Indicative policy rates, January 2001–May 2002</td>
<td>72</td>
</tr>
<tr>
<td>2.6 Terms of trade, 1996/97–2001/02</td>
<td>77</td>
</tr>
<tr>
<td>2.7 Coffee and noncoffee export earnings, 1997/98–2001/02</td>
<td>78</td>
</tr>
<tr>
<td>2.8 Nominal effective and real effective exchange rates, period average, 1991/92–2001/02</td>
<td>82</td>
</tr>
<tr>
<td>2.9 Share of outstanding public debt, by creditor, 2002</td>
<td>83</td>
</tr>
<tr>
<td>2.10 Proportion of population in poverty, by region, 1999/2000</td>
<td>86</td>
</tr>
<tr>
<td>2.11 Private sector–identified constraints to investment</td>
<td>92</td>
</tr>
<tr>
<td>3.1 GDP per capita, 1990–2000</td>
<td>102</td>
</tr>
<tr>
<td>3.2 GDP growth and inflation, 1998–2002</td>
<td>103</td>
</tr>
<tr>
<td>3.3 Sectoral shares in GDP, 2002</td>
<td>103</td>
</tr>
<tr>
<td>3.4 Budget deficit, 1996–2001</td>
<td>104</td>
</tr>
<tr>
<td>3.5 Consumer prices, 2002</td>
<td>108</td>
</tr>
<tr>
<td>3.6 Contributions to monetary growth, 2002</td>
<td>108</td>
</tr>
<tr>
<td>3.7 Sectoral shares in credit, 2001</td>
<td>109</td>
</tr>
<tr>
<td>3.8 Terms of trade, 1995–2004</td>
<td>111</td>
</tr>
<tr>
<td>3.10 Households under the poverty line, by urban and rural location, 1985–2000</td>
<td>119</td>
</tr>
<tr>
<td>3.11 Poverty by region, 2001</td>
<td>120</td>
</tr>
<tr>
<td>4.1 Real GDP growth, 1999–2002</td>
<td>132</td>
</tr>
<tr>
<td>4.2 Nominal exchange rate, 1999–2002</td>
<td>133</td>
</tr>
<tr>
<td>4.3 Current account balance, 1999–2002</td>
<td>133</td>
</tr>
<tr>
<td>4.4 Sectoral distribution of GDP, 2001</td>
<td>134</td>
</tr>
<tr>
<td>4.5 Inflation and exchange rate movement, 1990–2002</td>
<td>137</td>
</tr>
<tr>
<td>4.6 Fiscal performance and borrowing, 1992–2002</td>
<td>140</td>
</tr>
<tr>
<td>4.7 Aid flows to Mozambique, 1987–2000</td>
<td>141</td>
</tr>
<tr>
<td>4.8 New admissions into higher education institutions, 1992–99</td>
<td>144</td>
</tr>
<tr>
<td>5.1 Real GDP per capita growth, 1965–2001</td>
<td>158</td>
</tr>
<tr>
<td>5.2 Gross domestic investment, public investment, and private investment, 1984–2000</td>
<td>158</td>
</tr>
<tr>
<td>5.3 Sectoral distribution of GDP, 1997–2002</td>
<td>159</td>
</tr>
<tr>
<td>5.4 Electricity supply deficit, 1994–2000</td>
<td>161</td>
</tr>
<tr>
<td>5.5 Inflation (Consumer Price Index), 1983–2002</td>
<td>163</td>
</tr>
<tr>
<td>5.6 Ghana Stock Exchange All-Share Index, 2002</td>
<td>165</td>
</tr>
<tr>
<td>5.7 Effective nominal and real exchange rates, 1985–2000</td>
<td>167</td>
</tr>
<tr>
<td>5.8 Value and share of nontraditional exports in total exports, 1993–2000</td>
<td>172</td>
</tr>
<tr>
<td>5.9 Poverty incidence by region in 1999 and change in incidence since 1992</td>
<td>174</td>
</tr>
<tr>
<td>5.10 Poverty incidence, 1991/92 and 1998/99</td>
<td>175</td>
</tr>
<tr>
<td>6.1 Real GDP growth, 1997/98–2001/02</td>
<td>191</td>
</tr>
<tr>
<td>6.2 Sectoral shares of GDP, 2001/02</td>
<td>192</td>
</tr>
<tr>
<td>6.3 Total investment, amount and share of GDP, 1997/98–2001/02</td>
<td>196</td>
</tr>
<tr>
<td>6.4 Trends in overnight interbank interest rates, 2000–03</td>
<td>198</td>
</tr>
</tbody>
</table>
6.5 Inflation (Consumer Price Index), year on year change, 1992–2002 198
6.6 Fiscal balance, 1995/96–2001/02 201
6.7 Pound to dollar exchange rate and real effective exchange rate, 1990–2002 206
6.8 Historical trends in trade and current account balances, 1990–2001 206
6.9 International reserves, foreign exchange plus gold, 1995–2002 207
6.10 Capital flows, 1990–2002 207
6.11 Poverty incidence by governorate, 1999–2000 220
6.12 Annual real growth in per capita expenditures, 1995–2000 221
7.1 Contribution to GDP of selected sectors, 1960–2000/01 226
7.2 Real GDP growth, 1995–2002 229
8.1 Real GDP growth, with and without sugar, 1998–2002 251
8.2 Growth in selected sectors, 1998–2002 252
8.3 Savings and investment rates, 2000–02 253
8.4 Gender breakdown of unemployment, 1993–2001 259
8.5 Unemployment in Mauritius by education, age, and location, 2000 260
8.6 Budget deficit, 1997/98–2002/03 261
8.7 Capital and recurrent expenditure, 1997/98–2002/03 262
8.8 Indicative interest rates, July 2001–June 2002 266
8.9 Growth of monetary indicators, 1997/98–2001/02 266
8.10 Inflation rate, 1989/90–2001/02 267
8.11 Composition of exports of goods, 1998/99–2001/02 269
8.12 Composition of imports of goods, 1998/99–2001/02 269
8.14 Real and nominal exchange rates, June 1995–November 2002 271
8.15 Foreign direct investment inflows, selected countries, 1996–99 273

Tables

1.1 Quarterly changes in real GDP, industrial countries, 2000/Q1–2002/Q3 27
1.2 Distribution of GDP growth rates in Africa, 1998–2002 31
1.4 Tourism in Africa, selected years 42
1.5 Inflation rates in Africa, 2000–02 43
1.6 Capital flight from 30 African countries, 1970–96 45
1.7 Proportion of households always poor, sometimes poor, never poor 48
1.8 Financial impact of HIV/AIDS on six corporations in Southern Africa 52
1.9 Quality of economic policies survey, 2002 56
2.1 Determinants and components of broad money, June 2001 and 2002 70
2.2 Financial sector indicators, 2001 and 2002 74
2.3 Trend and composition of exports, 1997/98–2001/02 78
2.4 Trend and composition of imports, 1997/98–2001/02 79
2.5 Balance of payments, 1997/98–2001/02 80
2.6 Outstanding public debt, by creditor, June 1998–June 2002  83
2.7 Debt sustainability indicators, 2000/01–2002/03  84
2.8 Social indicators, latest years  84
2.9 Primary education indicators, 1994/95 and 2001/02  89
2.10 Health indicators, 1995 and 2000  90
3.1 Fiscal position, 1996–2001  104
3.2 Balance of payments, 1999–2001  110
3.3 Export values and volumes, Jan–Sept 2001 and 2002  111
3.4 External debt, selected years  112
3.5 Debt service savings from the HIPC Initiative, 2001–04  112
4.1 Mozambique’s progress towards the Millennium Development Goals  128
4.2 Macroeconomic trends, 1999–2002  132
4.3 Average annual sectoral growth rates, 2000–01  134
4.4 Cereal production, 2001/02  135
4.5 Fiscal performance, 2000–02  139
4.6 External trade, balance of payments, and debt, 2000–02  142
4.7 Human development indicators in Mozambique and neighboring countries, 2000  143
4.8 Poverty indices, 1996–97  147
4.9 Distribution of foreign and local direct investment, by province, 2001  147
4.10 Medium-term expenditures under the Action Plan for the Reduction of Absolute Poverty, 2001–05  149
4.11 Medium-term economic prospects, 2003–05  151
5.1 Sectoral growth rates, 1998–2002  157
5.2 Money supply and its makeup, 1999–2002  162
5.3 Ghana’s performance on convergence criteria, 2000–03  164
5.4 Fiscal performance 2000–02  166
5.5 External performance, 2000–02  167
5.6 Estimated medium-term impact of enhanced HIPC Initiative debt relief  168
5.7 Expenditure shares of education and health, 1998–2002  173
6.1 Sectoral shares of GDP, 1997/98–2001/02  192
6.2 Manufacturing growth, 1990 and 2000  193
6.3 Changes in the distribution of employment by institutional sector, 1996/97 and 2001/02  195
6.4 Recent monetary aggregates, end-June 1999–2002  197
6.5 Public domestic debt, 1999/2000–2001/02  202
6.6 Exports by commodity type, 2002  209
6.7 Public external debt, 1999/2000–2002/03  210
6.8 Public and private shares in GDP, investment, and employment in nonagricultural activities, selected years  213
6.9 Comparative health outcomes, Egypt and lower middle income countries, selected years  216
6.11 Educational attainment, by poverty level, 1999/2000  218
7.1 GDP by sector, 1997–2002  228
7.2 Financial operations of the central government, 1998–2002  234
7.3 Trends in money and credit, 1998–2002  235
7.4 Balance of payments, 1998–2002 236
7.5 Income inequality and poverty, 1960–94 240
8.1 Real GDP growth, 1998–2002 251
8.2 Public and private investment, 1998–2002 253
8.3 Growth in labour productivity, 1990–2001 260
8.4 Public sector debt, 1997/98–2001/02 263
8.5 Central government debt servicing, 1999/2000–2001/02 264
8.6 Banking sector indicators, 1997/98–2001/02 267
8.7 Balance of payments, 1998/99–2001/02 270
8.8 Budgetary allocations to the social sector, 1998/99–2002/03 278

Data notes

Wherever possible, the report shows fiscal data for the calendar year. Where data for the calendar year are not available, however, fiscal year data are used.

Two years separated by a dash (2001–02) indicate a range of calendar years, while two years separated by a slash (2001/02) indicate a fiscal year or, in the context of agriculture, an agricultural year.

Dollar figures are in current U.S. dollars unless otherwise specified. Billion means 1,000 million.
Foreword

The *Economic Report on Africa 2003* is the fourth in an annual series that reviews the continent’s economic performance and near-term prospects. Targeted to African and global policymakers, the reports are meant to stimulate discussion and change.

This year’s report builds on the work of the three previous reports in laying out an agenda for Africa based on systematic benchmarking of economic performance. It finds that growth slowed in Africa, to an average of 3.2% in 2002, from 4.3% a year before. That modest performance reflects the slower than expected recovery in world trade, the drought and AIDS in southern and eastern Africa, and the political and armed conflicts in several countries. Even so, well-managed countries, with solid reform agendas and good governance, performed well. Mozambique grew at 12%, among the fastest in Africa. And other well-managed reformers—Ethiopia, Rwanda, and Uganda—grew at 6% or more.

This mixed performance underscores the point that stop-go growth in Africa is not conducive to poverty reduction or sustainable improvements in living standards, and that one of the biggest challenges facing African countries is to sustain growth over a long period.

The report also identifies policies that are the best catalysts for sustained growth and development. The main message is that success in accelerating the pace of development will come to countries that maintain fiscal discipline, address deep pockets of poverty, provide opportunities for private entrepreneurs to flourish, and modernize their bureaucracies.

The report continues the innovation of last year’s by supplementing the traditional regionwide analysis with seven in-depth country studies. Those studies show the strong relationship between poverty and agroclimatic conditions—that poverty is more severe in rural Africa than in urban Africa. For example, Uganda’s solid economic growth has been accompanied by substantial poverty reduction, but within-country disparities are vast and the incidence of poverty is much higher in the north. And in Egypt, one of Africa’s emerging modern economies, poverty has declined overall, but it rose in southern Egypt between 1996 and 2000.

Drawing insights from the in-depth country studies, the report sharpens the policy prescriptions, making them much more relevant and practical for policymakers. First, sound economic governance creates an environment that encourages private groups and individuals to take risks, invest capital, and export. Second, governance is the result of strong public institutions—including the bureaucracies essential for policy formulation and implementation. Another major message: only sound governance can
stop poverty from becoming entrenched, investment from dwindling, chronic fiscal deficits from draining and then driving away international resources, and precious human resources from fleeing a country.

Strengthening the rules and institutions to sustain growth is thus central to Africa’s quest for sustained long-term development. The issues highlighted in this year’s report are central to that quest, but confronting them will require vision and courage—from African leaders, from the African people, and from all others with a stake in Africa’s future.

K.Y. Amoako
Executive Secretary
July 2003
Addis Ababa
A team under the overall guidance of Patrick Asea, Director of the Economic and Social Policy Division, Economic Commission for Africa (ECA), prepared this report. The team, led by Shamika Sirimanne, comprised Bethelhem Belayneh, Kwabia Boateng, Derese Degefa, Niall Kishtainy, Geoffrey Mwau, Patrick Osakwe, Oliver Paddison, and Alemayehu Seyoum, with first-rate research assistance from Desta Asgedom and Mamadou Bal. The team appreciates the excellent contribution from Elvira Ezekwe, who managed the financial accounts, and from Wengelawit Tsigie, who provided secretarial support. Others in the division and in the ECA who contributed to the report include Teshome Abebe, Andrew Allimadi, Fabrizio Carmignani, Sam Cho, Chukwudozie Ezigbalike, Nino Fluck, Adrian Gauci, Vittorio Gerosa, Aissatou Gueye, Abdalla Hamdok, Cornelius Mwalwanda, Kasirim Nwuke, Wilfred Ongaro, Antonio Pedro, Sumit Roy, Jean Thisen, and Elizabeth Wolde-Mariam. Special thanks go to Yetinayet Mengistu and Shewaye Woldeyes for the superb desktop publishing work. The work was carried out under the general direction of the Executive Secretary, K.Y. Amoako.

The report benefited from the comments and suggestions of two major peer review meetings. The report was enriched by comments from a group of eminent African scholars at a peer review meeting held in Addis Ababa. Participating were Kwesi Botchwey, Augustin Fosu, Yansane Kerfalla, Mwangi Kimenyi, Simba Makoni, Charles Okeahalam, and Terry Ryan. The team appreciates reviews received from the external peer review meeting held in Washington D.C. that further enriched the report. Participating in the meeting were Fernando Goenha and Armando Pangueme of the Embassy of Mozambique; Sonal Shah of the Center for Global Development; Willene Johnson of Cornell University; Raj Bardouille, Carl Gray, and Adam Smith of the United Nations Department of Economic and Social Affairs; Ousmane Doré, David Dunn, Alvaro Manoel, Gamal El-Masry, Alphecca Muttardy, William Scott Rogers, and Ludvig Soderling of the International Monetary Fund; and Patience Bongiwwe Kunene, Abraham Mwenda, Haruna Mohammed, John Randa, and Samuel Wangwe of the World Bank.

The comments and contributions from colleagues in ECA offices, particularly Emile Ahohe, Hakim Ben Hammouda, Sylvain Maliko, Guillermo Mangue, Andre Nikwigize, Halidou Ouedraogo, and Abdelilah Ouadouaq, are noted with appreciation. Government and nongovernmental institutions as well as international organizations, including the United Nations Development Programme, United Nations Industrial Development Organization, United Nations Children’s Fund, International Monetary Fund, and the World Bank, contributed greatly in facilitating the conduct of country studies.
Preparation of the country reports was aided by background research undertaken by Gouda Abdel-Khalek, Michael Atingi-Ego, Shyam Nath, Manasseh Ntaganda, Albert Ondo-Ossa, and Nii Sowa. Quarterly country reports prepared by Michael Atingi-Ego, Abla El Khawaga, Alhassan Iddrisu, Nicholas Mvou, Manassah Ntaganda, and Reshma Peerun provided additional information. In addition, experts in 39 African countries undertook surveys to develop the Economic Policy Stance Index.

The final report was edited, designed, and produced by Communications Development Incorporated’s Bruce Ross-Larson, Meta de Coquereaumont, Joseph Costello, Elizabeth McCrocklin, Michael Molanphy, Christopher Trott, and Elaine Wilson.

Special thanks to Peter da Costa, Max Jarrett, Teshome Yohannes, Kibruyisfa Achamyel, and other members of ECA Communication Team, who provided input to the copyediting, production, and design of the report.
Overview—Accelerating the Pace of Development

The economic performance of African economies fell short of expectations in 2002, with growth slowing from an average of 4.3% in 2001 to 3.2% in 2002. In 2002, of the 53 countries in Africa, only 5 achieved the 7% growth rate required to meet the Millennium Development Goals. Of the others, 43 registered growth rates below 7%, and 5 registered negative growth.

The modest overall performance in 2002 reflects the weaker global economy and a slower than expected rebound in world trade. Africa’s economic performance was weakened by drought and HIV/AIDS in various parts of southern and eastern Africa, and political and armed conflicts in the Central African Republic, Côte d’Ivoire, Madagascar, and Zimbabwe.

But well-managed countries, with solid reform agendas and a record of stability and good governance, performed well. Mozambique had growth of 12%—among the fastest in Africa. Other well-managed reformers—Ethiopia, Rwanda, and Uganda—grew at 6% or more.

Highlights for 2002

*World trade beginning to recover.* World trade began to recover from a decline in 2001, with the seasonally adjusted value of U.S. merchandise exports in the first half of 2002 growing at an annualized 7.2% over the first half of 2001. Other regions have not shown such strong improvements.

*Commodity prices on an upward trend.* Commodity prices recovered strongly as global economic activity picked up. The rise in crude oil prices will slow growth in Africa but will loosen the financing constraints for oil-exporting countries. Rising cocoa prices could benefit producers such as Côte d’Ivoire and Ghana. Despite the upward trend, some commodities have had stagnant or declining prices, notably coffee, tea, and cotton. That will reduce the foreign exchange earnings of such countries as Ethiopia, Kenya, and Uganda.

*Foreign direct investment down.* Foreign direct investment inflows to Africa declined by $6 billion, in line with the downward trend worldwide, a result of the faltering global economic recovery. Foreign direct investment in Africa continued to be hampered by
weak governance, poor infrastructure and institutions, and ongoing conflicts in a large number of countries.

**Privatization still slow and reluctant.** An important source of foreign direct investment is privatization, yet progress on privatization has been slow, with activity concentrated in a handful of countries: South Africa, Ghana, Nigeria, Zambia, and Côte d’Ivoire. Of the 2,300 privatizations in Sub-Saharan Africa over 1991–2000 only 66 were of higher value and economically significant enterprises. The vast majority were sell-offs of ailing or small firms. So far, privatization has not boosted investment in Africa.

**Pledges made to increase official development assistance.** The UN Conference on Financing for Development in Monterrey in March 2002 elicited pledges to increase official development assistance (ODA) over the medium term from its current level of $50 billion for all aid recipients. Promises from the European Union (EU) and United States alone would generate an extra $12 billion a year from 2006 onwards for all developing countries, with much for Africa. That is a welcome improvement, though well short of the extra $50 billion a year required globally to reach the Millennium Development Goals.

**But there are worrying trends.** ODA flows to Africa are usually analyzed in the aggregate, with little attention to particular sectors, masking worrying trends. For the “production sectors”—agriculture, manufacturing, trade, banking, and tourism—ODA declined from 17% in 1975–80 to 11% in 1995–2000. In absolute terms, bilateral ODA flows to African economies have dropped in the last decade, with the exception of flows to education.

**Capital flight, equivalent to Sub-Saharan Africa’s GDP . . .** New data for 30 countries shows that capital flight over the past 27 years amounted to about $187 billion. Including imputed interest earnings, the accumulated stock of capital flight was about $274 billion at the end of 1996. Angola, Cameroon, Côte d’Ivoire, the Democratic Republic of Congo, and Nigeria have the highest stocks of capital flight. Five of the 30 countries—Benin, Mali, Niger, Senegal, and Togo—exhibited “negative” stocks of flight capital, indicating that their recorded capital inflows exceed recorded uses of foreign exchange.

. . . is apparently debt-driven. The data show that roughly 80 cents on every dollar that flowed into Africa from foreign loans flowed back out as capital flight in the same year, suggesting widespread capital flight fuelled by debt. And every dollar added to the stock of external debt added roughly three cents to the annual capital flight in all subsequent years. So, debt relief strategies will bring long-term benefits to African countries only if accompanied by measures to prevent a new cycle of external borrowing and capital flight.

**Saving and investment still low.** A key constraint to growth in Africa remains its low rates of saving and investment. And even countries that achieved high rates failed to reap the benefits in growth, suggesting low efficiency of resource use.
**Trade and current accounts in deficit.** Eleven countries had unsustainable current account deficits of more than 5% of GDP in 2002, while eight had surpluses, the result of higher export revenues. (The rest ran deficits of less than 5%). Several initiatives, notably the U.S. African Growth and Opportunity Act (AGOA), should help to increase African exports. Improving access for agricultural products to developed countries remains a key challenge.

**Fiscal policy continuing to improve.** Overall fiscal discipline improved. But fiscal profligacy remains a problem, with a number of countries having deficits of more than 3% of GDP. In some countries, notably Nigeria, this was driven by increased spending in the run-up to elections. In others, such as Angola, spending pressure came from post-conflict reconstruction needs. True, there are some strong performers, but much more needs to be done to improve fiscal management across the continent.

**Monetary and exchange rate policies sound.** Monetary and exchange rate policies were fairly sound in 2002, with 11 countries holding inflation under 3% as a result of prudent policies. But some countries had massive price increases because of conflict and political crises. The CFA franc appreciated against the dollar, which could hurt the competitiveness of countries with high trade exposures, such as Mali and Senegal. North African exchange rates were generally stable.

**Agriculture and food security in crisis.** Agriculture in many countries suffered from the adverse climatic conditions in 2002. Flooding hit food production in Algeria, Kenya, and Senegal. Countries in Eastern and Southern Africa faced a food crisis because of drought. In Ethiopia a quarter of the population needs food aid; in Zimbabwe close to half.

**Country efforts to reduce poverty intensified.** Despite the weaker than expected overall performance in 2002, countries in the region continued to strengthen macroeconomic fundamentals and intensify their focus on reducing poverty. The number of African countries preparing interim or final Poverty Reduction Strategies increased significantly, with nine countries finalizing them in 2002, up from four in 2001.

**Second-generation reforms firmly in place for top performers.** The Economic Policy Stance Index now pays particular attention to the efforts of countries to deepen their second-generation reforms. In the top-ranked countries—Botswana, South Africa, Mauritius, Namibia, and Tunisia, in that order—market liberalization is more advanced, and policy reversals are minimal. Institutions of policy analysis and coordination are better. Efforts to promote women’s access to education and health and gender equality in employment are highly rated. Propoor policies and targeting are effective. The legal system is effective at enforcing contracts. Laws and regulations are more predictable and transparent—and applied more uniformly. The quality of the civil service is better. And the access to and reliability of telecommunications, transport, and electricity are greater. Moreover, poverty rates are relatively low in the top performers, and fixed and mobile telephone networks, which are closely correlated with road networks, are more extensive in all these countries by a considerable margin.
Important strides towards implementing the African Peer Review Mechanism. The New Partnership for Africa’s Development (NEPAD) made important strides in operationalizing the African Peer Review Mechanism (APRM) in 2002, critical for African prospects because it represents a bold approach for building capable states with good governance for sustainable development. Through peer pressure and peer learning, the APRM can act as a commitment mechanism to help monitor and assess the progress of African countries in implementing the NEPAD.

Medium-term outlook mixed. The outlook for 2003 is mixed, with heightened uncertainty about the robustness of the world economic expansion tempering any budding enthusiasm. In addition to deteriorating business sentiment in industrial economies, rising oil prices and financial sector turbulence are amplifying the risk of a return to a global slowdown. This is likely to be further exacerbated by the impact of the U.S.-led war against Iraq on the global economy (box 1). All in all, growth in the region is expected to rebound moderately in 2003—to 4.2%.

Distilling lessons from the seven countries

The countries profiled in this year’s Report reveal the range of African policy challenges. Summarized here are four key challenges in accelerating the pace of development:

• Escaping poverty—going beyond averages.
• Achieving fiscal sustainability—exiting aid dependence.
• Energizing African bureaucracies—enhancing the capacity to deliver.
• Moving to mutual accountability and coherence—taking the best route to development effectiveness.

The purpose is to highlight best and worst practices, draw lessons from the experiences of the seven countries, and provide overall policy guidance to African countries. The

Box 1
Economic impact of the Iraq war—small

The impact of the Iraq war on Africa’s economies depends on several factors: how the conflict affects the U.S. and global economy, how it influences trade and financial flows to the continent, and whether a country is a net oil importer.

Overall, the short war will have little net impact on African economies. The temporary increase in oil and gold prices will benefit the large exporters of oil and gold—Nigeria, Algeria, Angola, and South Africa—countries that account for much of Africa’s GDP. Landlocked and net oil-importing countries will face short spikes in inflation and balance of payments disequilibria. The way these countries manage this external shock will determine the net effect on their economies.
countries profiled this year are Egypt, Gabon, Ghana, Mauritius, Mozambique, Rwanda, and Uganda.

**Escaping poverty—going beyond averages**

The remarkable consensus and commitment for poverty reduction from governments around the world led to the Millennium Development Goals, to reduce the proportion of people in poverty by 50% by 2015 and to reduce other forms of human deprivation.

Even if the absolute poverty goal is achieved—and prospects for doing this are good for several African countries—deep pockets of poverty will remain within countries.¹ People chronically poor suffer poverty for many years, often for a lifetime, and are likely to transfer their poverty to their children. These are the people who benefit least from economic reforms. They experience social exclusion, because of gender, ethnicity, disability, caste, or social position. They often live in remote areas under harsh agroclimatic conditions.

Recent evidence suggests a strong relationship between poverty and agroclimatic conditions in various African countries (ECA 2002). Large differences in living standards between regions in the same country are correlated with unequal distributions of natural assets, differences in agroclimatic conditions, or differences in geographic conditions, such as remoteness from markets and transport routes (Bigman and Fofack 2000). This is intuitive. Households in remote areas, living on fragile lands, would be expected to have fewer opportunities and face greater risks and vulnerability than households in better-endowed areas. It is also consistent with the fact that poverty is more severe in rural Africa than in urban.

Several country profiles underscore this important point—the need to focus on spatial and temporal dimensions of poverty.² Uganda’s solid economic growth—averaging 6% a year over the past decade—has been accompanied by substantial poverty reduction, but there remain vast regional disparities in the incidence of poverty, with a clear spatial pattern. The more affluent central crescent area around Lake Victoria has made great strides in economic development, while the drier, more disadvantaged northern part of the country has fallen even farther behind. Uganda’s case is of concern because the spatial divide in poverty has been accentuated by almost two decades of civil conflict.

The spatial dimensions of poverty are also evident in Egypt, Ghana, and Mozambique. In Egypt—one of Africa’s emerging modern economies—the absolute level of poverty has declined, but in upper Egypt it increased between 1996 and 2000. In Ghana, national statistics show a decline in poverty from 52% to 40% over the past decade—lifting 2 million people out of poverty. But those statistics mask an increase in poverty in 3 of 10 regions—central, northern, and upper east. In Mozambique—one of the
fastest growing economies in Africa—poverty remains stubbornly high at 62% of the population, but it is clearly worse in the north.

The countries covered in this report suggest several ways of tackling spatial-temporal poverty. This overview highlights three particularly innovative strategies: poverty-sensitive distribution formulas for fiscal transfers, public expenditure tracking systems, and private provision of social services.

Government spending should be poverty sensitive
Uganda has found that government expenditures (through various fiscal transfer mechanisms) do not adequately redress regional inequalities. The current transfer payment formula allocates 85% of transfers according to the size of the district population and 15% according to the geographical location, with no consideration to poverty.

The regional distribution of transfers to local governments indicates that the western region has received the largest share (27%), followed closely by the eastern (26%), the central (25%), and the northern (22%), where poverty is highest. But if the transfer payment formula considered poverty across districts, in addition to population and size of the districts, more transfers would go to the northern districts. Such a poverty-sensitive distribution would allocate 29% to the northern region, 26% to the western, 23% to the central, and 22% to the eastern.

Public expenditure tracking systems
Addressing spatial poverty also depends on how resources are translated into basic services for the poor—in such areas as health, education, water and sanitation, and energy. Public spending on these services is often biased against the poor and against rural dwellers. Ghana shows significant inequality in the distribution of educational facilities among the 10 regions and between rural and urban areas. Literacy and enrolment rates are lower in the poorer northern regions, with poor school conditions, low quality, irrelevant curriculums, and a lack of teachers. Accentuating the problems: the higher cost of schooling, with poor parents having to bear any additional costs.

Even when public spending is reallocated towards the poor, the delivery of services too often fails the poor. This may be due to corruption, imperfect monitoring of local government expenditures, and weak capacity of local governments. Rwanda and Uganda have tried to improve services by involving poor people in services through the Poverty Reduction Strategy process and by improving local expenditure monitoring systems. Uganda has had impressive results with its Public Expenditure Tracking System, introduced in 1996. The flow of intended capitation grants reaching schools shot up from 13% (on average) in 1991–95 to about 80–90% in 1999–2000.

Private participation in service delivery
Most public delivery systems are highly centralized, with almost all human development programmes designed and controlled by central authorities. Given the weak
national institutions, this centralization reduces the effectiveness of human development efforts. These overly centralized systems focus on inputs rather than outcomes, are associated with low transparency and accountability, and ultimately produce inferior service delivery (Jimenez 1995; World Bank 2000).

To improve service delivery, governments are relying more on private provision and financing, as for health and education in Egypt and Ghana. Private participation in the provision of health services in Ghana is quite intensive, with about 42% of health facilities owned by the private sector. But private facilities are concentrated in the urban areas. Only mission hospitals are predominant in the poor regions. The best way to improve private participation in poor rural regions? Encouraging community-based, NGO-run health and education facilities.

Achieving fiscal sustainability—exiting aid dependence

Many countries profiled in this report depend on foreign aid to fund large amounts of government spending, consumption, and investment. For instance, aid accounts for more than 50% of Uganda’s budget, 60% of Rwanda’s, and 70% of Mozambique’s. Yet there is mounting evidence that aid in large quantities is a double-edged sword—initially helping but eventually weakening a country’s economic performance (Lancaster and Wangwe 2001). Recent research shows that foreign aid crowds out private investment—a damning indictment, because the early rationale for foreign aid (the two-gap model) was to narrow the gap between savings and investment in poor countries (Clemens 2002). Private investment is the most robust variable in explaining cross-country growth. And if foreign aid crowds out private investment, the prospects for greater prosperity in aid-dependent countries are slim.

Nowhere is this more evident than in Ghana, which has undertaken significant reforms over the past 20 years but has little to show in tangible benefits for the majority of its people. The high aid dependence reflected in poor fiscal sustainability has hurt the Ghanaian economy, with fiscal woes providing an important explanation for the lack-lustre economic performance. A chronically weak fiscal position resulting in huge budget deficits and associated spikes in inflation—often associated with political economy issues—heightened uncertainty over the credibility of government policies. This increased the risk premium associated with investing in Ghana, leading domestic and foreign investors to adopt a wait-and-see attitude.

The huge fiscal deficits led to explosions in domestic debt. Financing the domestic debt has crowded out credit to the private sector, further constraining financing options for firms. Financing deficits by issuing high-yielding treasury bills inverted the yield curve for government securities, giving higher rewards to investors in short-dated securities than in long-dated securities. With many investors preferring short-term government
treasury bills, private firms have had trouble raising long-term capital. This has also shifted resources from the securities market to the government bill market, leaving the securities market thin and illiquid.

Egypt’s fiscal deficit has also been on the rise. Like Ghana, it has seen rapidly rising domestic debt, with interest payments on this debt, along with the wage bill, taking up around half of public expenditure. Because these areas of expenditure cannot be cut back easily, they seriously reduce the authorities’ room for maneuver in fiscal policy. With sluggish economic growth and high domestic interest rates the ratio of domestic debt to GDP is likely to continue to rise, posing difficulties in macroeconomic management.

**Fiscal sustainability requires going beyond the country’s external debt to the sustainability of aggregate public sector debt**

**Heavily Indebted Poor Country status confers benefits and risks**

Foreign aid provided through concessional loans to many African countries over the past several decades has created large debt overhangs and significant debt servicing obligations. The poor fiscal state of several African countries and their high levels of external debt led the World Bank and the International Monetary Fund (IMF) to develop the Heavily Indebted Poor Countries (HIPC) Initiative. The programme contemplates forgiving a fraction of these countries’ bilateral and multilateral debt. The funds freed by debt relief are to be devoted to effective social programmes, which in the eyes of the multilateral institutions will reduce poverty. In addition, the country is expected to impel broad economic reforms to strengthen the productive sector and increase the potential for growth.

An important principle guiding the programme is that in the post-HIPC era the country will achieve “external sector sustainability”, and thus not require new rounds of debt forgiveness. The Bank and the IMF (2001, p. 4) have stated this principle in the following way:

[B]y bringing the net present value (NPV) of external debt down to about 150 percent of a country’s exports or 250 percent of a country’s revenues at the decision point, [the programme] aims to eliminate this critical barrier to longer term debt sustainability for these countries.

An important question tackled here is what type of fiscal policy will be consistent with maintaining debt sustainability in the post-HIPC era. As the excerpt above suggests, the multilaterals have focused on policies required to stabilize the ratio of external debt to exports. The Ghana profile shows that a comprehensive answer to the fiscal sustainability question requires going beyond the country’s external debt to the sustainability of aggregate public sector debt, including both foreign and domestic debt. Ghana has accumulated a significant stock of domestic debt, purchased by the local banking sector, pension funds, and individuals. Indeed, by ignoring domestic debt, sustainability analyses may underestimate the fiscal effort that poor countries will have to make in the post-HIPC era.
Such large fiscal adjustments could have important political economy consequences (Edwards 2002). First, the adjustments may reduce the funds available to implement the antipoverty programmes. And second, very large reductions in primary expenditures may lead to political instability and backtracking on reform.

**Slipping back into the debt trap**

Unless HIPC countries, such as Ghana, Uganda, and Rwanda, receive substantial concessional aid in the future, their public sector debt is likely to become unsustainable once again. Uganda, the first country to graduate from the enhanced HIPC programme in 2000, is in a difficult situation. The debt and debt service indicators in net present value terms show that its debt sustainability has not improved since it received HIPC debt relief. The net present value of debt to exports ratio increased from 170% in 2001 to 200% in 2002 and is projected by the IMF to increase to 208% in 2003, well above the threshold of 150% under the enhanced HIPC framework. Similarly the net present value of the debt-GDP ratio is projected to increase from 20% in 2001 to 22% in 2003.

The reason for sliding back into the debt trap: without large volumes of concessional assistance, these countries would be forced to undertake major fiscal adjustments to achieve sustainability (Edwards 2002). Adjustments of this magnitude usually crowd out social expenditures, including poverty alleviation programmes, and tend to create political economy difficulties.

**The optimal size of a fiscal deficit**

The fiscal sustainability question in Rwanda is slightly different. Tensions are emerging between the requirements for macroeconomic stability and for poverty reduction and post conflict construction. The fiscal deficit, on the rise in recent years, is projected to remain high over the medium term. The reason is the increase in public expenditures to address poverty reduction goals set out in the Poverty Reduction Strategy and the need for post-conflict reconstruction—for demobilization and for establishing peoples courts, the genocide survivors fund, and governance commissions. Some development partners recommend that a country like Rwanda, with large fiscal deficits financed by grants and international borrowing, should reduce the deficit in the medium term rather than mobilize additional resources.

Further contradictions have emerged with Rwanda’s HIPC status. The use of exports in the HIPC debt ratios implies that absolute levels of debt per capita will be particularly low for a closed economy, such as Rwanda. This has increased the debt relief but it will also reduce the possibilities for new borrowing. So, over the medium term, rising spending needs for poverty reduction and post-conflict reconstruction mean that Rwanda is unlikely to adhere to low debt to GDP ratios as required by HIPC. The reason? Doing so would reduce the government’s ability to contract new loans. It is clear that adherence to HIPC debt ratios has hidden costs that may easily outweigh the benefits.
Several lessons from Rwanda question the relevance of current modalities in the HIPC programme. First, as illustrated in the profile, Rwanda’s underlying debt sustainability indicators appear to be flawed. Much of the sustainability analysis by the World Bank and IMF is based on rather optimistic assumptions for future economic performance, the external environment, and projected financing needs.

Second, macroeconomic sustainability cannot be divorced from political sustainability. The legacy of violence must be considered, especially with past civil violence a strong predictor of future violence. The needs of social and political reconciliation are therefore critical. And a macroeconomic programme that does not address these issues could be dangerous.

An alternative to the HIPC criteria would be to link debt relief to a proportion of revenues needed for essential spending, possibly with different limits set for different groups of countries. One proposal is to add a criterion for countries emerging from conflict—putting an upper limit to the fiscal revenues used for debt servicing. HIPC needs must also take greater account of external shocks and the critical role of declining terms of trade in the buildup of debt, an issue so far neglected (Birdsall and Williamson 2002; Nissanke and Farrarini 2002).

Even strong performers are concerned about fiscal imbalances
The Mauritius profile highlights another angle in fiscal sustainability. With stellar macroeconomic performance, the economy grew 5–6% a year over the last 20 years. Inflation remained in single digits. And the fiscal deficit averaged about 4% a year between 1985 and 1999. But in 2001 it jumped to about 6.7% of GDP, and for 2002 it is expected to remain around 6%–6.5%, narrowing to previous levels from then onward.

These higher deficits are the result of a massive investment programme by the government to prepare the Mauritius workforce and infrastructure for economic diversification—away from the traditional sectors of sugar, textiles, and apparels, now losing their potential as engines of growth, and towards a knowledge-based economy. There is concern among some development partners that higher deficits will threaten fiscal sustainability. The analysis here shows that this may not be the case. The main issue is to resolve the tension between higher deficits in the short term and investment that may yield higher returns in the medium to long terms.

A smooth exit requires a strong private sector
Exiting aid dependence and improving the fiscal position of African countries will require governments to implement policies and use resources to promote growth that will expand public revenues and obviate the need for future aid.

A strong private sector is critical to achieving this goal. Only through a strong private sector that contributes to the state's coffers will the abysmally poor fiscal position of
African countries be improved. The point is not that countries should not improve tax administration and reduce leakages due to inefficient spending—it is that they should also take actions to broaden the tax base, so that they can get more tax revenues for the same marginal tax rate.6

Managing the transition to less development assistance and more private capital flows will require a combination of measures—to increase domestic resource mobilization, provide greater debt relief, reform the current aid regime, improve market access, and enhance the policy environment. This will include improving the business climate—strengthening corporate governance, commercial justice systems, and the regulatory environment. It will also include improving pricing and access in electricity, transportation, and telecommunications, igniting the private sector’s supply response.

Energizing African bureaucracies—with more capacity to deliver

The public service bureaucracies will play a critical role in accelerating the pace of development (figure 1). Yet they play a contradictory role, at once part of the problem and part of the cure (Kayiizi-Mugerwa 2003). Economic reforms are matters of public policy. But policies are no more effective than the bureaucracies trying to implement them.

Egypt and Ghana demonstrate the predicament. Despite 20 years of institutional reforms in the public sector, there is little to show for it. These reforms, like those in many African countries, focused on quantitative issues—wage and hiring freezes, downsizings, and retrenchments. They paid little attention to more subtle and challenging issues of bureaucratic quality. In Egypt, state capacity needs badly to be reinvigorated to improve export competitiveness and propel the economy to a higher stage of development. But the reform of institutions faces political and administrative constraints. In Ghana the situation has deteriorated so much that the current government now faces a crisis in the public service.

Two statements from the Ghana Poverty Reduction Strategy reinforce this assessment (Ghana 2003, p. 109):

It would appear that the totality of the public sector reform programme might be beyond the capacity of the available human and financial resources to plan and implement.

However the reform process cannot proceed effectively without sustained and palpable political commitment, the enforcement of agreed proposals for reform from a political and official level and provision of adequate resources.

The key reform in Ghana—the Public Financial Management Reform Programme, initiated in 1995—introduced an integrated payroll and personnel database, a medium-term
Figure 1
Bureaucratic quality is positively related to development

Note: The Bureaucratic Quality Index combines factor loadings of government stability, democratic accountability, law and order, and corruption. The sample consists of 39 African countries.
Several factors are responsible. But compensation and ineffectual management of the public service—including the absence of an overall human resource development, use, and retention strategy—are the prime causes.

**Participatory policymaking can be highly effective**

In stark contrast, the policy formulation process in Mauritius “contains a very strong dose of consultation, dialogue, consensus building, and democratic principles, ensuring that all concerned stakeholders are actively involved” (Bonaglia and Fukusaku 2002, pp. 171–73). Public-private partnership is pervasive in Mauritian policymaking, and nongovernmental organizations have always been an important part of Mauritian society. As a direct result, public policies have supported high rates of private investment.

The Joint Economic Council is the private sector’s apex organization. When a private sector position needs to be voiced, the council expresses it after consulting with members. At least twice a year the government holds meetings with the council, chaired by the prime minister and attended by senior ministers. Structured consultations are also held with private sector organizations, trade unions, and the minister of finance to prepare the national budget. Between budget preparations sessions, there is constant dialogue between the private sector and government through meetings on specific policy matters. Business, labour unions, and government are involved in tripartite wage negotiations.

Private sector and union representatives sit on the National Negotiating Committee on Post-Lomé discussions, the World Trade Organization standing coordination committee, and the Regional Cooperation Council. They also take part regularly in World Trade Organization ministerial conferences.

The participatory policymaking in Mauritius enables all stakeholders to shape the national economic strategy, with private needs reflected in government policy, in line with the country’s development objectives.

**Moving to mutual accountability and coherence—the best route to development effectiveness**

There is much dissatisfaction with the state of development partnerships in Africa (ECA 2001). It stems from a vicious circle of high expectations, grand promises, and only partial accomplishment of goals. There is also the frustration of Africans (that expected benefits were not fully realized) and of development partners (that imple-
There is much dissatisfaction with the state of development partnerships in Africa: it stems from a vicious circle of high expectations, grand promises, and only partial accomplishment of goals.

"There is much dissatisfaction with the state of development partnerships in Africa: it stems from a vicious circle of high expectations, grand promises, and only partial accomplishment of goals."

Implementation was not as expected and the funds provided were not used effectively. The African side blames unrealistic project design, excessive conditions (some of which were just plain wrong), and slow and unpredictable access to promised funds. The donors blame corruption, inadequate political will, and poor implementation by the Africans. There is considerable evidence to support both points of view (Lancaster and Wangwe 2001).

If the pace of Africa’s development is to be accelerated it is imperative that the relationship between Africa and its partners be within the context of interdependence, cooperation, and mutual accountability (ECA and OECD 2002). That is the emerging consensus. Predictability and accountability should be mutual. National leaders should carry out their programmes and inform supporting partners of any changes. Partners should provide the promised resources in a timely manner or consult on the proposed changes. Each should be accountable for fulfilling commitments. Agreements should be clear, stating events and timing, with all to be monitored.

This consensus is reflected in the pledge by world leaders at the UN Conference on Financing for Development in Monterrey:

A substantial increase in ODA and other resources will be required if developing countries are to achieve the internationally agreed development goals and objectives, including those contained in the Millennium Declaration. To build support for ODA, we will cooperate to further improve policies and development strategies, both nationally and internationally, to enhance aid effectiveness (para 22).

The international community is also committed to intensifying efforts to lower external debt burdens, improve market access, and reduce constraints that prevent poor countries from fully realizing the benefits of globalization. In turn, developing countries acknowledged that they must take responsibility for good governance and sound policies, as African leaders are doing under the New Partnership for Africa’s Development (NEPAD). These leaders have committed to implementing sound economic policies, tackling corruption, putting in place good governance, investing in people, and establishing an investment climate to attract private capital. Mutual accountability requires that pledges by both sides be monitored. Box 2 describes an indicative “first set” of performance indicators that could be used to jointly monitor progress by African countries and external development partners on specific commitments and related reform efforts.

Increase the predictability of aid flows

Several country profiles underscore the importance of mutual accountability for development effectiveness. For instance, an important feature of mutual accountability is that partnership arrangements should be clear and predictable. It is accepted that major changes in a recipient country may legitimately require a revaluation of partnership agreements (for instance, if serious conflict breaks out in the country that had been
### Box 2

**Possible indicators for joint reviews of development effectiveness**

**For external development partners**

**Medium-term aid flows and support within local medium-term budgeting and planning frameworks**
- Proportion of donors working within medium-term development frameworks derived from national Poverty Reduction Strategies.
- Proportion of aid resources included or reported within medium-term expenditure frameworks.

**Donor practices**
- Progress in reducing the number of donor missions and increasing the number of joint missions.
- Progress in sharing country analytical work programmes and products of donor agencies, and more systematic preparation of such products in ways that strengthen partner capacity.
- Extent to which donors are working jointly (joint sector support, joint budget support, joint evaluations, delegated cooperation).
- Extent to which donors use common reporting formats.

**Capacity building**
- Support for national capacity development strategies.
- Donor policies and practices on use and remuneration of local professionals in donor field offices and in public service (use of project implementation units and salary and other incentives in relation to local salary structures).

**For African countries**

**Peace, security, and political governance**
- Free and fair elections of all branches of the state, independence of the judiciary, and existence of a free press.
- Clear separation of powers of the judiciary, legislative, and executive branches.
- Freedom of association of political parties, trade unions, peasant organizations, and other private organizations.
- Absence of involvement in nonsanctioned military conflict in other sovereign states.

**Economic and corporate governance**
- Comprehensive and transparent public accounts covering both expenditures and revenues (including royalties).
- Existence of an independent public accounts committee in the legislature with an oversight function. Implementation of recommendations of the committee and independent government auditors.
- Legislation requiring parliamentary approval of external debt.
- An independent commercial justice system.
- Three-year moving average for inflation and the average weighted tariff rate.
- Barriers to capital imports not excessive.

*(continued on next page)*
This was the case in Uganda, where an unplanned increase in defense spending of about 0.5% of GDP in 2002/03 budget led to a reevaluation of multilateral and bilateral relationships. Defense expenditures are projected to be around 5.6% of GDP in 2002/03 compared with 4.6% in the previous three years. The rise in the defense budget, especially the spending over budget, has raised concerns among several donors, with the government arguing that the increase in spending is necessary to decisively address the security situation in the north.

However, the foreign partner too frequently makes unilateral changes in agreements without consultation. The result: serious disruption of important national programmes and uncertainty about how to plan for the future. In Ghana development assistance that was expected in January 1, 2002 was belatedly received on December 31, 2002. The budget deficit rose to 6.9% of GDP in 2002 (from 4.4% the year before) partly because only 18% of promised grants had been received by the third quarter.

Mutual accountability requires clear understanding by both parties about the timing of release of promised aid funds, and donors should be held accountable for delivering on their promises. Consultation should be the rule if changes are thought to be needed.

To address the unpredictability of aid flows, donors need to programme their aid over a multiyear timeframe consistent with the financial planning horizon of recipient governments.

**Box 2 (continued)**

*Possible indicators for joint reviews of development effectiveness*

- Regulation of business not overly burdensome.
- Independence of the central bank.
- A nationally owned development plan (or poverty reduction strategy) produced in a participatory fashion and covering trade and private sector development.
- A medium-term expenditure framework (or other medium-term budgetary and planning mechanism) and prioritized sector programmes to ensure effective use of resources.

*Human development*

- Childhood immunization coverage (DTP3) of at least 50 percent.
- Nonsalary recurrent spending on basic education per school-age child of at least 10 percent of government revenue.
- An HIV/AIDS treatment and mitigation policy.
- Gender equity in access to primary education.

*Capacity building*

- Existence of an operational government strategy for national capacity building, including civil service reform, encompassing salary top-ups.
For this to happen:

- Medium-term commitments should be aligned with medium-term expenditure frameworks, so that the country can plan Poverty Reduction Strategy activities well in advance.
- Yearly disbursements should be aligned with the fiscal budget so that countries can deliver services planned in the medium-term expenditure framework.
- Development partners should provide recipient governments with full information on aid flows, on a regular and a timely basis.
- Development partners should let the recipient government know in advance what information should be included in the annual reviews, streamlining the requests and reducing the number of additional ad hoc requests for information.

Consider Rwanda, where the British government in 1998 entered a 10-year relationship to improve the predictability of resource flows and set up an independent body to review donor practices. The United Kingdom has also led the way in shifting funding towards budget support, with a new programme of budget support of £76 million for 2000–03 agreed in 2000.

**Reduce donor “frenzy”**

Partnership based on mutual accountability should reduce the high transaction costs for recipient countries. Many African countries receive assistance from several partners in the same economic sectors, with each partner insisting on detailed conditions for its assistance. The conditions exacted by the partners often are not consistent. And the timeframe for the partner agreements tends to be short, creating uncertainty for ongoing programmes and requiring the time of national leaders to negotiate follow-on agreements.

Reducing the high transactions cost requires improving donor coordination and harmonizing development assistance programmes. For this the partners need to align their policies and programmes with the Poverty Reduction Strategy or other nationally owned development plans.

The Uganda profile shows that donors are aligning their programmes around the PRS. But this is not happening across a wide range of countries. For example, in Mozambique, where some progress has been made in this regard, the government is concerned about the burden presented by project aid that bypasses national systems and priorities. Aid is fragmenting ministries, weakening national and ministerial identity, and undermining authority.

Rwanda has new Guidelines for Productive Aid Coordination, with the Poverty Reduction Strategy now providing the framework for aid coordination. It is also considering a lead agency arrangement, with the largest donor to a sector taking the lead in that sector. A lot more needs to be done in this area (box 3).
Reducing transaction costs may require that development partners move away from project aid towards budget support, which for countries with transparent budget procedures and sound public expenditure management systems is another critical feature of mutual accountability, as in Ghana.

**Box 3**

*Despite the rhetoric, donors not yet fully behind Poverty Reduction Strategies*

The Strategic Partnership with Africa carried out pilot action learning missions to three African countries in 2002. The purpose was to investigate specific measures for aligning donor practices with national Poverty Reduction Strategy (PRS) processes and cycles. The missions were to explore, with governments and in-country donors, the possibilities for developing a coordinated government-led, annual PRS cycle, with aid financing, procedures, and practices lined up behind a national review process and budget cycle. The missions also sought to elicit an agenda of the changes needed for donor policies, procedures, and practices to line up behind a nationally led PRS cycle.

**Findings**

- The number of donor conditions has shown no tendency to decrease.
- The process for agreeing to specific policy actions required by donors remains nontransparent, and is not based on the country’s own policymaking process.
- Reporting requirements have not been aligned, either with each other or with the countries’ own information systems.

**Actions by African governments**

- Translate medium-term indicators, targets, and policy commitments into annual goals against which progress can be measured.
- Clarify the link between the PRS annual review and national budget and planning cycles.
- Clarify the links between PRSs and sector programs.
- Ensure consistency between the PRS and medium-term budget allocations.

**Actions by donors**

- Agree to use the annual PRS review to assess and review country performance and conditions.
- Align disbursements with the government’s budget cycle.
- Notify governments, in advance, of the specific information they would like to see included in the annual reviews, and streamline their requests.
- Avoid making additional ad hoc requests for information.
- Support governments through capacity building and appropriate technical assistance.
- Align conditionality with the PRS, and simplify it where possible. A common set of conditions would include all the requirements of all donors providing budget support, but each donor would link its support to its own subset of conditions and render its own judgement about whether these conditions have been met.

**Source:** Strategic Partnership for Africa 2002.
The government of Ghana has a multidonor budgetary programme to support the Poverty Reduction Strategy, requiring donors to provide resources through the government budget and in line with the budget cycles. Participating development partners follow common rules for disbursement and commit themselves to firm financing over the coming year, with indicative commitments for the following two years. Funds are not earmarked for specific activities. Instead, the government and the development partners participating in the programme have agreed to focus on some key reform areas viewed as critical for the successful and efficient implementation of the strategy: public finance accountability reforms, budget processes, decentralization, civil service reform, and governance. For each area of priority actions, a policy matrix will provide benchmarks for monitoring progress.

The process is facilitated through regular quarterly mini-consultative group meetings. Regular monitoring reports from the government will be in a standard format, including quarterly reports on macroeconomic indicators, the policy matrix, expenditures against the budget and releases, and implementation of the strategy. In turn, development partners are to provide quarterly reports on disbursements and projections of disbursements for the next two quarters.

Making development policies coherent

The success of development policy depends on the effects of other policies, which intentionally or unintentionally may impair development cooperation. The coherence of development policies has to do with ensuring that all policies affecting African development prospects are synergistic—and do not conflict or nullify each other. A lack of coherence has been shown to lead to ineffectiveness (failure to achieve objectives), inefficiency (waste of resources), and loss of policy credibility.

Chapter 1 of the report documents several examples of incoherence in the development policies of Africa’s major partners. For example, the EU advocates African countries’ integration into the world economy, but its trade policy has numerous protectionist elements, especially in agriculture. An open trade policy and dismantling of the Common Agricultural Policy would complement EU development efforts rather than frustrate them.

To improve food security in West Africa, German development cooperation has promoted beef production in that region, but the success of these projects has been threatened by subsidized EU beef exports to the same countries. The 2002 U.S. Farm Bill, scaling up subsidies, is another example of a policy that conflicts with the government’s pledge to reduce poverty in Africa.

In general, Africa’s international partners have not implemented their commitments, particularly for enhancing market access and eliminating trade-distorting agricultural subsidies. Abolishing OECD agricultural subsidies would provide developing countries with three times their current ODA receipts. The elimination of all tariff and non-tariff
Tariff escalation in the international trade regime makes it difficult for African countries to diversify their economies towards high-value-added processed goods. Tariff peaks—rates above 15%—are often concentrated in products of export interest to developing countries. Two sectors that matter most for developing country exporters are textiles and agriculture. Tariff barriers in textiles remain high, while high tariffs for agricultural commodities and the continued subsidization of agriculture in many OECD countries repel agricultural exports.

The success of the Doha Development round of multilateral trade negotiations is crucial for improving market access for Africa’s exports. But given the apparent breakdown in these crucial talks, there is a strong case for OECD countries to frontload the benefits of trade liberalization for the poorest countries by providing immediate duty-free and quota-free market access.7

Because Africa depends more on external trade than do other developing regions, expanding market access for its exports is a clear priority. Of developing country GDP in 2001, 34% came from the exports of goods and services, but for Sub-Saharan Africa, the figure was 40%.

**Mutual accountability—Africa’s role**

Mutual accountability is a two-way process. Partners have to fulfill their part of the bargain, and Africans have to fulfill theirs. For Africans, the commitment to self-monitoring and to peer learning is the linchpin to accountability. (This is distinct from the accountability of having recipients report their compliance with donor requirements, including conditionality.) NEPAD is implementing an African Peer Review Mechanism (APRM) to encourage self-monitoring and peer learning (box 4). This systematic assessment tool will track progress of outcomes, identify and reinforce best practices, assess capacity gaps, and implement the required corrective actions.

Several African countries have already agreed to undergo peer reviews. What is left now is to move forward with implementing APRM and show that African countries are fulfilling their side of mutual accountability.

**Good governance is the key to mutual accountability**

Several country profiles demonstrate the progress African countries have made in improving governance. In Mozambique the current president has announced that he will step down in 2004 and refrain from anointing a successor. This is a potent signal of the political leadership’s commitment to democracy and the rule of law.

Rwanda is also taking positive steps towards deepening democracy and good governance, announcing that multiparty presidential and parliamentary elections will be held...
in mid-2003. Crucial to the success of this gradual political normalization are attempts
to foster social reconciliation through local tribunals, aimed at paving the way for the
eventual reintegration of genocide suspects into their communities. Connected to these
efforts is a bold decentralization programme to increase community participation, but
serious capacity constraints are apparent in most localities.

Ghana’s smooth political transition in January 2001 brings hope that the new gov-
ernment will create an atmosphere of transparency and participation. This has led to
more open debates on major policy reforms, such as the recent increase in fuel prices,
the adoption of the Heavily Indebted Poor Countries Initiative, and privatization of
water.

Mauritius, with a long period of political stability, remains a sterling example of democ-

cy. The rule of law prevails. Property rights are respected. And public sector activi-
ties have been transparent and conducive to private sector activities. The result: the
transformation of a poor country with a per capita income of $260 at the beginning of
the 1960s to a middle-income country with a per capita income of $3,800 in 2003.

**Box 4**

*NEPAD and the African Peer Review Mechanism*

A critical plank of the New Partnership for Africa’s Development (NEPAD) is the African Peer
Review Mechanism (APRM). The APRM will be used to assess the performance of African coun-
tries in terms of their compliance with a number of agreed codes, standards, and commitments
that underpin good governance and sustainable development. It represents a sea change in the
thinking of African leaders as they seek to reverse political authoritarianism, state failure, and cor-
ruption to embrace and consolidate democracy and ensure sound and transparent economic
management.

The Economic Commission for Africa has been deeply involved in developing the economic
and corporate governance codes and standards for the APRM. Good economic and corporate
governance can help countries attract more investment and achieve higher rates of per capita
growth. A state that applies rules and policies predictably and fairly, ensures order and the rule of
law, and protects property rights will generate confidence and attract more domestic and foreign
investment. That, in turn, will generate trade and faster economic growth, providing the where-
withal for sustainable development.

The weakness of the institutions of economic and corporate governance, as a constraint on
sustainable development in Africa, is clear and convincing, limiting the public sector in the fulfill-
ment of its economic functions. Strong institutions are needed to maintain fiscal and monetary
discipline, mobilize resources, and set priorities among the competing demands for those
resources. Similarly, institutional arrangements are required for the efficient delivery of pro-poor
public services. In addition, there must be institutional mechanisms to ensure accountability
through the capacity to monitor and enforce rules and to regulate economic activities in the pub-
lic interest. The APRM has the potential to make these desires a reality.
Notes

1. For instance, Uganda has reduced poverty by 22 percentage points over 10 years.
2. The temporal aspect of poverty refers to transitions into and out of poverty, which are often correlated with seasonal fluctuations in food availability.
3. This contradicts the now classic study that finds that where the policy environment is supportive of economic investment, an extra dollar of aid increases investment by nearly twice that amount (Dollar and Burnside 1998).
4. Fiscal sustainability refers to a situation in which the ratio of a country’s public sector debt to GDP is stationary and consistent with overall demand—both domestic and foreign—of government securities.
5. The World Bank and the IMF (2001) recognize that there is no assurance that these countries will not face future debt problems. According to their document, achieving sustainability will require a rapid and stable rate of economic growth.
6. Higher marginal tax rates are likely to have a greater disincentive effect on trade and private investment.
7. Canada announced duty-free, quota-free access to the least developed countries at the Kananaskis G-8 Summit in June 2002. The African Growth and Opportunity Act gives African countries access to the U.S. market.

References


Recent Economic Trends in Africa and Prospects for 2003

The performance of African economies fell short of expectations in 2002—with growth slowing from an average of 4.3% in 2001 to 3.2% in 2002, reflecting the weaker global economy and the slower-than-expected rebound in world trade. In early 2002 it seemed that a global economic recovery, led by the United States, was under way. But by mid-2002 weaknesses in emerging markets and in mature equity markets increased the risk aversion of investors. Africa’s growth prospects were further weakened by the lagged effects of low commodity prices in 2001, the droughts in various parts of southern and eastern Africa, and the political and armed conflicts in some parts of the region—notably, the Central African Republic, Côte d’Ivoire, Madagascar, and Zimbabwe.

Despite the weaker performance, countries continued to strengthen their macroeconomic fundamentals and intensify their focus on reducing poverty. Nine countries were preparing either interim or final Poverty Reduction Strategies, up from four in 2001.

For 2003 the outlook is mixed, with growth expected to rebound modestly to 4.2%. In addition to deteriorating business sentiment in industrial economies, rising oil prices and financial turbulence amplify the risk of returning to a global slowdown.

Downside risks in Africa stem from the deteriorating political and economic situations in Zimbabwe and Côte d’Ivoire, with possible contagion effects in the western and southern subregions. In Zimbabwe the crisis brought high and growing inflation, lowered food production, and increased the number of people facing starvation and famine. So far, the conflict in Côte d’Ivoire has not had any major adverse effect in the subregion. But if it persists, there would be disruptions in cocoa supplies to world markets and in the economic activities of neighbouring states.

Renewed flooding and drought in various parts of the continent, especially in the Horn of Africa and the southern region, may affect agricultural production in 2003. In Ethiopia 15 million people face starvation because of failed rains and harvests, with dire consequences for health, labour force participation, and near-term growth.

The U.S. decision in May 2002 to introduce a six-year $51.7 billion farm bill boosting crop and dairy subsidies by 67% doesn’t help Africa’s prospects. The subsidy will reduce agricultural prices, making it difficult for small African countries to compete.
The global recovery—a mirage?

Since the end of 2001 there has been a turnaround in global economic activity, driven largely by economic developments in the United States. The turnaround gathered momentum in the first quarter of 2002 and led to optimistic forecasts about the prospects for future growth (figure 1.1 and table 1.1). Events of the last quarter of 2002 suggest that the global recovery continued, if slower than earlier expected. The reasons? The diminished pace of economic recovery in the United States in the second quarter of 2002. The declines in equity prices in major financial markets. The rising risk premiums associated with the volatile situation in the Middle East and their impact on oil prices. And the deteriorating economic conditions in several Latin American countries.

Figure 1.1
Developed country growth—rebounding
Annual GDP growth, OECD, EU and G-7 countries, 2000/Q3–2002/Q3
(percentage change over the same quarter of the previous year)
Is the U.S. economy headed for a double-dip recession?
The recent declines in equity prices in all major financial markets, the decline in business and consumer sentiments in the third quarter of 2002, and the signs of slow and fragile growth in the U.S. economy in the second half of the year have raised concerns about the timing of the recovery, prompting speculation that the United States may be headed for a double-dip recession, sliding back into another recession after a short-lived recovery. Although most economists recognize this possibility, the general feeling is that it is unlikely because:

- Current U.S. inflation is low—1.1% in 2002—so there is room for monetary policy to stabilize the economy, if needed. In addition, because of the long lags in the monetary transmission mechanism, it is likely that the full positive effects of the interest rate cuts witnessed between the last quarter of 2001 and the second half of 2002 have not been completely realized in the economy. It is therefore likely that this will add some strength to the recovery in the near term.
- Recent gains in labour productivity imply further increases in real wages and disposable income, increasing consumer spending and thus growth.
- Given the U.S. government’s steps to strengthen corporate governance and auditing, it is likely that the equity market will stabilize, increasing consumer confidence and thus spending.
- There are indications that the Bush administration will increase government spending if the economy is falling into a tailspin.

Table 1.1
Quarterly changes in real GDP, industrial countries, 2000/Q1–2002/Q3
(percentage change over previous quarter)

<table>
<thead>
<tr>
<th>Region</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Q1</td>
<td>Q2</td>
<td>Q3</td>
</tr>
<tr>
<td>OECD</td>
<td>1.1</td>
<td>0.5</td>
<td>0.4</td>
</tr>
<tr>
<td>EU15</td>
<td>0.8</td>
<td>0.4</td>
<td>0.6</td>
</tr>
<tr>
<td>Euro Area</td>
<td>0.9</td>
<td>0.4</td>
<td>0.6</td>
</tr>
<tr>
<td>G7</td>
<td>0.9</td>
<td>0.4</td>
<td>0.6</td>
</tr>
<tr>
<td>Canada</td>
<td>1.5</td>
<td>1.3</td>
<td>0.5</td>
</tr>
<tr>
<td>Germany</td>
<td>1.0</td>
<td>0.1</td>
<td>0.0</td>
</tr>
<tr>
<td>France</td>
<td>0.8</td>
<td>0.2</td>
<td>0.5</td>
</tr>
<tr>
<td>Italy</td>
<td>0.8</td>
<td>0.6</td>
<td>0.1</td>
</tr>
<tr>
<td>Japan</td>
<td>2.0</td>
<td>1.4</td>
<td>0.5</td>
</tr>
<tr>
<td>UK</td>
<td>0.5</td>
<td>0.4</td>
<td>0.6</td>
</tr>
<tr>
<td>United States</td>
<td>0.6</td>
<td>0.1</td>
<td>0.3</td>
</tr>
</tbody>
</table>

Note: Data are seasonally adjusted.
Source: OECD 2002 (March, September, and December).
In tandem with evidence of moderating U.S. economic growth, there are increasing concerns that the momentum of growth will ease in Japan, despite strong export performance in the first half of 2002. The Japanese economy is plagued by weak private domestic demand, ongoing price deflation, and severe structural problems, particularly in banking. Real GDP fell 0.7% in 2002, with an increase of 0.8% expected in 2003. For the world’s second largest economy, the slow pace of economic growth has adverse effects on global demand and the outlook for prices of Africa’s export commodities.

Economic performance in the euro area, Africa’s most important market for non-oil exports, remains weak. Real GDP growth in the euro area was 0.8% in 2002, with an increase to 1.8% expected in 2003.

Outside the euro area, growth in the United Kingdom was weak in the last quarter of 2001 and the first quarter of 2002 but picked up in the second half to bring it to 1.5% for the year, with an increase to 2.2% expected in 2003. About 7% of Africa’s exports of goods and services go to the United Kingdom, so any improvements in the economic outlook for this economy would have positive effects on the region.

Commodity prices—surging
Since the beginning of 2002 commodity prices have recovered remarkably, reflecting a rebound in global economic activity. The World Bank price index for petroleum increased from 84.4 in the fourth quarter of 2001 to 117.7 in the third quarter of 2002, while the index for non-energy commodities rose from 75 to 84.9. There was also an increase in the index for metals and minerals, from 69.4 to 71.5.

Crude oil prices have been rising since the beginning of 2002 despite weak world oil demand and ample supplies. Cocoa prices, which have generally increased since 2000, surged in 2002 because of declining supply and the fact that in July Armajaro—a U.K. trading company—bought vast quantities of cocoa at the London International Financial Futures Exchange in an apparent bid to push up prices. In addition, the recent outbreak of political and armed conflict in Côte d’Ivoire—the world’s largest producer of cocoa, with approximately 40% of global output—generated concerns about the stability of the global cocoa supply and resulted in cocoa prices hitting a 17-year high in October. The average annual price of cocoa increased from 90.6 cents per kilogram in 2000 to 169.9 cents per kilogram in 2002.

The prices of tea and coffee have generally been on the decline since 2000, due to over-supply and high stocks. But the price of tea picked up slightly in the beginning of 2002. Gold prices increased from $278 per troy ounce in the fourth quarter of 2001 to $314 in the third quarter of 2002.

Foreign direct investment—still on the decline
African countries have the highest rate of return on investment in the world—four times more than in the G-7 countries, twice more than in Asia, and two-thirds more than in...
Despite this fact, and the improvements in the macroeconomic policy environment since the mid-1990s, the region has difficulty attracting foreign investment.

In 2002 world foreign direct investment (FDI) dropped 27% because of the lower than expected recovery in the global economy and the adverse effects of the corporate auditing and accounting scandals in some advanced countries. In Africa FDI inflows declined by $6 billion, from a peak of $17 billion in 2001. The decline is attributable to the unusual increase in inflows to South Africa and Morocco in 2001 as well as the intensification of political and social conflicts in some African countries, affecting investor sentiments.

**Official development assistance—new promises**

Prospects for official development assistance (ODA) flows to Africa are likely to improve in the short to medium term because of fresh commitments to increase development assistance to the region.

- The European Union (EU) announced that all its member states should seek to meet or exceed the current EU average of 0.33% of gross national income by 2006, as an intermediate step towards the target of 0.7%. The United States announced that it would provide, through its Millennium Challenge Account, an extra $5 billion of aid a year from 2006 onward and an extra $10 billion in total between 2002 and 2006. Together, these increases would amount to an extra $12 billion a year from 2006 onward, a step in the right direction but far short of the $50 billion a year needed from 2001 for all developing countries to meet the Millennium Development Goals.

- Canada has also announced increases in aid. At the Group of Eight (G-8) summit in Kananaskis, Canada, in June 2002, Canada committed an additional CAN$6 billion to Africa over five years—including the CAN$500 million Canada Fund for Africa announced earlier. This commitment is especially welcome because it is in the December 2001 budget and therefore built into existing fiscal frameworks.

Leaders of the G-8 countries—in their Africa Action Plan unveiled at Kananaskis—indicated that half the new development assistance announced at the March 2002 Monterrey meeting would be directed to Africa. The challenge is to ensure that these commitments actually become available and are deployed more effectively than in the past.


- ODA for economic infrastructure and services covers assistance for networks, utilities, and services, including energy, transportation, and communications. It declined from 23% in 1975–80 to 15% in 1995–2000.

Foreign direct investment flows to Africa declined by $6 billion, from a peak of $17 billion in 2001.
• ODA for programme assistance covers balance of payments and budget support—and funds made available for capital projects at the recipient’s choice. It dropped from 38% from 1975–80 to 12% in 1995–2000.
• ODA for social infrastructure and services covers efforts to develop human resources and improve living conditions, including education, health, and water supply. It increased from 11% to 37%.

Between 1990 and 2000 ODA was down by more than half for agriculture, transportation and communications, energy, and trade and tourism (figure 1.3). Flows to education rose from $0.3 billion in 1990 to $1.4 billion in 2002, reflecting donor interest in social sector programs aligned with Poverty Reduction Strategies.

Recent economic developments in Africa

Of the 53 countries in Africa, only 5 achieved the 7% growth rate in 2002 required to meet the Millennium Development Goals, 43 had growth below 7%, and 5 registered negative growth (table 1.2 and figure 1.4). For the region as a whole, real GDP grew 3.2% in 2002, compared with 4.3% in 2001.

Growth slows in regional powerhouses

The slowdown in regional growth is due to slower growth in four of the five largest economies in the region: Algeria, Egypt, Morocco, and Nigeria.

Figure 1.2

ODA down for economic infrastructure—up for social

• In Algeria the decline from 5% in 2001 to 2.7% in 2002, despite an increase in oil prices, reflects political and religious tensions, flooding in the east, and weak competitiveness in the industrial sector.

• In Egypt the decline from 3.5% to 3% is due primarily to higher domestic interest rates, sluggish private sector growth, regional insecurity, and lack of political will by the government to implement far-reaching economic and social reforms, such as privatization and trade liberalization.

• In Morocco the decline from 6.5% to 4.3% was due to weak domestic demand and reduced tourism.

• In Nigeria growth declined from 4% to 2.6%, reflecting the combined effect of political risk and deteriorating economic fundamentals emanating from weak fiscal behaviour.

The slowdown in regional growth is due to slower growth in four of the five largest economies in the region.

Figure 1.3
Education now receives the most bilateral assistance
Aid flows to Africa from Development Assistance Committee donors, 1990 and 2000 (US$ billions)

Table 1.2
Distribution of GDP growth rates in Africa, 1998–2002 (number of countries)

<table>
<thead>
<tr>
<th>Range</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negative growth</td>
<td>2</td>
<td>0</td>
<td>1</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Zero or positive growth</td>
<td>51</td>
<td>53</td>
<td>52</td>
<td>48</td>
<td>48</td>
</tr>
<tr>
<td>Low (0–3.9%)</td>
<td>23</td>
<td>26</td>
<td>37</td>
<td>19</td>
<td>27</td>
</tr>
<tr>
<td>Medium (4.0%–7.0%)</td>
<td>26</td>
<td>23</td>
<td>14</td>
<td>24</td>
<td>16</td>
</tr>
<tr>
<td>High (&gt;7.0%)</td>
<td>2</td>
<td>4</td>
<td>1</td>
<td>5</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: Economic Commission for Africa, from official sources.
South Africa, which accounts for about 35% of the GDP of the five largest economies in Africa, grew 3% in 2002, up from 2.5% in 2001. This weak performance despite recent increases in the prices of its export commodities, particularly gold, is due in part to sluggish growth in the euro area. In addition, the appreciation of the rand against the dollar in the second and third quarters reduced the competitiveness of South African exports. And the South African Reserve Bank tightened monetary policy on a number of occasions to reduce inflationary pressures.

**Southern Africa grew faster than the other subregions**

With the exception of Southern Africa, growth slipped in all subregions—by 3 percentage points in the north, 0.4 in the west, 0.5 in the east, and 1.5 in the centre (figure 1.5).

- In North Africa the decline reflects heightened political tension in the Middle East and the subdued growth in the euro area, a major trading partner.

---

**Figure 1.4**

*The best performers and the worst*

Real GDP growth rates for the top 10 and the bottom 5 African countries, 2002 (%)

<table>
<thead>
<tr>
<th>Country</th>
<th>Growth Rate (2002)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equatorial Guinea</td>
<td>25</td>
</tr>
<tr>
<td>Mozambique</td>
<td>15</td>
</tr>
<tr>
<td>Angola</td>
<td>10</td>
</tr>
<tr>
<td>Chad</td>
<td>10</td>
</tr>
<tr>
<td>Rwanda</td>
<td>10</td>
</tr>
<tr>
<td>Uganda</td>
<td>5</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>5</td>
</tr>
<tr>
<td>Cape Verde</td>
<td>5</td>
</tr>
<tr>
<td>Benin</td>
<td>0</td>
</tr>
<tr>
<td>Mauritania</td>
<td>0</td>
</tr>
<tr>
<td>Africa</td>
<td>0</td>
</tr>
<tr>
<td>Gabon</td>
<td>0</td>
</tr>
<tr>
<td>Guinea-Bissau</td>
<td>-10</td>
</tr>
<tr>
<td>Malawi</td>
<td>-10</td>
</tr>
<tr>
<td>Madagascar</td>
<td>-10</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>-10</td>
</tr>
</tbody>
</table>

*Source: Economic Commission for Africa, from official sources.*
In West Africa the decline is due in part to slower growth in Nigeria—the largest economy in the subregion—from 4% in 2001 to 2.6% in 2002. Reductions in the pace of economic activity in Burkina Faso, Guinea-Bissau, Niger, Senegal, and Sierra Leone also contributed.

In East Africa a 3.5% decline in Madagascar, coupled with modest declines in Djibouti, Ethiopia, Kenya, Somalia, and Tanzania, contributed to the slowdown.

In Central Africa the slowdown is due largely to declines in Equatorial Guinea (from 66.1% to 24.4%), Congo (from 2.9% to 1.7%), and Cameroon (from 5.2% to 4.9%). For the second year in a row, Equatorial Guinea is the fastest growing economy in Africa, thanks to oil and gas.

In Southern Africa growth increased from 2.4% in 2001 to 3.3% in 2002, largely reflecting improvements in South Africa, Angola, Lesotho, and Namibia.

**Agriculture and food security**

Since 2000 there has been a general deterioration in agriculture, reflecting the slowdown in global economic activity and poor weather. Estimates for 2001 suggest that agricultural production grew by a meager 0.8% in Sub-Saharan Africa (excluding South Africa). Although this is better than the 0.3% decline in 2000, it is far below the sector’s average growth of 3.9% in 1992–96.

In 2002 unfavourable weather created severe problems. In Kenya flooding due to heavy rains affected about 30,000 people. In Senegal flooding in February killed 500,000 livestock, destroyed 20,000 homes, and damaged 2,500 hectares of crops. In Algeria agricultural output fell 3.2% in 2002, partly because of flooding in the east in July and August. In Botswana, Ethiopia, Lesotho, Malawi, Mauritania, Namibia, and...
Niger, Swaziland, Tunisia, Zambia, and Zimbabwe drought and generally dry conditions reduced agricultural production (box 1.1). Tunisia’s agricultural output declined 14% in 2002.

Despite the poor weather in some parts of the region, agricultural production was expected to grow in 2002 by 11% in Morocco, 5.1% in Uganda, 4.1% in Ghana, 4.0% in Nigeria, 3.4% in Egypt, 3.5% in Cameroon, 3.2% in South Africa, and 2.5% in Côte d’Ivoire.

Food insecurity—the lack of access by an individual or a group of individuals to enough food for an active, healthy life—is becoming a serious development challenge in the Sahel as well as in parts of eastern and southern Africa. In Ethiopia close to a quarter of the population faces the risk of famine and urgently needs food aid. In Zimbabwe 49% of the population requires emergency food aid, in Lesotho 30%, in Malawi 29%, in Zambia 26%, and in Swaziland 24%.

Declining productivity in agriculture and severe drought have reduced food security in Zimbabwe. After independence and several land reform attempts, most of the large commercial farms were still held by whites, then 1% of the population. In 2001–02 much of the commercial farmland was forcibly resettled, but having inexperienced farmers on commercial land hurt agricultural production (figure 1.6).

Savings and investment—still low
An investment to GDP ratio of 25% or more is needed to accelerate growth in Africa. Historically, savings and investment ratios have been very low on the continent, an important constraint on development.

Box 1.1
Ethiopia—famine in a growing economy

Ethiopia’s growth in the last few years has been quite remarkable, reflecting partly the positive effects of the cessation of hostilities with Eritrea and the benefits of debt relief under the HIPC Initiative. With real GDP growth of 8.7% in 2001 and 6.1% in 2002, it is one of the few African countries close to reaching the growth target of 7% required to meet the Millennium Development Goals.

But the recent gains in growth performance in Ethiopia may be wiped out by famine, from failed rains and harvests in the countryside, exposing a quarter of the population to the risk of starvation. Famine is not new in Ethiopia. The first recorded cases of famine in Ethiopia occurred between 1540 and 1742, and there were about 10 famine incidents within this period. This was followed by the “great Ethiopian famine” of 1888–92, killing roughly a third of the population. There was also famine in the Wollo province during 1972–74. The most recent famine was in 1984.

Source: Economic Commission for Africa, from official sources.
In 2000 the average savings ratio for the region was 21.0%, and the average investment ratio 21.8%. Equatorial Guinea, the Republic of Congo, Algeria, Gabon, Mauritius, and Angola had savings and investment ratios above 25% in 1998–2000. Equatorial Guinea, Lesotho, São Tomé and Príncipe, Eritrea, Seychelles, Gabon, Angola, the Republic of Congo, Mozambique, Burkina Faso, and Mauritius had investment ratios above 25%. Of 42 countries considered, only Mauritius, Equatorial Guinea, and the Republic of Congo had high savings and investment ratios as well as high growth over the period (figure 1.7). The other countries had either low savings and investment ratios or low growth.

Privatization—still slow and reluctant
As part of efforts to deepen economic reforms and increase private sector involvement in economic activities in Africa, many countries have developed privatization schemes to increase private investment in key public enterprises. Government-run telecommunications companies have been privatized or are being privatized in Tunisia, Ethiopia, Mauritius, and the Central African Republic. State-run agricultural firms have been privatized in Ethiopia and Morocco.

In 2003 privatization efforts are intensifying in Algeria, Ghana, South Africa, and Uganda. But Cameroon, Egypt, Gabon, and Niger are finding it difficult to accelerate the pace of privatization due to concerns about possible outbreaks of violence and resistance by trade unions and other interest groups. Although privatization of public enterprises would eventually increase the overall efficiency of domestic resource use, it has not yet led to more total investment on the continent.

Indeed, the region has privatized only about 40% of its state-owned enterprises. And much of the divestiture has been for smaller, less valuable, often moribund manufacturing, industrial, and service concerns. Of the roughly 2,300 privatizations in 1991–2000, only about 66 involved higher value, economically important firms (table 1.3). An additional 92 transactions were in transport, some of which might have been classified as infrastructure. But even if these are included, less than 7% of the sales have touched upper-end infrastructure firms.

Activity has been concentrated in a few countries. Of the $9 billion raised from 1991 to 2001, a third was generated by a handful of privatizations in South Africa (figure 1.8). Another third came from sales in Ghana, Nigeria, Zambia, and Côte d’Ivoire. Some 26 African countries, together, have privatized a scant $0.7 billion in assets.

African states have retained significant minority equity stakes in the few infrastructure privatizations they have concluded, holding back from the market an average of one-third of the shares. Continuing government involvement and share retention reduce the number of bidders and therefore the price per share sold. The slow pace of sales, the reluctance to place assets with the highest potential value on the market, the failure to sell all shares, poor business and legal environments, and the deficiencies of
government regulation and administration—all combine to leave Africa at the back of the pack in privatizing infrastructure.

**Communication networks—improving**

International bandwidth in bits per capita, a new measure of Internet use, shows how a country is progressing towards an information-based economy. Bandwidth availability in Africa varies tremendously but is generally very low. Although there are few intra-African links, the marine fibre cables are operational and should provide faster and cheaper routes in and out of Africa.

**Trade and the current account—deteriorating**

In 2002 the region had a 0.5% deterioration in its terms of trade, 3.2 percentage points better than that in 2001. The smaller deterioration reflects largely the improvement in commodity prices in 2002. For Sub-Saharan Africa the terms of trade improved by 0.6%.

*Figure 1.6*

**Zimbabwe: drought and inexperienced farming hurt agricultural production**

Land distribution in Rhodesia changed slightly over time. But a majority of the best farmland was held by whites, who were a tiny minority . . .
Access to markets. One of the challenges to trade in Africa is increasing access to developed country markets. At the Fourth 2001 World Trade Organization (WTO) Ministerial Conference held in Doha, WTO member states agreed to undertake negotiations to improve market access for agricultural products exported by developing nations (box 1.2). Since African countries export mostly agricultural commodities, they are likely to benefit.

Other measures to improve market access for Africa include:

- The U.S. African Growth and Opportunity Act (AGOA), introduced in 2000, gives most African countries preferential access to the U.S. market for petroleum products, agricultural goods, and such manufactures as textiles. Exports from Gabon, Lesotho, Madagascar, Nigeria, South Africa, and Swaziland have already increased as a result of this scheme. Malawi and Zambia are expected to benefit.

...And after independence, the Mugabe government made promises about land reform, none of which altered the distribution significantly. Continued conflicts have caused numbers of white farmers to drop.

According to the commercial farmers' union, nearly all the white-owned farms have some squatters, and most of the large scale commercial land has been slated for confiscation. Some of the land appears to have gone to top government officials and the president's relatives, including his wife.

Consequently, many Zimbabweans are facing famine.
this year through an increase in textile exports. Although the act gives African nations an advantage over other regions, it does not cover all exports from Africa and so its potential benefits to the region will be limited.

• The Everything-But-Arms initiative was approved by the European Union in February 2001 with the objective of eliminating quotas and duties on all goods, except arms, from 49 least developed countries, most in Africa.

**Current account.** For the 28 African countries that have data, 8 had current account surpluses in 2002, supported largely by higher export revenues—Algeria, Botswana, Côte d’Ivoire, Equatorial Guinea, Libya, Mauritius, Namibia, and South Africa.

Eleven countries had unsustainable current account deficits of more than 5% of GDP in 2002—Burkina Faso, Chad, Gabon, Lesotho, Malawi, Niger, Senegal, Tanzania, Uganda, Zambia, and Zimbabwe. With a wallopıng deficit of 48% of GDP, Chad is the worst performer. Its revenues from cotton and cattle exports are declining, and its imports increasing, owing to food shortages and the need for intermediate capital goods for the Doba oil project.

**Intra-African trade—still low**

Trade among Sub-Saharan African countries (Africa-to-Africa trade) accounts for only 12% of Sub-Saharan exports, up 8% from 1989. The eight major established regional arrangements did not contribute to the increase: their shares of Africa-to-Africa trade were either stagnant or declining between 1989 and 1993.

**Figure 1.7**

*Getting the trinity right—more savings, investment, and growth*

**Note:** High growth means a growth rate greater than 5%. High savings means a savings ratio greater than 25%. High investment means an investment ratio greater than 25%.

**Source:** Economic Commission for Africa, from official sources.
Table 1.3  

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of transactions</th>
<th>Sale value (US$ millions)</th>
<th>Share of total divested (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Angola</td>
<td>57</td>
<td>6.0</td>
<td>—</td>
</tr>
<tr>
<td>Benin</td>
<td>28</td>
<td>49.0</td>
<td>38</td>
</tr>
<tr>
<td>Burkina Faso</td>
<td>23</td>
<td>9.0</td>
<td>32</td>
</tr>
<tr>
<td>Burundi</td>
<td>38</td>
<td>4.0</td>
<td>—</td>
</tr>
<tr>
<td>Cameroon</td>
<td>48</td>
<td>244.0</td>
<td>28</td>
</tr>
<tr>
<td>Cape Verde</td>
<td>42</td>
<td>53.0</td>
<td>—</td>
</tr>
<tr>
<td>Central African Republic</td>
<td>18</td>
<td>—</td>
<td>50</td>
</tr>
<tr>
<td>Chad</td>
<td>35</td>
<td>12.0</td>
<td>—</td>
</tr>
<tr>
<td>Congo, Rep. of</td>
<td>65</td>
<td>50.0</td>
<td>—</td>
</tr>
<tr>
<td>Congo, Dem. Rep. of</td>
<td>5</td>
<td>—</td>
<td>4</td>
</tr>
<tr>
<td>Côte d’Ivoire</td>
<td>82</td>
<td>622.0</td>
<td>55</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>10</td>
<td>410.0</td>
<td>6</td>
</tr>
<tr>
<td>Gabon</td>
<td>1</td>
<td>—</td>
<td>6</td>
</tr>
<tr>
<td>Gambia</td>
<td>17</td>
<td>2.4</td>
<td>85</td>
</tr>
<tr>
<td>Ghana</td>
<td>181</td>
<td>936.5</td>
<td>69</td>
</tr>
<tr>
<td>Guinea</td>
<td>31</td>
<td>45.0</td>
<td>27</td>
</tr>
<tr>
<td>Guinea-Bissau</td>
<td>25</td>
<td>0.5</td>
<td>64</td>
</tr>
<tr>
<td>Kenya</td>
<td>189</td>
<td>381.0</td>
<td>79</td>
</tr>
<tr>
<td>Lesotho</td>
<td>10</td>
<td>6.5</td>
<td>20</td>
</tr>
<tr>
<td>Madagascar</td>
<td>61</td>
<td>16.9</td>
<td>33</td>
</tr>
<tr>
<td>Malawi</td>
<td>11</td>
<td>53.2</td>
<td>44</td>
</tr>
<tr>
<td>Mali</td>
<td>59</td>
<td>67.4</td>
<td>92</td>
</tr>
<tr>
<td>Mauritania</td>
<td>19</td>
<td>1.2</td>
<td>20</td>
</tr>
<tr>
<td>Mozambique</td>
<td>474</td>
<td>135.0</td>
<td>39</td>
</tr>
<tr>
<td>Niger</td>
<td>10</td>
<td>1.8</td>
<td>18</td>
</tr>
<tr>
<td>Nigeria</td>
<td>30</td>
<td>893.5</td>
<td>6</td>
</tr>
<tr>
<td>Rwanda</td>
<td>1</td>
<td>—</td>
<td>3</td>
</tr>
<tr>
<td>São Tomé &amp; Principe</td>
<td>4</td>
<td>0.4</td>
<td>—</td>
</tr>
<tr>
<td>Senegal</td>
<td>39</td>
<td>415.0</td>
<td>23</td>
</tr>
<tr>
<td>Sierra Leone</td>
<td>8</td>
<td>1.6</td>
<td>31</td>
</tr>
<tr>
<td>South Africa</td>
<td>8</td>
<td>3,151.0</td>
<td>—</td>
</tr>
<tr>
<td>Sudan</td>
<td>32</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Tanzania</td>
<td>199</td>
<td>287.0</td>
<td>53</td>
</tr>
<tr>
<td>Togo</td>
<td>49</td>
<td>38.0</td>
<td>89</td>
</tr>
<tr>
<td>Uganda</td>
<td>102</td>
<td>174.0</td>
<td>79</td>
</tr>
<tr>
<td>Zambia</td>
<td>253</td>
<td>828.0</td>
<td>90</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>6</td>
<td>217.0</td>
<td>10</td>
</tr>
<tr>
<td>Total</td>
<td>2,270</td>
<td>9,111.9</td>
<td>40</td>
</tr>
</tbody>
</table>

— not available.  
*Source: Economic Commission for Africa, from official sources.*
Five countries dominate Africa-to-Africa trade—Côte d’Ivoire, Nigeria, Kenya, Zimbabwe, and Ghana. Côte d’Ivoire accounts for 25% of the exports, Nigeria 20%, Kenya 9%, Zimbabwe 9%, and Ghana 9%. On the import side Côte d’Ivoire is again the leader, but there is much less concentration. While only five countries account for 75% of exports, 16 countries account for a similar share of imports.

The importance of Africa-to-Africa trade varies widely across countries—it accounts for less than 2% of Kenya’s imports but more than 50% of the Seychelles’ imports. Such wide differences indicate that tariff revenue losses associated with regional trading arrangements could fall very unevenly on participating countries. Very little or no trade occurs between countries that are geographically distant, such as Nigeria and Tanzania.

What are the prospects for increased regional trade in Sub-Saharan Africa? Good, for several reasons. First, significant unrecorded cross-border trade occurs in the region. The share of unrecorded trade in total trade of the Economic Community of West African States (ECOWAS) region is between 20% and 25%. The unrecorded trade between Togo and Ghana is several times the official trade. About 30% of Uganda’s exports are outside official channels.

Second, foodstuffs and feeds dominate the fastest growing products in Africa-to-Africa trade. Zimbabwe alone accounts for almost 99% of the exports of unmilled maize, the fastest growing product and also the largest product, with current exports approaching $500 million. Regional trade arrangements can enable Uganda to benefit from expanded trade opportunities in foods and feeds.

---

**Figure 1.8**

South Africa leads in privatization

Privatization transaction values, cumulative for 1991–2001 (US$ millions)

<table>
<thead>
<tr>
<th>Country</th>
<th>Privatization Values (US$ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Africa</td>
<td>3,500</td>
</tr>
<tr>
<td>Ghana</td>
<td>2,500</td>
</tr>
<tr>
<td>Nigeria</td>
<td>2,000</td>
</tr>
<tr>
<td>Zambia</td>
<td>1,500</td>
</tr>
<tr>
<td>Côte d’Ivoire</td>
<td>1,000</td>
</tr>
<tr>
<td>Senegal</td>
<td>500</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>500</td>
</tr>
<tr>
<td>Kenya</td>
<td>500</td>
</tr>
<tr>
<td>Tanzania</td>
<td>500</td>
</tr>
<tr>
<td>Cameroon</td>
<td>500</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>500</td>
</tr>
</tbody>
</table>

Source: Economic Commission for Africa, from official sources.
Electricity is the tenth fastest-growing product in Africa-to-Africa trade, with Ghana alone accounting for 90%, at $220 million. Uganda has the potential to tap into this trade with its abundance of hydroelectric power, so it should press for greater access to markets where it has export potential.

**Tourism—Africa’s silent success**

Between 1990 and 2000 tourism in Africa grew at an annual rate of 6.2%, well above the world average of 4.3%. In 2001 tourism receipts totaled $11.7 billion, a mere 2.5% of global tourism receipts, with arrivals at 4% of global inbound tourism (table 1.4).

**Box 1.2**

*Doha development round falters*

World Trade Organization (WTO) talks on farm trade reform appear to have faltered. Ministers from nearly two dozen countries meeting in Tokyo in February 2003 seem farther apart than ever on how to lower agricultural tariffs. For the vast majority of WTO members, the agriculture talks are by far the most important issue in the Doha development trade round, due to end in December 2004.

The centrepiece of the talks are proposals by Stuart Harbinson, chairman of the WTO agriculture negotiations, to expand market access for imports and to slash the $1 billion a day that industrial countries spend supporting farmers.

The United States and other exporting nations want agricultural tariffs cut for all categories and limits on access dropped. Developing nations with large farming populations want barriers kept in place. The European Union, Japan, and other developed countries want nontrade issues like food safety and the environment considered. The United States and the Cairns Group of agricultural exporting countries are urging radical and rapid cuts in farm protection. The European Union, backed by Japan, the Republic of Korea, Switzerland, and some other European nations, insists on smaller and slower reforms.

Japan, determined to protect its rice farmers, calls the Harbison draft too ambitious. Japan’s agriculture minister said the proposed import tariff reductions, which would slash the 490% rice tariff by at least 45 percentage points, were not acceptable.

The EU, backed by Japan and Korea, offered a 36% average cut in tariffs (allowing flexibility for “sensitive” products, such as rice), a 45% reduction in export subsidies, and a 55% cut in trade-distorting domestic farm supports. These would be implemented over six years from 2006.

But the real pain for the EU comes in Harbison’s proposals on subsidies—the elimination of export subsidies within 10 years and the halving of trade-distorting farm supports and of subsidies in the blue box (payments to farmers to limit production).

The United States and the 16-strong Cairns Group led by Australia called for a 25% ceiling on all farm tariffs, rapid elimination of export subsidies, and deeper cuts in domestic supports. The United States has opposed efforts to treat agriculture separately from discussions on products and services. Japan and the European Union, Harbison said, benefit with the United States when tariffs on manufactured goods are lowered, yet insist that their farm goods should be exempt.

*Source: Economic Commission for Africa, from official sources.*
Largely due to the after effects of the September 11 terrorist attack in New York, 2001 was a difficult year for tourism, although less difficult than expected, with a decrease in receipts at a world level of 2.6% and arrivals of 0.6%. Even so, Africa performed strongly, with 8.1% growth in arrivals in the first eight months of 2001, partly offset by a 3.5% decline in the last four. Overall for 2001 arrivals grew 4.3% and receipts 8.8%.

About 95% of arrivals in Africa are in 20 of the 53 African countries. In 2001, 40% of international tourist arrivals on the continent were from Africa, followed by Europe (36%), the Middle East (4%), the Americas (4%), and Asia and the Pacific (3%) (WTO 2002). Adding domestic tourism, 75% of all arrivals are within Africa, making the scale of domestic tourism an important (and often overlooked) feature.

Zimbabwe has 67% of its arrivals coming from Africa and 33% from outside, earning an average of $67 per person. But Mauritius has only 25% of its tourists from Africa, while 67% are Europeans, who spend an average of $947.

**Fiscal policy—stronger fundamentals**

Before the late 1990s African governments had a tendency towards excessive fiscal spending. Since then, more countries are showing fiscal restraint and adopting sound macroeconomic policies.

But fiscal profligacy remained a problem in some parts of the region, as evidenced by the countries with fiscal deficits of more than 3% of GDP in 2002: Algeria, Angola, Ghana, Kenya, Malawi, Mauritius, Morocco, Namibia, and Nigeria.

In some countries—such as Algeria and Nigeria—the higher deficits were due to government attempts to influence voters and get re-elected. The amended Nigerian budget for 2002 brought a 20% increase in government spending. This boost, in the runup to elections in March 2003, increased the already high inflationary pressure in

---

**Table 1.4**

Tourism in Africa, selected years (US$ billions)

<table>
<thead>
<tr>
<th>Region</th>
<th>International tourism receipts</th>
<th>Share of global tourism receipts (%)</th>
<th>Annual growth in receipts (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>8.1</td>
<td>10.8</td>
<td>11.7</td>
</tr>
<tr>
<td>North Africa</td>
<td>2.7</td>
<td>3.7</td>
<td>4.2</td>
</tr>
<tr>
<td>West Africa</td>
<td>0.7</td>
<td>1.1</td>
<td>1.2</td>
</tr>
<tr>
<td>Central Africa</td>
<td>0.1</td>
<td>0.1</td>
<td>—</td>
</tr>
<tr>
<td>Eastern Africa</td>
<td>1.9</td>
<td>2.6</td>
<td>2.7</td>
</tr>
<tr>
<td>Southern Africa</td>
<td>2.6</td>
<td>3.4</td>
<td>—</td>
</tr>
</tbody>
</table>

— not available.

the economy and is likely to force authorities to tighten their monetary stance in the second half of 2003, with adverse consequences for growth in the short term. In Angola the higher deficits were needed to finance reconstruction after the devastating armed conflict between the government and the UNITA rebels.

Countries in North Africa had lower ratios of fiscal deficit to GDP in 2002 than those in Sub-Saharan Africa. Countries in the CFA zone had lower ratios than non-CFA countries, thanks to the fiscal restraints of a single currency and monetary policy in the CFA zone. West African countries outside the CFA zone are expected to show more fiscal restraint if they follow through with their decision to form a second monetary zone in the subregion.

Fiscal policy was tight in some countries—including Botswana, Senegal, Sudan, Cameroon, and Gabon—with the last two registering fiscal surpluses in 2002. Despite the improvements, more needs to be done to tighten fiscal policy and check excessive government spending.

**Monetary and exchange rate policy—relatively sound**

*Inflation.* Monetary policy has been relatively tight, bringing inflation down to single digits in several countries. The number with double-digit inflation came down from 30 in 1995 to 11 in 2002, and 26 countries had inflation of less than 5% in 2002 (table 1.5).

The worst performers in 2002 were the Democratic Republic of Congo with an inflation rate of 27.7%, Angola with 108.5%, and Zimbabwe with 137.2%. The high inflation in Angola is due to the effect of armed conflicts between the government and UNITA rebels as well as poor fiscal management. In Zimbabwe it is due largely to inappropriate economic policies and the effect of the political crisis on prices for domestic imported food, which account for a large share of the consumer price index.


**Table 1.5**

*Inflation rates in Africa, 2000–02 (%)*

<table>
<thead>
<tr>
<th>Rate</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negative</td>
<td>7</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>0–4.9</td>
<td>19</td>
<td>21</td>
<td>26</td>
</tr>
<tr>
<td>5–9.9</td>
<td>13</td>
<td>15</td>
<td>12</td>
</tr>
<tr>
<td>10–19.9</td>
<td>5</td>
<td>5</td>
<td>7</td>
</tr>
<tr>
<td>20–50.0</td>
<td>4</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>More than 50</td>
<td>3</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>Total number of countries</td>
<td>51</td>
<td>51</td>
<td>51</td>
</tr>
</tbody>
</table>

*Source: IMF 2002.*
In Ethiopia food prices were lower because of weaknesses in agricultural demand and the resulting decline in rural incomes. The recent drought in the country and failed harvest put upward pressure on grain prices and eliminated the deflationary pressures stifling growth. In Uganda bountiful harvests caused food prices to decline.

Of the five largest economies in the region, inflation will continue to pose a problem in South Africa due in part to the lagged effect of the depreciation of the rand in 2001 and the upward pressure on food prices caused by the recent incidents of drought in parts of the country. In 2002 inflation was about 8%, above the target of 3–6% set by the South African Reserve Bank. In Nigeria inflation remains high, but it came down to 16% in 2002, from 19% in 2001. The modest decline reflects the central bank’s tight monetary policy stance in the first half of the year, along with an expansionary fiscal policy, blunting the decline in inflation despite a reduction in the growth of broad money supply (M2) from 27% in 2001 to 16% in 2002. In Algeria, Egypt, and Morocco inflationary pressures remain largely subdued—with less than 5% inflation, driven largely by the tightening of monetary policy.

**Exchange rates.** The CFA franc appreciated against the dollar for much of the year because of the depreciation of the dollar against the euro in the first and second quarters. By the end of the year the CFA franc had appreciated 6% against the dollar. In Burkina Faso, the Central African Republic, and Côte d’Ivoire the impact on competitiveness will be minimal because of their low trade exposure to the United States. But in Gabon, Mali, and Senegal the appreciation will limit the ability to take advantage of opportunities for increased exports to the United States under the African Growth Opportunity Act.

In Egypt, Morocco, and Tunisia nominal exchange rates were fairly stable due to direct government intervention or an exchange rate peg. A large number of currencies in the non-CFA Sub-Saharan African countries depreciated against the dollar in 2002. And six countries had extremely high exchange rate volatility.

**Capital flight—fueled by foreign debt**
Real capital flight over 1970–96 amounted to about $187 billion for 30 countries (table 1.6). Including imputed interest earnings, the accumulated stock of capital flight was about $247 billion. This group of countries is a net creditor to the rest of the world in the sense that their private assets held abroad, as measured by capital flight including interest earnings, exceed their total liabilities as measured by the stock of external debt. Their net external assets (accumulated flight capital minus accumulated external debt) amounted to about $85 billion.

The ratio of capital flight stock to GDP exceeds 200% for eight countries, with a weighted average of 172% for the group. Angola, Cameroon, Côte d’Ivoire, the Democratic Republic of Congo, and Nigeria have the highest stocks of capital flight. Five of the 30 countries (Benin, Mali, Niger, Senegal, and Togo) exhibit a negative stock of flight capital, indicating that their recorded capital inflows exceed recorded uses of foreign exchange.
External borrowing appears to be the single most important determinant of capital flight (Ndikumana and Boyce 2002). In 1970–96 roughly 80 cents of every dollar that flowed into the region from foreign loans flowed back out as capital flight in the same period.

### Table 1.6

<table>
<thead>
<tr>
<th>Country</th>
<th>Period covered</th>
<th>Real capital flight</th>
<th>Cumulative stock of capital flight, including imputed interest</th>
<th>Net external assets</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Value</td>
<td>% of GDP</td>
<td></td>
</tr>
<tr>
<td>Angola</td>
<td>1985–96</td>
<td>17,032.5</td>
<td>20,405.0</td>
<td>9,179.9</td>
</tr>
<tr>
<td>Benin</td>
<td>1974–96</td>
<td>−3,457.4</td>
<td>−6,003.8</td>
<td>−7,598.1</td>
</tr>
<tr>
<td>Burkina Faso</td>
<td>1970–94</td>
<td>1,265.5</td>
<td>1,896.6</td>
<td>700.4</td>
</tr>
<tr>
<td>Burundi</td>
<td>1985–96</td>
<td>818.9</td>
<td>980.9</td>
<td>−146.0</td>
</tr>
<tr>
<td>Cameroon</td>
<td>1970–96</td>
<td>13,099.4</td>
<td>16906</td>
<td>7,364.4</td>
</tr>
<tr>
<td>Central African Republic</td>
<td>1970–94</td>
<td>250.2</td>
<td>459.0</td>
<td>−482.1</td>
</tr>
<tr>
<td>Congo, Dem. Rep.</td>
<td>1970–96</td>
<td>10,035.4</td>
<td>19,199.9</td>
<td>6,373.5</td>
</tr>
<tr>
<td>Congo, Rep.</td>
<td>1971–96</td>
<td>459.2</td>
<td>1,254.0</td>
<td>−3,986.6</td>
</tr>
<tr>
<td>Côte d’Ivoire</td>
<td>1970–96</td>
<td>23,371</td>
<td>34,745.5</td>
<td>15,221.9</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>1970–96</td>
<td>5,522.8</td>
<td>8,017.9</td>
<td>−2,060.7</td>
</tr>
<tr>
<td>Gabon</td>
<td>1978–96</td>
<td>2,988.7</td>
<td>5,028.1</td>
<td>717.7</td>
</tr>
<tr>
<td>Ghana</td>
<td>1970–96</td>
<td>407.3</td>
<td>289.3</td>
<td>−6,152.9</td>
</tr>
<tr>
<td>Guinea</td>
<td>1986–96</td>
<td>342.8</td>
<td>434.2</td>
<td>−2,806.1</td>
</tr>
<tr>
<td>Kenya</td>
<td>1970–96</td>
<td>815.1</td>
<td>2,472.6</td>
<td>−4,458.4</td>
</tr>
<tr>
<td>Madagascar</td>
<td>1970–96</td>
<td>1,649.0</td>
<td>1,577.5</td>
<td>−2,568.3</td>
</tr>
<tr>
<td>Malawi</td>
<td>1970–94</td>
<td>705.1</td>
<td>1,174.8</td>
<td>−971.3</td>
</tr>
<tr>
<td>Mali</td>
<td>1970–96</td>
<td>−1,203.6</td>
<td>−1,527.2</td>
<td>−4,533.2</td>
</tr>
<tr>
<td>Mauritania</td>
<td>1973–95</td>
<td>1,130.8</td>
<td>1,830.0</td>
<td>−572.2</td>
</tr>
<tr>
<td>Mauritius</td>
<td>1975–96</td>
<td>−267.8</td>
<td>465.9</td>
<td>−1,351.7</td>
</tr>
<tr>
<td>Mozambique</td>
<td>1982–96</td>
<td>5,311.3</td>
<td>6,206.9</td>
<td>−1,359.4</td>
</tr>
<tr>
<td>Niger</td>
<td>1970–95</td>
<td>−3,153.1</td>
<td>−4,768.9</td>
<td>−6,392.1</td>
</tr>
<tr>
<td>Nigeria</td>
<td>1970–96</td>
<td>86,761.9</td>
<td>129,661.0</td>
<td>98,254.4</td>
</tr>
<tr>
<td>Rwanda</td>
<td>1970–96</td>
<td>2,115.9</td>
<td>3,513.9</td>
<td>2,470.8</td>
</tr>
<tr>
<td>Senegal</td>
<td>1974–96</td>
<td>−7,278.1</td>
<td>−9,998.2</td>
<td>−13,661.1</td>
</tr>
<tr>
<td>Sierra Leone</td>
<td>1970–95</td>
<td>1,472.8</td>
<td>2,277.8</td>
<td>1,072.7</td>
</tr>
<tr>
<td>Sudan</td>
<td>1970–96</td>
<td>6,982.7</td>
<td>11,613.7</td>
<td>−5,358.3</td>
</tr>
<tr>
<td>Togo</td>
<td>1974–94</td>
<td>−1,382.1</td>
<td>−1,618.3</td>
<td>−3,149</td>
</tr>
<tr>
<td>Uganda</td>
<td>1970–96</td>
<td>2,154.9</td>
<td>3,316.1</td>
<td>−358.3</td>
</tr>
<tr>
<td>Zambia</td>
<td>1970–91</td>
<td>10,623.5</td>
<td>13,131.2</td>
<td>5,491.8</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>1977–94</td>
<td>8,222.3</td>
<td>10,882.9</td>
<td>6,074.8</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>186,796.9</td>
<td>273,824.3</td>
<td>84,956.5</td>
</tr>
</tbody>
</table>

Source: Ndikumana and Boyce 2002.
year, suggesting widespread debt-fueled capital flight. (Debt-fueled capital flight occurs when funds borrowed abroad are reexported as private assets.) In addition, every dollar added to the stock of external debt added roughly 3 cents to annual capital flight in subsequent years, suggesting that outflows were exacerbated by the debt-driven capital flight. (Debt-driven capital flight occurs when capital flees a country in response to economic circumstances attributable to the external debt itself.) The findings imply that debt-relief strategies will bring long-term benefits to African countries only if measures prevent a new cycle of external borrowing and capital flight. This will require substantial reforms by creditors and debtors to promote responsible lending and accountable debt management.

The results also indicate that past capital flight tends to persist, providing fairly robust support for the propositions that capital flight is negatively related to the growth rate gap between the African country and its OECD trade partners, to the volume of domestic credit to the private sector, and to a political-governance index of voice and accountability. This suggests that Sub-Saharan Africa can reduce capital flight by improving these broader dimensions of economic performance and institutional reform—and by having greater transparency and accountability in capital account transactions.

Poverty reduction—encouraging trends

With close to half the population in Africa living below $1 a day, poverty remains a daunting social and economic challenge. Yet several African countries, with more than half the Sub-Saharan population, recorded successes in reducing poverty (figure 1.9).

Poor households are larger, tend to be in the poorest regions, are less literate, and have lower nutrition levels and life expectancy than the average. But additional evidence shows that fewer than a quarter of the people in a range of African countries are always poor, with up to 60% of the population moving in and out of poverty. This pattern confirms data from other developing countries—that transitory poverty is common—pointing to the importance of reducing vulnerability and securing livelihoods as an antipoverty strategy (table 1.7).

Countries intensified their efforts to reduce poverty, as summarized in Poverty Reduction Strategies (PRSs) and other national development strategies. The number of African countries preparing either the interim or final PRSs during the period increased significantly. Nine countries finalized their PRSs in 2002, up from four in 2001.

Combating HIV/AIDS, malaria, and tuberculosis

The spread of HIV/AIDS and the resurgence of malaria and tuberculosis are major causes of death and devastation in Africa. An estimated 81% of the world’s AIDS–related deaths, 90% of the malaria deaths, and 23% of the tuberculosis deaths occur in Africa.
AIDS, malaria, and tuberculosis undermine productive capacity, overload health services, increase social distress, and perpetuate poverty (box 1.3). At the macroeconomic level, it is estimated that HIV/AIDS reduces GDP growth in Africa by 0.5–2.6% a year on average. Other estimates suggest that Africa’s GDP would be as much as $100 billion greater if malaria had been eliminated years ago. And in countries with a high burden of tuberculosis, the loss of productivity is estimated at 4–7% of GDP.

**Figure 1.9**

*Some progress in reducing poverty in the 1990s*

Proportion of population in poverty (%)

- Burkina Faso
- Ethiopia
- Ghana
- Kenya
- Madagascar
- Mali
- Mauritania
- Niger
- Nigeria
- Senegal
- Tanzania
- Uganda
- Zambia
- Zimbabwe


**Source:** Christiaensen, Demery, and Paternostro 2002.
HIV/AIDS has reached epidemic proportions in Africa. At the end of 2001 Africa remained the region most severely affected by HIV/AIDS, with an estimated 28.5 million people living with the disease, including an estimated 2.6 million children under 15 (UNAIDS 2002). Africa is the only continent with HIV prevalence higher for women than for men. Of 28.5 million Africans living with HIV/AIDS, 15 million are women. More telling, 83% of the world’s women with HIV/AIDS are African. The disease orphaned more than 10 million children in Sub-Saharan Africa by the end of 2001.

Worst affected are Botswana, Zimbabwe, Swaziland, Lesotho, Namibia, South Africa, Zambia, Kenya, Malawi, Mozambique, and Central African Republic (figure 1.10), and the epidemic is also escalating in Cameroon and Côte d’Ivoire. But some African countries have combated HIV/AIDS with interventions aimed at behavioural changes. Adult prevalence rates continue to decline in Senegal and Uganda (UNAIDS 2002).

Tuberculosis and malaria—a high toll

Sub-Saharan Africa has the highest tuberculosis incidence in the world, contributing to 20% of the global caseload, with an estimated 200 million of about 600 million Africans carrying the tuberculosis bacillus (Nyarko 2001). People who are HIV-positive are more likely to develop active tuberculosis than those who are HIV-negative (Anderson and Maher 2001). The number of tuberculosis cases in the region is projected to rise to about 4 million new cases per year by 2005.

Malaria is still epidemic in most parts of Sub-Saharan Africa. Accounting for 90% of all fevers in Africa, it imposes severe consequences on populations living in malaria

Table 1.7

Proportion of households always poor, sometimes poor, never poor

<table>
<thead>
<tr>
<th>Country</th>
<th>Period</th>
<th>Always poor</th>
<th>Sometimes poor</th>
<th>Never poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Côte d’Ivoire</td>
<td>1985–86</td>
<td>14.5</td>
<td>20.2</td>
<td>65.3</td>
</tr>
<tr>
<td>Côte d’Ivoire</td>
<td>1986–87</td>
<td>13.0</td>
<td>22.9</td>
<td>64.1</td>
</tr>
<tr>
<td>Côte d’Ivoire</td>
<td>1987–88</td>
<td>25.0</td>
<td>22.0</td>
<td>53.0</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>1994–95</td>
<td>24.8</td>
<td>30.1</td>
<td>45.1</td>
</tr>
<tr>
<td>South Africa</td>
<td>1993–98</td>
<td>22.7</td>
<td>31.5</td>
<td>45.8</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>1992–95</td>
<td>10.6</td>
<td>59.6</td>
<td>29.8</td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chile</td>
<td>1967–85</td>
<td>54.1</td>
<td>31.5</td>
<td>29.8</td>
</tr>
<tr>
<td>China</td>
<td>1985–90</td>
<td>6.2</td>
<td>47.8</td>
<td>46.0</td>
</tr>
<tr>
<td>India</td>
<td>1968–70</td>
<td>33.3</td>
<td>36.7</td>
<td>30.0</td>
</tr>
<tr>
<td>India</td>
<td>1975–83</td>
<td>21.8</td>
<td>65.8</td>
<td>12.4</td>
</tr>
<tr>
<td>Pakistan</td>
<td>1986–91</td>
<td>3.0</td>
<td>55.3</td>
<td>47.2</td>
</tr>
<tr>
<td>Russia</td>
<td>1992–93</td>
<td>12.6</td>
<td>30.2</td>
<td>14.4</td>
</tr>
</tbody>
</table>

endemic and epidemic-prone regions. There are at least 300 million acute cases of malaria each year globally, resulting in more than a million deaths, about 90% in Africa, mostly young children. Africa’s leading cause of under-five mortality (20%), malaria accounts for 10% of the continent’s disease burden and 40% of public health spending.

Overwhelming evidence suggests that children under-five and pregnant women have the highest risk of malaria-related sickness and death. With a median under-five child mortality risk of 8.0 per thousand, 70% of the malaria deaths are recorded among children in Sub-Saharan Africa (WHO/UNAIDS 2002; Snow and others 1998).

HIV/AIDS—high human and economic costs

HIV/AIDS also raises the risks and costs of doing business in Africa, destroying the twin rationale for globalization: cheap labor and fast-growing markets. The epidemic

**Box 1.3**

*Socioeconomic impact of HIV/AIDS, malaria, and tuberculosis*

Estimates suggest that Africa’s GDP would be as much as $100 billion greater if malaria had been eliminated years ago. And in countries with a high burden of tuberculosis, the loss of productivity due to the disease is estimated at 4–7% of GDP annually.

Apart from the effects on growth, the socioeconomic impacts are enormous. Some findings:

- The International Labour Organization predicts that, as a result of HIV/AIDS, the labour force in high-prevalence countries will fall by 20–30% by 2020. The average productive labour time lost to tuberculosis is 20–30% of household income, about three to four months of lost work time. The average person-days lost to HIV/AIDS and related illness in Ethiopia’s enterprise workplace ranged from 30 to 60 days a year.
- These diseases add an intolerable burden on already overstretched and inefficient health systems. For example, in 2001 HIV/AIDS patients occupied 39% of the beds in Kenyatta Hospital in Nairobi, Kenya, and 70% of those at the Prince Regents Hospital in Bujumbura, Burundi. The annual direct medical costs of AIDS (excluding antiretroviral therapy) have been estimated at about $30 per capita, at a time when per capita public health spending among Africa countries is less than $10.
- The impact on education is already felt. Some 85 percent of teachers with HIV/AIDS die 10 years before they are due to retire. The average percentage of expected teacher deaths in southern Africa ranges from 0.5% to 2.1% a year between 2000 and 2010. The World Bank estimates that an infected teacher or education officer is likely to lose six months of professional time before developing AIDS and a further 12 months after developing it.
- The impact on agriculture and food security is considerable. Most people in rural Africa are engaged in subsistence farming, and illnesses reduce workload and output. HIV/AIDS is seen as one of the contributing factors to the current food shortage in southern Africa. Studies in Côte d’Ivoire and Namibia confirm the negative impact of illness on crop production in rural households.

thus forces both transnational and domestic corporations to think twice before investing in countries with high HIV prevalence rates.

HIV/AIDS raises costs through several channels (box 1.4). It kills young and middle-aged adults in their most productive years as employees and customers, adding to labor costs and slowing growth rates. It erodes the competitive advantage that many corporations derive from low-cost labor in developing counties, driving up health care costs and reducing productivity for years.

Due to the long latency between infection and the onset of symptoms, a company is not likely to see the costs of HIV/AIDS until 5 to 10 years after an employee is infected. During most of that period, the employee will be fully productive at work. But the company acquires the liability for a stream of future costs from the time of infection. Those costs cannot be avoided because in an increasing number of countries it is illegal to dismiss a worker on the grounds of being infected with HIV.

**Figure 1.10**

*HIV infection rates vary greatly*

*HIV prevalence in adults ages 15–49, 2001 (%)*

![Map of Africa showing HIV infection rates](image)

Source: Adapted from UNAIDS 2002.
A recent study analyzed the impact of AIDS on six corporations, four of them subsidiaries of transitional corporations, based in South Africa and Botswana (Rosen and others 2003). The companies were large by developing country standards, reporting sales of between $35 million and $3.4 billion. They operated six industries—mining, metals, processing, utilities, agribusiness, retail, and media—and employed between 500 and 35,000 workers (table 1.8).

The prevalence of HIV ranges from 7.9% (or 1 in every 12 employees) in company A to 29% (nearly 1 in 3) in Company C. Companies in mining, metals processing, and agribusiness were affected the most, with more than 23% of their employees suffering from HIV/AIDS, slightly less than South Africa’s prevalence of 25%. Unskilled and skilled workers were two to three times more likely to be infected than supervisors and managers.

The cost of one HIV infection ranged from less than half the affected employee’s annual salary at company E to more than 3.5 times the employees yearly salary at company C.

**Box 1.4**
*The costs of HIV/AIDS to an employer*

<table>
<thead>
<tr>
<th>From one employee with HIV/AIDS</th>
<th>Individual costs</th>
<th>Organizational costs</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Medical care</td>
<td>• Reduced on-the-job productivity</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Benefits payments</td>
<td>• Reduced productivity due to employee’s absences</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Recruitment and training of replacement worker</td>
<td>• Supervisor’s time in dealing with productivity losses</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Vacancy rate until replacement is hired</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Reduced productivity while replacement worker learns the job</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>From many employees with HIV/AIDS</th>
<th>Individual costs</th>
<th>Organizational costs</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Insurance premiums</td>
<td>• Senior management time</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Accidents due to ill workers and inexperienced replacement workers</td>
<td>• Production disruptions</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Costs of litigation over benefits and other issues</td>
<td>• Depressed morale</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Loss of experienced workers</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Deterioration of labor relations</td>
<td></td>
</tr>
</tbody>
</table>

The annual AIDS “tax” on business ranged from 0.4% of the wage bill at company E to 5.9% of the wage bill at company C in 2001. In absolute terms it was $11.9 million a year at company A.

Unskilled workers at companies B, D, and E were not eligible for many of the benefits that other employees received, and lower level workers received only minimal health care benefits. The companies also capped their annual contributions to employee benefit funds, holding costs constant as claims rose, leaving workers to bear more of the financial burden on their own.

More progress needed to deepen-second-generation reforms

The Expanded Policy Stance Index tries to assess the state of economic policy and identify key areas for improvement. This year’s index pays particular attention to second-generation reforms in contract enforcement, policy ownership, and regulatory structures because of their importance in accelerating the pace of Africa’s development (box 1.5).

Sound macroeconomic management—a hallmark of best performers

Botswana, South Africa, Mauritius, Namibia, and Tunisia fill the top five spots in the ranking in this year’s Expanded Policy Index. All of them, except perhaps Namibia, are known as good performers in a number of policy areas, and a closer look at Namibia reveals comparable achievements, particularly in macroeconomic management.

Table 1.8
Financial impact of HIV/AIDS on six corporations in Southern Africa

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Workforce size</td>
<td>&gt;25,000</td>
<td>5,000–10,000</td>
<td>500–1,000</td>
<td>500–1,000</td>
<td>&lt;500</td>
<td>1,000–15,000</td>
</tr>
<tr>
<td>Estimated share of labor force HIV-positive (%)</td>
<td>7.9</td>
<td>23.7</td>
<td>29.0</td>
<td>23.6</td>
<td>10.5</td>
<td>10.2</td>
</tr>
<tr>
<td>Average cost per HIV infection as a multiple of median salary</td>
<td>3.23</td>
<td>0.82</td>
<td>3.63</td>
<td>0.76</td>
<td>0.46</td>
<td>2.90</td>
</tr>
<tr>
<td>Total annual cost of AIDS</td>
<td>$11.9 million</td>
<td>$594,000</td>
<td>$206,000</td>
<td>$93,400</td>
<td>$13,300</td>
<td>$1 million</td>
</tr>
<tr>
<td>Total annual cost of AIDS as a share of salaries and wages (AIDS tax; %)</td>
<td>3.7</td>
<td>1.8</td>
<td>5.9</td>
<td>1.9</td>
<td>0.4</td>
<td>2.4</td>
</tr>
<tr>
<td>Potential net returns on treatment programmes</td>
<td>$4.88 million</td>
<td>$49,100</td>
<td>$34,400</td>
<td>$12,200</td>
<td>$184</td>
<td>$580,000</td>
</tr>
<tr>
<td>Potential reduction in AIDS tax due to treatment programmes (%)</td>
<td>32.5</td>
<td>5.5</td>
<td>15.7</td>
<td>8.9</td>
<td>0.8</td>
<td>40.4</td>
</tr>
</tbody>
</table>

Source: Rosen and others 2003.
The top five countries have, on average, lower foreign debt, lower budget deficits, and lower discount rates. They accumulated a relatively small amount of external debt, averaging 30% of GDP but ranging from about 4% of GDP in Namibia to 55% of GDP in Tunisia. Equally important, their debt stocks did not rise substantially during that year. Similarly, the deficit in the government budget (excluding all grants) remained below 4% of GDP (except in Mauritius, at 6.5% of GDP), changing very little from the previous year. Lower discount rates are also a feature of the top five countries, averaging 10.4%. At 14.3% Botswana recorded the highest rate, while at 5.8% Tunisia had the lowest.

**Second-generation reforms firmly in place in top performers**

The top five also score high on the qualitative indicators. Market liberalization is more advanced, with few policy reversals. Institutions for policy analysis and coordination are better. Government efforts in promoting women’s access to education and health and gender equality in employment are highly rated. Pro-poor targeting is more sharply focused and the effectiveness of pro-poor policies is greater, especially those for microfinance, rural development, urban housing, and adult literacy. The legal system is more effective at enforcing contracts. Laws and regulations are more predictable and transparent—and are

---

**Box 1.5**

**Expanded Policy Stance Index**

The Expanded Policy Stance Index covers three broad areas of policy performance: macroeconomic policies, poverty reduction policies, and institution-building policies.

- The macroeconomic policies cluster covers monetary, fiscal, exchange rate, and macroeconomic policy coordination, as well as trade, financial sector, product market, factor market, and sectoral policies.
- Poverty reduction policies include pro-poor targeting, gender development, and Poverty Reduction Strategies.
- The institution-building cluster covers legal structure and regulation (property rights, contract enforcement), transaction costs (transport, telecommunications, water and electricity supply), central bank independence, private and public sector coordination, and public enterprises and the civil service.

Two types of data are used in constructing the index. The first are quantitative data on national aggregates, and the second, qualitative information collected from individual respondents through surveys in 29 countries in 2002. The surveys are a useful source of information because the success of policy interventions depends on the actions that economic agents take in response to them. Such actions are conditioned by the perceptions of economic agents about the various characteristics of policies. For instance, if people believe that a policy package will be reversed, they will act accordingly and refrain from making the choices that would lead to the realization of the objective associated with the policy package. Given the paucity of quantitative information on the quality of government policies, information on perceptions can fill part of the gap.

*Source: Economic Commission for Africa, from official sources.*
applied more uniformly. The quality of the civil service is better. And the access to and reliability of telecommunications, transport, and electricity are greater. Fixed and mobile telephone networks, closely correlated with other infrastructural determinants of transactions costs, are more extensive—by a considerable margin. Moreover, poverty rates are low in South Africa, Mauritius, and Tunisia.

In contrast, Nigeria, Guinea, Chad, Zimbabwe, and Republic of Congo are at the other end of the ranking. They have accumulated considerable external debt, averaging 113%
of GDP and ranging from about 73% of GDP in Nigeria to 163% of GDP in Zimbabwe. Budget deficits are high in Chad (12% of GDP) and Zimbabwe (35% of GDP), and discount rates are high in Guinea (16%), Nigeria (17%), and Zimbabwe (57%).

Their qualitative indicators depict a similar (or worse) picture. The liberalization achieved is rather limited, and policy reversals are more frequent. Government capacity for policy analysis and coordination, including the relevant institutions, is weak (except in Zimbabwe). Efforts to target the poor are ineffective. Government promotion of equal job opportunities for women is not robust. The effectiveness of the legal system in enforcing contracts is weak. The predictability and transparency of laws and regulations are low. Uniformity is lacking in the application of laws and regulations. The quality of the civil service is very low. And the access to—and reliability of—telecommunications, transport, and electricity is unsatisfactory. Political tensions make the situations in these countries even more difficult.

**High marks to macro reforms and poverty reducing policies**

The qualitative surveys reveal some interesting results on the state of economic policy in Africa (table 1.9). Macroeconomic policies, as a group, received the highest approval rating by stakeholders on government policy. Around 75% of respondents believe that their governments are doing a good job in macro management. The worst raw scores and ranks are for the quality of public sector management, while poverty reduction, sectoral policies and policies for market and institutional development are ranked second, third, and fourth.

**But weak institutions are holding back progress**

The survey questions attempt to elicit the perceptions of stakeholders on the pace and effectiveness of second-generation reforms, which are essentially institutional and structural, involving five interrelated dimensions:

- *Poverty reduction*—to alleviate poverty and promote equity.
- *Contract enforcement*—to secure property rights, strengthen the legal and justice system, and build effective conflict resolution mechanisms.
- *Ownership*—to enhance ownership through effective participation of stakeholders and consensus-building.
- *Regulation*—to improve the quality of regulation including independence, integrity, transparency, consistency, and predictability for the shift away from direct government management of the economic sphere.
- *Sectoral transformation*—to promote the appropriate pattern of sectoral development.

Some reforms of this type are being initiated in the continent—good examples are gender equality and central bank independence. But the higher raw scores and lower approval ratings of the corresponding policy clusters highlight the still unsatisfactory pace of second-generation reforms in many parts of the continent.
Poverty reduction top on agenda

The results show that poverty reduction has become the central plank of policy in survey countries. The poverty reduction policy cluster ranks second, with an approval rating of 66% from stakeholders on government policy. Corroborating this is the fact that of 29 African countries that adopted an interim or full Poverty Reduction Strategy by the end of 2002, 24 are in the sample here, many of them in the implementation phase.

The promotion of gender equality in access to education, health, and employment is rated particularly high, with an approval rating of 79%. The correctness of the Poverty

Table 1.9
Quality of economic policies survey, 2002

<table>
<thead>
<tr>
<th>Policy dimension</th>
<th>Average raw score</th>
<th>Rank by raw score</th>
<th>Approval rating (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Macroeconomic policies</td>
<td>2.705</td>
<td>1</td>
<td>75.48</td>
</tr>
<tr>
<td>Monetary policy</td>
<td>2.705</td>
<td>3</td>
<td>74.49</td>
</tr>
<tr>
<td>Exchange rate policy</td>
<td>2.711</td>
<td>4</td>
<td>74.05</td>
</tr>
<tr>
<td>Macroeconomic policy coordination</td>
<td>2.699</td>
<td>2</td>
<td>77.89</td>
</tr>
<tr>
<td>Sectoral policies</td>
<td>3.222</td>
<td>3</td>
<td>61.96</td>
</tr>
<tr>
<td>Trade policy</td>
<td>3.213</td>
<td>8</td>
<td>2.15</td>
</tr>
<tr>
<td>Financial sector policy</td>
<td>3.149</td>
<td>7</td>
<td>63.93</td>
</tr>
<tr>
<td>Product market policy</td>
<td>3.336</td>
<td>12</td>
<td>58.20</td>
</tr>
<tr>
<td>Factor market policy</td>
<td>3.346</td>
<td>13</td>
<td>57.63</td>
</tr>
<tr>
<td>Sectoral development strategies</td>
<td>3.064</td>
<td>6</td>
<td>67.92</td>
</tr>
<tr>
<td>Poverty reduction</td>
<td>3.070</td>
<td>2</td>
<td>65.73</td>
</tr>
<tr>
<td>Pro-poor targeting</td>
<td>3.257</td>
<td>10</td>
<td>64.15</td>
</tr>
<tr>
<td>Policies for gender development</td>
<td>2.698</td>
<td>1</td>
<td>78.81</td>
</tr>
<tr>
<td>Poverty Reduction Strategy</td>
<td>3.257</td>
<td>9</td>
<td>59.98</td>
</tr>
<tr>
<td>Market and institutional development</td>
<td>3.310</td>
<td>4</td>
<td>61.06</td>
</tr>
<tr>
<td>Legal structure and regulation</td>
<td>3.562</td>
<td>15</td>
<td>53.86</td>
</tr>
<tr>
<td>Transactions costs</td>
<td>3.611</td>
<td>16</td>
<td>51.36</td>
</tr>
<tr>
<td>Central bank independence</td>
<td>2.794</td>
<td>5</td>
<td>74.51</td>
</tr>
<tr>
<td>Private and public sector coordination</td>
<td>3.273</td>
<td>11</td>
<td>64.52</td>
</tr>
<tr>
<td>Public sector management</td>
<td>3.769</td>
<td>5</td>
<td>46.56</td>
</tr>
<tr>
<td>Administration of public enterprises</td>
<td>3.369</td>
<td>14</td>
<td>56.25</td>
</tr>
<tr>
<td>Civil service</td>
<td>4.170</td>
<td>17</td>
<td>36.87</td>
</tr>
</tbody>
</table>

Note: The table reports the average raw scores accorded to the major areas of policy and the corresponding approval rating calculated as the average percentage of respondents who expressed their agreement (as ‘strongly agree’, ‘agree’, or ‘weakly agree’) with the positive statement regarding the relevant policy attribute or outcome. The ranking determined by the raw scores is also included. The semantic scale spans strongly agree (coded 1), agree (2), weakly agree (3), weakly disagree (4), disagree (5), and strongly disagree (6). So, low scores indicate better performance.

Source: Economic Commission for Africa, from official sources.
Reduction Strategy in being broadly pro-poor and reflecting the key development problems of these countries got a 68% approval rating. A similar rating goes to the record of governments in enhancing pro-poor targeting.

Disagreement enters for the credibility and effectiveness of those policies. A low approval rating (47%) is given for the extent that implementation of the Poverty Reduction Strategy accords well with what was planned. Considerable reservation is also registered on how much the poor will actually benefit from these policies (45% approval).

A qualitative Poverty Reduction Policy Stance Index was developed to rank countries on their performance in poverty policy, spanning pro-poor targeting, policies for gender development, and the Poverty Reduction Strategy. Botswana, Tunisia, South Africa, Namibia, and Mauritius emerge as the top five performers (figure 1.12). Their efforts in promoting women’s access to education and health and gender equality in employment are rated highly. Comparable achievements are also recorded in pro-poor targeting and effectiveness of pro-poor policies.

The bottom-five countries—Zimbabwe, the Republic of Congo, Kenya, Comoros, and the Democratic Republic of Congo—have unsatisfactory efforts to target the poor, with weak benefits to the poor from pro-poor policies. Similarly, government promotion of equal job opportunities for women is not robust.

**Market and institutional development is weak**

The average performance on the continent is weak in market and institutional development. More specifically, key determinants of transactions costs and contract enforcement are deemed still inadequate. Corruption adds significantly to the cost of economic activity (75% of survey participants agree), and the costs of electricity and transport are restrictively high (67% and 64% agree). And while appreciable improvements in the access to and quality of telecommunication services are recorded (with approval ratings of 78% and 84%), cost and waiting times for telephone installation and repair remain a concern (with only around 40% agreeing that services are adequate).

Contract enforcement is another area for improvement. The effectiveness and impartiality of the legal and regulatory system have an approval rating of 54%. Specific areas of concern are the effectiveness and impartiality of courts in cases against the government (37% approval rating), extent of crime (41%), effectiveness of the legal system in enforcing contracts (49%), police effectiveness in protecting people and property (50%), the predictability of laws and regulations (51%), transparency of laws and regulations (53%), and protection of land rights (57%).

The speed of reform is deemed comparably slow in the areas of private and public sector coordination (an indicator of consensus-building and ownership) and public sector
management (which combines efficiency in the administration of state-owned enterprises, privatization, and quality of the civil service). The weaknesses of the civil service are particularly highlighted. The attractiveness of incentives in the civil service received an approval rating of only 20%. Also scoring low were meritocratic recruitment (approval rating of 39%), promotion (40%), and the regularity of skill upgrades (45%).

**Figure 1.12**

*Botswana, Tunisia, South Africa, Namibia, and Mauritius—the top 5 Qualitative Poverty Reduction Policy Stance Index, 2002*

Note: The scores are standardized from 0 to 1. Lower scores on the index indicate better performance.

Source: Economic Commission for Africa, from official sources.
A qualitative Institution-Building Policy Stance Index was developed to rank countries according to the performance of policies (figure 1.13). It produces the same top five and bottom five countries as the qualitative Poverty Reduction Policy Stance Index. Indeed, the correlation between these two indices is 0.99, indicating a close link between building the right institutions and reducing poverty.

**Figure 1.13**

*Botswana, Tunisia, South Africa, Mauritius, and Namibia—the top 5*

*Qualitative Institution-Building Policy Stance Index, 2002*

*Note:* The scores are standardized from 0 to 1. Lower scores in the index indicate better performance.

*Source:* Economic Commission for Africa, from official sources.
The close movements of the three qualitative policy stance indices underscore the importance of macroeconomic stability, pro-poor targeting, and credible institutions for sustained economic growth and poverty reduction. They reveal that civil service reform, legal and regulatory reform, and further liberalization and effective regulation of the transport, telecommunications, and power sectors are a priority.

Medium-term prospects—mixed

In the near term, growth prospects for African countries will depend mainly on the strength of the recovery in global economic activity, the outlook for commodity prices, the progress in reducing political and armed conflicts, and the commitment of African leaders to macroeconomic stability and the principles of good governance.

Modest improvement in growth in 2003

Economic growth is expected to increase from 3.2% in 2002 to 4.2% in 2003, driven mainly by recent economic and political events in and outside Africa:

- An increase in peace agreements and a reduction in armed conflicts: consider the ceasefire in Angola following the death of the UNITA rebel leader, Jonas Savimbi; the tentative peace in West Africa between Liberia and Sierra Leone; the cessation of hostilities in the Horn of Africa between Eritrea and Ethiopia; the July 2002 peace agreement between the Democratic Republic of Congo and Rwanda in Pretoria; and the recent resumption of peace talks between the Sudanese government and the rebel Sudan People’s Liberation Army (SPLA). The cessation of hostilities in these countries is expected to result in a redirection of military spending towards economic and social projects that will reinvigorate growth.
- An increase in the number of African countries eligible for debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative. This is expected to free up resources—for social expenditures directed at vulnerable groups—and boost economic activity.
- The bottoming out of the global slowdown. An improvement in economic activity should be expected in most of the world’s regions in the third quarter of 2003,
spurring economic activity in Africa through increased aid, trade, and foreign investment. In the OECD area growth is expected to increase from 1.5% in 2002 to 2.2% in 2003, in the United States from 2.3% to 2.6%, and in the European Union from 0.9% to 1.9%. Japan is expected to move from a negative growth rate of –0.7% in 2002 to a positive growth rate of 0.8% in 2003.

- The decision by six West African countries to form a monetary union in 2005. The attempts by governments to meet the convergence criteria are likely to improve the macroeconomic policy environment in the subregion, boosting future growth.
- The events of September 11, 2001, and the resulting international war against terrorism. Economic effects for Africa will be positive to the extent that the activities of militant groups are checked in unstable African countries and that western nations become more involved in the economic and political development of African nations to discourage them from providing safe-havens to terrorists. There are already indications that this is happening. Africa featured prominently on the agenda of the last G-8 Summit in Kananaskis, Canada. And several advanced countries have promised to support development efforts in Africa.

The pace of economic activity is expected to improve next year in all five subregions. In 2003 growth is projected to be 4.9% in North Africa, 4.4% in East and Central Africa, 3.6% in Southern Africa, and 3.3% in West Africa. North Africa is projected to have the highest growth rate in the region, driven by strong growth in Algeria (5.9%), Sudan (5.7%), Tunisia (5.5%), and Egypt (4.6%). East Africa is projected to have the second highest growth rate in the region, driven by strong growth in Rwanda (6.5%), Uganda (6%), Madagascar (5.5%), Tanzania (5.2%), and the Democratic Republic of Congo (3.8%).

All West African countries—except Côte d'Ivoire, Liberia, Guinea-Bissau, and Sierra Leone—are projected to have growth of 3.0% or more in 2003, underpinned in part by an expected improvement in the prices of key commodities exported by the subregion—notably gold, oil, and cocoa. Guinea Bissau will grow by a meager 1.5%, and Liberia by 1.6%. Economic activity is expected to pick up in Nigeria, with growth projected at 3.0%. Underpinning the improvement would be an increase in oil revenue if OPEC increases its oil quota. Nigeria has already indicated that it would ask for an increase in its quota, likely to be approved if political tensions between the United States and Iraq continue unabated.

In Southern Africa growth is expected to increase from 3.3% in 2002 to 3.6% in 2003 reflecting improvements in the prices of key export commodities—gold, oil, diamonds, and copper. Zimbabwe is expected to have a negative growth rate (~4.6%), explained in part by the political and economic crisis in the country. With an expected growth rate of 10.2% Mozambique will be the fastest growing economy in the subregion, thanks to sound macroeconomic policies and funds from debt relief under the HIPC Initiative. Because of the likelihood that gold and diamond prices will increase, growth is expected to rise in South Africa from 3.0% in 2002 to 3.3% in 2003.
Prospects for Africa in the medium term will be influenced largely by the strength of the recovery in global economic activity, developments in commodity markets, and adoption of sound macroeconomic policies and good governance.

With Equatorial Guinea continuing to have very impressive growth of 21.7% and with strong growth in Cameroon and São Tomé and Príncipe, the Central African sub-region is expected to have a slight boost in growth from 4.0% in 2002 to 4.4% in 2003.

Risks and uncertainties
As usual, there are some downside risks to the realization of the projected growth rate for Africa:

- The deteriorating political and economic situation in Zimbabwe and Côte d’Ivoire.
- Renewed incidents of flooding and drought in various parts of the continent, especially in the Horn of Africa and the Southern African region.
- The decision by U.S. President Bush in May 2002 to introduce a six-year $51.7 billion farm law, boosting crop and dairy subsidies by 67%. There is the concern that the subsidy will lead to lower prices for agricultural products, making it difficult for small African countries to compete on the world market.
- Inflationary pressures in two of the five big economies in Africa—South Africa and Nigeria—as well as in countries such as Angola, Zimbabwe, the Democratic Republic of Congo, and Malawi would reduce the ability of the monetary authorities to stimulate the economy.
- The high probability of an El Niño phenomenon in 2003—as suggested by the International Research Institute for Climate Prediction—and the associated deterioration of global weather conditions.

In sum, the mixed prospects for Africa in the medium term will be influenced largely by the strength of the recovery in global economic activity, developments in commodity markets, progress in reducing regional insecurity, adoption of sound macroeconomic policies and the principles of good governance, and the ability and willingness of African leaders to intensify much-needed economic and social reforms.

Note

References


Uganda—A Tale of Two Economies?

The Ugandan economy grew 6.2% in 2001/02 (July–June), slightly above the 5.9% growth a year before. The solid growth has been accompanied by substantial poverty reduction—lifting more than 4 million people from poverty (22% of the population) in a decade. But there is no room for complacency. One Ugandan in three still lives below the poverty line. More disturbing: the national poverty numbers mask vast regional disparities. The central and western areas of the country have grown more rapidly than the northern and the eastern, with the high levels of poverty in the northern region of grave concern. Uganda’s economic performance may thus be a tale of two economies, with excellent national growth and poverty numbers masking huge swaths of the economy that have not enjoyed the benefits.

Inequalities between the more affluent central crescent area around Lake Victoria and the drier, more disadvantaged northern part of the country have been exacerbated by the pattern of development in the last 10 years. The north has lagged largely due to a civil war that has dragged on for two decades. Having one region lag far behind can engender bitterness and ultimately foster rebellion. Thus fear of civil conflict along regional or ethnic lines is reason for genuine concern over Uganda’s spatial pattern of development.

Despite higher spending on social services, most social indicators are still below the average for such comparators as Ghana, Kenya, and Zambia. This reflects systemic problems in public service delivery at the district level and specific problems associated with HIV/AIDS. Improving the quality of social services, especially in education and health, remains crucial for further gains.

Prudent macroeconomic management coupled with good weather kept inflation at single digit levels in 2001/02. Financial sector reforms have helped deliver financial stability. Savings and domestic investment rates remain lower than in other Sub-Saharan countries but are trending upward.

The fiscal programme, while exercising restraint, has delivered priority expenditures as outlined in the Poverty Reduction Strategy. But the government still relies on donor funding for close to 60% of the development budget, showing the high aid dependency of the economy. The fiscal deficit, excluding grants, rose slightly from 11.2% of GDP in 2000/01 to 12.6% in 2001/02.
During 2001/02 monetary policy achieved stable and low inflation rates. And sterilization actions by the Bank of Uganda diverted pressure on the Ugandan shilling to appreciate. Overall, the movement in monetary aggregates has been in line with the monetary policy stance. Net foreign assets of the banking system grew by 28.2% in 2001/02 to a comfortable $992 million, around six months of imports.

The export sector remains highly concentrated in commodity exports. But the share of coffee, 59% of export earnings in 1997/98, declined to 19% in 2001/02. The current account balance has been persistently in deficit, rising over the years to $476 million in 2001/02. Even so, the external position showed some strengthening in 2001/02, with an overall deficit of $2.8 million, far less than the $55.6 million in 2000/01.

Despite strategies to reduce the debt burden, the total debt stock continues to rise. In 2001/02 the debt stock stood at $3.8 billion, with a debt stock to GDP ratio of 68.2%.

Most of the potential for economic growth and poverty reduction through macroeconomic reforms has been exploited. Further impetus to growth requires deeper reform to create an enabling environment for the private sector. It also requires reducing regional disparities to unleash the full potential of the population. It is farmers, traders, and the rest of the private sector that can lift Uganda's growth one notch up from an average of 6% a year to the 7% required to achieve the government’s goal of reducing income poverty to 10% by 2017.

But the private sector has many concerns, ranging from corruption to inadequate infrastructure, poor public service provision, and low access to financial services. Reforms thus have to deal with difficult governance issues and fundamental structural changes to the economy.

**Recent economic performance**

Even in the midst of a difficult international environment and with deteriorating terms of trade, Uganda’s economic performance has been solid. In 2001/02 the economy grew 6.2%, slightly above the 5.9% in 2000/01 (figure 2.1). The resilience of the economy to external shocks is a product of prudent macroeconomic policies leading to macroeconomic stability. GDP per capita grew 3.9% in 2001/02.

**Developments in the real sector**

The fastest growing sector in 2001/02: transport and communications, up 10.2%, compared with growth of 8.1% the previous year. This was followed by mining and quarrying, manufacturing, construction, wholesale and retail trade, and electricity and water services. The agricultural sector grew 5.1% in 2001/02, up from 4.6% the previous year. Overall, monetary GDP grew 6.7%, up from 6.1% in 2000/01, and nonmonetary GDP grew 4.3%, up from 5.4%.

Given agriculture’s importance, the country’s economic growth depends on its modernization and diversification.
Agriculture dominates the Ugandan economy, at 41% of GDP in 2001/02 (down from 72% in the late 1970s). It provides employment to about 80% of the labour force and generates almost all the country’s exports. Given agriculture’s importance, the country’s economic growth depends on its modernization and diversification. Broader access to rural credit and better public service delivery, particularly good infrastructure, need attention.

The Plan for Modernization of Agriculture envisions eradicating poverty through a dynamic agricultural and agro-industrial sector—profitable, competitive, and sustainable. The plan identifies six core areas for government action: research and technology, advisory services, access to rural finance, education in the sector, access to markets, and sustainable natural resource management.

Mining, representing only 1% of GDP, remains largely untapped. Recent efforts to attract foreign investment have resulted in some exploration activities in gold, phosphates, and petroleum.

Manufacturing, accounting for about 10% of GDP, is based largely on processing sugar, cotton, and food crops. A recent survey financed by the World Bank found tremendous foreign investor interest in agro-processing (EIU 2002). Government strategy for manufacturing emphasizes agro-based and small and medium-size industries. Building managerial and technical skills and increasing private participation through privatization are a big part of the strategy. The Uganda Investment Authority has been aggressively promoting horticulture and food processing and packaging.

**Figure 2.1**

**Growth is robust**

*GDP growth, 1998/99–2001/02 (annual percentage change)*

![GDP growth, 1998/99–2001/02 (annual percentage change)](image)

*Source: Economic Commission for Africa, from official sources.*
Savings still low

Savings remain low, but on an upward trend. Gross domestic savings rose from 4.6% of GDP in 1997/98 to 7.3% in 2001/02. Gross national savings, which includes private transfers and grant financing of the government budget, rose from 10.4% of GDP to 13.6%. Private savings have been on an upward trend, while public savings have been declining (figure 2.2).

The upward trend in private savings is in line with the financial sector’s recovery from the bank failures in 1998. Its recovery shows up in the higher private shilling deposits at banks, up by 30% from $461.5 million in June 1999 to $601 million in June 2002. Even so, other unproductive savings—such as real estate and foreign currencies held for wealth and speculative motives—still impede the growth of urban household financial savings. Because of the limited access to financial services, the assets of rural households are in commodity stocks, livestock, and land—the nonmonetary economy, an efficiency loss to the economy.

The recent decline in public savings comes from higher spending on poverty reduction programmes. The government’s medium-term fiscal programme aims to reconcile this spending with fiscal sustainability, with the deficit targeted to fall gradually as a result of better revenue performance, increasing public savings.

Private investment sluggish

Despite major improvements in the policy environment, private investment remains low (10%) and close to the Sub-Saharan average (figure 2.3). Why the sluggish investment

![Figure 2.2](image_url)
response to the improved policy environment? Greater competition, due to economic liberalization, has put pressure on firms to cut costs. But many of these costs (related to utility services, transport, and corruption) are not under a firm’s control. Erratic infrastructure services, arbitrary tax administration, and crime also affect perceptions of the risks of investing in partly irreversible capital (Reinikka and Svensson 2000). Firms, particularly small ones, are also liquidity constrained, able to invest only when internal funds are available.

Gross domestic savings fell short of gross domestic investment by about 13% of GDP from 1997/98 to 2001/02. The gap has been financed by highly concessional loans from the African Development Bank and the International Development Association.

Monetary policy—targets achieved

The major objective of monetary policy is to achieve price stability conducive to growth. In response to the negative headline inflation rates registered in 2001/02 (for the prices of all goods and services), the monetary policy stance was eased. Overall, the monetary policy stance adopted during the year was cautious, creating few disturbances on the domestic and foreign exchange markets.

Monetary policy has moved gradually from reliance on direct to indirect instruments. Initially, largely on account of the rudimentary financial system and the limited array of instruments, coordination with fiscal policy was an important part of monetary policy.

Figure 2.3
Investment close to Sub-Saharan average

Source: Economic Commission for Africa, from official sources.
evident in the surrendering of treasury bill issuance by the Ministry of Finance, Planning, and Economic Development to the Bank of Uganda. But by June 2002 the array of instruments for managing liquidity and enhancing monetary policy had been widened.

**Developments in monetary aggregates**

The annual growth rate of M3 for the period ending June 2002 was almost 22%, up from 18% for the period ending June 2001 and 16% for the period ending June 2000. Developments in M3 have been largely a result of the accelerated growth in all components of M3. M2 grew 25%, 10 percentage points above the rate in June 2001. On the supply side, net foreign assets of the banking system grew 28% in 2001/02, compared with 34% in 2000/01. Net domestic assets remained unchanged, after declining 15.5% in 2000/01 (table 2.1).

The Bank of Uganda’s external assets rose nearly 22%, while its liabilities declined 3.4%. Foreign liabilities declined largely because of repurchases with the International Monetary Fund (IMF). Assets increased because of higher budgetary support by donors.

Noteworthy in net domestic assets is the slow growth in private sector credit. Private sector credit grew only 1.8% in 2001/02, down from 9.4% in 2000/01. The decline is partly a result of increased recoveries, as reflected in the decline in nonperforming assets to about 5% of private sector credit.

**Table 2.1**

**Determinants and components of broad money, June 2001 and 2002 (US$ millions)**

<table>
<thead>
<tr>
<th>Aggregate</th>
<th>End-June 2001</th>
<th>End-June 2002</th>
<th>Absolute change</th>
<th>Percentage change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net foreign assets</td>
<td>773.3</td>
<td>991.5</td>
<td>218.2</td>
<td>28.2</td>
</tr>
<tr>
<td>Bank of Uganda</td>
<td>505.9</td>
<td>696.4</td>
<td>190.5</td>
<td>37.6</td>
</tr>
<tr>
<td>Commercial banks</td>
<td>267.3</td>
<td>295.1</td>
<td>27.8</td>
<td>10.4</td>
</tr>
<tr>
<td>Net domestic assets</td>
<td>238.0</td>
<td>238.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Claims on government</td>
<td>294.1</td>
<td>317.5</td>
<td>23.4</td>
<td>7.9</td>
</tr>
<tr>
<td>Claims on private sector</td>
<td>405.4</td>
<td>412.8</td>
<td>7.3</td>
<td>1.8</td>
</tr>
<tr>
<td>Claims on other public entitiesa</td>
<td>7.2</td>
<td>4.9</td>
<td>(2.3)</td>
<td>(31.9)</td>
</tr>
<tr>
<td>Other items net</td>
<td>–468.8</td>
<td>–497.2</td>
<td>(28.4)</td>
<td>(6.1)</td>
</tr>
<tr>
<td>Broad money (M3)</td>
<td>1,011.3</td>
<td>1,229.5</td>
<td>218.2</td>
<td>21.6</td>
</tr>
<tr>
<td>Foreign exchange deposits</td>
<td>249.2</td>
<td>277.7</td>
<td>28.5</td>
<td>11.4</td>
</tr>
<tr>
<td>Currency in circulation</td>
<td>223.6</td>
<td>260.0</td>
<td>36.4</td>
<td>16.3</td>
</tr>
<tr>
<td>Demand deposits</td>
<td>308.4</td>
<td>394.3</td>
<td>86.0</td>
<td>27.9</td>
</tr>
<tr>
<td>Savings and time deposits</td>
<td>230.1</td>
<td>297.5</td>
<td>67.4</td>
<td>29.3</td>
</tr>
</tbody>
</table>


a. Includes state-owned enterprises and local governments.

*Source:* Economic Commission for Africa, from official sources.
Domestic price developments—good weather turns inflation negative

The inflation outturn in the 1990s was impressive, maintained on average in single digits—a big change from the volatile consumer prices in the 1980s, with headline inflation of 250% in 1987. The success in managing inflation is due to the simultaneous strengthening of liquidity and budget management, especially since 1992.

From September 2001 to June 2002 the economy’s headline inflation rate was negative (figure 2.4), largely because of the sharp drop in food prices, the result of good weather. Annual food crop inflation declined from –3.7% in July 2001 to –28.5% in December 2001 before rising to –13.0% in June 2002. Since October 2001 annual underlying inflation (for all goods and services minus food crops) has been positive, but well below 5%.

Interest rates—heading downward

The annualized 91-day treasury bill rate declined from 12% in September 2001 to a low of 3% in March 2002, with the rediscount rate and the bank rate following a similar pattern (figure 2.5). This decline is due mainly to a reduction in the volume of treasury bills, as the Bank of Uganda curtailed their use for sterilization of inflows. Since March 2002, however, the treasury bill rate has been on the rise.

Commercial bank deposit and lending rates registered only a marginal decline. For shilling-denominated deposits, the weighted time deposit rate was 3.6% in June 2002, down from 6.6% in June 2001. The weighted lending rate also declined, to 17.6% from 21.7%. Despite monetary easing, private credit did not respond. Nor has

Private sector credit grew only 1.8% in 2001/02, down from 9.4% in 2000/01

Figure 2.4

Inflation plummets

Inflation in December 1999/2000–2001/02 (%)
the large spread between the lending and deposit rate changed, despite the impressive drop in nonperforming loans. Contributing to the wide spreads are the cost to banks of meeting prudential requirements and the high cost of doing business, particularly for communication, electricity, rents, and security services (Kasekende and Atingi-Ego 1996, 1999). Stringent collateral requirements add to these costs. With legal property titles not clear-cut, the banks have to investigate property deeds offered as collateral by the borrowers and several guarantors, costly in staff time and effort. Yet another reason for the wide spread is the inability of the Bank of Uganda to signal its intentions to the market, given the high volatility in treasury bill volumes.

Banking sector—considerably stronger

Uganda’s financial sector has undergone considerable reforms—to strengthen, broaden, and deepen the financial system and to encourage competition within it. Full liberalization of interest rates and relaxation of entry requirements brought in new banks and other financial institutions. The Bank of Uganda has also instituted a framework for more effective supervision and enforcement of prudential regulations, including the recent increase in minimum capital requirements for financial institutions. As evidence of its strict surveillance of the financial sector since 1998/99 and its intolerance of unethical practices, the Bank of Uganda has closed four insolvent banks due to fraud and mismanagement.

A new Financial Institutions Bill, presented to parliament, strengthens licensing, specifies corporate governance requirements, tightens restrictions on insider lending and large loan exposures, and requires prompt corrective action for distressed banks.

Figure 2.5

Interest rates declining
Indicative policy rates, January 2001–May 2002 (%)
The financial sector is trying to reduce the cost of doing business. An electronic clearing system, inaugurated in May 2002, is expected to reduce the time to clear a cheque from three working days to two. To attract savers, most commercial banks have also introduced debit cards, cash cards, automatic teller machines, and specially packaged accounts. And to deepen the financial sector, enhance competition, and ensure a wider financial product range, the Bank of Uganda has allowed the entry of foreign banks.

The government has finally divested itself of banking business through the Bank of Uganda’s sale of the state-owned Uganda Commercial Bank (box 2.1). To continue to improve confidence in the banking sector it would help to create credit rating bureaus, strengthen bankruptcy laws, and quickly resolve nonperforming assets.

The reforms have improved Uganda’s financial indicators (table 2.2). But it is too early to gauge how much confidence these reforms have generated among investors, domestic and foreign. But weaknesses remain in access to credit by smaller enterprises.

**Fiscal policies and developments—pursuing prudent policies**

Prudent fiscal management has had a big role in keeping inflation in single digits. With the limited potency of monetary policy, cash-budget management allowed fiscal

**Box 2.1**

*Successful resolution of the Uganda Commercial Bank*

An initial attempt to privatize the Uganda Commercial Bank to a Malaysian firm, Westmont, failed because of the poor handling of the divestiture and serious concerns raised by parliament on the process, prompting the Bank of Uganda’s intervention.

Four banks were subsequently invited to conduct due diligence checks on the bank, two submitting bids to purchase it. The Bank of Uganda decided that selling the Uganda Commercial Bank to the international Stanbic would best meet its objectives. Stanbic bought 80% of the shares while the government retained 20%, available to the general public through the Uganda Securities Exchange.

There were various allegations of irregularities in the deal with Stanbic, particularly that the sale price was lower than the value of assets (New Vision 2003). But the U.K. auditors that investigated the allegations gave the all-clear sign to the deal.

The sale of Uganda Commercial Bank achieved the government’s long-standing goal of getting out of the ownership and management of commercial banks. More important, the Bank of Uganda attracted a major international bank—with operations in 17 African countries, assets of $38 billion, and capital of $2.3 billion—to purchase the Uganda Commercial Bank and assume responsibility for its branch network and countrywide retail banking operations.

The medium-term expenditure framework is the main mechanism for linking the poverty strategy to the budget.

Fiscal policy geared to poverty reduction

The government’s medium-term fiscal programme has the dual aim of sustaining financial stability and supporting poverty reduction programmes. The medium-term expenditure framework is the main mechanism for linking the Poverty Reduction Strategy to the budget (box 2.2).

The fiscal deficit has been on the rise because of higher government spending on poverty reduction programmes. The fiscal deficit, on a cash basis, rose from 1.4% of GDP in 1997/98 to 5.5% in 2001/02, while the deficit, excluding grants, rose from 6.5% to 12.6%. The 2001/02 deficit was financed largely by donor assistance, which amounted to 11.7% of GDP, mainly reflecting budgetary support from the World Bank for a Poverty Reduction Support Credit (IMF 2002b).

Recurrent spending remained fairly constant throughout 1997/98 to 2000/01, rising significantly only in 2001/02. The rise was mainly due to higher spending under the Poverty Action Fund (channeling part of the debt relief under the Heavily Indebted Poor Countries Initiative), remuneration to members of parliament, and allocations for the state house, missions abroad, local government elections, and defense (Uganda, Background to the Budget 2001/02).

Defense spending is estimated to have risen to 5.3% of GDP in 2001/02, from 4.2% in the previous three years. The growth in the defense budget—especially the spending over and above the budget—is raising concerns for some donors. The government deems it necessary to address security in northern regions, where the poor identify insecurity as their main concern.

Table 2.2

Financial sector indicators, 2001 and 2002 (%)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>End-June 2001</th>
<th>End-June 2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial depth (M2/GDP)</td>
<td>8.2</td>
<td>15</td>
</tr>
<tr>
<td>Private sector deposits (share of GDP)</td>
<td>5.0</td>
<td>11.0</td>
</tr>
<tr>
<td>Assets of the banking system (share of GDP)</td>
<td>12.1</td>
<td>26.7</td>
</tr>
<tr>
<td>Nonperforming assets (share of outstanding loans)</td>
<td>50.0</td>
<td>5.0</td>
</tr>
</tbody>
</table>

Source: Economic Commission for Africa, from official sources.
Meanwhile, development spending has been rising, financed mainly from external sources, which accounted for 71% during 1997/98 to 2000/02. Bolstering the domestic financing of development spending will be important for reducing this aid dependency.

**Revenue performance—sluggish**

Despite efforts by government to enhance collection, revenues have been sluggish, hampered by deficiencies in tax administration, a narrow tax base, noncompliance, and corruption. This weak revenue performance also puts the medium-term expenditure framework process in disarray.

Several measures have been taken to improve the efficiency of tax administration and reform tax policy. In 1997 and 1998 the Income Tax Act streamlined exemptions and introduced accelerated depreciation allowances for investments in plant, machinery, and equipment.

**Box 2.2**

*Linking the Poverty Reduction Strategy to the budget*

Before 1992 Uganda produced yearly budgets. Fiscal policy was not linked to development planning, and changes in expenditure allocations were based on incremental adjustments to the previous year’s budget.

Since 1997/98 the government has used the medium-term expenditure framework to allocate resources in a framework that ensures consistency with overall resource constraints and to align expenditure priorities with Poverty Reduction Strategies. The medium-term expenditure framework sets sector and district spending ceilings within a rolling three-year framework, considering macroeconomic developments and the prospects for resource mobilization, both domestic and external. District and sectoral working groups, comprising the Ministry of Finance and line ministries, then help develop sectoral priorities within the expenditure limits, ensuring that these are in line with Poverty Eradication Action Plan/Poverty Reduction Strategy priorities. The process culminates in working groups preparing sectoral and district Budget Framework Papers that get incorporated into the medium-term expenditure framework.

Within the medium-term expenditure framework the government initially created a Poverty Action Plan to earmark savings from debt relief under the HIPC Initiative for basic social services. Since then, the plan has attracted additional donor funds.

The medium-term expenditure framework has significantly improved the budget and planning process. It has also increased the harmonization of donor financing plans with Poverty Eradication Action Plan/Poverty Reduction Strategy objectives. But its success depends on the government’s realizing the financing assumptions. For external funding, the timeliness and predictability of aid flows are crucial. Equally important is realizing domestic revenues as projected. More progress is needed on both fronts.

*Source: ECA 2001.*
In 2001/02, for the first time in three years, fiscal revenues increased, to 12% of GDP, mainly due to higher revenues from income and value-added taxes. But Uganda’s revenue performance is still lower than the 20% for other Sub-Saharan African countries. Efforts are under way to expand the tax base, enhance tax compliance, and improve tax administration by stamping out corruption in the Uganda Revenue Authority. Only a thorough anticorruption programme will improve revenue collection in the medium term. The government recently granted ad hoc investment incentives to some entrepreneurs, a practice that could lower the already-low revenue performance.

**Weak capacity hinders fiscal transparency and service delivery**

Measures to monitor and control spending have been introduced at central and local government levels. Domestic development outlays have been brought under the Commitment Control System to monitor, report, and enforce government spending commitments. Under the extensive decentralization that began in 1993, the government has also transferred a large volume of budgetary resources to districts, consistent with shifting the delivery of most public services to the districts.

There has been good progress in monitoring spending in education and health. But overall enforcement has been weak, because of low capacity in line ministries and local governments. It appears that local governments are not fully capable of coping with the decentralization of fiscal responsibilities, even less so now that poverty reduction efforts require that a large share of government expenditures be at the local government level. Tracking local government activities and expenditures has been problematic, with accounts not timely. Weak capacity thus hinders the main objective of decentralization—efficient service delivery.

**External sector policies and developments**

Exports are mostly agricultural products, with coffee the main export crop, and imports are mostly manufactured goods. The share of coffee in total export revenues fell from 59% in 1997/98 to about 19% in 2001/02, reflecting fluctuations in international prices. Revenues from nontraditional exports (fish, cut flowers, and gold) have grown steadily in recent years, showing progress in export diversification.

The persistent fall in international commodity prices has led to a downward trend in the terms of trade. Import prices were generally stable, while realized export unit values declined almost across the board (figure 2.6). The trade and current account balances have been in persistent deficit, widening over the years, a symptom of how much Uganda relies on donor assistance to finance its import bill.

Even so, the external position strengthened somewhat in 2001/02. The overall deficit was $2.8 million, down from $55.6 million in 2000/01. This was financed largely through
exceptional financing consisting mainly of debt cancellations under the HIPC Initiative and deferred debt payments to countries that have not accepted HIPC terms. Exceptional financing in 2001/02 stood at $105.1 million, with $72.2 million for debt cancellation under the HIPC Initiative and $32.9 million for repurchases made to the IMF.

**Merchandise exports rose marginally**
Merchandise exports rose slightly from $441.8 million in 2000/01 to $444.2 million in 2001/02, largely because of noncoffee exports. Coffee export receipts were down from $109.7 million in 2000/01 to $85.3 million in 2001/02 because of the drop in world market prices from $0.64 per kilogram to $0.45 (figure 2.7). Noncoffee export receipts were up 8% in 2001/02, rising to $358.9 million from $332.1 million. Fish exports rose to $80.9 million, up from $50.1 million (table 2.3). The increase was due to higher volumes and prices. Uganda’s export destinations are now more balanced, with the European Union absorbing 29%, the Common Market for Eastern and Southern Africa (COMESA)4 20%, and Asia 19%. If sustained, this shift would reflect some success in market diversification, reducing overreliance on a few markets.

**Merchandise imports on the rise**
Total merchandise imports rose from $973.3 million in 2000/01 to $1,221.1 million in 2001/02, partly because of the increase in private nonoil imports, which were up 11% (table 2.4). Government imports also rose—from $121.9 million in 2000/01 to $136 million in 2001/02. With world oil prices lower, oil imports dropped from $136.1 million in 2000/01 to $124.7 million in 2001/02.

**Figure 2.6**
*Trends of trade trending downward*
*Terms of trade, 1996/97–2001/02 (Index 1999/2000 = 100)*

![Chart](chart.png)

Source: Economic Commission for Africa, from official sources.
Figure 2.7
Exports diversifying away from coffee
Coffee and noncoffee export earnings, 1997/98–2001/02 (US$ millions)

Table 2.3
Trend and composition of exports, 1997/98–2001/02 (US$ millions)

<table>
<thead>
<tr>
<th>Exports</th>
<th>1997/98</th>
<th>2000/01</th>
<th>2001/02a</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coffee</td>
<td>268.9</td>
<td>109.7</td>
<td>85.3</td>
</tr>
<tr>
<td>Total noncoffee</td>
<td>189.6</td>
<td>332.1</td>
<td>358.9</td>
</tr>
<tr>
<td>Cotton</td>
<td>11.4</td>
<td>14.1</td>
<td>13.3</td>
</tr>
<tr>
<td>Tea</td>
<td>35.0</td>
<td>35.9</td>
<td>26.9</td>
</tr>
<tr>
<td>Fish</td>
<td>28.0</td>
<td>50.1</td>
<td>80.9</td>
</tr>
<tr>
<td>Beans</td>
<td>2.2</td>
<td>2.0</td>
<td>1.5</td>
</tr>
<tr>
<td>Maize</td>
<td>8.1</td>
<td>6.1</td>
<td>13.1</td>
</tr>
<tr>
<td>Flowers</td>
<td>6.8</td>
<td>13.2</td>
<td>15.9</td>
</tr>
<tr>
<td>Gold</td>
<td>25.5</td>
<td>58.5</td>
<td>56.7</td>
</tr>
<tr>
<td>Tobacco</td>
<td>10.8</td>
<td>27.7</td>
<td>32.3</td>
</tr>
<tr>
<td>Sisimim (sesame)</td>
<td>0.0</td>
<td>0.7</td>
<td>0.5</td>
</tr>
<tr>
<td>Electricity</td>
<td>12.0</td>
<td>16.7</td>
<td>13.9</td>
</tr>
<tr>
<td>Hides/skins</td>
<td>7.8</td>
<td>22.7</td>
<td>19.7</td>
</tr>
<tr>
<td>Cobalt</td>
<td>0.0</td>
<td>12.8</td>
<td>11.0</td>
</tr>
<tr>
<td>Others</td>
<td>42.0</td>
<td>71.6</td>
<td>74.0</td>
</tr>
<tr>
<td>Grand total</td>
<td>458.5</td>
<td>441.8</td>
<td>444.2</td>
</tr>
</tbody>
</table>

a. Estimated.

Source: Economic Commission for Africa, from official sources.
About 29% of imports come from COMESA, with Kenya, still the main source, accounting for 18%. Asia accounted for 27%, the European Union 24%, and the Middle East 10%.

**Service exports and transfers—up marginally**

Service exports rose from $187.7 million in 2000/01 to $193.4 million in 2001/02. Tourism, showing some recovery after the Bwindi National Park murders in 1999, accounted for 82% of nonfactor service exports. Payments for services abroad also increased, leaving Uganda a net importer of nonfactor services.

Private transfers continued to be a significant part of foreign exchange inflows, with net private transfers rising from $166.4 million in 2000/01 to $474.6 million in 2001/02, close to half from nongovernmental organizations. Official transfers to Uganda declined to $375.2 million in 2001/02, from $420.8 million the previous year.

**The capital and financial account improves**

Uganda removed all restrictions on international capital transactions in 1997 (box 2.3), and the capital and financial account recorded surpluses for the last five years, mainly because of donor funding. In 2001/02 the surplus was $473.2 million, up from $309.5 million the year before. Donor and private loan disbursements more than offset debt repayments. Foreign direct investment also grew, if marginally, from $143.8 million in 2000/01 to $145.7 million in 2001/02 (table 2.5).

**Exchange rate policy—shilling remains stable**

Uganda now operates a flexible exchange rate regime, allowing the value of the shilling to change against all other currencies in line with market conditions and the underlying economic fundamentals. Bank of Uganda intervention aims to reduce wide fluctuations, without targeting any predetermined level or trend. Its exchange rate policy is geared at creating a viable and sustainable external sector.

**Table 2.4**

*Trend and composition of imports, 1997/98–2001/02 (US$ millions)*

<table>
<thead>
<tr>
<th>Imports</th>
<th>1997/98</th>
<th>2000/01</th>
<th>2001/02*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>966.2</td>
<td>973.3</td>
<td>1,221.1</td>
</tr>
<tr>
<td>Government imports</td>
<td>193.4</td>
<td>121.9</td>
<td>136.0</td>
</tr>
<tr>
<td>Project</td>
<td>170.8</td>
<td>89.6</td>
<td>108.8</td>
</tr>
<tr>
<td>Nonproject</td>
<td>22.6</td>
<td>32.3</td>
<td>27.1</td>
</tr>
<tr>
<td>Private sector imports</td>
<td>572.3</td>
<td>737.7</td>
<td>791.3</td>
</tr>
<tr>
<td>Oil</td>
<td>70.3</td>
<td>136.1</td>
<td>124.7</td>
</tr>
<tr>
<td>Nonoil</td>
<td>502.0</td>
<td>601.6</td>
<td>666.6</td>
</tr>
<tr>
<td>Other imports</td>
<td>200.4</td>
<td>113.7</td>
<td>293.8</td>
</tr>
</tbody>
</table>

*a. Estimated.*

*Source: Economic Commission for Africa, from official sources.*
The Ugandan shilling remained relatively stable against the dollar during most of 2001/02. The interbank weighted-period average mid-rate appreciated by 0.5%, compared with a depreciation of 16.5% in 2000/01, largely because of donor inflows and stronger noncoffee exports. On a few occasions during the year the Bank of Uganda increased net sales of dollars in the foreign exchange market to mop up excess liquidity. It was feared early on that lumpy and significant donor resources would appreciate the nominal and real exchange rates, hurting exports. But sterilization by the Bank of Uganda ensured that the exchange rate remained competitive.

The average nominal effective exchange rate appreciated by 2.3%, while the real effective exchange rate depreciated by 0.4% during 2001/02. But on an end-period basis, both rates depreciated, by 6.9% and 9.8% (figure 2.8).

### Table 2.5

**Balance of payments, 1997/98–2001/02 (US$ millions)**

<table>
<thead>
<tr>
<th>Balance of payments</th>
<th>1997/98</th>
<th>2000/01</th>
<th>2001/02 a</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current account balance</td>
<td>-251.7</td>
<td>-365.1</td>
<td>-476.0</td>
</tr>
<tr>
<td>Exports (fob)</td>
<td>458.4</td>
<td>441.8</td>
<td>444.2</td>
</tr>
<tr>
<td>Imports (fob)</td>
<td>-966.2</td>
<td>-973.3</td>
<td>-1,221.1</td>
</tr>
<tr>
<td>Service (net)</td>
<td>-202.0</td>
<td>-293.0</td>
<td>-447.2</td>
</tr>
<tr>
<td>Income (net)</td>
<td>-83.9</td>
<td>-127.9</td>
<td>-101.7</td>
</tr>
<tr>
<td>Current transfers (net)</td>
<td>542.0</td>
<td>587.3</td>
<td>849.8</td>
</tr>
<tr>
<td>General government</td>
<td>507.0</td>
<td>420.8</td>
<td>375.2</td>
</tr>
<tr>
<td>Private transfers (net)</td>
<td>35.0</td>
<td>166.5</td>
<td>474.6</td>
</tr>
<tr>
<td>Capital and financial account</td>
<td>351.9</td>
<td>309.5</td>
<td>473.2</td>
</tr>
<tr>
<td>Capital transfers</td>
<td>40.6</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Financial account</td>
<td>311.4</td>
<td>309.5</td>
<td>478.4</td>
</tr>
<tr>
<td>Foreign direct investment</td>
<td>120.0</td>
<td>143.8</td>
<td>145.7</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>191.4</td>
<td>165.8</td>
<td>332.7</td>
</tr>
<tr>
<td>Medium and long–term loans</td>
<td>212.0</td>
<td>181.7</td>
<td>362.4</td>
</tr>
<tr>
<td>Debt amortization</td>
<td>-68.5</td>
<td>-81.9</td>
<td>-80.9</td>
</tr>
<tr>
<td>Short–term loans (net)</td>
<td>-20.6</td>
<td>-15.9</td>
<td>-29.7</td>
</tr>
<tr>
<td>Errors and omissions</td>
<td>18.1</td>
<td>-14.0</td>
<td>62.4</td>
</tr>
<tr>
<td>Overall balance</td>
<td>100.2</td>
<td>-55.6</td>
<td>-2.8</td>
</tr>
<tr>
<td>Financing items</td>
<td>-100.2</td>
<td>55.6</td>
<td>2.8</td>
</tr>
<tr>
<td>Use of IMF credit (net)</td>
<td>-4.6</td>
<td>-20.9</td>
<td>-37.0</td>
</tr>
<tr>
<td>Change in gross reserves</td>
<td>-128.6</td>
<td>-19.3</td>
<td>-127.7</td>
</tr>
<tr>
<td>Exceptional financing</td>
<td>14.9</td>
<td>109.7</td>
<td>105.1</td>
</tr>
</tbody>
</table>

a. Estimated.

*Source: Economic Commission for Africa, from official sources.*
Box 2.3
Liberalizing the capital account: a lesson for other countries?

Liberalization of the capital account in 1997 was preceded by successful macro reforms. These reforms reduced the fiscal deficit significantly and ensured financing of the remaining deficit in a noninflationary manner. They strengthened the prudential supervision and regulation of financial institutions, especially in foreign exchange risk exposure. They liberalized the domestic financial sector. And they restructured debt.

Uganda’s experience with a liberal capital account cannot be compared with those of southeast Asian countries because Uganda’s financial markets are not well developed and its markets are not liquid enough to facilitate the development of financial instruments that could attract portfolio investment.

Results so far are positive
The inflow of foreign capital—largely in trade flows, transfers, and investment flows—has been fairly large. Uganda has:

- Elicited participation in the domestic capital market, with some interest from foreign fund managers in shilling-denominated assets. The recent issue of East African Development Bank (EADB) bonds attracted foreign participation. And the promissory notes issued by the government have attracted foreign interest.
- Increased private sector investments.
- Shifted from shilling-denominated to dollar-denominated accounts, opening avenues for diversification of savings and borrowing for domestic agents.
- Ensured continuing fiscal discipline and prudent conduct of monetary policy.

But there may be challenges in the future
Foreign exchange inflows under a liberal capital account challenge the stability of the foreign exchange market and the management of liquidity.

- On many occasions, the authorities are constrained in their efforts to deal with inflows known to be temporary because of programme requirements to achieve a floor on net international reserves.
- The capital account was liberalized before a system was put in place to collect data on capital account transactions. The system for holding regular surveys and reporting requirements has just been developed. Laws revoking the Exchange Control Act of 1969 and liberalizing foreign exchange transactions have yet to be passed.
- Liberalization of the capital account created new forms of risk for domestic banks, which they have little experience managing.
- The vulnerability to speculative attacks and the possibility of contagion effects could cause massive outflows of capital.
- Instruments need to be developed to deal with the exposure risks and the uncertainty the private sector faces in a situation where markets and hedging instruments are lacking.

Source: Economic Commission for Africa, from official sources.
External debt management strategies and trends

Uganda's pursuit of sound macroeconomic policies and commitment to structural reforms enabled it to become the first country to qualify for debt relief under the HIPC Initiative. The usual three-year interval between the decision and completion points was reduced to one year, with a decision point set in April 1997 and the completion point reached in April 1998, when Uganda received $347 million in debt relief. Uganda also became the first country to benefit from the enhanced HIPC initiative in April 2000, when it secured $656 million in debt relief.

Even with debt relief, Uganda's debt sustainability has not improved much. Its stock of outstanding and disbursed external debt at the end of June 2002 was estimated at $3.8 billion, an increase of 11.5% over June 2001. The total debt stock as a ratio of GDP also rose to 68% in June 2002, from 65% a year before. In line with Uganda's debt strategy, which requires new borrowing on highly concessional terms, about 82% of external debt is owed to multilateral institutions (figure 2.9).

The ratio of debt service (including IMF maturities) to total exports of goods and non-factor services was 24% in June 2002, down from 27% in June 2001. This was largely a result of increasing exports and a decline in debt service from $167.2 million to $153.8 million (table 2.6).

The debt and debt service indicators in net present value terms also show that Uganda's debt sustainability has not improved since it received HIPC debt relief. The net present

Figure 2.8

Shilling fairly stable against the dollar in 2002
Nominal effective and real effective exchange rates, period average, 1991/92–2001/02 (1990=100)

Note: Downward movement is appreciation. An upward movement is depreciation.
Source: Bank of Uganda.
value of the debt to exports ratio increased from 171% in 2000/01 to 199% in 2001/02—and it is projected by the IMF to increase to 208% in 2002/03. Compare that with the threshold of 150% established under the enhanced HIPC framework. Similarly the net present value of the debt to GDP ratio is projected to increase from 20% in 2000/01 to 22% in 2000/03 (table 2.7). Improving debt sustainability is a priority for the medium term, but any external shocks to real GDP and exports or a severe depreciation of the shilling could easily derail Uganda’s efforts.

**Figure 2.9**

*Most debt is multilateral*

*Share of outstanding public debt, by creditor, 2002*

![Pie chart showing debt composition by creditor category.]

**Table 2.6**

*Outstanding public debt, by creditor, June 1998–June 2002 (US$ millions)*

<table>
<thead>
<tr>
<th>Creditor category</th>
<th>End-June 1998</th>
<th>End-June 2001</th>
<th>End-June 2002*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total debt stock</td>
<td>3,631.0</td>
<td>3,395.2</td>
<td>3,782.9</td>
</tr>
<tr>
<td>Multilateral</td>
<td>2,826.8</td>
<td>2,892.9</td>
<td>3,102.7</td>
</tr>
<tr>
<td>Non–Paris Club bilateral</td>
<td>423.6</td>
<td>341.3</td>
<td>371.7</td>
</tr>
<tr>
<td>Paris Club bilateral</td>
<td>324.4</td>
<td>122.9</td>
<td>115.0</td>
</tr>
<tr>
<td>Commercial</td>
<td>33.4</td>
<td>18.0</td>
<td>34.6</td>
</tr>
<tr>
<td>Other loan category</td>
<td>22.6</td>
<td>20.1</td>
<td>158.9</td>
</tr>
<tr>
<td>Debt service</td>
<td>173.7</td>
<td>167.2</td>
<td>153.8</td>
</tr>
<tr>
<td>Debt service to export of goods and nonfactor services (%)</td>
<td>27.4</td>
<td>26.6</td>
<td>24.1</td>
</tr>
<tr>
<td>Debt service to GDP (%)</td>
<td>1.4</td>
<td>0.7</td>
<td>0.6</td>
</tr>
<tr>
<td>Debt stock to GDP (%)</td>
<td>58.8</td>
<td>64.7</td>
<td>68.2</td>
</tr>
</tbody>
</table>

*a. Estimates.

Source: Economic Commission for Africa, from official sources.*
Social sector developments

Sound macroeconomic management that generated higher growth in the last decade enabled Uganda to improve the living standards of the population (table 2.8). The proportion of people living in poverty declined from 56% in 1992 to 35% in 2000. And thanks to higher public spending on basic services, most key education and health indicators improved. The government made tremendous progress in improving the efficiency of public spending on social services through the public expenditure tracking system (box 2.4).

These impressive gains aside, one in three Ugandans still lives below the poverty line. The overall poverty numbers also hide vast regional and urban-rural disparities. And despite the substantial increases in public spending on basic services, most social indicators are below the average of such comparator countries as Ghana, Kenya, and Zimbabwe. The HIV/AIDS epidemic, though now under control, has also taken a toll on social indicators.

**Table 2.7**
Debt sustainability indicators, 2000/01–2002/03 (%)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2000/01</th>
<th>2001/02</th>
<th>2002/03</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net present value of debt to exports ratio(^a)</td>
<td>170.9</td>
<td>199.0</td>
<td>208.7</td>
</tr>
<tr>
<td>Net present value of debt to revenue ratio</td>
<td>186.9</td>
<td>180.1</td>
<td>181.8</td>
</tr>
<tr>
<td>Net present value of debt to GDP ratio</td>
<td>20.3</td>
<td>21.2</td>
<td>22.4</td>
</tr>
</tbody>
</table>

\(^a\) In relation to the average of three consecutive years of exports of goods and services ending in the recent year.

**Source:** IMF 2002b.

**Table 2.8**
Social indicators, latest years

<table>
<thead>
<tr>
<th>Region/country</th>
<th>Infant mortality rate (per 1,000 live births) 2000</th>
<th>Under-five mortality rate (per 1,000) 2000</th>
<th>Life expectancy at birth (years) 2000</th>
<th>Combined gross enrolment rate, primary, secondary, and tertiary (%) 1999(^a)</th>
<th>Adult literacy rate, ages 15 and older (%) 2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub-Saharan Africa</td>
<td>107</td>
<td>174</td>
<td>48.7</td>
<td>42</td>
<td>61.5</td>
</tr>
<tr>
<td>Uganda</td>
<td>81</td>
<td>127</td>
<td>44.0</td>
<td>45</td>
<td>67.1</td>
</tr>
<tr>
<td>Ghana</td>
<td>58</td>
<td>102</td>
<td>56.8</td>
<td>42</td>
<td>71.5</td>
</tr>
<tr>
<td>Kenya</td>
<td>77</td>
<td>120</td>
<td>50.8</td>
<td>51</td>
<td>82.4</td>
</tr>
<tr>
<td>Nigeria</td>
<td>110</td>
<td>184</td>
<td>51.7</td>
<td>45</td>
<td>63.9</td>
</tr>
<tr>
<td>Tanzania</td>
<td>104</td>
<td>165</td>
<td>51.1</td>
<td>32</td>
<td>75.1</td>
</tr>
<tr>
<td>Zambia</td>
<td>112</td>
<td>202</td>
<td>41.4</td>
<td>49</td>
<td>78.1</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>73</td>
<td>117</td>
<td>42.9</td>
<td>65</td>
<td>88.7</td>
</tr>
</tbody>
</table>

\(^a\) Preliminary UNESCO estimates subject to revision.

**Source:** UNDP 2002.
Poverty reduction is at the heart of the country’s development strategy. The Poverty Eradication Action Plan/Poverty Reduction Strategy sets out to reduce income poverty to 10% of the population by 2017 by creating a better enabling environment for economic activities and by directly increasing living standards.

**Spatial dimensions of poverty**
Mean consumption per adult equivalent rose by 4.6% a year between 1992 and 2000, but the growth was much higher in urban areas (6.2%) than in rural (3.9%). Within rural areas, regions with higher initial incomes grew faster—in rural central by 5.2% a year, in rural western by 4.5%, in rural eastern by 3.9%, and in rural northern by only 0.5%.

A similar disparity can be observed in the dynamics of poverty. Of urban households that were poor in 1992, 61% moved out of poverty by 1996, but of rural households only 39% did (Okidi and Mugambe 2002).

*The north is significantly poorer.* The largest reduction in the proportion of people in poverty was reported in the central region (from 46% in 1992 to 20% in 1999), where the initial incidence of poverty was the lowest in 1992 (figure 2.10). Both the eastern and western regions also saw poverty decline, though to a lesser extent. But in the northern region the incidence of poverty increased to 65% in 1999 from 59% two years earlier. A similar picture emerges when comparing poverty dynamics across regions. In the northern regions only 27% of the households that were poor in 1992 moved out of

**Box 2.4**

Public funds finally reach schools

In 1996 Uganda became the first country to apply a public expenditure tracking system. Its use was prompted by the observation that despite a substantial increase in public spending on education since the late 1980s, officially reported primary enrollment remained stagnant.

The survey quantified the adverse effects of asymmetric information on the flow of funds. It found that 87% of nonwage funds allocated to districts either disappeared for private gain or were used by district officials for purposes unrelated to education. Following publications of the survey findings, the central government began publishing the monthly intergovernmental transfers of public funds in major newspapers and broadcasting the information on radio, and required primary schools to post information on inflows of funds for all to see. This not only made information available to parent and teacher groups, but also signaled to local governments that the center had resumed its oversight function, creating incentives for increased accountability among local agencies.

Initial assessments of these reforms a few years later, through two locally implemented follow-up surveys, show that the flow of intended capitation grants improved dramatically, from 13% (on average) reaching schools in 1991/95 to about 80–90% reaching schools in 1999 and 2000.

Source: Economic Commission for Africa, from official sources.
poverty by 1996, far less than in eastern (37%), western (60%), and central (63%) regions (Okidi and Mugambe 2002). The north has disadvantages of remoteness, continuing civil conflict, unfavourable agroclimatic conditions, low population density, and many internally displaced people (box 2.5).

Several factors may explain these spatial variations in growth and poverty reduction. First, Uganda’s growth in the 1990s reflects its recovery from disaster. By 2000 the economy was just returning to the income per capita of the early 1970s. Disastrous economic policies, invasions, and civil war had undermined the formal economy and caused “a retreat to subsistence”. This hit urban areas more than rural areas. So when security and a stable economic policy framework were restored, there was more scope for the formal economy to bounce back, and economic opportunities improved more in urban areas. This may also explain the better performance of central rural areas, likely to have benefited from proximity to major urban centres.

Second, the restoration of security has been uneven. The slow growth of northern rural areas—and to some extent eastern—reflects not only distance from the cities but also poor security. Indeed, it is possible that security did not improve in some parts of the country—four districts were excluded from the 1999/2000 poverty survey due to insecurity, up from two in 1992/93 and none in 1993/94.

Third is the local impact of the coffee boom in 1994/95, when unit values for Ugandan coffee exports rose to $2.55 a kilogram from $0.82 in 1992/93. Coffee accounts for a sizable share of income only in the western and central regions—it is not grown in the northern region. The incidence of poverty increased to 65% in 1999 from 59% two years earlier.

In the northern region the incidence of poverty increased to 65% in 1999 from 59% two years earlier.

<table>
<thead>
<tr>
<th>Region</th>
<th>Proportion of Population in Poverty, 1999/2000 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>North</td>
<td>65</td>
</tr>
<tr>
<td>East</td>
<td>45</td>
</tr>
<tr>
<td>West</td>
<td>35</td>
</tr>
<tr>
<td>Central</td>
<td>25</td>
</tr>
<tr>
<td>National</td>
<td>30</td>
</tr>
</tbody>
</table>

Source: Appleton and others 1999; Appleton 2001.
north. It is likely that much of the windfall was saved, resulting in a permanent rise in income (Collier and Gunning 1999).

**Poverty in food crops sector.** There are wide disparities in the ability of various socio-economic groups to benefit from economic opportunities created by the stable macro-economic environment. The food crop sector, mainly subsistence farming, was the poorest in 1992, with poverty declining from 64% in 1992 to 58% in 1996 (Okidi and

**Box 2.5**

**The untold side of the success story**

The benefits of Uganda’s high growth have not been evenly distributed across the country. There are still great inequalities between the more affluent central crescent around Lake Victoria and the drier, more disadvantaged northern region. The north lags far behind the rest of the country in food security, health, and education.

The northern districts have suffered deaths, torture, abduction of children, disruption of livelihoods, and displacement. More than 800,000 people have been displaced by civil war and live in squalid camps. Another 150,000 refugees in 66 settlements in eight districts are also in need of food. According to the World Food Programme 108,000 tons of food were needed for the first six months of 2003 to avoid famine in the war-torn north.

**Distribution of poverty in Uganda**

![Map of Uganda showing distribution of poverty](image)

*Source: Economic Commission for Africa, from official sources.*
Mugambe 2002). Compare that with cash-crop farming, the second poorest in 1992, with 60% in poverty, but that then dropped to 41% in 1996. The removal of market controls on coffee benefited smallholder coffee farmers, enabling them to get better farmgate prices, especially with international coffee prices high in the mid-1990s.

National welfare inequality has not changed much over the years. So the downward trend in poverty emanated from faster economic growth, not from a redistribution of wealth. Those who remained poor have not had access to the economic opportunities created by high growth. They may be subsistence farmers, who do not operate in the formal economy. They may lack human and technical skills to benefit from new opportunities. They may belong to vulnerable groups—women, children, refugees. And they may be subject to disruptions from war and natural disaster.

The government is working to improve fiscal decentralization, equalization grants, social spending, targeted intervention programmes, and agricultural development programmes. But more commitment is necessary to address the deep pockets of poverty by concentrating on the priorities identified by the poor themselves: improving security, curbing corruption, and increasing access to basic social services, infrastructure, and markets (Uganda, Ministry of Finance, Planning, and Economic Development 2000). Establishing political stability and ending the economic alienation of the north region should be a key priority for the government.

**Poverty-sensitive distribution of resources**

The pattern of government expenditures through various fiscal transfer mechanisms may not adequately redress regional inequalities. (The analysis here draws on Uganda 2002.) The transfer formula allocates 85% of transfers according to district population and 15% according to geographical area. This formula applies to the Local Government Development Programme, the Unconditional Grant, the Plan for Modernization of Agriculture Grant, the National Agricultural Advisory Services Grant, and the Agriculture Extension Grant.

The regional distribution of transfers to local governments indicates that of 501.9 billion Ugandan shillings (around a quarter of the budget for 2001/02), the western region received the largest share (27%), followed closely by the eastern (26%), the central (25%), and the northern (22%).

On the basis of recent trends in economic growth and regional inequality, the Ministry of Finance, Planning, and Economic Development has analyzed the geographical pattern of government expenditure under the medium-term expenditure framework and come up with a weight that would be poverty-sensitive, using three factors to determine transfers:

- **Population size:** Districts with a higher population should receive more resources because they carry a higher burden of service delivery.
• **Geographical area**: Larger districts should receive more resources, because it is more costly to provide services to a geographically disbursed and isolated population.
• **Poverty level**: Poor districts should receive more transfer payments, because with their limited economic activity, they have a lower tax base than rich districts.

For illustrative purposes, the ministry gives the following weights—population (60%), area (20%), and poverty (20)—and using these weights it develops a poverty sensitive distribution.

The central and western regions have bigger populations (28%) than the eastern (25%) and northern (19%). The northern region is the largest in area (42%), followed by the western, central, and eastern. The central region has the biggest share of total household expenditure (39%), followed by the western (27%), eastern (23%), and northern (11%).

Given the weights in this example, a poverty-sensitive distribution would allocate 29% to the northern region (up from 23%), 26% to the western, 23% to the central, and 22% to the eastern. Increasing the allocation to the north could be done only after displaced people are resettled in their home villages and provided decent homes.

**Education—primary education for all**

Government policy on education is to increase the access to primary education. In 1997 the government launched the Universal Primary Education (UPE) programme, entitling up to four children per family to free primary education (the president recently announced its extension to every child). Primary education now receives about 70% of the education budget. The public expenditure tracking system, introduced in 1996, made sure that 80–90% of funds actually reached schools in 1999/2000 (see box 2.4).

The programme has the potential to be one of the most important poverty reduction strategies in Uganda. Estimates of the direct impact of education show that universal primary education would increase agricultural production by about 15%, more than the agricultural productivity gains from access to roads and extension services (Deininger and Okidi 2001). The improvement in primary education indicators has been substantial (table 2.9).

**Table 2.9**

Primary education indicators, 1994/95 and 2001/02

<table>
<thead>
<tr>
<th>Indicator</th>
<th>1994/95</th>
<th>2001/02</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public expenditure on education (% of government expenditure)</td>
<td>15.0</td>
<td>24.4</td>
</tr>
<tr>
<td>Enrolment rate in primary schools (%)</td>
<td>55</td>
<td>98</td>
</tr>
<tr>
<td>Ratio of girls to boys</td>
<td>45:55</td>
<td>45:55</td>
</tr>
<tr>
<td>Primary school dropout rate (%)</td>
<td>70</td>
<td>6.6</td>
</tr>
</tbody>
</table>

*Source: Economic Commission for Africa, from official sources.*
With tremendous achievements in quantity, greater efforts are now needed in improving quality indicators, such as the number of qualified teachers and the pupil-teacher and pupil-classroom ratios. The government is also reforming higher education, with enrolment already rising.

**Health—fighting illness on all fronts**

The Uganda (2002) Participatory Poverty Assessment identified ill health as the most frequently cited cause and consequence of poverty by the poor. The government has responded by allocating more resources, increasing the number of health facilities across the country, and re-orienting health services from curative to preventive, with particular attention to health education and information and to public health programmes.

Uganda’s aggressive response to HIV/AIDS shows the government’s commitment to fighting ill health on all fronts. The government’s first policy actions were to open a public debate on HIV/AIDS, taboo at the time, and to call for international assistance. The government then increased civil society participation in HIV/AIDS programme planning and design, to build awareness across the country. Most important, the government took a multisectoral approach to AIDS, involving 12 line ministries.

The strategy paid off. Once number one in the world for HIV infections, Uganda became one of the first countries in Africa to reverse the HIV prevalence rate in the adult population—from 15% in 1993 to about 7% in 2002. The largest decline was observed among adolescents (ages 15–19)—from 32% in 1992 to 10% by 1998. But tackling the issue of AIDS orphans—8% of Africa’s children orphaned by AIDS live in Uganda—remains a priority.

Other performance indicators have improved as well (table 2.10). Infant mortality has declined from 88 per 1,000 births in 1995 to 81 in 2000. The percentage of one-year-olds fully immunized rose from 66% in 1995 to 83% in 2000 and more than 90% in

### Table 2.10

**Health indicators, 1995 and 2000**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>1995</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public expenditure on health (% of GDP)</td>
<td>1.6</td>
<td>7.0</td>
</tr>
<tr>
<td>Infant mortality rate (per 1,000 live births)</td>
<td>88</td>
<td>81</td>
</tr>
<tr>
<td>Under-five mortality rate (per 1,000)</td>
<td>141</td>
<td>127</td>
</tr>
<tr>
<td>Maternal mortality rate (per 1,000 live births)</td>
<td>12</td>
<td>5</td>
</tr>
<tr>
<td>Life expectancy at birth (years)</td>
<td>40.5</td>
<td>44.0</td>
</tr>
<tr>
<td>Share of people with access to safe water (%)</td>
<td>46</td>
<td>50</td>
</tr>
<tr>
<td>Share of people with access to sanitation (%)</td>
<td>57</td>
<td>80</td>
</tr>
<tr>
<td>Share of one-year-olds fully immunized (%)</td>
<td>66</td>
<td>83</td>
</tr>
</tbody>
</table>

*Source: UNDP 2002; Economic Commission for Africa, from official sources.*
Accessibility to health care improved from 49% in 1995 to 70% in 1999 and about 80% in 2001. The challenge now is to ensure improvements in the quality of medical care.

Unleashing the private sector—many challenges to surmount

The potential of macroeconomic reforms to increase growth and reduce poverty has now been largely exploited. Providing further impetus to growth requires a deeper reform agenda to create an enabling environment for the private sector—reforms to make difficult governance and structural changes.

The average real GDP growth rate of 6% over the last decade, though impressive, is still below the target 7% a year required to achieve the government’s goal of reducing income poverty to 10% by 2017. Lifting growth by one notch thus falls squarely on the private sector. For a predominantly rural agrarian economy, private sector–led growth hinges on modernizing and diversifying agriculture. Since the majority of the poor make a living out of agriculture, such policies would also reduce poverty.

Throughout the last decade the government has undertaken a series of reforms to address private sector development and create an investor-friendly environment: removing controls on agricultural products, particularly for coffee, liberalizing trade and international capital flows, and privatizing state-owned enterprises.

So far the domestic sector has not responded strongly. Even though inflows of foreign direct investment increased steadily from about $54 million in 1993 to about $145 million in 2002, they are not an adequate response to Uganda’s impressive economic management.

The private sector identifies the high price and low quality of utility services and high taxes and interest rates as major constraints to investment (figure 2.11). Corruption, access to finance, tax administration, and the cost of raw materials are next in line as leading constraints.

The government is trying to tackle some of these constraints. The Uganda Electricity Board—a 100% government-owned monopoly since 1964—was unbundled into separate generation, transmission, and distribution entities and privatized. Generation capacity increased from 260 MW in 2000 to 300 MW in 2002 with the addition of two turbines at Kiira Power/Owen Falls extension.

In December 2001 the World Bank Group agreed to support the Bujagali Hydropower Project in Uganda, describing it as a key investment in poverty reduction for a country in which less than 3% of the population has access to grid-supplied electricity. The

Infant mortality has declined from 88 per 1,000 births in 1995 to 81 in 2000.
A hydropower station will be built, owned, and operated by AES Nile Power Limited, a private firm. The sponsor is the AES Corporation, a public corporation headquartered in Arlington, Virginia.

Telecommunications prices have declined and access has greatly improved with the entry of two additional mobile telephone providers—MTN of South Africa and Telecel of Switzerland. Attempts have been made to strengthen tax administration by changing the senior management of the Uganda Revenue Authority. Security concerns have also been

**Figure 2.11**

*High utility prices, taxes, and interest rates top constraints to investment*

*Private sector–identified constraints to investment*

<table>
<thead>
<tr>
<th>Constraint</th>
<th>1.0</th>
<th>1.5</th>
<th>2.0</th>
<th>2.5</th>
<th>3.0</th>
<th>3.5</th>
<th>4.0</th>
</tr>
</thead>
<tbody>
<tr>
<td>High utility prices</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High taxes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Poor utility services</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest rates</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corruption</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access to finance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax administration</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of raw materials</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insufficient demand</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local competition</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of business services</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crime/security</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access to land</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of skilled labour</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Uncertainty about government policies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exchange rate</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inflation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access to raw materials</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Competition from imports</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gov’t debt burden</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other regulations</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Import/export regulations</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unclear property rights</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Political instability</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Note: 1=no obstacle, 2=minor, 3=moderate, 4=major, 5=severe*

*Source: Reinikka and Svensson 1999.*
addressed with Operation Wembley—a zero-tolerance crackdown on armed robbers in June 2002. While the government has tried to improve the business environment, more needs to be done, particularly in the financial sector, infrastructure, and governance.

**Improving access to the financial sector**

Uganda’s financial sector, after many reforms, has emerged much stronger in recent years. But weaknesses still exist in access to credit. Commercial bank lending rates are still prohibitively high. Limiting the ability of small enterprises to borrow are high collateral requirements by banks and the fact that land is not accepted as collateral. Most small firms have access to credit only through microfinance institutions, which operate in a regulatory vacuum.

With the majority of poor people in rural areas and engaged in agriculture, strengthening microfinance should be a priority. Reform will address the problem of outreach. It will minimize the risk of exposure for clients. It could offer a reliable institutional setup to mobilize savings in rural areas (Kasekende 2002). And it could improve the health of the financial sector.

**Improving infrastructure**

The government is developing and maintaining infrastructure facilities to reduce the cost of services and improve quality and accessibility. Limiting itself to a regulatory role, the government aims to increase private participation in the operation, financing, and ownership of infrastructure services. Already, there are signs of greater competition and efficiency.

The government is also overhauling postal, telecommunications, energy, water, and transport services, long a major constraint. The benefits of liberalizing the telecom sector are already being felt, but the benefits from other utility privatizations have yet to be seen. Regulatory structures need to be improved along with privatization to realize the benefits.

With significant budget increases over the last four years, the main road programme is funded at 90% of the Poverty Reduction Strategy requirement. But the rural road programme, also crucial, is still underfunded (UN 2002).

Transport and other import-related costs add about 50% on average to the cost of imported inputs (Reinikka and Svensson 1999). Being landlocked makes transportation more expensive. Processing time and unexpected delays create additional burdens. It takes 30 days on average for imported inputs to reach the nearest port (typically Mombasa), another 30 days to reach Ugandan customs, and another 9 days to reach the firm.

**Addressing governance—some way to go**

Concerns about governance, particularly corruption and insecurity, are high on the list of constraints to private participation in economic activities. These are also highlighted by the poor as impediments to their livelihoods.
Corruption—strong commitment needed. Corruption in Uganda, prevalent in the highest levels on down, significantly increases the cost of doing business. Firms and households identify police and the judiciary as the most corrupt. The Uganda National Integrity Survey of 1998 reveals that 63% of respondents paid bribes to police officers and 50% had bribed court officials. Corruption in the police forces is well documented in the Sebutinde report that investigated police corruption in 2001 (box 2.6).

On the positive side, corruption is now discussed openly, particularly in the media, and government inquiries are launched on several cases. The population is becoming less tolerant of corruption in high places. The government, partly pressed by donors over the misuse of their funds, has taken several steps to enhance the integrity and accountability of its institutions. Recent measures:

- Strengthening anticorruption institutions—the Inspector General, the Auditor General, and the Department of Public Prosecution—through capacity building and additional budgetary resources.
- Establishing a Ministry of Ethics and Integrity to set standards and inquire into matters related to corruption.

Box 2.6
Poor governance widespread in the public sector

According to the Transparency International corruption perception index of 102 countries for 2002, Uganda ranks 92. A national survey on corruption in the public sector, conducted in 1998, partly explains why Uganda still has such a bad ranking. About 70% of households interviewed reported corruption in public services to be very high, especially among the police and judiciary.

Based on the percentage of service users who paid a bribe, Mbale District was found most corrupt, with an amazing 73%, and Kisoro District the least corrupt, with only 11%. Users who pay bribes reported that they do not even get better services.

The factors leading to the spread of corruption are deep-seated, dating to independence and Idi Amin’s years in power.

By the time President Museveni came to power, Uganda had experienced virtually every kind of corrupt practice imaginable. The new administration made clear that it viewed corruption as one of the evils inherited from the past and a key obstacle to progress. But the fight against corruption is still difficult. For instance, the Sebutinde report on corruption in the Uganda Revenue Authority shows how staff acquired wealth by helping importers evade taxes. The corruption indicator of the International Country Risk Guide also shows that perceived corruption has become worse in the past five years.

The press has been of great importance in curbing corruption and providing the public with information about reforms. The government recognizes the value of a free press, with the state-controlled media fairly free to report on abuses of public office.

• Initiating inquiries into corruption in public services, including investigations of police forces and employees of the Uganda Revenue Authority.
• Introducing a leadership code for declaring assets and incomes of government officials and parliamentarians.

As voiced by the Minister of Ethics and Integrity, the government has so far failed to address corruption effectively (EIU 2002). The challenge is to muster political will at the highest levels to implement the anticorruption strategy. That would stamp out corruption and reassure investors, both domestic and foreign, about the prevailing business climate in the country.

Insecurity persists in many parts of the country. The poor security situation in many parts of the country remains a serious constraint to private activities and overall development. Armed conflicts have severely impaired livelihoods in the north and some parts of the west and east. The north, where a bush war has been waged for the last 10 years, has suffered the most. In the west, Uganda’s involvement in the Democratic Republic of Congo was a major concern. A UN panel recently reported alleged looting of Congolese wealth by members of the Ugandan armed forces (UN 2001).

Persistent conflicts do not bode well for maintaining political and fiscal stability or attracting external funding from donors and foreign investors. Poor people living in conflict-ridden regions, the biggest losers, identify ongoing wars, rebel activity, cattle raiding, and theft as their biggest concerns (Uganda, Ministry of Finance, Planning, and Economic Development 2000). This is telling indeed.

Medium-term outlook—promising

The medium-term outlook is promising. GDP is projected to grow at an average of 5% in 2002/03 and 6% over the next two years, and the annual underlying and headline inflation rates are expected to remain below 5%. Gross domestic investment is expected to rise to more than 22% of GDP, while domestic and national savings will remain within the current range. Revenue is also projected to rise to about 13% of GDP, and gross reserves to remain at about six months of future imports. With stronger revenues the fiscal deficit is projected to decline to about 11% of GDP (excluding grants) in 2002/03 and 10% in 2003/04. Export receipts are projected to increase by about 10% a year, with the terms of trade improving as the diversification drive gains momentum.

But significant risks lie ahead. The aid dependence of the budget and development programmes and the high military expenditures are concerns. Moreover, negative shocks to GDP growth or exports could severely affect the external debt profile. So sustaining macroeconomic stability and high economic growth rates should be the key objectives of economic policy in the medium term. Any policy slippage would compromise the national development objective of reducing poverty.
Despite commendable gains in poverty reduction, one in three Ugandans still lives below the poverty line, and most social indicators are still below the average for comparator countries. Improving poverty and social indicators requires faster growth, from 6% a year to 7% to achieve the country’s goal of reducing poverty to 10% by 2017. Having now largely exploited the potential for economic growth through sound macro-economic policies, the medium-term challenge would be to find a new source of growth: the private sector.

Creating an enabling environment for the private sector requires deeper structural and governance reforms. The government has to deepen financial reforms, improve the provision of public services, and address widespread corruption and insecurity in many parts of the country. Uganda has a challenging task ahead before taking off.

Notes

1. Headline inflation is based on relative changes in prices of all goods and services. All conversions from Ugandan shillings to U.S. dollars are based on the end period exchange rate for June 2000.

2. M3 includes currency in circulation and private sector deposits, including foreign currency deposits.

3. M2 includes currency in circulation and private sector deposits, excluding foreign currency deposits.

4. COMESA member countries include: Angola, Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia, and Zimbabwe.

References


———. Background to the Budget. Various issues. Kampala.


Rwanda—HIPC Contradictions Restrain Development

Amid war, genocide, and conflict in neighbouring Burundi and the Democratic Republic of Congo, the Rwandan economy grew by 9.9% in 2002. This impressive performance was driven partly by favourable weather that boosted agricultural output. Inflation stayed under 4% in 2001 and 2002. But the large spending requirements of social reconstruction raise problems for macroeconomic policy, particularly fiscal management.

In the years after the civil war, security had to be reestablished in the face of threats by armed groups. A grave humanitarian emergency followed the killing of 800,000–1,000,000 people in a population of 7.5 million in the spring of 1994. The violence also displaced some 2 million civilians and destroyed infrastructure and assets. Rural areas suffered particularly from the loss of labour and livestock. The proportion of people in poverty rose from 48% in 1985 to 68% in 2000. In addition, female-headed and child-headed households had little access to land or labour markets.

Despite these challenges the fiscal deficit fell from 13.2% of GDP in 1996 to 8.3% in 1998. But it bounced back to 11% of GDP in 2002 and will remain high over the medium term. The Poverty Reduction Growth Facility, agreed in late 2002 with the International Monetary Fund (IMF), made some allowance for “exceptional” expenditures for people’s courts (gacaca), demobilization, the genocide survivors fund, and three governance commissions. But some development partners recommend that Rwanda, with large fiscal deficits financed by grants and international borrowing, should reduce the deficit in the medium term rather than mobilize additional resources.

Further contradictions have emerged with Rwanda’s heavily indebted poor country (HIPC) status. The use of exports in the HIPC debt sustainability ratios means that the level of debt to exports will be high for countries with low exports, such as Rwanda. This has increased the debt relief, but it also means reductions in new borrowings to maintain the sustainability of debt. So, over the medium term, rising spending needs for poverty reduction and post-genocide reconstruction make it unlikely that Rwanda can adhere to low debt to GDP ratios as required by the HIPC Initiative—because that would reduce the government’s ability to contract new loans. Clearly, adherence to HIPC debt ratios has hidden costs that may easily outweigh the benefits.
A longer term development policy and reform agenda is articulated in the government’s *Vision 2020*, with the objective of becoming a middle income country. Poverty reduction objectives have been crystallized in the Poverty Reduction Strategy and institutionalized through more transparent budgetary procedures (box 3.1).

**Box 3.1**  
*Rwanda’s Vision 2020*

Eight years on from the 1994 genocide, Rwanda is entering a new phase of reconstruction, set out in the *Vision 2020*. The key parts of *Vision 2020*:

*Good governance.* Grassroots democratization is essential for increasing popular participation. Given recent history, security is also a priority, along with the promotion of human rights. Sound economic management and macroeconomic stability are also an integral part of good governance.

*Rural economic transformation.* Recapitalization and transformation of the rural economy are essential to increase agricultural incomes and off-farm employment.

*Development of services and manufacturing.* Development of industrial and service sectors and the reestablishment of Rwanda as a regional trade center are other important sources of growth.

*Human resource development.* Rwanda has a scarcity of human capital. Increases in educational attainment are required to close the skills gap. Better health care services are also a priority, to reverse the decline in health indicators and deal with malaria and HIV/AIDS.

*Development of the private sector.* The business environment needs to be reformed to reduce the risks of doing business in Rwanda. Liberalization, privatization, and increased public-private partnership are also needed, as well as formalization of the informal sector.

*Regional and international economic integration.* Rwanda, a member of the Common Market for Eastern and Southern Africa (COMESA), is committed to exploiting the opportunities offered by similar frameworks, including the U.S. Africa Growth and Opportunity Act (AGOA).

*Poverty reduction.* This is the ultimate aim of all other objectives. Reduction of inequality is also essential, including that arising from gender and age.

**Selected targets for Vision 2020**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2000</th>
<th>2020 target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Literacy (%)</td>
<td>48</td>
<td>100</td>
</tr>
<tr>
<td>Life expectancy (years)</td>
<td>49</td>
<td>55</td>
</tr>
<tr>
<td>Infant mortality rate (per 1,000 live births)</td>
<td>110</td>
<td>30</td>
</tr>
<tr>
<td>Poverty (% under $1 a day)</td>
<td>64</td>
<td>30</td>
</tr>
<tr>
<td>Erosion-protected land (%)</td>
<td>20</td>
<td>100</td>
</tr>
<tr>
<td>Secondary teachers, qualified (%)</td>
<td>20</td>
<td>100</td>
</tr>
</tbody>
</table>

Recent economic developments

Growth over the last 10 years was strongly affected by the genocide of 1994 (box 3.2), when GDP collapsed by around 50%, and then by the postwar reconstruction, when it boomed to 18% on average between 1995 and 1998. After that, growth stabilized, falling to 6% in 2000 and 6.5% in 2001. Despite strong growth in recent years, per capita GDP has not returned to prewar levels (figure 3.1). Sustained per capita income growth, rising living standards, and poverty reduction have remained limited by structural and environmental constraints. Productivity growth in agriculture, by far the largest sector

Box 3.2
How conflict affects development

Social disintegration during war pushes up transaction costs as informational access deteriorates and contract enforcement becomes a problem. Machinery and tools are especially vulnerable to looting and destruction. The economy therefore shifts from transaction-intensive and asset-vulnerable sectors towards those less transaction-intensive and asset-vulnerable.

The structural change in the figure seems to suggest these factors at work in Rwanda. The agricultural sector is likely to be the least transaction-intensive sector. The share of agriculture in GDP rose sharply over 1994, interrupting a previous decline. There was also a sharp decline in the share of the service sector, with many transaction-dependent firms, such as banks and trading companies. The economy has not yet reverted to its pre-conflict structure, but the slight decline in the share of agriculture in GDP and the increase in the service sector’s share may indicate a gradual return to the market. It is essential to revive the credibility of the exchange mechanism and to provide supporting infrastructure, such as roads. Rebuilding trust through policies fostering social reconciliation is also essential.

Trends in sectoral shares, 1985–2000 (% of GDP)

Source: Economic Commission for Africa, from official sources.
In 2002 real GDP growth was high, at 9.9% of the economy, has remained sluggish. With high population growth rates, this has put a brake on sustained improvements in living standards.

The real sector—rapid but fragile growth

The economy remains vulnerable to adverse climatic conditions, as in 2000 when El Niño phenomena hurt agriculture. In contrast, in 2002 despite the global downturn and sluggish commodity prices, real GDP growth was high at an estimated 9.9% (figure 3.2), with agriculture growing at 14.4%. The high output was driven by favourable weather conditions rather than underlying sustained productivity growth, highlighting the low technology base of this key sector and the economy’s vulnerability to future climatic shocks.

With robust agricultural growth, GDP in 2002 was supported by rapid expansion in construction, growing at 15%, partly the result of house-building by returnees. This growth may understate the true growth when informal activities are considered.

Structural diversification of the economy through the development of nonagricultural sectors has remained limited, and growth from this source is of minor significance. Agriculture, the main driver of growth (figure 3.3), is subsistence activity and has few links with other economic sectors. In 2002 manufacturing growth was 5%, down from 7.2% the previous year. Manufacturing remains beset by technological and skill constraints. Services grew by 4.5% in 2002, virtually unchanged from the previous year. The sector’s growth has slowed since 1997, partly because of the gradual phasing out of emergency relief.

Figure 3.1
Genocide cuts incomes

Source: Economic Commission for Africa, from official sources.
Fiscal policy—tensions between poverty reduction and macroeconomic stability

Rwanda’s historical experience of civil conflict and genocide has generated structural biases in fiscal policy. In particular, spending patterns during the 1990s have tilted towards military and security expenditures to the detriment of outlays on infrastructure and social sectors (table 3.1). Following the genocide, the fiscal deficit fell as revenue levels recovered after productive sectors recommenced operations. But with limited domestic resources, Rwanda’s fiscal position has remained in deficit, reaching 8.9% of GDP in 2000 and 9.5% in 2001 (figure 3.4) and is likely to reach 11% of GDP in 2002.

**Figure 3.2**

*Strong growth with low inflation*

**GDP growth and inflation, 1998–2002 (%)**

![GDP growth and inflation chart](chart)

- GDP growth
- Inflation

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP Growth</th>
<th>Inflation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>8.0%</td>
<td>3.5%</td>
</tr>
<tr>
<td>1999</td>
<td>9.0%</td>
<td>2.5%</td>
</tr>
<tr>
<td>2000</td>
<td>7.0%</td>
<td>1.5%</td>
</tr>
<tr>
<td>2001</td>
<td>8.0%</td>
<td>0.5%</td>
</tr>
<tr>
<td>2002</td>
<td>10.0%</td>
<td>1.0%</td>
</tr>
</tbody>
</table>

*a. Estimated.*

**Source:** Economic Commission for Africa, from official sources.

**Figure 3.3**

*Agriculture—nearly half the economy*

**Sectoral shares in GDP, 2002**

- Agriculture: 47%
- Industry: 18%
- Services: 35%

**Source:** Economic Commission for Africa, from official sources.
As Rwanda pushes forward with its Poverty Reduction Strategy, spending must be reoriented towards reconstruction and poverty alleviation. These include requirements arising directly from the post-conflict situation for spending on infrastructure and the rehabilitation of farming systems. Politically, reconciliation calls for spending on genocide

**Table 3.1**

Fiscal position, 1996–2001 (US$ millions)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total revenue</td>
<td>128.4</td>
<td>192.1</td>
<td>208.2</td>
<td>190.5</td>
<td>176.3</td>
<td>194.6</td>
</tr>
<tr>
<td>% of GDP</td>
<td>9.3</td>
<td>10.4</td>
<td>10.6</td>
<td>9.9</td>
<td>9.7</td>
<td>11.4</td>
</tr>
<tr>
<td>Tax revenue</td>
<td>118.0</td>
<td>181.5</td>
<td>197.5</td>
<td>180.9</td>
<td>167.6</td>
<td>179.5</td>
</tr>
<tr>
<td>Nontax revenue</td>
<td>10.4</td>
<td>10.3</td>
<td>10.7</td>
<td>9.6</td>
<td>8.5</td>
<td>15.1</td>
</tr>
<tr>
<td>Total expenditure and net lending</td>
<td>310.6</td>
<td>362.4</td>
<td>370.3</td>
<td>378.6</td>
<td>338.0</td>
<td>356.9</td>
</tr>
<tr>
<td>% of GDP</td>
<td>22.5</td>
<td>19.6</td>
<td>18.9</td>
<td>19.6</td>
<td>18.7</td>
<td>21.0</td>
</tr>
<tr>
<td>Current expenditure</td>
<td>182.2</td>
<td>211.6</td>
<td>237.5</td>
<td>257.6</td>
<td>228.9</td>
<td>242.4</td>
</tr>
<tr>
<td>Education</td>
<td>21.5</td>
<td>32.4</td>
<td>35.0</td>
<td>51.5</td>
<td>61.6</td>
<td>67.3</td>
</tr>
<tr>
<td>Health</td>
<td>4.6</td>
<td>5.0</td>
<td>8.2</td>
<td>9.9</td>
<td>9.8</td>
<td>11.5</td>
</tr>
<tr>
<td>Agriculture</td>
<td>2.3</td>
<td>2.0</td>
<td>3.2</td>
<td>3.6</td>
<td>2.8</td>
<td>3.8</td>
</tr>
<tr>
<td>Defence</td>
<td>73.7</td>
<td>77.1</td>
<td>85.8</td>
<td>80.9</td>
<td>66.2</td>
<td>64.6</td>
</tr>
<tr>
<td>Capital expenditure</td>
<td>128.4</td>
<td>152.4</td>
<td>133.4</td>
<td>122.2</td>
<td>107.8</td>
<td>112.9</td>
</tr>
<tr>
<td>Budget deficit</td>
<td>−182.2</td>
<td>−170.6</td>
<td>−162.1</td>
<td>−188.1</td>
<td>−161.9</td>
<td>−162.3</td>
</tr>
<tr>
<td>% of GDP</td>
<td>13.2</td>
<td>9.2</td>
<td>8.3</td>
<td>9.7</td>
<td>8.9</td>
<td>9.5</td>
</tr>
</tbody>
</table>

*Source: Economic Commission for Africa, from official sources.*

**Figure 3.4**

Fiscal deficit down—but now on the rise

Budget deficit, 1996–2001 (% of GDP)

*Source: Economic Commission for Africa, from official sources.*
trials and on demobilization and reintegration. These special circumstances come on top of the needs in health, education, and agricultural modernization and the broader requirements of economic diversification, putting pressure on the fiscal deficit.

Rwanda’s creditors have argued for any unavoidable extra expenditure to be financed by grants rather than concessionary finance because of Rwanda’s HIPC status. But the savings from the HIPC Initiative have so far been limited. So, in the medium term Rwanda is unlikely to meet its HIPC targets. And its fiscal constraints will require further external inflows, some likely in loans rather than grants. This tension illustrates the problems with the HIPC Initiative’s underlying design, especially its impact in Rwanda’s special circumstances (box 3.3).

Resource constraints. Rwanda’s growing expenditure needs exceed its domestic resources and aid flows, which fell from $110 per capita in 1995 to $45 by the end of the 1990s. Cash crops and (undeveloped) manufacturing are the main sources of domestic revenue, reduced by war and genocide. Agricultural revenues remain vulnerable to poor weather. In addition, population displacement has greatly disrupted agriculture and thus economic activity and revenue. Other post-conflict countries—with revenue more dependent on capital-intensive sectors, such as oil and mining—are less affected by population movements (Ndikumana 2001). In addition, political and social unrest led to a slump of 78% in tax volumes in 1994 (World Bank 2002). Revenues have since recovered to prewar levels.

A further structural problem is tax leniency, with loopholes and poor enforcement, thanks to political patronage and clientelism. Progress on this front will require building a more transparent bureaucracy and a strong state. Tariff-cutting commitments as part of the Common Market for Eastern and Southern Africa (COMESA) are also likely to put pressure on revenues.

Given these problems, the government is trying to improve revenues. A value-added tax (VAT) has been introduced, and tax enforcement strengthened. And strong growth in 2001, driven by agriculture and mining, also supported revenue. But even moderate success in these revenue-raising initiatives is unlikely to close the gap with expenditures. In the long term higher revenues can come only from sustained growth and economic diversification.

Fiscal deficit sustainability. The likely deficit of 11% of GDP in 2002 was higher than the 9.9% target because of demobilization costs incurred with the Rwandan army’s withdrawal from the Democratic Republic of Congo. This expansionary fiscal stance sparked robust debate with the IMF about the sustainable deficit level, a key issue during the recent talks for renewing Rwanda’s Poverty Reduction and Growth Facility. With the holdup in negotiations, several donors delayed their disbursements. An eventual compromise was reached between the Rwandan government and the IMF, with a projected deficit of 9.4% of GDP agreed for 2003. After the negotiations, extra expenditures for the forthcoming election, the health sector, and roads were included in the 2003 budget, now likely to take the deficit beyond that agreed with the IMF.
The Poverty Reduction Strategy sets out three scenarios for future spending: high, medium, and low. The spending plans agreed under the negotiations with the IMF appear to correspond broadly to the low scenario, and the extra expenditure introduced in the 2003 budget will push the fiscal deficit beyond the level set out in this scenario—to around 11% of GDP.

Concerns about the extra spending relate to macroeconomic stability and financing. Possible macro effects include inflationary pressure and the blunting of export incentives by external revenue inflows. But such risks must be considered in Rwanda’s context (box 3.4). Too great an emphasis on fiscal targets can be misleading: the composition and quality of expenditure and the likely effects on long-term growth and poverty reduction can

**Box 3.3**

**HIPC Initiative’s flaws and the post-conflict context**

For many African countries, including Rwanda, the HIPC Initiative is not providing the “exit” from unsustainable debt needed to meet the Millennium Development Goals. Rwanda has the added complication of its post-conflict context, starkly illustrating some of the HIPC Initiative’s defects.

A key criticism of the HIPC Initiative is that its indicators of underlying debt sustainability are flawed. Much of the sustainability analysis by the World Bank and IMF is based on rather optimistic assumptions about future economic performance, the external environment, and the extent of projected financing needs. Rwanda illustrates each of these problems. There are huge risks to optimistic GDP growth projections of at least 6% over 2000–10. The external environment is likely to remain unfavorable, with declining coffee prices. And financing needs will continue to be great because of the post-conflict context.

An alternative to the HIPC criteria would be to link debt relief to a proportion of revenues needed for essential spending, possibly with different limits for different groups of countries. African leaders under the New Economic Partnership for Africa’s Development have advocated this approach. In a similar vein, new proposals put forward in the U.S. Congress would add criteria to the HIPC framework. For example, countries suffering an HIV/AIDS crisis would put aside no more than 5% of their revenues for debt servicing. A similar approach could also be adopted for post-conflict countries. It has also been suggested that HIPC needs to take greater account of external shocks. This reflects the critical role of declining terms of trade in the buildup of debt, an issue previously neglected.

Rwanda’s expenditure requirements in its post-conflict context raise issues about the HIPC process. First, the spending needs of post-conflict reconstruction and reconciliation will be essential to future social stability and so are particularly critical. A larger resource envelope may reduce the likelihood of future conflict by allowing more broad-based spending, helping to calm social grievances. Second, much of Rwanda’s debt was accumulated under a regime that presided over the genocide. This suggests an application of the “doctrine of odious debt”. The current regime should not be held accountable for debts resulting from earlier external inflows propping up an administration intent on widespread killing.

differ markedly across countries. For Rwanda much of the proposed extra spending is to meet the needs of a society emerging from conflict. Implementing such a program will pose enormous challenges, but if the program is sound, implementation would be justified on political, economic, and social grounds.

The effects on inflation will depend on patterns of spending and on how the extra spending is financed. And the biggest constraints to exports are not price distortions—they are the technical backwardness of export sectors and the history of poorly executed investments.

Monetary policy and the financial sector
Monetary policy, fairly successful in recent years, has been geared towards price stability. The government has also focused on the banking sector, especially on establishing a sound regulatory framework for credit delivery.

Prices and monetary policy. Prices have remained relatively stable, with inflation estimated to have stayed under 3% in 2001 and 2002 (see figure 3.2). Because the economy is largely nonmonetized and based on subsistence agriculture, inflation is heavily influenced by output in the agricultural sector. With a favourable climate, strong growth in agricultural output helped to stabilize prices. In addition, the National Bank of Rwanda has intervened to stem fast liquidity growth. So, despite a depreciating exchange rate in 2002, inflation remained tamed, with prices actually declining in the 12 months ending April 2002 (figure 3.5).

But prices have since assumed an upward trend, partly the result of increasing the VAT from 15% to 18%. Higher international oil prices, downward movements in the exchange rate, and the VAT increase have also pushed up the retail price of gasoline between January and September 2002, so transport costs could put pressure on food prices. Also contributing was 10% growth in broad money between December 2001 and July 2002, driven partly by private sector credit, with commerce accounting for the largest share of the increase and agriculture the least (figure 3.6). This higher liquidity was paralleled by declines in interest rates, with commercial bank lending rates falling

Box 3.4
Fiscal policy after conflict

The resources required for the expenditures under the higher Poverty Reduction Strategy scenarios are unlikely to be available. But there are clear economic reasons for the moderate increases in spending. Nor can macroeconomic sustainability be divorced from political sustainability, particularly given Rwanda’s recent history. The legacy of violence must be considered, especially in the light of evidence suggesting that a strong predictor of civil violence is the previous occurrence of such violence. The needs of social and political reconciliation are therefore critical. A macroeconomic program that does not address these issues could be extremely dangerous.

Source: Economic Commission for Africa, from official sources.
from 17.3% in December 2001 to 15.0% by August 2002, reflecting more liquidity in the banking system and greater competition among banks.

The loosening of the monetary stance was also the result of central bank financing of government operations, increased by the delay in donor disbursements. After May 2002

**Figure 3.5**
*Inflation spikes in 2002*

*Consumer prices, 2002 (year-on-year percentage change)*

![Figure 3.5](image)

*Source:* Economic Commission for Africa, from official sources.

**Figure 3.6**
*Credit to the private sector leads monetary growth*

*Contributions to monetary growth, 2002 (percentage change)*

![Figure 3.6](image)

*Source:* Economic Commission for Africa, from official sources.
the National Bank of Rwanda acted to stem this liquidity increase with money market interventions and new government securities, leading to a 6.1% decline in broad money between July and September 2002, part of a continuing trend away from direct to indirect instruments of monetary policy.

The banking sector—weighed down by bad loans. Of nine commercial banks in Rwanda, five were established after 1994. All remain conservative in their range of services and cautious in lending activities. The sector’s performance is hobbled by the huge portfolio of nonperforming loans, some 40% of the total portfolio at the end of 2001 (IMF 2002a). These accumulated because of lax supervisory controls, economic instability, and road tonnage limits imposed on Rwandan trucks by the Kenyan government, hurting trade and transport. An important barrier to restoring the banks’ financial soundness is the lack of legal provisions for claiming the collateral assets of defaulting firms. Bank lending to the private sector remains heavily constrained, with lending rates staying high to counter the risk of loan default.

To deal with these problems, the government is establishing a sound legal and regulatory framework for credit delivery. The National Bank of Rwanda is working with the Ministries of Finance and Justice and the bankers association to find ways of improving loan recovery. An action plan detailing specific steps was completed in December 2002. The National Bank of Rwanda is also strengthening its supervisory role over commercial banks and improving its regulatory framework. It is also strengthening its risks and unpaid debts unit to improve the quality of credit information. Several commercial banks are being restructured, with some sell-offs planned.

Credit issues—access skewed and generally limited. Bank lending is concentrated in commerce and construction (figure 3.7), with agriculture getting less than 2%, despite its importance. There are institutional constraints to lending to this sector, as the rural economy is largely noncommercialized. Difficult to acquire, credit remains largely short

Figure 3.7
Agriculture—not being financed
Sectoral shares in credit, 2001

Source: Economic Commission for Africa, from official sources.
term. Retail banking is limited to richer households, and poor households are unlikely to have access to the formal financial sector. The Poverty Reduction Strategy thus includes provisions for expanding microcredit facilities and devising a legal and regulatory framework for microfinance. In addition, the banques populaires are being recapitalized to facilitate the expansion of credit to farmers.

External sector
Rwanda’s trade and current account balances have remained in deficit over the last two years (table 3.2). The main reason is the narrow export base of cash crops along with colombe-tantalite (coltan), leaving total values vulnerable to the vagaries of international commodity prices (figure 3.8). In addition, the country’s landlocked position generates high transport costs, pushing the services account into deficit. The country has depended on aid flows to fund its external imbalances, building up external debt.

The recent global slowdown drove down prices of nonoil commodities, including coffee and tea, which provide more than 80% of Rwanda’s export earnings. After rising 14% in 2001, exports of crops slipped 0.4% in 2002. Coltan prices also slumped in 2002, further depressing export values. For January–September 2002, exports were $49.4 million, down 39% from the same period in 2001, when there was a short boom in coltan exports. The sharper reductions in value than in volume show the effect of declining international prices (table 3.3). Imports have fallen slightly over 2002 as a result of reduced food imports, but the decline in value terms is far less than that of exports. Rwanda’s trade balance is likely to have remained in deficit over 2002, with the deficit to September totaling $131.6 million, a slight decrease from the same period the previous year.

Exchange rate trends. Floated in 1995 the Rwandan franc has depreciated gradually, moderated by exchange market interventions by the National Bank of Rwanda. Through September 2002 the lower exports and the delays in foreign aid disbursements led to a

Table 3.2
Balance of payments, 1999–2001 (US$ millions)

<table>
<thead>
<tr>
<th>Item</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports</td>
<td>62.0</td>
<td>89.8</td>
<td>93.3</td>
</tr>
<tr>
<td>Imports</td>
<td>248.8</td>
<td>239.8</td>
<td>255.2</td>
</tr>
<tr>
<td>Trade balance</td>
<td>–186.7</td>
<td>–150.1</td>
<td>–161.8</td>
</tr>
<tr>
<td>Services balance</td>
<td>–154.4</td>
<td>–156.8</td>
<td>–139.0</td>
</tr>
<tr>
<td>Transfer balance</td>
<td>198.3</td>
<td>216.6</td>
<td>190.7</td>
</tr>
<tr>
<td>Current account balance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Including official transfers</td>
<td>–142.9</td>
<td>–90.2</td>
<td>–110.2</td>
</tr>
<tr>
<td>Excluding official transfers</td>
<td>–323.0</td>
<td>–295.8</td>
<td>–279.2</td>
</tr>
<tr>
<td>Excluding official transfers (% of GDP)</td>
<td>–16.7</td>
<td>–16.3</td>
<td>–16.4</td>
</tr>
</tbody>
</table>

Source: Economic Commission for Africa, from official sources.
foreign exchange shortage of $51 million, eroding reserves, still equivalent to more than five months of imports. Against the dollar, the franc depreciated by 2.6% from the end of 2001 to the end of June 2002, continuing recent trends. So far this has not led to serious inflationary pressures, thanks to good harvests and prudent monetary policies. And the introduction of foreign exchange auctions has increased the transparency of the National Bank of Rwanda’s open market operations.

**Figure 3.8**

*Collapsing terms of trade*

*Terms of trade, 1995–2004 (2001 = 100)*

![Graph showing collapsing terms of trade between 1995 and 2004.](image)

*Source:* Economic Commission for Africa, from official sources.

**Table 3.3**

*Export values and volumes*

<table>
<thead>
<tr>
<th>Export</th>
<th>Jan–Sept 2001</th>
<th>Jan–Sept 2002</th>
<th>Change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total export value (US$ millions)</td>
<td>80.7</td>
<td>49.4</td>
<td>−38.8</td>
</tr>
<tr>
<td>Coffee</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value (US$ millions)</td>
<td>17.2</td>
<td>12.1</td>
<td>−29.8</td>
</tr>
<tr>
<td>Volume (tons)</td>
<td>15,517.2</td>
<td>15,742.3</td>
<td>1.5</td>
</tr>
<tr>
<td>Tea</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value (US$ millions)</td>
<td>19.1</td>
<td>17.2</td>
<td>−10.2</td>
</tr>
<tr>
<td>Volume (tons)</td>
<td>12,584.0</td>
<td>11,886.3</td>
<td>−5.5</td>
</tr>
<tr>
<td>Coltan</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value (US$ millions)</td>
<td>38.1</td>
<td>12.8</td>
<td>−66.4</td>
</tr>
<tr>
<td>Volume (tons)</td>
<td>1,240.0</td>
<td>961.4</td>
<td>−22.5</td>
</tr>
</tbody>
</table>

*Source:* Economic Commission for Africa, from official sources.
External flows and the debt stock. Given the long-standing deficit on the current account and the limited potential for private financing as a HIPC, Rwanda depends on official flows to close its financing gap. In 2001 official transfers constituted around 58% of foreign exchange receipts, equivalent to around 60% of the current account deficit. Over time these inflows have built up the stock of external debt, to $1.3 billion at the end of 2001, most of it concessionary (table 3.4).

Under the HIPC Initiative the net present value of the debt stock in 2001 was reduced to 180% of the value of exports, for a $25 million saving (table 3.5). Previously Rwanda’s debt had been paid from an international trust fund, discontinued under the terms of the HIPC Initiative. So in 2001 the actual savings to the Rwandan government was only $4.5 million (this is expected to increase in the medium term). The HIPC Initiative has thus made a negligible contribution to progress on poverty reduction targets. With an ongoing need for external financing because of pressing expenditure requirements, Rwanda is unlikely to meet its HIPC targets in the medium term (see box 3.3).

**Table 3.4**

**External debt, selected years**  
(USS millions)

<table>
<thead>
<tr>
<th>External debt</th>
<th>1997</th>
<th>2000</th>
<th>2001*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total external debt outstanding</td>
<td>1,138.0</td>
<td>1,305.0</td>
<td>1,316.0</td>
</tr>
<tr>
<td>Multilateral</td>
<td>927.4</td>
<td>1,137.1</td>
<td>1,169.4</td>
</tr>
<tr>
<td>International Development Association</td>
<td>557.5</td>
<td>723.5</td>
<td>714.8</td>
</tr>
<tr>
<td>International Monetary Fund</td>
<td>40.4</td>
<td>85.8</td>
<td>84.3</td>
</tr>
<tr>
<td>Bilateral</td>
<td>201.4</td>
<td>167.4</td>
<td>145.9</td>
</tr>
<tr>
<td>Paris Club</td>
<td>93.7</td>
<td>73.1</td>
<td>74.2</td>
</tr>
<tr>
<td>Non–Paris Club</td>
<td>107.7</td>
<td>94.3</td>
<td>71.7</td>
</tr>
<tr>
<td>Commercial</td>
<td>9.1</td>
<td>0.6</td>
<td>0.6</td>
</tr>
<tr>
<td>Total debt stock (% GDP)</td>
<td>61.6</td>
<td>72.1</td>
<td>77.3</td>
</tr>
</tbody>
</table>

a. Estimated.  
Source: Economic Commission for Africa, from official sources.

**Table 3.5**

**Debt service savings from the HIPC Initiative, 2001–04**  
(USS millions)

<table>
<thead>
<tr>
<th>Item</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt service due before HIPC</td>
<td>46.72</td>
<td>46.19</td>
<td>50.66</td>
<td>61.49</td>
</tr>
<tr>
<td>Debt service due after HIPC</td>
<td>22.06</td>
<td>11.25</td>
<td>9.23</td>
<td>15.5</td>
</tr>
<tr>
<td>Total HIPC saving</td>
<td>24.67</td>
<td>34.94</td>
<td>41.43</td>
<td>45.99</td>
</tr>
<tr>
<td>Accruing to Rwanda</td>
<td>4.45</td>
<td>12.05</td>
<td>16.76</td>
<td>19.36</td>
</tr>
<tr>
<td>Accruing to donors through multilateral fund</td>
<td>20.22</td>
<td>22.88</td>
<td>24.67</td>
<td>26.63</td>
</tr>
</tbody>
</table>

Source: Economic Commission for Africa, from official sources.
Institutional reforms

Key institutional changes include reform of the centralized bureaucracy, with fiscal decentralization, and privatization focused on development objectives.

Decentralization

A key plank of institutional reform is the decentralization program aimed at reforming the centralized and hierarchical state bureaucracy. A decentralization law was passed in 2001, setting up various tiers of government, including 11 provinces along with the city of Kigali, 106 districts, and many subdistrict cellules. The Common Development Fund, established to allocate funds to district programs, will eventually take 10% of central government revenue. And with decentralization of revenue accompanying decentralization of expenditure functions, regional governments will be able to raise some of their income from local sources. The reform program is also harnessing ubedebe, promoting community cooperation and the collective articulation of needs. It is envisaged that cellule-level planning will eventually be integrated into broader medium-term expenditure framework processes.

Two motives drive the initiatives. First, decentralized systems of government are believed to promote efficient service delivery. Second, decentralization is seen as a tonic to the predatory centralized regime that presided over the genocide. In the runup to the 2003 presidential and parliamentary elections, the current regime needs to be seen as building the beginnings of more participatory institutions. Decentralization is also linked to processes of reconciliation, as embodied in gacaca (box 3.5). Institutional reform is thus essential for future stability (boxes 3.6 and 3.7). The reforms are therefore being driven more by political than economic or administrative necessity. The enabling legislation has moved forward faster than the growth in local administrative capacity to implement the program.

With resources susceptible to capture by local elites, decentralization does not automatically enhance pro-poor service delivery (Crook and Sverrisson 2001). The direct economic benefits of decentralization need to be justified by local politics and local administrative capacities. Attempts are being made to integrate lower tiers of government into the broader planning frameworks now being created. But the lack of local capacity could make it difficult to establish more strategic and comprehensive approaches to expenditure and budgeting, such as sectorwide approaches and medium-term expenditure framework initiatives.

Private sector development and privatization

Many privatizations under the 1996 privatization law were essentially liquidations of nonfunctioning state-owned enterprises, mainly from the agro-industrial sectors, whose physical and human assets had been damaged or destroyed in the civil war. Only now is the privatization initiative bringing developmental objectives to the fore. A privatization secretariat has been set up to support the program, and a regulatory agency established to set tariffs, grant licenses, and prevent companies from acting as private monopolies.
Box 3.5
Gacaca mechanisms for social reconciliation

In 1996 the government passed a law to prosecute people suspected of genocide-related crimes committed during 1991–94. Resolution of the large number of cases was slow, and full settlement was predicted to take a century. Around 107,000 people remain in prison, most of these held in connection with the genocide.

To expedite prosecution, the government has set up gacaca courts based on traditional community institutions of dispute resolution. Suspects will be tried in front of the communities in which crimes were committed. The tribunals will not deal with the most senior organizers of the genocide, who are to be tried by the UN’s International Criminal Tribunal for Rwanda, based in Arusha, Tanzania.

For gacaca suspects who admit their crimes, sentences will be reduced. Because many have already been in custody for a number of years, this will lead to their release and return to their communities. The process is premised on collective forgiveness as a first step to rebuilding communities and achieving social stability through the rehabilitation of trust (figure 1).

Recent social research has shown the ongoing social and psychological legacy of the genocide in terms of lack of trust. The success of the initiative depends on widespread awareness of the process across all social groups (figure 2).

Figure 1
People who perceive trust as a major social problem, by genocide experience

<table>
<thead>
<tr>
<th>(%) of population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Present during genocide, family loss</td>
</tr>
<tr>
<td>Absent during genocide, family loss</td>
</tr>
<tr>
<td>Present during genocide, no family loss</td>
</tr>
<tr>
<td>Absent during genocide, no family loss</td>
</tr>
</tbody>
</table>

Figure 2
People with good knowledge of gacaca, by education

<table>
<thead>
<tr>
<th>(%) of population</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
</tr>
<tr>
<td>Primary</td>
</tr>
<tr>
<td>Secondary</td>
</tr>
<tr>
<td>Post-secondary</td>
</tr>
</tbody>
</table>

The sale of the telephone operator, Rwandatel, should be concluded by the end of 2003, with 55% to a strategic investor, 5% to employees, 1% to the government, and the rest to other investors. Electrogaz, the water and electricity provider, will remain in state ownership, with its management privatized through a long-term management contract. The other main sector for privatization is tea. Two of the nine factories are slated for sale as part of a pilot.

**Box 3.6**

*Strengthening institutional quality—the key to stability*

The ethnic and linguistic fragmentation of societies has been used by several economists to explain Africa’s poor growth, the outbreak of civil war, and the occurrence of genocide. Recent research finds that the probability of genocide increases when countries are more ethnically fragmented. But this effect is found only for countries with low-quality institutions, nontransparent bureaucracies, and poor contract enforcement. Ethnically fragmented countries with poor institutions, such as Angola, Nigeria, and Sudan, are thus at a markedly higher risk of genocide.

In ethnically fragmented countries with high-quality institutions, such as Canada, Malaysia, and Thailand, the negative effects of ethnic fragmentation disappear. Certain ingredients of a good institutional structure—such as efficient bureaucratic procedures, freedom from government expropriation, and the rule of law—may provide avenues for the peaceful settlement of distributive conflicts between ethnic groupings.

But other models suggest very different effects from ethnic fragmentation. The data used to generate these sorts of statistical results are extremely unreliable in conflict-affected countries. The use of econometric techniques has also been criticized for oversimplifying the complex social, political, and economic dynamics surrounding conflict. Even so, the results suggest the importance of institutional strengthening in conflict-affected countries such as Rwanda. The building of an inclusive and nonpartisan state bureaucracy is likely to be essential to future stability.

**Fragmentation, institutions, and genocide**

<table>
<thead>
<tr>
<th>Probability of genocide</th>
<th>Ethnolinguistic fragmentation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td></td>
<td>Medium</td>
</tr>
<tr>
<td></td>
<td>High</td>
</tr>
<tr>
<td>Medium</td>
<td>Low</td>
</tr>
<tr>
<td></td>
<td>Medium</td>
</tr>
<tr>
<td></td>
<td>High</td>
</tr>
<tr>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td></td>
<td>Medium</td>
</tr>
<tr>
<td></td>
<td>High</td>
</tr>
</tbody>
</table>

Privatization appears to have political support because of the limited capacity of the state to revitalize firms. But buyer interest has been slight, partly the result of the poor shape of assets and human resources in many of the firms being sold. And in the runup to sell-offs, the government has had little incentive to invest in ailing enterprises. A key challenge is putting in place the institutional mechanisms for the effective regulation of privatized firms.

Social sectors

Government spending on the social sectors in Rwanda lags behind that in other Sub-Saharan countries, crowded out by military spending of 24.4% of GDP in 1992–97, more than twice the Sub-Saharan average of 11.5%. Strengthening education and health is a key priority in the Poverty Reduction Strategy.

Education—improving outcomes and equity

In 1992–97 Rwanda’s education spending amounted to 3.3% of GDP compared with 4.9% for Sub-Saharan Africa (Ndikumana 2001). Recent improvements in key indicators reflect a gradual increase in the share of education in total expenditure from 12% in 1996 to 24% in 2001 (IMF 2002a).

- The gross primary enrolment rate improved from 88% in 1999 to 97% in 2000, and is now estimated at 100%. But the quality of primary and secondary education is

Box 3.7

Institutions, ethnicity, and reform

Rebuilding the capacity of the civil service is critical for putting in place the technical and administrative prerequisites for achieving the targets in Vision 2020 and the Poverty Reduction Strategy. Previous regimes have used civil service appointments as tools of political patronage to bolster support from some ethnic groups. In the post-colonial period discriminatory practices in state employment fostered Hutu domination of the public sector. Such biases can heighten feelings of exclusion among some groups. In the early 1990s structural adjustment and privatization policies inadvertently implied a reversal of these long-standing biases. By rolling back the state and promoting the private sector, these reforms appeared as a threat to Hutu elites in favor of the Tutsis, traditionally perceived to dominate the private sector. The genocide has been interpreted by some as a last ditch attempt by these threatened groups to maintain their hold on power and privilege.

True, the causes of the genocide are complex and multiple. But the application of one size fits all policy prescriptions to this volatile situation may have been unwise. At an international level, future donor policies in institutional reform must be sensitive to underlying social realities. And as the Rwandan state seeks to build its legitimacy, it must be seen to be impartial towards the different social groups, especially in the current drive towards a meritocratic and transparent civil service.

Source: Economic Commission for Africa, from official sources.
low, evident in literacy rates of 48% for women and 58% for men (Rwanda, Ministry of Finance and Economic Planning 2002a).

- Transition rates from primary to secondary levels are low, and dropout and repetition rates at the primary level remain high. Only 7% of the population over 15 years old has a secondary education, and only 0.4% a tertiary education.
- Educational attainment also has a clear income dimension, with only 15% of the poorest fifth of the population completing primary education, compared with 53% for the richest fifth (Rwanda, Ministry of Finance and Economic Planning 2002a).
- Fewer than half of teachers are adequately trained.
- The education system does not equip students with the skills needed for the labour market.

To begin addressing these needs, skills-oriented colleges have been set up, such as the Kigali Institute of Science and Technology. Vocational courses are to be promoted in secondary schools, and the school curriculum is to be reviewed (box 3.8).

Health—improving access

In 1992–98 Rwanda’s per capita expenditure on health averaged just over $9, less than a quarter of the $38 average for Sub-Saharan Africa. The country fares slightly better in health expenditure as a percentage of GDP, with an average of 4.2%, compared with 3.9% for Sub-Saharan Africa (World Bank 2002). And share of health in total expenditure increased from 1.4% in 1996 to 5.1% in 2001. But on several health indicators, Rwanda lags behind the Sub-Saharan average.

- Child mortality rose sharply during the genocide, and although falling later, it remains significantly above the pre-genocide rate and high by African standards (figure 3.9).
- Life expectancy, at 40 years, is still significantly worse than the Sub-Saharan average of 49 years.

**Box 3.8**

*The sectorwide approach in education*

In planning and policy management, education is a key area where the shift from an emergency response to a development focus has begun to be institutionalized. The sector is the first to put in place a sectorwide approach aimed at strategically integrating all projects relating to education and orienting them towards the goals of the Poverty Reduction Strategy and Vision 2020. This process has resulted in a strategic plan for 2003–08, devised by the Ministries of Education and Gender, local governments, donors, NGOs, and other bodies. The sectorwide approach should guide the education sector’s input into the medium-term expenditure framework and provide an early indication of the challenges likely to be faced as the approach is applied in other sectors.

*Source: Economic Commission for Africa, from official sources.*
HIV/AIDS prevalence of 8.9% in 2001, though well below those in southern Africa and below the African average of 10.3%, is on the rise. So, HIV/AIDS could hurt long-term growth and development prospects.

Causes of ill health include limited access to health services, a result of low income, poor information, and little education, as well as limited access to clean water. Malaria and malnutrition have also been major contributing factors. There is also a critical shortage of key health workers, with only 1.8 doctors per 100,000 inhabitants, particularly in rural provinces (EIU 2002).

Use of health services, already low, has fallen in recent years, with the number of new cases per inhabitant entering the health system annually falling from 0.34 in 1998 to 0.26 in 2000. Cost appears to be a major constraint. In the Core Welfare Indicators Survey 15% of respondents had been unwell in the month preceding the survey but had not used health services because of the cost (Rwanda, Ministry of Finance and Economic Planning 2001a). More than 20% of rural residents cite cost barriers, compared with 9% for the urban poor and 6% for the urban population overall. Only 8.8% of hospital patients were from the poorest fifth of the population, while 43% were from the richest fifth.

The Poverty Reduction Strategy aims to improve access to health care by reducing costs to the poor, enhancing information provision to communities, improving the quality of health services, and dealing with malaria and HIV/AIDS. Institutional mechanisms

**Figure 3.9**

*Higher child mortality after genocide*

*Child mortality, 1986–90 to 1996–2000 (deaths per 1,000 children under five years old)*

*Note:* The data are derived from interviews with surviving mothers and do not include the deaths of children of mothers who died in the genocide. The figures are therefore likely to understate child mortality during the early 1990s.

*Source:* Economic Commission for Africa, from official sources.
are being put in place to achieve these aims. For example, *mutuelle* health insurance schemes address cost, while in the *ubedebe* initiative community health workers at the cellule level improve information flows.

**Poverty patterns and poverty reduction—violence intensifies the drivers of poverty**

The number of households under the poverty line reached 53% in 1993 and jumped to 78% in 1994, with a clear rural-urban divide (figure 3.10). Although rapid postwar growth supported fast reductions in poverty, the levels remain well above those before 1994. Traditionally driving poverty were poor agricultural performance, limited non-farm employment opportunities, and low levels of skills, leaving households vulnerable to weather and terms of trade shocks.

These factors were compounded by the genocide. Many households lost wage-earners and key assets, such as livestock. The number of female-headed and female-dominated households rose dramatically. By 1996 women headed 34% of households, and widows headed 21%. There are also some 85,000 child-headed households (Rwanda, Ministry of Finance and Economic Planning 2002a). Such households are economically vulnerable because of limited wage-earning opportunities and lack of access to land. And with the loss of adult male family members, household members are at greater risk of violence.

The transition to stability has generated waves of population movement, adding to social insecurity. Returning populations lack access to land and shelter (some 192,000 families remain without proper shelter). A villagization program has been initiated to resettle these groups. But the settlements lack basic infrastructure and access to

---

**Figure 3.10**

*Poverty up sharply in 1994*

*Households under the poverty line, by urban and rural location, 1985–2000 (%)*

![Graph showing poverty levels by urban and rural location, 1985–2000](chart)

---

Source: Economic Commission for Africa, from official sources.

Poverty levels remain well above those before 1994.
healthcare and education. All these factors disrupt income streams and survival strategies, exposing households to considerable vulnerability.

Urban Kigali has much lower levels of poverty than rural areas (figure 3.11). A range of problems face outlying regions. In the southern province of Butare, population pressure and low agricultural investment have contributed to declining soil quality—and the region has the highest proportion of widow-headed households, at 28% (Rwanda, Ministry of Finance and Economic Planning 2002a). In Gisenyi in the northwest—an area traditionally advanced in agriculture, with comparatively high fertilizer use—insecurity and the destruction of infrastructure have severely reduced access to markets. Coping strategies there are leading to further environmental and soil degradation. The province with the widest and deepest poverty, Gikongoro in the south, is densely populated, and households have depended on migration to other areas. But heightened insecurity has disrupted this traditional source of income, pushing 77% of households into poverty and 57% into extreme deprivation by 2001.

The framework for poverty reduction

Poverty in Rwanda stems from underlying structural problems and the debilitating effects of extreme violence. Efforts to reduce poverty must address purely economic problems but will have to do so within the context of dealing with the political and historical legacies. The spending requirements of social reconciliation and related processes of decentralization and demobilization have a central place in the Poverty Reduction Strategy. In addition, the strategy sets out a number of key priority areas

**Figure 3.11**

*High rural poverty rates*

*Poverty by region, 2001 (% of households)*

Note: Extreme poverty refers to households falling below the food poverty line.

Source: Economic Commission for Africa, from official sources.
aimed at cutting poverty to less than half the 2001 level by 2015, including rural modernization and human development (box 3.9).

The objectives in the Poverty Reduction Strategy are extremely demanding, particularly on institutional and financial capacities, but there has been little significant progress towards their realization. The Poverty Reduction Strategy framework has not had enough coordination and harmonization between donors. Nevertheless, the first stages of institutionalizing these goals in a medium-term expenditure framework have begun. Ministries have defined their priority areas through the Poverty Reduction Strategy to allow their integration into the more transparent budgetary framework (box 3.10).

One problem with Rwanda’s Poverty Reduction Strategy is inadequate coordination and streamlining by donors. Recent proposals to improve the Poverty Reduction Strategy framework are based on a more robust common framework for conditionalities between donors (see box 3.9).

**Policy challenges in key sectors**

The Poverty Reduction Strategy calls for modernization of the agricultural sector, where productivity is low. In industrial sectors, the effects of the genocide compound problems of low human capital and technology, high costs, and limited access to finance.

**The agricultural sector—boosting productivity**

Poor living standards and declining incomes are rooted in agriculture, which employs 90% of the workforce and is thus critical for living standards and poverty rates.

High rainfall and steep slopes encourage soil erosion, while management of this problem through terracing and planting hedgerows has not been completely effective (Clay and Lewis 1996). In addition, land scarcity and population pressure have changed the structure of landholdings, which in turn has affected land management (Clay 1996). Population pressure on scarce land has led to more farming on marginal areas and more renting of separated plots of land. This fragmentation has intensified cropping, without accompanying soil conservation investments, degrading soil and reducing yields.

With land now scarce, rising output will have to come from higher productivity through technological improvements in fertilizers and soil conservation. Chemical fertilizer usage is low, only 3% of cultivated land in 2000 (Kelly and others 2001). One of the most serious constraints is farmers’ lack of knowledge about fertilizer.

Commercial agriculture faces low prices and high costs. Output of Rwanda’s main cash crop, coffee, fell by nearly 80% between 1990 and 2001, with prices approaching the point where farmers abandon their coffee trees or even uproot them (Loveridge, Nyarwaya, and Shingiro 2002). Such disinvestment does not bode well for the capacity of producers to take advantage of possible upturns in international prices. One proposal...
Rwanda’s Poverty Reduction Strategy, approved by the boards of the IMF and World Bank in August 2002, sets out the key requirements for reducing poverty within the country’s broader development framework in Vision 2020. The main objectives:

- **Rural development and agricultural transformation.** Measures to modernize farming techniques, improve farmers’ knowledge, support off-farm employment, provide credit, improve rural infrastructure, and use labor-intensive rural public works.
- **Human development.** Actions to improve health provision (including measures on malaria, HIV/AIDS, and family planning), skills and educational development, and water supply and resettlement.
- **Economic infrastructure.** Measures to develop roads, energy, and communications, including energy provision to poor households and rural enterprises.
- **Governance.** Measures on a host of related issues, including security and demobilization, reconciliation, decentralization, constitutional change, and civil service reform with the introduction of sectoral strategies and the use of more transparent and accountable procedures.
- **Private sector development.** Measures to promote investment and export promotion, reform of the financial sector, privatization, and greater private sector representation.
- **Institutional capacity building and other cross-cutting issues.** Given the loss of skills as a result of the genocide, measures to rehabilitate the capacity of institutions and put in place incentives to retain skilled personnel. Other cross-cutting areas are technology, gender, environment, villagization, HIV/AIDS, and employment.

Progress has been made in monitoring poverty, orienting expenditure to social sectors, and implementing the medium-term expenditure framework. But the government has also said that donor coordination and accountability need to be improved as the Poverty Reduction Strategy process progresses (see figure). In addition, donors and multilateral institutions remain prescriptive on policy approaches, despite the Poverty Reduction Strategy framework’s gloss of “country ownership”.

**Box 3.9**

*Rwanda’s Poverty Reduction Strategy*

Rwanda’s Poverty Reduction Strategy, approved by the boards of the IMF and World Bank in August 2002, sets out the key requirements for reducing poverty within the country’s broader development framework in Vision 2020. The main objectives:

- **Rural development and agricultural transformation.** Measures to modernize farming techniques, improve farmers’ knowledge, support off-farm employment, provide credit, improve rural infrastructure, and use labor-intensive rural public works.
- **Human development.** Actions to improve health provision (including measures on malaria, HIV/AIDS, and family planning), skills and educational development, and water supply and resettlement.
- **Economic infrastructure.** Measures to develop roads, energy, and communications, including energy provision to poor households and rural enterprises.
- **Governance.** Measures on a host of related issues, including security and demobilization, reconciliation, decentralization, constitutional change, and civil service reform with the introduction of sectoral strategies and the use of more transparent and accountable procedures.
- **Private sector development.** Measures to promote investment and export promotion, reform of the financial sector, privatization, and greater private sector representation.
- **Institutional capacity building and other cross-cutting issues.** Given the loss of skills as a result of the genocide, measures to rehabilitate the capacity of institutions and put in place incentives to retain skilled personnel. Other cross-cutting areas are technology, gender, environment, villagization, HIV/AIDS, and employment.

Progress has been made in monitoring poverty, orienting expenditure to social sectors, and implementing the medium-term expenditure framework. But the government has also said that donor coordination and accountability need to be improved as the Poverty Reduction Strategy process progresses (see figure). In addition, donors and multilateral institutions remain prescriptive on policy approaches, despite the Poverty Reduction Strategy framework’s gloss of “country ownership”.

**Moving to a common Poverty Reduction Strategy framework**

**Links between Poverty Reduction Strategy policy matrix and donor conditionality**

- **Medium-term Poverty Reduction Strategy policy matrix and indicators**
  - World Bank
  - Other
  - IMF

**Poverty Reduction Strategy–based common conditionality framework for budget and project support**

- **Annualized Poverty Reduction Strategy policy matrix and indicators**
  - World Bank
  - IMF
  - Other

- **Donor benchmarks and conditions streamlined with the Poverty Reduction Strategy matrix. Additional requirements to meet donor needs (fiduciary safeguards, political governance) should be shared and kept to a minimum**

**Source:** SPA 2002; Economic Commission for Africa, from official sources.
for reviving the sector is to upgrade quality and tap into premium and “fair trade” western markets (Loveridge, Mpyisi, and Weber 2002). But this would require considerable investments to improve washing and processing facilities.

Production of the other main cash crop, bananas, declined by some 70% over the last decade, partly because of reduced manure usage, lower government investment, and political instability (Donovan and others 2002). Because households engaged in cash cropping tend to have a lower incidence of poverty than those dependent on subsistence activities, the declines in cash crop outputs may have negative implications for household livelihoods.

Solutions require integrated packages. The use of inorganic fertilizer must be combined with organic inputs along with land conservation, particularly in Rwanda’s hilly terrain. Fertilizer use must be increased by enhancing farmers’ knowledge and offsetting the risk of initial investments in inputs, especially when cultivators are at the bottom

**Box 3.10**

**Institutional mechanisms to put poverty-oriented expenditures in place**

Putting in place a medium-term expenditure framework and institutionalizing poverty-reduction objectives, the budgetary reforms have achieved certain objectives. But they still face constraints in the four principles underlying the approach:

**Transparency.** All ministries are now employing a strategic planning model linking activities with defined objectives. Provinces have been part of this model since 2002. This has aided transparency in the preparation of the budget and provided mechanisms for linking the budget with objectives in the Poverty Reduction Strategy. But in the execution of budgetary plans transparency has not yet been achieved in the linkage between funds requested under subprograms and the objectives used to define the budgetary allocations at the preparation stage.

**Coordination.** Important achievements have been made in linking the priority areas of the Poverty Reduction Strategy with the detailed spending allocations in the medium-term expenditure framework. Ministries have identified priority programs on the basis of the Poverty Reduction Strategy and integrated them into the process. But projects in individual sectors have not yet been generally integrated into sectorwide strategies. Such an approach would help to bring greater clarity of aims to the medium-term expenditure framework. Efforts in this direction have begun in education.

**Comprehensiveness.** Though improved, challenges remain in achieving a comprehensive and integrated budget. In particular, management of the development and recurrent budgets by separate parts of the bureaucracy causes problems. Preparation of the development budget has not been well integrated into the medium-term expenditure framework process.

**Predictability.** Fluctuations in external funding have implications for the predictability of revenues, especially in Rwanda’s shaky macroeconomic environment. Because of the delay in donor disbursements as a result of the problems surrounding the Poverty Reduction Growth Facility negotiations, 2002 was a particularly bad year.

**Source:** Economic Commission for Africa, from official sources.
of their learning curves. And improvements in marketing infrastructures are sorely required in the form of better roads and information. The Poverty Reduction Strategy contains important provisions in these areas aimed at modernizing the sector, but attempts to push the necessary investments remain limited.

**Nonagricultural sectors—underdeveloped and lacking skills**

The industrial sector remains weak and of marginal significance, employing less than 2% of the population and contributing only an estimated 18% to GDP in 2002 (Rwanda, Ministry of Finance and Economic Planning 2001b). Firms are small, with only 12 companies having more than 500 employees. Larger manufacturing enterprises are active mainly in beverages, tobacco, cement, textiles, and tea and coffee processing.

Industrial enterprises were badly hurt by the civil war. Many went out of business, and those that survived had to deal with the destruction of physical capital and the loss of workers and skills. Growth in the industrial sectors will be critical for increasing employment opportunities and living standards, particularly with scarce land and low productivity growth in agriculture. The sector shares weaknesses with the industrial sectors of many other African countries: low human capital and technology, high production and transportation costs, inefficient bureaucratic procedures, and limited financial services. In Rwanda the effects of genocide compound these problems, hampering the development of a strong entrepreneurial class.

Some efforts have been made to deal with these shortcomings, with a new private sector federation, an investment promotion agency to streamline investment procedures, and promotion of vocational education. The Poverty Reduction Strategy sets out a financial sector reform plan and an overhaul of the commercial legal environment to support the private sector. But initiatives to develop the nonagricultural sectors remain limited relative to the enormous and diverse challenges in strengthening the economy.

**Medium-term outlook—some slowdown in growth**

GDP growth will continue to be driven by agriculture and by high public expenditures, supported with donor funding. The rapid growth in 2002 was the result of very favourable weather. Some slowdown is expected, to around 6.5% in 2003 and 2004, with outcomes sensitive to weather. With Rwanda’s high aid dependence, greater volatility of external inflows would be damaging. Monetary policy will remain centred on price stability, though inflation is likely to drift slightly upwards to around 4% in 2003—a result of VAT increases and exchange rate depreciation. The main influence on the external balances will be the international prices of Rwanda’s main exports: tea and coffee. With inventories at record highs, the downward trend in coffee prices is expected to continue over the coming years, keeping the trade and current account balances in deficit. The requirements of poverty reduction and reconstruction will continue to put upwards pressure on the fiscal deficit, likely to be above 10% of GDP in 2003.
Failures in governance reforms could hurt the broader process of reconciliation in which they are embedded. If the institutions through which reconciliation is being managed lose credibility, this will affect the integrity of the 2003 elections, which in turn could affect prospects for future political stability and economic growth. Other problems stem from the demobilization of troops and the likely release of thousands of genocide suspects (see box 3.5). Judicious political management of these connected processes will therefore be critical, and the emerging institutional framework must be seen to include all ethnic groups.

Unexpected costs arising from reconciliation, elections, and demobilization could upset attempts to build a well-functioning and accountable economic bureaucracy if initiatives such as the medium-term expenditure framework are derailed. Here, the fast pace of decentralization poses risks for more efficient budgetary processes, particularly with the limited institutional capacities at the local levels. This key element of reform must thus be carried forward with an eye to these critical constraints: too rapid an implementation could disrupt moves towards better economic management.

To the extent that the events of 1994 were conditioned by poverty and resource scarcity, diagnosis and possible solutions in the economic sphere will have to occur in tandem with social reconstruction and reconciliation. Given the dominance of agriculture in GDP and total employment, solutions to its problems will be vital. Essential prerequisites for its strengthening are technical progress and higher levels of commercialization. Given the land scarcity and soil degradation, economic diversification and the development of nonagricultural wage-labour opportunities will have to be propelled. Progress on this demanding set of tasks will increase living standards.

Rwanda’s post-conflict situation must be taken into account, particularly in the conduct of fiscal policy. The crucial requirements of reconciliation, political normalization, and economic development may keep the fiscal deficit fairly high over the medium term. If sound expenditure implementation can be achieved, this will be justifiable. Given Rwanda’s special context, donors need to be forgiving of reasonable deviations from the precepts of orthodox macroeconomic stabilization policy.

Moderate progress in the areas identified is likely to bring clear economic and social benefits. But the Poverty Reduction Strategy’s aim of cutting poverty to half the 1990 level by 2015 will require average annual GDP growth of 7–8%. Given the structural weaknesses and the interlocking political and economic risks, poverty reduction of such magnitude is unlikely.

References


———. 2001b. Rwanda Development Indicators. Kigali.


Mozambique—The Elusive Quest for Pro-poor Growth

Mozambique’s economy grew at a phenomenal 12% in 2002, with strong performance forecast for 2003. Despite several natural disasters over the past decade, Mozambique was one of the fastest growing economies in Africa. Per capita incomes almost doubled—from $139 in 1990 to about $220 in 2001, laying the foundation for achieving several of the Millennium Development Goal targets (table 4.1). This remarkable performance is attributable largely to the end of civil conflict and a comprehensive economic reform that abandoned central planning and embraced a market approach to growth and development.

The better policy environment brought in more official development assistance—averaging 60% of the government budget for 1996–2001. Those aid inflows have also catalyzed a surge in foreign direct investment to $300 million a year, well above the African average. Mozambique receives more than $40 per capita in aid flows, and gross investment stands at 30% of GDP—much higher than the African average of $19 per capita in aid, and investment of 18% of GDP for 1995–2001.

Yet an estimated 64% of the population was below the poverty line in 2001, down from 69% in 1996 (Mozambique 2001). The reasons for the slow response of poverty to Mozambique’s high rate of growth hark back to the aftermath of the colonial period, when the country was plunged into war. The conflict raged from 1975 until the 1992 Rome Agreement between the ruling Front for the Liberation of Mozambique (Frelimo) and the Mozambique National Resistance (Renamo).1 The war polarized the population, devastated agriculture, and destroyed social and economic infrastructure, including much of the transport system. Despite attempts to target the poorest in society, many benefits of the recent economic growth have been channelled into social and physical infrastructure that benefits both the poor and the nonpoor.

If Mozambique sustains the current average GDP growth rate, spurred by manufacturing, and implements effective pro-poor action programmes, poverty could be reduced from 64% to between 32% and 36% by 2006.

Given the massive inflow of external funds, a major objective of macroeconomic policy has been to keep the economy from overheating, without diminishing government spending on poverty reduction and other social sector activities. The Bank of Mozambique’s strategy has been to keep the bank rate high to minimize growth in demand for money. Rising oil prices could push inflation up in 2003, but it is expected
A major challenge is to implement second-generation reforms, such as privatization, decentralization of development programmes, and reform of public services. Earlier economic reforms eliminated subsidies and quantitative restrictions on imports, simplified import tariffs, and liberalized crop marketing. Foreign exchange and interest rates have also been liberalized, with macroeconomic policy adjusted accordingly.

Mozambique faces three big challenges:

- Reducing income and spatial inequalities.
- Reducing the vulnerability of the population to floods, cyclones, and drought, which in 2000 reduced GDP growth to a mere 1.6% from the previous average of 9%.
- Producing the human resources for effective fiscal decentralization and better public service delivery.

To meet these challenges pro-poor growth strategies need to be coordinated in a comprehensive framework, targeting agriculture, with the majority of the population engaged in subsistence activities. Of particular concern is the lack of credit for small businesses. A micro and rural finance system should be developed to help allocate resources efficiently. Capacity weaknesses in the public services have to be overcome through retraining and institutional reforms, and social infrastructure has to be expanded in rural areas. The domestic transport network, especially linking north and south.

### Table 4.1

**Mozambique’s progress towards the Millennium Development Goals**

<table>
<thead>
<tr>
<th>Target</th>
<th>Will target be met?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduce extreme poverty by half</td>
<td>Possibly</td>
</tr>
<tr>
<td>Reverse the spread of HIV</td>
<td>Possibly</td>
</tr>
<tr>
<td>Reduce food poverty</td>
<td>Unlikely</td>
</tr>
<tr>
<td>Increase access to safe water</td>
<td>Unlikely</td>
</tr>
<tr>
<td>Achieve universal access to primary education</td>
<td>Unlikely</td>
</tr>
<tr>
<td>Eliminate gender disparity in primary and secondary education</td>
<td>Unlikely</td>
</tr>
<tr>
<td>Reduce under-five mortality rate</td>
<td>Unlikely</td>
</tr>
<tr>
<td>Reduce maternal mortality ratio</td>
<td>Possibly</td>
</tr>
<tr>
<td>Halt and begin to reverse the incidence of malaria</td>
<td>Unlikely</td>
</tr>
<tr>
<td>Integrate principles of sustainable development in policy</td>
<td>Possibly</td>
</tr>
</tbody>
</table>

*Source: UNDP and Mozambique 2002.*
south, needs attention. Transparency and accountability in public finance management has to increase significantly (box 4.1). Reform of the judiciary has to speed the effort towards good governance.

To promote democracy and good governance, President Chissano has announced that he will step down in 2004, and a new candidate has been nominated by the ruling party to contest the 2004 elections. But more needs to be done to promote faster national reconciliation and integration.

**Macroeconomic developments**

Economic growth is accelerating, export revenues are rising, and the structure of the economy is changing, with agriculture's share falling and industry's rising. Inflation is on the decline, and while financial sector recovery has been slow, social spending is up and military spending is down.

**Economic growth—strong and accelerating**

Real GDP growth is accelerating, from an average of 6.5% for 1987–96 to 11% in 1997–99 and 13% in 2001–02, though it dropped slightly to 12% in 2002 (figure 4.1 and table 4.2). The major sources of growth since 2000 have been post-flood reconstruction, the large investment in aluminium production, and recovery in agricultural output (Mozambique and EU 2002).

Export revenues in dollars increased, but the trade and current account deficits remained high due to the high import requirements of large projects, notably the Mozal aluminium plant and the gas pipeline (figures 4.2 and figure 4.3).

**Sectoral performance—signs of structural transformation**

The structure of the Mozambican economy, dominated by agriculture and services in the 1980s and 1990s, is changing as the aluminium and gas projects reach full capacity. The share of agriculture in GDP dropped from 34% in 1991 to 22% in 2001, while that of industry, buoyed by aluminium, gas, and electricity production, rose from 9.2% to 26% (figure 4.4 and table 4.3). The industrial sector is thus poised to become the country’s largest sector, with growth of 34% in 2001 and an estimated 12% in 2002, with 6% growth in manufacturing and 108% growth in construction works related to the gas pipeline and other big projects.

*Agriculture—imperative for modernization*. Mozambique has great potential for faster agricultural growth, especially for export. Agriculture is the main source of livelihood for rural households, 80% of the country’s population. The principal cash crops are cotton, cashews, maize, tobacco, sugar, coconut, tea, and fruit. The largest export earners are prawns, cotton, and cashews. Prawn exports in 2001 amounted to $86 million, and cashew exports to about $13 million. Cotton has a workforce of about 250,000 farm households, and annual exports of more than $20 million.
**Box 4.1**

*What do residents want the government to know and do?*

<table>
<thead>
<tr>
<th>Area</th>
<th>Issues, concerns, and suggestions</th>
</tr>
</thead>
</table>
| Governance            | • Commitment to public sector reform is evident from the top of the political hierarchy but not middle-level personnel.  
                         | • Reorientation and retraining of middle-level personnel is required.  
                         | • Decentralization is a key factor in improving public service delivery and reducing corruption.  
                         | • Progress on decentralization is too slow.  
                         | • Human and material capacity at the local government level are weak.  
                         | • An independent judiciary must be ensured.  
                         | • Progress on judicial reforms is too slow.  
                         | • Pace towards national reconciliation and integration is slow. |
| Trade and investment  | • The Investment Promotion Centre should be strengthened and made independent of the Ministry of Planning and Finance.  
                         | • Incentives created for foreign direct investment should be extended to local investors, particularly in agriculture and industry.  
                         | • Small and medium-size enterprises face management and financial problems, due to weakness in human resource capacity and in the banking system.  
                         | • Customs and tax regulations are cumbersome and uncertain, with a lack of coordination among revenue agencies.  
                         | • Business wants a logical, rational tax system—not necessarily lower tax rates—to reduce uncertainty in financial planning.  
                         | • The high value-added tax (VAT) rate is encouraging underground cross-border trade, undermining local legal business. Prompt refunds of VATs must be ensured.  
                         | • Opportunities for trade—under the South African Development Community, World Trade Organization, U.S. African Growth and Opportunity Act—are growing but the capacity of local firms to meet international standards is low. Need a national trade strategy incorporating training, research, information-sharing, technology, and finance and a supportive regulatory environment. |
| Business and regulation| • Many rules and regulations—particularly for registration, licensing, and corporate taxation—are outmoded, cumbersome, and ambiguous.  
                         | • Due to underfinancing from central government, municipalities harass local businesses for revenue. |
| The rural poor         | • Measures may be needed to reduce the impact of trade liberalization on the rural poor in agriculture and agro-processing. |

(continued on next page)
**Box 4.1 (continued)**

*What do residents want the government to know and do?*

<table>
<thead>
<tr>
<th>The rural poor (continued)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Access to primary, secondary, and tertiary education is key to rural poverty reduction. Teachers and private investors need incentives to move to rural areas.</td>
</tr>
<tr>
<td>• The agro-processing business for cashews, sugar, and fish needs to be revived.</td>
</tr>
<tr>
<td>• Food security should be strengthened by installing rural food storage facilities, improving transportation networks, and providing small irrigation facilities.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Financial sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Interest rates are too high.</td>
</tr>
<tr>
<td>• The central bank needs to develop an effective microfinance system, linking informal and rural business to modern banking and finance with a supportive policy and regulatory environment.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Education and training</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Lack of an educated and skilled workforce could hinder long-term growth.</td>
</tr>
<tr>
<td>• Access to education is a key to reducing poverty and inequality.</td>
</tr>
<tr>
<td>• Private participation in the provision of higher education and professional training must be facilitated.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Infrastructure and utilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The infrastructure linkages between regions and provinces need to be strengthened.</td>
</tr>
<tr>
<td>• Effective competition in the sector should be ensured.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Labour laws</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Regulations for hiring foreign workers are too cumbersome. Obtaining a work permit is time-consuming.</td>
</tr>
<tr>
<td>• The bureaucracy intervenes too much in industrial relations.</td>
</tr>
<tr>
<td>• Modern, flexible, and user-friendly labour laws are needed.</td>
</tr>
<tr>
<td>• The industrial labour force needs training and re-orientation from its socialist mindset.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Land acquisition</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Land is not easily marketed. It is vested in the government but changing hands on the black market at exorbitant prices.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Medium-term economic prospects</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Weak, because of the high failure rate of local enterprises. There is a need for national corporate empowerment.</td>
</tr>
<tr>
<td>• Good, because improved governance is generating inflows of foreign direct investment and donor funds and new opportunities for trade in agro-industry and tourism. Implementation of reforms, especially in governance and business regulations, and commitment to the rule of law must be adhered to.</td>
</tr>
</tbody>
</table>

*Source: Economic Commission for Africa, from official sources.*
Figure 4.1

GDP rising, with one bad year and down a bit in 2002
Real GDP growth, 1999–2002 (%)

Table 4.2

Macroeconomic trends, 1999–2002

<table>
<thead>
<tr>
<th>Indicator</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002a</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP (US$ billions)</td>
<td>4.1</td>
<td>3.9</td>
<td>3.8</td>
<td>4.4</td>
</tr>
<tr>
<td>Real GDP growth (%)</td>
<td>7.5</td>
<td>1.6</td>
<td>13.9</td>
<td>12.0</td>
</tr>
<tr>
<td>Inflation, end of period (% year on year)</td>
<td>4.8</td>
<td>11.4</td>
<td>21.9</td>
<td>9.1</td>
</tr>
<tr>
<td>Exchange rate (meticais per dollar, end of period)</td>
<td>13,253</td>
<td>17,141</td>
<td>23,320</td>
<td>24,000</td>
</tr>
<tr>
<td>Exports (fob, US$ millions)</td>
<td>284</td>
<td>364</td>
<td>704</td>
<td>850</td>
</tr>
<tr>
<td>Imports (fob, US$ millions)</td>
<td>1,090</td>
<td>1,162</td>
<td>1,300</td>
<td>1,400</td>
</tr>
<tr>
<td>Current account balance (US$ millions)</td>
<td>–912</td>
<td>–880</td>
<td>–736a</td>
<td>–700</td>
</tr>
<tr>
<td>Reserves (excluding gold, US$ millions)</td>
<td>652</td>
<td>725</td>
<td>716</td>
<td>790</td>
</tr>
<tr>
<td>Import cover (months)</td>
<td>5.2</td>
<td>5.4</td>
<td>4.9</td>
<td>5.0</td>
</tr>
<tr>
<td>Total external debt (US$ billions)</td>
<td>5.65</td>
<td>5.37</td>
<td>5.0a</td>
<td>6.0</td>
</tr>
<tr>
<td>External debt to GDP ratio (%)b</td>
<td>138</td>
<td>146</td>
<td>153a</td>
<td>189</td>
</tr>
<tr>
<td>Net foreign direct investment (US$ millions)</td>
<td>382</td>
<td>139</td>
<td>255</td>
<td>805</td>
</tr>
<tr>
<td>Net official development assistance (US$ millions)</td>
<td>804</td>
<td>876</td>
<td>540a</td>
<td>565</td>
</tr>
</tbody>
</table>

a. Estimated.
b. Before debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative.

Source: Economic Commission for Africa, from official sources.
**Figure 4.2**

*Metical slipping against the dollar*

*Nominal exchange rate, 1999–2002 (metrical per dollar)*

![Graph showing nominal exchange rate from 1999 to 2002 with a trend line indicating the metical slipping against the dollar.]

*a. Estimated.*

**Source:** Economic Commission for Africa, from official sources.

**Figure 4.3**

*Trade balance gradually improving*

*Current account balance, 1999–2002 (US$ millions)*

![Bar chart showing the current account balance from 1999 to 2002 with bars indicating a gradual improvement.]

*a. Estimated.*

**Source:** Economic Commission for Africa, from official sources.
Small irrigation schemes could provide some protection for poor farmers against both floods and drought, helping to stabilize production and boost incomes.

About 46% of the country’s land area is suitable for agricultural production, but the supportive environment—the production, storage, and distribution infrastructure, credit and extension services—necessary for take-off is lacking. Largely rainfed, agriculture is dominated by smallholders, with an average farm size of 2.4 hectares and low yields. Of the arable land area of 36 million hectares, only 5.4 million hectares (about 15%) are under cultivation and only 120,000 hectares are irrigated.

But the country’s agriculture is subject to severe droughts and flood in the south and devastating cyclones in the north. In 2001/02 drought in the south cut the region’s cereal production by a third, leaving half a million people at risk of famine (table 4.4). Small irrigation schemes could provide some protection for poor farmers against both floods and drought, helping to stabilize production and boost incomes.

Cashew production, once the most important source of livelihood and export earnings, virtually collapsed with the closing of processing plants (box 4.2). In May 2002 a new plant was opened in Namige, Nambula Province. Research findings show that labour-intensive techniques, not the highly mechanized factories of the past, could add value to processed nuts at a competitive cost, making local processing internationally com-

---

**Figure 4.4**

*Industry poised to become largest sector*

*Sectoral distribution of GDP, 2001*

![Sectoral distribution of GDP, 2001](chart)

*Source: Economic Commission for Africa, from official sources.*

**Table 4.3**

*Average annual sectoral growth rates, 2000–01 (%)*

<table>
<thead>
<tr>
<th>Sector</th>
<th>2000</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>-10.3</td>
<td>14.0</td>
</tr>
<tr>
<td>Mining</td>
<td>-29.4</td>
<td>12.6</td>
</tr>
<tr>
<td>Industry (manufacturing and construction)</td>
<td>4.3</td>
<td>34.1</td>
</tr>
<tr>
<td>Services (trade, transport, and communications)</td>
<td>11.3</td>
<td>-8.3</td>
</tr>
<tr>
<td>All sectors</td>
<td>1.6</td>
<td>13.9</td>
</tr>
</tbody>
</table>

*Source: Economic Commission of Africa, from official sources.*
petitive (McMillan, Rodrik, and Welch 2002; Mozambique, Ministry of Agriculture 2001). A World Bank (1995) study had shown that the value added by the mechanized processing industry was marginal or negative in 1988–92.

Fisheries accounted for almost 40% of Mozambique’s exports in 2001. Direct employment in the sector is estimated to be between 75,000 and 80,000, 90% of them artisanal fishers or people associated with handling and distributing an artisanal catch (Nathan Associates 2002). Almost no growth is expected from fisheries in 2002, because of measures to conserve prawn stocks.

Sugar is now receiving government support to improve the regulatory environment and access to credit—and to attract more investment, particularly from Mauritius and South Africa. Showing the sector’s export, employment, and poverty reduction potential, several

**Table 4.4**

*Cereal production, 2001/02*

<table>
<thead>
<tr>
<th>Region</th>
<th>Volume of output (thousand tons)</th>
<th>Change from previous year (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>North</td>
<td>619</td>
<td>22</td>
</tr>
<tr>
<td>South</td>
<td>163</td>
<td>-34</td>
</tr>
<tr>
<td>Centre</td>
<td>992</td>
<td>6</td>
</tr>
<tr>
<td>National</td>
<td>1,773</td>
<td>5</td>
</tr>
</tbody>
</table>

*Note: Cereal comprises maize, sorghum, rice, and millet, in order of volume.*

*Source: EIU 2002.*

**Box 4.2**

*When economic reform goes wrong: cashews*

In the 1960s Mozambique produced half the world’s cashews, with production at 156,000 tons in 1964. In 1975 the government banned the export of raw cashews, and the country became the first in Africa to process cashews on a large scale, with 14 processing factories by 1980. In 1992 the export ban on raw cashews was lifted as part of a policy reform agenda proposed by the World Bank. An export tax of 20–40% of the fob price was imposed in 1994, gradually reduced to 14% by 1997. It was hoped that resources would be allocated more efficiently and the incomes of cashew farmers would be boosted. Competition among buyers increased the farmgate prices of raw cashews, though only about 40–50% of this rise went to farmers (around $2.1–2.6 million). The rest went to traders.

Liberalization effectively killed cashew processing because plants were not efficient enough to withstand the competition. Of the sector’s labour force of 11,000, 90% lost their jobs. It is estimated that poor households and workers lost $3.5–4.0 million as a result of the liberalization policy—simply because the dynamic consequences of the policy on an imperfect market situation were not adequately addressed.

*Source: Adapted from McMillan, Rodrik, and Welch 2002.*
scientific studies justify continuing government support (box 4.3). Three processing plants have been rehabilitated to ensure a steady market for higher farm production, generating an estimated 20,000 new jobs.

**Industry, mining, and construction.** Industry, mining, and construction have been the fastest growing sectors over the last 10 years, with growth rates of 10%, 12%, and 54% in 2001. Metallurgical products, beverages, and food processing lead manufacturing. Aluminium has been a major source of growth of manufacturing output. BHP Billiton Aluminium SA is expanding its plants in the country, at Mozal 2, to double its aluminium production to 500,000 tons. Sugar processing is receiving more attention, with investments expected to reach $312 million in 2005.

Mining—mainly marble, granite, gold, and bauxite—contributes 2% of GDP and 7% of exports. The unlicensed production of gold and gemstones, not included in official statistics, is said to be on the increase, with an estimated 50,000 artisanal workers in alluvial gold and gemstone work. The titanium project by Southern Mining Company, on its completion in 2006, will be the country’s largest mining enterprise. Construction is due to start in 2004, involving an investment of about $1.5 billion, $495 million in the first phase alone. In addition, Kenmore Resources of Ireland has entered into the development and construction stage of its titanium project in the northern province of Nambula.

A major constraint facing these growing sectors: human resources. Professional and other high-skill workers are not readily available, and recruitment of expatriates faces cumbersome administrative procedures.

**Services.** Services are dominated by internal trade, transport, and communication—and government services. Tourism’s contribution is small, even though the country boasts exceptional flora and fauna. The Investment Promotion Centre has identified tourism as one of the most viable investment opportunities in the country. Most tourism investments

**Box 4.3**

**Sugar production has great potential for poverty reduction**

Sugar production can do much to reduce poverty—through direct and indirect employment creation and income generation. Employment is projected to reach 21,000 full-time and seasonal jobs, at an average capital expenditure of $20,000 per job, and domestic consumption is increasing. Market access to the South African Development Community and EU amounts to 160,000–280,000 tons a year. Currently a net importer of sugar, Mozambique has the potential to produce 428,000 tons a year. With an average field and factory cost of $180 a ton, it has the potential to be one of the lowest cost global producers of sugar. Investment in sugar is projected to reach more than $300 million by 2005, but it needs supportive trade and investment policies to realize its full potential.

*Source: FAO 2000.*
are for beach destinations, such as the Sodetur-Balanchard project, estimated at $800 million. Other attractions include the Bazaratu Archipelago and the Ibo Islands. The new Ministry of Tourism has identified several community-based ecotourism projects (around the Gorongosa National Park and the Ponta do Ouro zone), good for poverty reduction and conservation. But the lack of air and road transport and telecommunications poses a major constraint to tourism development.

Mozambique has focused on developing transportation corridors to capitalize on its natural resources and trading location. The demand for transport and shipping facilities is high among the three neighbouring landlocked countries—Malawi, Zambia, and Zimbabwe—as well as South Africa. In 2000 the three main ports of Maputo, Beira, and Nacala and the two secondary ports of Quelimane and Pemba handled about 6 million tons of cargo for Mozambique’s neighbours, 48% of it for Zimbabwe and 34% for South Africa (Mozambique and EU 2002). Development of the Maputo Corridor between Maputo Port and Witbank, South Africa, could reduce travel distances and facilitate exports and foreign investment. But north-south road links are still poor and vulnerable to natural disasters.

Monetary policy—inflation on the decline

Inflation slowed in 2002, to 9.1% from 21.9% in 2001 (figure 4.5), a result of tight monetary policy and higher cereal production. Holding the increase in the minimum wage to 22%, the rate of inflation in 2001, helped contain cost inflation. (Before 2002...
the minimum-wage increments had exceeded the previous year’s inflation rate, stoking inflation.) Higher reserve requirements (from 7.9% in 2000 to 11.5% in April 2002) and treasury bill rates (from 21.4% to 31.7%) also helped slow inflation. Reinforcing the measures: strict monitoring of prudential norms by the central bank.

To sterilize the increased liquidity caused by foreign aid inflows and the impact of treasury operations, annual expansion of the money stock (M2, currency in circulation plus current and time deposits) has been set at 19%. In 2001 and 2002 the growth in M2 was 25%, better than the 42% in 2000 (Bank of Mozambique 2001, 2002). The main sources of monetary expansion in 2002 were the increase in credit to the economy, the exchange rate depreciation (which resulted in a revaluation of deposits denominated in dollars and other foreign exchange), and deterioration in the net position of government accounts with the banking sector—together accounting for more than 80% of the growth in M2. Credit to the economy increased 23% between December 2001 and June 2002, with about 82% to the private economy. The largest beneficiaries were industry (18%) and agriculture (16%), where 55% of net credit went to capital investments.

Exchange rate depreciation slowed with restrictive monetary policy, higher aluminium exports, and rising donor and foreign direct investment inflows. The local currency slipped by less than 4% in 2002. Nominal exchange rate depreciation has generally been above annual inflation, implying a depreciation in the real exchange rate, improving the competitiveness of Mozambique’s exports (Bank of Mozambique 2001).

Financial sector—recovering slowly
The financial sector’s health has been closely linked to that of the two largest banks, Banco Austral and Banco Commercial de Moçambique (box 4.4). Nonperforming loans, poor loan recovery, and links to the country’s elite call for comprehensive reforms—and for strengthening the regulatory oversight of the banking sector, to maintain investor confidence.

Given the high cost of recapitalizing the failing banks, costs that compete with pro-poor expenditures, strengthening banking supervision should be a government priority. The supervision department of the central bank should receive full authority to implement prudential regulations. Banks should be monitored for compliance with the recently introduced monthly reporting on capital adequacy ratios—and penalized for incomplete or erroneous data. To send a strong signal that the government will not bail out ailing banks, it needs to divest its holdings in the banking sector.

Fiscal policy—military expenditures down, social spending up
The structure of public expenditures has changed significantly since the 1992 peace accord. Reported military expenditures dropped from 10% of GDP in 1990 to 2.4% in 1999. Social expenditures have increased—to rebuild the economy, reduce poverty, and improve literacy (table 4.5).
The aim of fiscal policy is to rebuild the country’s economic and social infrastructure and stimulate growth while keeping inflation low. That requires elimination of monetary financing of the budget deficit and the adoption of overall parameters for both external and domestic debt policy and sustainability (World Bank 2001b).

Net domestic financing of the budget deficit declined from 1.8% of GDP in 1992 to −1.2% in 1994 and remained negative until 2001, consistent with the central bank policy of not monetizing fiscal deficits. In contrast, net external borrowing has averaged

**Box 4.4**

**Privatizing major banks to avert a financial meltdown**

Banco Austral and Banco Comercial de Moçambique, two of the four major commercial banks in Mozambique, had 47% of the credit market, 48% of deposits, and 62% of bank branches in 2000.

After Banco Austral was privatized in 1996, it started recording heavy financial losses, which led to the withdrawal of the successful bidder. Several of the bank’s nonperforming loans were linked to powerful political figures. An attempt to investigate these loans led to the death of a central bank official, Antonio Siba-Siba, in August 2001. In advance of its sale the bank was restructured by the central bank to protect banking sector integrity. Banco Austral was successfully re-privatized in December 2001 and sold to the Amalgamated Banks of South Africa in 2002, for $10 million.

Before Banco Comercial de Moçambique, a former state-owned bank, was privatized in 1996, $14 million was stolen from the bank’s vaults. Carlos Cardoso, a newspaper editor investigating the fraud, was murdered. In 2001 the government merged Banco Comercial de Moçambique with Banco Internacional de Moçambique, which increased its share of the credit market to 56%, up from 16% in 2000. The merger is a major step in cleaning up the banking sector and establishing confidence.

*Source: Economic Commission for Africa, from official sources.*

**Table 4.5**

**Fiscal performance, 2000–02**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2000</th>
<th>2001</th>
<th>2002*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government expenditure (trillions of meticais)</td>
<td>16.6</td>
<td>22.7</td>
<td>27.4</td>
</tr>
<tr>
<td>As % of GDP</td>
<td>28.1</td>
<td>28.9</td>
<td>32.3</td>
</tr>
<tr>
<td>Social expenditures (% of government expenditure)b</td>
<td>28.6</td>
<td>30.4</td>
<td>35.8</td>
</tr>
<tr>
<td>Total domestic revenue (trillions of meticais)</td>
<td>7.5</td>
<td>9.6</td>
<td>11.2</td>
</tr>
<tr>
<td>As % of GDP</td>
<td>12.6</td>
<td>12.3</td>
<td>13.2</td>
</tr>
<tr>
<td>Fiscal deficit, excluding grants (trillions of meticais)</td>
<td>11.1</td>
<td>13.1</td>
<td>16.2</td>
</tr>
<tr>
<td>As % of GDP</td>
<td>15.5</td>
<td>17.6</td>
<td>19.1</td>
</tr>
<tr>
<td>Grants as % of GDP</td>
<td>10.9</td>
<td>12.3</td>
<td>10.8</td>
</tr>
</tbody>
</table>

a. Estimated.
b. Includes only education and health expenditures.

*Source: Economic Commission on Africa, from official sources.*
3% of GDP since 1992, peaking at 7.3% of GDP in 1994. Excluding grants, deficits fell from 21% of GDP in 1992 to 10% in 1996, but then rose to 20% in 1998. Including grants, deficits declined from about 5% of GDP in 1992 to less than 2% in 1999, but are also rising, reflecting the underlying fiscal expansion and domestic funding of poverty-related activities.

Overall, the fiscal situation continues to suffer from high deficits and heavy aid dependence (figures 4.6 and 4.7). Grants, external borrowing, and debt relief through the Heavily Indebted Poor Countries (HIPC) Initiative provided 49% of the funding for public expenditures in 2000, 51% in 2001, and 49% in 2002. With a large amount of additional external assistance not passing through the treasury account at the central bank, fiscal sustainability is a serious challenge.3

With tax revenue at 13% of GDP, well below the Sub-Saharan average of 18–20%, Mozambique needs to mobilize domestic revenue and adjust expenditures to ensure sustainability in the medium term. A 17% value-added tax was introduced, but given the regressive nature of indirect taxation, revenue growth has to be supported by increasing the scope and efficiency of income tax administration. New tax regulations meant to broaden coverage, particularly to corporate and personal incomes, were approved by parliament in April 2002. Under the new regulations, the personal income tax bracket has been extended from 10–20% to 10–35%, and the tax break enjoyed by civil servants to compensate for their low pay has been removed. In addition, the new tax regulations seek to ensure greater coordination and sharing of information between the tax administration and customs, through a computerized management information system.

**Figure 4.6**
*High deficits and aid dependence*

_Fiscal performance and borrowing, 1992–2002 (% of GDP)_

---

*Source: Mozambique, Ministry of Planning and Finance 2002b.*
The authorities are also planning to improve public financial management through more effective auditing and budget execution.

Coordination between the government and donors has improved, but project aid that bypasses national priorities is fragmenting ministries, weakening national identity, and undermining authority (OECD 2002). That makes it crucial to develop and implement an accounting and disbursement mechanism that coincides with the government’s financial management system.

**External trade—new trading partners**

The EU share of Mozambique’s exports dropped from 35% in 1990 to less than 30% in 1999. The import share fell from 33% to less than 16%, while South Africa’s share increased to 44%. Mozambique overtook Zimbabwe as South Africa’s largest African trading partner in 2001.

The composition of exports is changing from largely agriculture and fisheries to merchandise. Total merchandise exports rose from $364 million in 2000 to $704 million in 2001, an increase of 93%. Aluminium exports from the Mozal smelter accounted for $384 million, about 55% of merchandise exports, up from $60.2 million a year before.

Imports of roughly $1.2 billion a year comprise mainly raw materials, industrial equipment, and consumer goods. In 2001 imports for the Mozal plant and raw materials accounted for nearly half the total, and consumer goods for about a quarter.

**Figure 4.7**

*Heavy aid dependence*

*Aid flows to Mozambique, 1987–2000 (US$ millions)*

![Graph showing aid flows to Mozambique, 1987–2000 (US$ millions).](image-url)

*Source: UNDP and Mozambique 2002.*
Exports covered only a third of imports in 2000 (table 4.6). But with the Mozal aluminium plant, that improved to 54% in 2001 and 61% in 2002, for a current account deficit of 18% of GDP in 2002. External debt service in 2002 was about 5% of exports, compared with 9% in 2000 and 3.6% in 2001, the decline in 2001 resulting from HIPC debt relief and increased aluminium exports.

Mozambique is implementing a formal trade strategy to modernize the economy and take advantage of opportunities from the World Trade Organization (WTO) and the Southern Africa Development Community (SADC). The SADC Trade Protocol, which establishes a free trade agreement among the 14 member states, became effective in September 2000. Mozambique’s southern provinces are rapidly converging with their South African neighbours, with travel and trade on the increase.

The benefits of closer regional integration have already appeared in the trade with South Africa and in higher revenues from the transport corridors to Mozambique’s ports. Mozambique has several new export opportunities within the region, which already accounts for 46% of its exports. But the crisis in Zimbabwe, though it has led to some movement of farm investment towards Mozambique, has poisoned the regional investment environment.

Under the new Southern African Customs Union (with Botswana, Lesotho, Namibia, South Africa, and Swaziland), Mozambique will benefit from the elimination of the common external tariff. In 2002 the base tariff on clothing exports from Mozambique was reduced from 72% to 25%, and that on fishery products, fruits, and vegetables to zero. Mozambique is a crucial transit country in the Zambia–Malawi–Mozambique Growth Triangle. In addition, certain Mozambican products are no longer subject to quotas under a bilateral trade agreement with South Africa.

In December 2001 Mozambique was declared eligible for duty-free trade privileges under the U.S. African Growth and Opportunities Act after fulfilling the conditions of progress

**Table 4.6**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2000</th>
<th>2001</th>
<th>2002a</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports (% of imports)</td>
<td>31.3</td>
<td>54.1</td>
<td>60.7</td>
</tr>
<tr>
<td>Trade balance (% of GDP)</td>
<td>–20.8</td>
<td>–18.4</td>
<td>–13.7</td>
</tr>
<tr>
<td>Current account balance (% of GDP)</td>
<td>–27.7</td>
<td>–23.6</td>
<td>–17.6</td>
</tr>
<tr>
<td>Nominal depreciation of the metical against the dollar (annual %)</td>
<td>28.5</td>
<td>34.7</td>
<td>10.0</td>
</tr>
<tr>
<td>Debt service (% of exports, after HIPC Initiative debt relief)</td>
<td>9.1</td>
<td>3.6</td>
<td>5.2</td>
</tr>
<tr>
<td>Debt outstanding (% of GDP)</td>
<td>58.0</td>
<td>59.4</td>
<td>58.8</td>
</tr>
<tr>
<td>Present value of debt (% of GDP)</td>
<td>24.6</td>
<td>25.3</td>
<td>25.4</td>
</tr>
<tr>
<td>Reserves, including gold (millions of dollars)</td>
<td>746</td>
<td>680</td>
<td>695</td>
</tr>
</tbody>
</table>

*a. Estimated.
Source: Economic Commission on Africa, from official sources.*
towards market-based economic policies, improvement in the rule of law, implementation of poverty reduction programmes, and the protection of workers’ rights. Because of this new status, Mozambique is likely to attract investors into its textile industry from Mauritius and South Africa.

Human development

With social conditions weakened by exposure to floods and droughts and by the long war in the 1980s, indicators of human development are generally lower in Mozambique than among its neighbours (table 4.7).

Between 1965 and 1999 there were 12 major floods, 9 major droughts, and 4 major cyclones (almost one major disaster a year). The floods in February and March 2000 left 491,000 people displaced, 140,000 hectares of farmland inundated, and 52 rural health facilities and 500 primary schools damaged. There was also extensive damage to housing, roads, railways, and key utilities. The direct cost was estimated at $273 million, and the cost of reconstruction at $430 million (World Bank 2002a).

Education and employment

The adult literacy rate of 44.0% in 2000 is a big improvement over the 28.9% rate in 1985 and 40% in 1997, but it is still well below the Sub-Saharan average of 61.5% and the Least Developed Countries average of 52.8% (UNDP 2002). And the gender gap is wide, with female literacy at 28% and male literacy at 60%. About 87% of the population in rural areas and 50% in urban areas live in households where at least one adult female is illiterate.

Table 4.7

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Mozambique</th>
<th>Malawi</th>
<th>Tanzania</th>
<th>Zambia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adult literacy (%)</td>
<td>44</td>
<td>60</td>
<td>75</td>
<td>78</td>
</tr>
<tr>
<td>Combined enrolment rate (%)</td>
<td>23</td>
<td>73</td>
<td>32</td>
<td>49</td>
</tr>
<tr>
<td>Life expectancy (years)</td>
<td>44</td>
<td>40</td>
<td>51</td>
<td>41</td>
</tr>
<tr>
<td>Undernourished (%)</td>
<td>54</td>
<td>35</td>
<td>46</td>
<td>47</td>
</tr>
<tr>
<td>GDP per capita (PPP $)</td>
<td>854</td>
<td>943</td>
<td>523</td>
<td>780</td>
</tr>
<tr>
<td>Population below $1/day (%)</td>
<td>38</td>
<td>na</td>
<td>20</td>
<td>64</td>
</tr>
<tr>
<td>Population using improved water (%)</td>
<td>60</td>
<td>57</td>
<td>54</td>
<td>64</td>
</tr>
<tr>
<td>Population with access to essential drugs (%)</td>
<td>50–79</td>
<td>&gt;50</td>
<td>50–79</td>
<td>50–79</td>
</tr>
<tr>
<td>Per capita health expenditure</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PPP $, 1998</td>
<td>8</td>
<td>11</td>
<td>8</td>
<td>23</td>
</tr>
<tr>
<td>Share of public expenditures (%)</td>
<td>80</td>
<td>43</td>
<td>40</td>
<td>51</td>
</tr>
<tr>
<td>Adults with HIV/AIDS, 2001 (%)</td>
<td>13</td>
<td>15</td>
<td>8</td>
<td>22</td>
</tr>
</tbody>
</table>

Note: PPP is purchasing power parity.
Source: UNDP and Mozambique 2002.
The combined primary, secondary, and tertiary enrolment rate of 23% is significantly lower than the Sub-Saharan average of 42%. The main reason for the low enrolment: only 63% of the population live in villages with a primary school, and only 2% live close to a secondary school.

Little surprise, then, that there is an acute shortage of highly educated workers. In 1999 only 483 students graduated from higher education, far shy of the 1,200 professionals needed each year to fill vacancies in the public sector alone. Of the labour force of about 7 million, only 12% is in paid employment, 60% of them in the private sector. About 84% of the labour force can be classified as unskilled. Unemployment is estimated at about 21% (Harber 1999).

The government is improving public education administration, with funding under a fast-track provision of the World Bank’s Education for All Initiative. It is also working on increasing quality and efficiency and reducing cost. The Education Sector Strategic Plan of 1998—with the motto “Fight Exclusion: Renew the School”—targets all levels of education, but with little detail for secondary and tertiary education.

The main issues in higher education are gender and regional inequality, low graduation rates, and poor management of financial resources (World Bank 2002c). Female enrolment in higher education remains at about one-third of new admissions, though there has been some improvement since 1995 (figure 4.8). This is attributable largely to the opening of private institutions, where women make up about 43% of students, compared with about 25% in the public sector (Mozambique, Ministry of Higher Education, Science, and Technology 2000).

**Figure 4.8**

*Female enrolments—low but rising*

*New admissions into higher education institutions, 1992–99*

![Chart showing female enrolments in higher education institutions from 1992 to 1999.](image)
Private institutions are fee-paying while public ones are highly subsidized and have better facilities—another issue of gender inequality.

Regionally, the distribution of higher education enrolments is skewed in favour of Maputo Province, where most of the public higher education institutions are located. About 60% of newly admitted students in 1999 were from southern provinces, two-thirds of them from Maputo City alone.

Current government strategies for higher education are driven by three needs: to meet social demand for higher education through expansion in access and enhanced equity, to respond to labour market and national skill requirements, and to increase efficiency in resource use. Strategies include building the capacity of the Ministry for Higher Education, reforming curricula, expanding remedial programmes, introducing shorter duration programmes based on need, and improving learning environments, in particular, library and information technology facilities.

Despite these efforts the demand for places far outstrips the capacity of the government to fund them. New admissions in both public and private institutions of higher education are still under 2,500 a year, compared with the secondary education output of 4,000 students. With more investment in the country, the shortfall in the supply of professionals and educated labour could increase, calling for a new strategy (box 4.5).

**Health—improving but still below Sub-Saharan averages**
The average life expectancy is about 44 years, with significant regional disparities. The average is 62 years for women and 55 for men in Maputo Province, but 38 years for women and 36 for men in Zambezia Province.

**Box 4.5**
**Could fees increase enrolments?**

Public universities are constrained by low budgets. Only 100 of the more than 2,000 applicants to the economics department at the University of Eduardo Mondlane (UEM) are admitted each year. And the rate of graduation has been low because of ineffective faculty supervision.

Recently a partial fee-paying scheme has been introduced in some teaching departments of UEM, including the economics department. Students pay only one-third of the tuition charged at private universities, attending classes in the afternoon, after regular classes for government-sponsored students. The proceeds have been used to supplement faculty pay, paint the offices in the department, and buy new equipment, including computers, photocopying machines, and air conditioners. The faculty is spending more time with the students—enhancing supervision and the rate of graduation.

Source: Economic Commission on Africa interviews with UEM staff.
The infant mortality rate declined to 127 per 1,000 live births in 2000, compared with 162 in 1970, but remains higher than the Sub-Saharan average of 107. Maternal mortality is very high at 1,100 deaths per 100,000 live births, compared with 530 in Tanzania and 650 in Zambia. Less than 20% of the populace lives in a village with a nurse, midwife, or health post, only 2% near a doctor, and the average distance to a health post is 20–30 kilometres.

About 13% (710,000) of the adult population 15 to 49 years old was living with HIV/AIDS in 2001. And malaria and tuberculosis are rising at alarming rates.

The government has taken a robust stance in addressing the HIV/AIDS epidemic. It has established the National AIDS Council and adopted a multisectoral action plan to coordinate all AIDS-related activities in the provinces and regions. The main strategy is to improve access to voluntary testing and counselling, with assistance focusing on primary and secondary care. Public expenditure on health is projected to rise by about 25%, to $150 million by 2005, from $120 million today, because of the HIV/AIDS epidemic, which threatens to reduce GDP growth by 4 percentage points by 2010.

The Health Sector Strategic Plan (2001–2005–2010) attributes the poor health situation to low education, lack of safe drinking water, and the consequences of war. It seeks to promote quality health care for all by:

- Developing appropriate systems and programmes for the delivery of health care.
- Having communities participate in health care provision and administration.
- Collaborating with local and external partners in the delivery and financing of health care.

**Poverty reduction—slow progress**

The incidence of poverty—as measured by the head count index based on the basic consumption poverty line of 160,780 meticais (about $14) a month in 1996–97—was 69%, or roughly 12 million of the country’s 17 million people. In 2001 the estimated poverty incidence was 64%.

As in other developing countries, poverty in Mozambique is largely rural, highest in Sofala, Tete, and Inhambane provinces, with 80% of the people poor, and lowest in Maputo City, with 48% poor (table 4.8). Why the disparities? Unbalanced growth and differences in access to health and education.

Other demographic factors that influence the incidence of poverty are gender, education, and type and sector of employment. Male-headed households have lower incidences of poverty than female-headed households. Real consumption per capita is 15–18% higher in male-headed households than in female-headed households in urban areas, and 4–9% higher in the rural areas. The effects of literacy and education of the household head on per capita real consumption are stronger in the southern provinces than in the northern because of the greater opportunities for paid employment.
Poverty in Mozambique can also be attributed to low productivity in agriculture, lack of employment opportunities, weak physical infrastructure, and poor access to potable water, communications, and markets (Datt and others 2000). Poor integration of regional and local markets, because of weak transport infrastructure, also contributes to wide variations in welfare across regions. Disparities may deepen with the concentration of infrastructure investments in the Maputo area (table 4.9). Some parts of the country receive almost no direct investment.

**Table 4.8**

*Poverty indices, 1996–97*

<table>
<thead>
<tr>
<th>Regions/provinces</th>
<th>Food poverty headcount index</th>
<th>Basic consumption poverty gap index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural</td>
<td>55.7</td>
<td>20.3</td>
</tr>
<tr>
<td>Urban</td>
<td>44.5</td>
<td>16.0</td>
</tr>
<tr>
<td>Northern provinces</td>
<td>50.0</td>
<td>17.4</td>
</tr>
<tr>
<td>Central</td>
<td>59.4</td>
<td>22.6</td>
</tr>
<tr>
<td>South, with Maputo</td>
<td>47.7</td>
<td>16.5</td>
</tr>
<tr>
<td>South, without Maputo</td>
<td>54.1</td>
<td>19.3</td>
</tr>
<tr>
<td>National</td>
<td>53.4</td>
<td>19.4</td>
</tr>
</tbody>
</table>

*Note:* Disaggregated poverty data are not available for later years.

*Source:* Datt and others 2000.

**Table 4.9**

*Distribution of foreign and local direct investment, by province, 2001*

<table>
<thead>
<tr>
<th>Province</th>
<th>Foreign direct investment</th>
<th>National direct investment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>USS thousands</td>
<td>% of total</td>
</tr>
<tr>
<td>Maputo (city and province)</td>
<td>479,630</td>
<td>92.7</td>
</tr>
<tr>
<td>Sofala (centre)</td>
<td>17,370</td>
<td>3.4</td>
</tr>
<tr>
<td>Cabo Delgado (north)</td>
<td>8,859</td>
<td>1.7</td>
</tr>
<tr>
<td>Nampula (north)</td>
<td>5,818</td>
<td>1.1</td>
</tr>
<tr>
<td>Inhambane (south)</td>
<td>3,006</td>
<td>0.6</td>
</tr>
<tr>
<td>Manica (centre)</td>
<td>740</td>
<td>0.1</td>
</tr>
<tr>
<td>Zambezi Valley</td>
<td>706</td>
<td>0.1</td>
</tr>
<tr>
<td>Zambezia (centre)</td>
<td>706</td>
<td>0.1</td>
</tr>
<tr>
<td>Gaza (south)</td>
<td>445</td>
<td>0.1</td>
</tr>
<tr>
<td>Tete (south)</td>
<td>280</td>
<td>0.1</td>
</tr>
<tr>
<td>Niassa (north)</td>
<td>0</td>
<td>0.0</td>
</tr>
<tr>
<td>Total</td>
<td>517,561</td>
<td>100.0</td>
</tr>
</tbody>
</table>

The country’s new investment law calls the disadvantaged regions Rapid Development Zones, allowing special tax benefits for investors who establish operations in Niassa Province, Nacala District, Mozambique Island, Ibo Island, and Zambezi Valley (all the districts in Tete Province, and certain specified districts in Zambezia, Sofala, and Manica provinces). To ensure effective local participation in the new businesses, the activities eligible for fiscal benefits must promote development based on local comparative advantage: agriculture, forestry, aquaculture, livestock raising, lumbering, telecommunication, game animal exploitation, water supply, and electric energy generation, transmission, and distribution.

The government hopes to develop the Zambezi River Valley along the lines of the Tennessee Valley Authority (TVA) in the United States, and in February 2002 it opened discussions for possible assistance with TVA, the U.S. Agency for International Development, and the U.S. Army Corps of Engineers. When completed, the project would improve navigability, flood control, and reforestation and assist in industrial and agricultural development for a third of the country’s people.

The government also aims for high rates of sustainable, poverty-reducing growth by consolidating macroeconomic stability and increasing the provision of social services, based on:

- Pro-poor and pro-rural growth and development.
- Higher and more effective public expenditure, especially in education, health, and infrastructure.
- Conducive macroeconomic and business conditions.
- Private sector development.
- Good governance and justice.
- Strong central and local government institutional capacity to define, implement, and monitor public policies.

The medium-term expenditure framework seeks more effective use of public resources in education, health, agriculture, and rural development, for greater impact on poverty (table 4.10). The country reached the enhanced HIPC completion point in September 2001, reducing its foreign debt stock from about $6.1 billion to $1.6 billion. Debt relief will reduce annual debt repayment to $56 million between 2001 and 2012, half the $112 million due before June 1999. Though reduced, remaining debt is still close to half the budget for health.

Private sector—poised to benefit from regional markets

The private sector in Mozambique, weak after 15 years of socialism and state intervention, is moving away from a closed, centrally planned regime toward a market system underpinned by private ownership.
The quality and efficiency of business applications and queries has improved considerably in the last five years, with one-stop shops to deal with business registration and related issues (UNIDO 2002). The government has entered an agreement with the African Development Bank to set up a $4.7 million credit fund for small and medium-size enterprises, to complement UNIDO’s Integrated Programme for Small and Medium-Size Enterprises.

But bottlenecks remain: red tape, undercapitalization, a lack of skilled labour, investor-unfriendly labour laws, and weak infrastructure. The high cost of doing business in Mozambique is also attributed to outmoded and unclear rules and regulations and ineffective private-public consultative mechanisms (UNDP, UNIDO, and Mozambique Ministry of Industry and Commerce 2001; Nathan Associates 2002).7

**Foreign direct investment—from regional powerhouses**

In 1999 net flows of foreign direct investment hit 9.7% of GDP, 20 times the 0.4% in 1990. Flows are projected to reach $800 million, more than 20% of GDP, in 2002. Between January and August 2002 the Investment Promotion Centre approved about $1.7 billion in new projects, many of them large. The average investment rose from $21 million a year in 1989–94 to $800 million in 2002.

One of the main features of foreign direct investment flowing to Mozambique is this dominance of large projects. Another is the diversity of sources, from about 45 economies, ranging from Hong Kong to the United States (Mozambique, Ministry of Planning and Finance 2002b). South Africa has become the largest source of foreign direct investment in recent years, accounting for 70%, followed by Portugal (10%) and the United Kingdom (4%).

### Table 4.10


<table>
<thead>
<tr>
<th>Sector</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Priority areas</td>
<td>69.1</td>
<td>72.4</td>
<td>74.0</td>
<td>75.3</td>
<td>74.9</td>
</tr>
<tr>
<td>Education</td>
<td>24.1</td>
<td>20.7</td>
<td>21.3</td>
<td>21.4</td>
<td>21.5</td>
</tr>
<tr>
<td>Health</td>
<td>11.7</td>
<td>13.6</td>
<td>14.4</td>
<td>14.7</td>
<td>14.9</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>20.2</td>
<td>22.4</td>
<td>21.5</td>
<td>21.8</td>
<td>20.7</td>
</tr>
<tr>
<td>Agriculture and rural development</td>
<td>3.9</td>
<td>4.7</td>
<td>5.0</td>
<td>5.1</td>
<td>5.1</td>
</tr>
<tr>
<td>Governance</td>
<td>8.1</td>
<td>9.1</td>
<td>9.7</td>
<td>10.1</td>
<td>10.4</td>
</tr>
<tr>
<td>Other</td>
<td>1.1</td>
<td>1.7</td>
<td>2.1</td>
<td>2.2</td>
<td>2.3</td>
</tr>
<tr>
<td>Other sectors</td>
<td>30.9</td>
<td>27.6</td>
<td>26.0</td>
<td>24.7</td>
<td>25.1</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total (billions of meticais)</td>
<td>17,704</td>
<td>17,081</td>
<td>18,008</td>
<td>19,936</td>
<td>20,967</td>
</tr>
</tbody>
</table>

Source: Economic Commission for Africa, from official sources.
A major concern is that foreign investment projects provide limited employment opportunities for local labour because of the high skill requirements—and are insulated from the domestic economy through fiscal incentives and exemptions from administrative red tape. BHP-Billiton, owners of the Mozal aluminium smelter, have responded with a small and medium-size enterprise empowerment and linkages programme to provide technical support to local businesses, to train them in tendering procedures, and to improve their cost and financial management.

Privatization—mixed results
Second-generation reforms have focused on the public sector, privatization, the judiciary, tax administration and public financial management, and the legal and institutional environment for private sector development, all to reduce the cost of doing business and enhance the competitiveness of local production.

More than 840 companies were privatized between 1989 and 1997, 90% of them acquired by Mozambican companies and individuals. Privatization has been most successful in services, notably utilities and transport, probably thanks to the ease of valuing assets and the high interest of foreign investors. The energy sector has been liberalized, and the transport sector, including railways, has been partially liberalized. In May 2002 the domestic airline market was fully liberalized, to allow other airlines to operate on domestic routes previously monopolized by the state-owned airline, as specified under the Yamoussoukro Declaration on the Liberalization of Air Spaces in Africa. This is expected to result in lower domestic airfares as foreign companies enter the industry. In the telecommunication sector, Vodacom Mozambique, which has Vodacom South Africa as its majority owner, was awarded a license to set up the country’s second mobile telephone network in 2002.

Information and communication infrastructure—closing the digital divide
Telecommunication infrastructure is improving in Maputo and other urban centres, but remains weak in the rural areas. There are 4 telephone mainlines per 1,000 people (the average for Sub-Saharan Africa is 15), 2 cellular phone subscribers per 1,000 people (19 for Sub-Saharan Africa), and less than 0.1 internet host per 1,000 people (0.4 for Sub-Saharan Africa).

The government’s strategy is to develop information and communication technology policies to promote competition by liberalizing the telecommunications market and awarding new mobile telephony licenses, to provide universal access to communications services, and to coordinate public-private action to foster information and communication technology in education, health, human resources, information infrastructure, and government.

Public-private partnerships
Alone, neither the public sector nor the private sector can ensure sustained economic growth. But together they can promote Mozambique’s economic development, especially
in the provision of social services and public decisionmaking. Public-private consultations could help overcome the shortcomings in public resource management and enhance the delivery of public services. But the dialogue between the private sector and the central government is constrained by red tape, heavy bureaucracy, and a lack of incentives (Mozambique and EU 2002).

The government, the private sector, the donor community, and the universities agree that a sustained national consultative platform is critical to competitiveness and the inflow of foreign investment (UNDP, UNIDO, and Mozambique Ministry of Industry and Commerce 2001). So a secretariat for private-public dialogue has been set up to carry forward Mozambique’s development agenda.

Current policy is to involve the private sector in the construction and rehabilitation of transport infrastructure, in the management by contract or concession of ports, railways, airports, and air services and shipping.

Medium-term outlook—fairly favourable

The medium-term outlook is favourable because of improving agricultural production, new investments in aluminium and natural gas, and favourable international prices for aluminium, cotton, and shrimp. The economy is expected to grow 9–10% a year in 2003–05 (table 4.11). And aluminium production from the Mozal plant should generate about $3 billion in exports by 2006.

Higher oil prices would put pressure on local prices, as would growing social expenditures, especially on HIPC-related programmes. The government should thus continue its tight monetary stance and expand revenue collection efforts.

With poverty a major concern, implementation strategies for the Action Plan for the Reduction of Absolute Poverty should focus on labour-intensive export-oriented activities and on linkages between agriculture and agro-processing. The country also needs

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2003a</th>
<th>2004b</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth (%)</td>
<td>9.5</td>
<td>9.0</td>
<td>9.0</td>
</tr>
<tr>
<td>Inflation (%)</td>
<td>8.0</td>
<td>5.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Fiscal balance excluding grants (% of GDP)</td>
<td>-14.7</td>
<td>-13.2</td>
<td>-12.0</td>
</tr>
<tr>
<td>Trade balance (% of GDP)</td>
<td>-6.7</td>
<td>-2.4</td>
<td>4.1</td>
</tr>
<tr>
<td>Current account balance (% of GDP)</td>
<td>-10.0</td>
<td>-3.5</td>
<td>-3.5</td>
</tr>
</tbody>
</table>

* Forecast.
* Targeted.

Source: Economic Commission on Africa, from official sources.
to develop stronger links between the large foreign investment projects and the rest of the economy—to ensure faster growth, employment generation, and poverty reduction (box 4.6). In addition, the transfer mechanisms for getting public funds to provinces with development difficulties should be made more efficient.

Mozambique has to meet the standards of its neighbours in improving competitiveness—in innovating with policies, deepening reform of the public services, and streamlining banking procedures. President Chissano’s decision to step down in 2004 augurs well for national governance and the solidification of democratic institutions. But the challenges of good governance, national reconciliation, and political stability remain considerable, with accountability and transparency at the top of the agenda.

**Box 4.6**
**Threats to poverty reduction in Mozambique**

Mozambique’s economy has been growing at an average of 8% a year over the past decade, but the population living below $0.40 a day (the national poverty line) remains above 60%. The government has put in place a major effort under the Action Plan for the Reduction of Absolute Poverty to meet the challenges. But some serious questions remain.

- What is the capacity for the economy to continue to grow by at least 7% a year in the absence of generous development assistance?
- What would be the impact of natural disasters, notably floods in agricultural areas, for which there are no contingency plans?
- How can the mega projects, vulnerable to unforeseen international market developments, increase employment opportunities for the poor and unskilled?
- How can human resources be developed to support programme implementation?
- What will be the impact of HIV/AIDS?
- What needs to be done to increase the capacity of public and private institutions, particularly with decentralization?

*Source: UNDP and Mozambique 2002.*

**Notes**

1. In Portuguese Frelimo stands for Frente de Libertaçäo de Moçambique, and Renamo for Resistência Nacional de Moçambique.

2. Maize yields vary between 0.7 and 0.9 tons a hectare, against an average yield in Southern Africa of 1.2 tons a hectare (Mozambique and EU 2002).

3. Fiscal sustainability is achieved when the levels of domestic and external borrowing necessary to finance the budget deficit are not likely to lead to a debt crisis over time and rising interest rates do not crowd out domestic private investment.
4. There are two poverty lines, the food poverty line and the basic consumption poverty line, which includes nonfood consumption. For each poverty line there are different poverty lines for each province and for rural and urban areas. The national poverty line is a weighted average of the different regional poverty lines.

5. The national basic consumption poverty line of 160,780 meticais per month per person (about $170 per person per year, at the average exchange rate prevailing during the survey period), obtained from the 1996–97 National Household Survey of Living Conditions data, was based on estimates of mean per capita daily calorie requirements (food consumption) and nonfood components (see Datt and others 2000). The national food poverty line is 130,377 meticais (about $0.40) a day per person.

References


Ghana’s economy grew 4.5% in 2002, better than the 4.2% in 2001 and the 3.7% in 2000, but well below the target of 8% as outlined in Vision 2020. The robust recovery in gold and cocoa prices boosted the economy. Gold rose from $325 an ounce in 2001 to $347 in 2002. Cocoa prices soared to a 16-year high of $2,157 a ton in September 2002, 60% higher than in September 2001, given the disruption of production with the military uprising in Côte d’Ivoire, the world’s largest cocoa producer.

External reserves improved to about three months of imports in 2002, while the cedi remained stable against most major currencies. But the current account deficit increased from 4% of GDP in 2001 to 6.2% in 2002, largely because of high oil prices and high debt servicing costs. Lower debt service payments under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative should improve the external balance, to the tune of about $273 million.

The monetary policy stance improved in 2002—with inflation down to 15%, from 21% in 2001 and 40% in 2000. The inflation outturn was due largely to a substantial improvement in food supply, prudent monetary policy, and fiscal restraint. Interest rates kept to their downward trend, with the benchmark treasury bill discount rate declining from 27% at the end of December 2001 to 25% in September 2002. The fiscal deficit declined to 6% of GDP in 2002 from 9% a year before. A major setback for the stability of the financial sector: the accumulating debt of Tema Oil Refinery, more than $400 million in December 2002, a result of government delays in allowing total cost recovery for petroleum products distributed in the country. To restructure the refinery’s debt, subsidies on petroleum had to be lifted—this led to a 93% increase in petroleum prices in January 2003.

Rapid growth in the money supply and high inflation have hurt economic performance in recent years, locking Ghana into a low quality growth equilibrium by dampening private investment—a key determinant of economic growth.

- First, huge budget deficits and associated spikes in inflation heightened uncertainty about the government policies. This increased the risk premium in Ghana, leading domestic and foreign investors to wait and see.
- Second, the huge fiscal deficits led to an explosion in domestic debt, which crowded out credit to the private sector, further constraining financing options for firms.
- Third, deficit financing through the issue of high-yielding treasury bills has inverted the yield curve on government securities, giving higher rewards to...
National poverty statistics show a decline from 52% to 40% over the past decade—lifting 2 million people out of poverty. But the national statistics mask wide regional disparities, with increases in 3 of 10 regions—central, northern, and upper east. The trend in other social indicators is promising, with life expectancy up from 49 years to 57 and youth literacy reaching 91% in 2001. Of concern, per capita government spending on health and education has declined.¹

The medium-term outlook is cautiously optimistic largely because of better fiscal discipline and stronger exports. Rising external inflows from cocoa proceeds, gold sales, and remittances will stabilize the exchange rate. But downside risks include the danger of lax monetary and fiscal policies in the runup to the general election in 2005, especially massive wage increases unsupported by productivity gains. The conflict in Côte d’Ivoire could increase the risk premium for foreign and domestic investment, damping private sector activity and depressing remittances from the thousands of Ghanaians in Côte d’Ivoire. Additional downside risks include the high levels of domestic debt that may crowd out private investment and derail social programmes. Overall, however, Ghana stands to benefit as a result of the Côte d’Ivoire crisis.

A key policy challenge is to jump-start public service reforms in financial and economic management. Vigorous pursuit of these reforms will help promote a stable fiscal environment for private sector development and enhance implementation capacity for the country’s poverty reduction and social programmes. Other key challenges are to reverse the worsening of rural poverty and ease the political tensions arising from the debt-driven petroleum price increases in January 2003.

Recent economic developments

Despite better macroeconomic management, economic growth rose only slightly (box 5.1 and table 5.1). The 4.5% growth in 2002 is consistent with the average growth rate over the past 15 years, leading observers to suggest that Ghana is locked into a low growth trap (figure 5.1). Perhaps of more concern, growth has not transformed the structure of the economy or delivered significant improvements in the quality of life (Aryeetey and Fosu 2002; Killick 2000; Aryeetey, Harrigan and Nissanke 2000).

The structure of the economy shifted in the 1990s towards services, with little change in the share of industry. This shift is not a sign of structural change but merely reflects investors in short-dated securities than in long. So, many potential investors prefer to hold short-term instruments, restricting private firms from raising long-term capital. This means of deficit financing has also shifted resources from the securities market to the government bill market, leaving the securities market thin and illiquid.

For 1995–2002 private investment averaged only 4.1 percent of GDP, despite the recent improvements in fiscal discipline.
the direction of new short-term capital flows marking the end of stagnation (Aryeetey and Fosu 2002). Much of the increase in the share of the services comes from low-tech activities—wholesale, retail, restaurants, and hotels.

Underinvestment is the most consistent explanatory variable for the growth differences between Ghana and other countries (figure 5.2) (O’Connell and Ndulu 2000; Asea and Paddison 2003). This confirms other studies that show investment to be the most robust explanatory variable in the growth equation of developing countries (Levine and Renelt 1992). For Ghana, fiscal exuberance, reflected in high inflation and high government spending, has depressed economic growth.

**Box 5.1**

**Better economic management in 2001—the new government’s first year**

The government has managed the economy and met all the monetary and fiscal performance indicators under the International Monetary Fund (IMF)/World Bank programmes for 2001:

- The overrun on public sector borrowing requirements dropped from 981% in 2000 to a moderate 27% in 2001, while net domestic financing, adjusted for domestic payment arrears, improved from 9.3% of GDP in 2000 to 2.3% in 2001.
- The average inflation rate fell from 41% at the beginning of 2001 to 21% at the end of 2002.
- The average rate of depreciation of the cedi against the dollar declined from 49% in 2000 to 3.7% in 2001.
- The treasury bill rate declined from 47% to about 29%.
- Tax revenue increased by 18% through more effective tax administration.
- The net foreign assets position improved from –300 billion cedis (about $45 million) in 2000 to 2,300 billion cedis (about $180 million) at the end of 2001.
- Import cover of external reserves improved from 1 month in 2000 to 1.7 months in 2001.
- Streamlining the public debt accounting framework and shifting government domestic borrowing from bank to nonbank instruments eased pressure on credit available to the private sector.

*Source: Economic Commission for Africa, from official sources.*

**Table 5.1**

**Sectoral growth rates, 1998–2002 (%)**

<table>
<thead>
<tr>
<th>Sector</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>5.1</td>
<td>3.9</td>
<td>2.1</td>
<td>4.0</td>
<td>4.1</td>
</tr>
<tr>
<td>Industry</td>
<td>3.2</td>
<td>4.9</td>
<td>3.8</td>
<td>2.9</td>
<td>4.7</td>
</tr>
<tr>
<td>Services</td>
<td>6.0</td>
<td>5.0</td>
<td>5.4</td>
<td>5.1</td>
<td>4.7</td>
</tr>
<tr>
<td>GDP</td>
<td>4.7</td>
<td>4.4</td>
<td>3.7</td>
<td>4.2</td>
<td>4.5</td>
</tr>
</tbody>
</table>

*a. Estimated.*

*Source: Economic Commission for Africa, from official sources.*
Mining, up by about 5% in 2002 after a decline of 2% in 2001, and an upsurge in construction accounted for much of the growth in 2002. The weaknesses in mining, caused by a slump in the world price of gold in 2000 and early 2001, was overcome in 2002, as production increased. Ashanti’s gold production, down from 914,699 ounces in 2000

**Figure 5.1**

*Low quality growth trap?*

*Real GDP per capita growth, 1965–2001 (%)*

![Graph showing real GDP per capita growth](image)

*Source: Economic Commission for Africa, from official sources.*

**Figure 5.2**

*Investment—disappointing*

*Gross domestic investment, public investment, and private investment, 1984–2000 (% of GDP)*

![Graph showing investment](image)

*Source: Economic Commission for Africa, from official sources.*

to 781,503 ounces in 2001, will probably exceed 800,000 ounces in 2002 (Ashanti Goldfields Ltd. 2002).

Agriculture contributed about 36% of GDP in 2002, industry (including mining) 25%, and services 39%. The distribution of GDP has remained much the same since 1997, with the share of the services increasing marginally from 38% in 1997 to 39% in 2002 at the expense of agriculture, whose share fell from 37% to 36% (figure 5.3).

**Agriculture—exceeds targets**

With good weather, food crops exceeded their targets in 2002, pushing down the prices of some staple foods by more than 75% from December 2001 to December 2002.

Maize production in 2002 was 1.6 million tons, compared with the target of 1.4 million tons (Ghana, Ministry of Food and Agriculture 2003). Cassava recorded a surplus of 3.9 million tons, about 40% greater than the target of 9.8 million tons. Yam and plantain had surpluses of 2.2 million and 2.8 million tons. Rice production—which in the 1970s and 1980s accounted for 60% of national consumption and helped reduce the pervasive poverty in the northern regions, where rice is grown—picked up in 2001 with 316,000 metric tons from 230,000 tons in 2000.

For food crops, the livelihood for more than 60% of Ghanaian households, the government is concentrating on storage, processing, mechanization, and small-scale irrigation.

The President’s Special Initiatives for accelerating growth and poverty reduction include specific actions for cassava. A sizable amount of the surplus production is to be

---

**Figure 5.3**

No structural transformation

Sectoral distribution of GDP, 1997–2002 (%)

Source: Economic Commission for Africa, from official sources.

---
converted into products such as *gari*, cassava dough, and cassava powder, common staples for about 100 million indigenous people in coastal west and central Africa. The Ministry of Women and Children’s Affairs, through its Women’s Development Fund, acquired and installed 200 gari processing machines in the cassava growing areas of the country. A $4 million starch plant started operating in March 2003. And high-yielding disease-free cassava sticks have been introduced for planting. These initiatives will improve incomes for food farmers, the poorest occupational group in the country.

Cocoa remains one of the most important tree crops, providing livelihoods for more than a million Ghanaians and accounting for a third of foreign exchange. Of concern is the smuggling of cocoa to Togo and Côte d’Ivoire, one source of the long-term decline in formal production since the 1970s, because of the wide differences in producer prices between Ghana and its neighbours.

With the military uprising in Côte d’Ivoire, cocoa prices soared to $2,157 a ton in September 2002, about 60% higher than in December 2001. But this rise did not immediately help foreign exchange earnings because most cocoa is sold in forward markets.

Recent measures by government to improve cocoa production include introducing new agronomic technology, increasing producer prices, rehabilitating feeder roads in cocoa-growing areas, conducting regular spraying exercises to control diseases and pests, boosting local processing, and educating farmers. The Cocoa Research Institute of Ghana, in collaboration with the Ghana Cocoa Board, is experimenting with a new hybrid technology that will make cocoa an all-year crop in Ghana, to be harvested nine times instead of the present three.

**Industrial performance—disappointing**

The contribution of the manufacturing sector dropped from 15% of GDP in the mid-1970s to 9% in 2001. Ghana’s industry was heavily protected under import-substitution policies after independence, and with the liberalization of trade in 1984 many firms lost their monopoly positions and collapsed, especially in textiles and garments.

Energy supply has been one of the most formidable constraints to industrial production, with rising oil prices and power rationing because of low water levels at Akosombo Dam. The Volta River Authority has an installed capacity of 1,652 megawatts (MW), but produces only around 750 MW because of failed rains. National demand is 1,210 MW. The deficit is met by imports of electricity from Côte d’Ivoire, while consumption growth is held in check through load shedding and other power sharing arrangements (figure 5.4). To improve the situation, Ghana has begun constructing thermal power plants, and the Takoradi thermal plant produces 385 MW.

Ghana is also a partner in the West Africa Gas Pipeline Project, a 600-kilometre natural gas transmission pipeline from Nigeria through the Republic of Benin to Ghana, at an estimated cost of $500 million. The pipeline, which will have lateral lines to supply
Benin and Togo, will transport gas from the vast reserves in Nigeria. About 85% of the
gas transported to Ghana is for electricity generation and the remaining 15% for indus-
trial development. The government considers the project a cornerstone of the National
Energy Security and Sustainability Strategy. Gas deliveries from the project are expected
to start in late 2005 or early 2006.

**Services—slowing down**

Services, previously showing the strongest growth, slowed from 5.1% in 2001 to an esti-
ipated 4.7% in 2002, due to a slowdown in the expansion of government services. Tourism
remained the fastest growing service, with hotels and restaurants expanding rapidly, push-
ing receipts from $205 million in 1993 to $386 million in 2000. Tourist arrivals, mostly
Ghanaians living abroad, rose from 257,000 to 399,000 in the same period, implying an
increase in the average expenditure per tourist from about $800 to $970.

Growth in telecommunications has been slower than expected, due largely to problems
in the privatization of Ghana Telecom and in the licensing contracts of some new com-
panies. To take over the direct management of Ghana Telecom, the government of
Ghana brought in Telekom Malaysia, which holds only 30% of the shares.

Another problem is noncompliance with contractual agreements. Western Telecom-
munications (WESTEL), one of the four cellular phone operators in the country,
agreed to provide 400,000 connections between 1996 and 2000, but by the end of 2001
had reportedly provided only 2,000 connections. So growth in telephone lines has been
sluggish.² Telephone mainlines increased from 3 per 1,000 people in 1990 to 12 in

---

**Figure 5.4**

*Electricity production—short of demand*

*Electricity supply deficit, 1994–2000 (millions of kilowatt-hours)*

---


2. Growth in telephone lines has been sluggish.
2000, while cellular phone subscribers increased to 6 per 1,000 people from almost zero—both well below the average for Sub-Saharan Africa of 15 mainlines and 19 cellular subscribers per 1,000 people.

**Monetary policy stance—improving**

The year-on-year growth in broad money (M2+) increased almost 48% in 2002, up from 36% in 2001. All the major components of broad money, particularly savings, time deposits, and foreign currency deposits, reflected the increase (table 5.2). Even so, the Bank of Ghana and the government remain committed to restraint. Interest rates maintained their downward trend, though at 32–40% the rates are still too high to make bank credit accessible to the private sector. The treasury bill discount rate fell to 24% in September 2002, from 27% in December 2001, while the major commercial banks adjusted their base interest rates down from an average of 35% in December 2001 to 27% in April 2002. The average bank lending rate remained high at 36%, way above the average interest rates on demand and savings deposits of 8–9.5%.

Inflation declined from 21% in 2001 to 15% in 2002 (figure 5.5), thanks to the improved food supply and the stability of the cedi against the dollar, supported in part by the inflow of remittances from Ghanaians abroad, $1.2 billion in 2002. Food prices, with a 52% weight in the Consumer Price Index, fell in the last quarter. But monetary growth threatened price stability because of the growth in foreign currency deposits and quasi money. Inflation is certain to rise in 2003 (the projection is 18%) with the 98% petroleum price increase announced in January 2003.

Other important policy actions in 2002 include the Bank of Ghana Act, establishing the independence of the central bank. It also establishes a Monetary Policy Committee,

<table>
<thead>
<tr>
<th>Money supply</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Narrow money</td>
<td>2,543</td>
<td>3,534</td>
<td>5,155</td>
<td>6,979</td>
</tr>
<tr>
<td>Quasi money</td>
<td>1,434</td>
<td>1,788</td>
<td>2,752</td>
<td>4,207</td>
</tr>
<tr>
<td>Broad money supply, M2</td>
<td>3,977</td>
<td>5,323</td>
<td>7,907</td>
<td>11,179</td>
</tr>
<tr>
<td>Foreign currency deposits</td>
<td>970</td>
<td>1,943</td>
<td>2,374</td>
<td>3,990</td>
</tr>
<tr>
<td>Broad money supply, M2+</td>
<td>4,947</td>
<td>7,266</td>
<td>10,281</td>
<td>15,169</td>
</tr>
<tr>
<td>Net foreign assets</td>
<td>57</td>
<td>-299</td>
<td>1,503</td>
<td>2,303</td>
</tr>
<tr>
<td>Net domestic assets</td>
<td>4,891</td>
<td>7,564</td>
<td>8,778</td>
<td>12,866</td>
</tr>
<tr>
<td>Net credit to government sector</td>
<td>3,024</td>
<td>6,068</td>
<td>6,563</td>
<td>8,604</td>
</tr>
<tr>
<td>Net credit to private sector</td>
<td>2,466</td>
<td>3,836</td>
<td>4,472</td>
<td>10,009</td>
</tr>
<tr>
<td>Other items</td>
<td>-600</td>
<td>-2,340</td>
<td>-2257</td>
<td>-5,747</td>
</tr>
<tr>
<td>Total money supply</td>
<td>4,947</td>
<td>7,266</td>
<td>10,281</td>
<td>15,169</td>
</tr>
</tbody>
</table>

---

Table 5.2

Money supply and its makeup, 1999–2002 (billions of cedis)

*Projections based on end-September figures.

Source: Economic Commission for Africa, from official sources.
to help the Bank of Ghana design appropriate policies to maintain macroeconomic stability and mobilize savings for national development. The bank revised its reserve requirement on foreign currency holdings to encourage foreign currency deposits, allowing commercial banks to hold primary (cash) reserves against foreign currency deposits in foreign currency rather than cedis.

**Monetary convergence—generally slow**
Progress towards establishing the Second West African Monetary Zone by 2005—with Ghana, The Gambia, Guinea, Nigeria, Liberia, and Sierra Leone—has been slow, both in establishing the required institutions and in fulfilling the convergence criteria (box 5.2). The union is aimed at facilitating trade, travel, and tourism among West African countries. Public awareness campaigns in member countries began in February 2002 to ensure that the public fully understands the costs and benefits of monetary integration. A fast-track approach, involving external technical assistance to member governments and central banks under the new West Africa Monetary Institute in Accra, is to achieve the convergence criteria by 2005. Ghana has made good progress towards the convergence criteria, to be fully met by the end of 2004 (table 5.3).

**Equity and credit markets—not serving the private sector well**
Equity and credit markets are an important source of finance. But the equity market is still in its infancy. The bond market remains extremely weak. And the banking system is plagued with nonperforming loans.

---

**Figure 5.5**
*Inflation down again*

*Inflation (Consumer Price Index), 1983–2002 (%)*

Source: Economic Commission for Africa, from official sources.
The Ghana Stock Exchange began operation in 1990, but it remains small with a market capitalization of only 1.2% of GDP, compared with 6.2% in Côte d’Ivoire and 5.2% in Kenya. Turnover remains sluggish at 0.5, compared with 2.2 in Kenya.

The Ghana Stock Exchange All-Share Index rose from 956 at the beginning of 2002 to 1,395 at year’s end (figure 5.6). The government is privatizing the Cocoa Processing

**Box 5.2**

**Will Ghana benefit from monetary union?**

Ghana is one of five West African countries contemplating establishing a second West African monetary zone. A recent study finds that Ghana, The Gambia, Guinea, and Sierra Leone would be worse off in the zone than if they had their own monetary policies. Nigeria is the only country that will be better off. Ghana suffers a net loss because of three factors:

- Nigeria has very high spending propensities relative to the other countries.
- Nigeria has very different terms of trade shocks from those of the other countries.
- Nigeria accounts for 68% of the group’s GDP, so it would dominate the union’s monetary policy.

Ghana accounts for 18% of the group’s GDP, has a spending propensity almost the same as the average for the group, and its terms of trade shocks are negatively correlated to the average for the group. But if Ghana enters a monetary union that includes all Economic Community of West Africa States, the net benefits to Ghana are positive because its spending propensity is higher than the average for the group. When Nigeria’s spending propensity is the same as the average for the Economic Community, Ghana’s membership gain increases because Nigeria’s fiscal distortion is eliminated.


**Table 5.3**

**Ghana’s performance on convergence criteria, 2000–03 (%)**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>New West Africa Monetary Zone target</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflation rate</td>
<td>Single digit</td>
<td>40.7</td>
<td>21.3</td>
<td>15.2</td>
<td>18.0</td>
</tr>
<tr>
<td>Fiscal deficit/GDP</td>
<td>5 or less</td>
<td>9.7</td>
<td>9.0</td>
<td>6.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Central bank financing/tax revenue</td>
<td>10 or less</td>
<td>57.9</td>
<td>17.9</td>
<td>10.0</td>
<td>10.0</td>
</tr>
<tr>
<td>Foreign reserves (months of import cover)</td>
<td>3 or more</td>
<td>1.0</td>
<td>1.7</td>
<td>2.6</td>
<td>3.0</td>
</tr>
</tbody>
</table>

a. Estimated.

b. Targeted.

*Source:* West African Monetary Institute 2001; Economic Commission for Africa, from official sources.
Company by divesting 25% of its shareholding, which would increase the number of listed companies to 24. The company will have a capitalization of more than 800 billion cedis, second only to Ashanti Goldfields Ltd., which has a market capitalization of 2,100 billion cedis.

Credit markets in Ghana perform poorly because of the way the government finances its expenditures. Issuing large quantities of high-yielding bills to meet fiscal requirements has inverted the yield curve on government securities, giving higher rewards to investors in short-dated securities. So, many potential investors, including banks, prefer to hold short-term government treasury bills. This has shifted resources from the money markets to the government bill market, leaving the money markets both thin and illiquid. One solution to this problem is to revitalize the bond market.

The lack of a vibrant bond market can be attributed to the unfavourable economic environment, the availability of investment substitutes, weak secondary markets, and the absence of a credit rating agency.

**Fiscal policy—greater discipline, but some slippage**

An encouraging recent development: greater fiscal discipline. Note the turnaround from unbridled, wayward spending to strict management of scarce government revenues—and from careless seepage of tax proceeds into private pockets to controlled channeling of proceeds into the government treasury. The overall cash deficit declined from 8.5% of GDP in 2000 to 4.4% in 2001 (table 5.4). The outturn for 2002 deteriorated, however, with the cash deficit rising to 6.9% of GDP.

**Figure 5.6**

*Stocks up 46%*

*Ghana Stock Exchange All-Share Index, 2002*

![Graph showing Ghana Stock Exchange All-Share Index, 2002](chart.png)

*Source: Economic Commission for Africa, from official sources.*
All major components of government revenues (except nontax revenue) exceeded their targets, with taxes on international trade overperforming by over 30%, thanks to better tax administration and surveillance on the borders. Nonreceipt of project and programme grants was the main reason for the shortfall in nontax revenues, about 50% of the target. By the third quarter of 2002, only 18% of programme grants had been received. Assistance under the Heavily Indebted Poor Countries (HIPC) Initiative, about $273 million, exceeded the target.

The increase in the 2002 deficit is attributable mainly to the programme expenditures arising from grade adjustments in the Ghana Education Service under the Universal Salary Structure and the payment of additional duty allowances in the public health sector—and to the delays in external inflows.

The public sector borrowing requirement, a key performance criterion for the IMF’s Poverty and Growth Facility arrangement, has been consistently breached. For example, it was overrun by 981% in 2000. But the overrun in 2001 was only 27%. Financing by accumulating payments arrears declined from a high of nearly 33% of total domestic borrowing in 1999 to 2.5% in 2001.

The biggest fiscal challenge at the beginning of 2001 was the domestic debt. When the new government took over in January 2001, the domestic debt was not immediately known. Different government agencies supplied figures that changed by the day, in a range of 9 to 12.5 trillion cedis. The recent improvements in public debt accounting should address this uncertainty. And the shift from bank to nonbank instruments to meet the government’s borrowing requirements means less crowding out of the private sector.

### Table 5.4
Fiscal performance 2000–02 (billions of cedis)

<table>
<thead>
<tr>
<th>Item</th>
<th>2000</th>
<th>2001</th>
<th>2002*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payments</td>
<td>9,916</td>
<td>11,680</td>
<td>16,359</td>
</tr>
<tr>
<td>Receipts</td>
<td>9,916</td>
<td>11,680</td>
<td>16,359</td>
</tr>
<tr>
<td>Total tax revenue</td>
<td>4,811</td>
<td>6,904</td>
<td>8,786</td>
</tr>
<tr>
<td>Grants</td>
<td>574</td>
<td>1,570</td>
<td>1,982</td>
</tr>
<tr>
<td>Other receipts, including project loans and divestiture proceeds</td>
<td>2,134</td>
<td>2,344</td>
<td>4,660</td>
</tr>
<tr>
<td>Net domestic financing</td>
<td>2,397</td>
<td>862</td>
<td>139</td>
</tr>
<tr>
<td>Financing gap</td>
<td>0</td>
<td>0</td>
<td>792</td>
</tr>
<tr>
<td>Overall cash deficit (% of GDP)</td>
<td>8.5</td>
<td>4.4</td>
<td>6.9</td>
</tr>
<tr>
<td>Domestic revenue (% of GDP)</td>
<td>17.7</td>
<td>18.2</td>
<td>18.7</td>
</tr>
<tr>
<td>Tax revenue (% of total payments)</td>
<td>48.5</td>
<td>59.1</td>
<td>53.7</td>
</tr>
</tbody>
</table>

*Estimated.

Source: Economic Commission for Africa, from official sources.
**External trade and payments—better in 2002**

The Ghanaian economy is very dependent on the external sector. Gold, cocoa, and timber contribute more than 70% to export revenues while 60% of the country’s budget is supported by external inflows. So any external shock easily manifests itself first in the exchange rate, which then reverberates to other aspects of the economy. Between 1984 and 2000 the nominal exchange rate fell from 36 cedis to the dollar to 5,400. In 2000 alone the nominal exchange rate was down by 98%, but year on year there was a deceleration to 5% in 2001 (figure 5.7).

The external balance worsened in the 1990s. In 1997 the balance of trade deficit was 5.8% of GDP, compared with 1% in 1984, and in 2000 it increased to 8.4% (table 5.5). What explains this? Weak export capacity, the long-term decline in international prices for cocoa and gold, and rapid growth in the demand for consumer imports.

**Figure 5.7**

*Exchange rates—plummeting*

*Effective nominal and real exchange rates, 1985–2000 (1995=100)*

<table>
<thead>
<tr>
<th>Year</th>
<th>Nominal effective exchange rate</th>
<th>Real effective exchange rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>1,500</td>
<td>1,200</td>
</tr>
<tr>
<td>1990</td>
<td>600</td>
<td>300</td>
</tr>
<tr>
<td>1995</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>2000</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

*Source: Economic Commission for Africa, from official sources.*

**Table 5.5**

*External performance, 2000–02*

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade balance</td>
<td>–830</td>
<td>–848</td>
<td>–821</td>
</tr>
<tr>
<td>Growth of exports (%)</td>
<td>–3.5</td>
<td>–2.2</td>
<td>7.6</td>
</tr>
<tr>
<td>Growth of imports (%)</td>
<td>–15.2</td>
<td>–3.9</td>
<td>7.8</td>
</tr>
<tr>
<td>Average cedi-dollar exchange rate</td>
<td>5,431</td>
<td>7,300</td>
<td>8,200</td>
</tr>
<tr>
<td>Current account balance (% of GDP)</td>
<td>–8.4</td>
<td>–6.6</td>
<td>–2.2</td>
</tr>
<tr>
<td>Gross external reserves (months of imports)</td>
<td>1.0</td>
<td>1.7</td>
<td>2.6</td>
</tr>
</tbody>
</table>

*a. Estimated.*

*Source: Economic Commission for Africa, from official sources.*
The external reserve position depends on aid inflows, given the weaknesses of exports. In 2000 the import coverage of external reserves dropped to about one month. Despite one of the worst trade performances in 2001, a substantial increase in external assistance improved the balance of payments, and gross international reserves rose slightly to seven weeks of import cover. Exceptional programme support—$364 million in programme grants, concessional loans, and deferred loan repayments—moderated the poor performance of traditional exports in the balance of payments.

Ghana reached the decision point under the enhanced HIPC Initiative in February 2002.

The enhanced HIPC Initiative

Ghana was eligible for debt relief under the enhanced HIPC Initiative in 1999, but not until February 2001 did the government opt for debt relief. When Ghana became eligible for relief in 1999, its debt burden indicators were not significantly above the critical values. The relief that Ghana would have qualified for was thus not very large, especially given the costs. One such cost was Japan’s warning that Ghana, under the HIPC Initiative, would not be eligible for bilateral loans from Japan.

At the end of 2000 the total nominal public external debt stock was estimated at $5.9 billion, including $40 million in repayment arrears. Total debt in net present value terms was estimated at $3.8 billion, about 558% of government revenues, 152% of exports of goods and nonfactor services, and 77% of GDP. (Table 5.6 shows the estimated impact of debt relief on debt service ratios.) Of the debt 52% was owed to multilateral creditors and 48% to bilateral and commercial creditors. The International Development Association (IDA), IMF, and African Development Bank accounted for 93% of the multilateral debt. Japan and the United Kingdom were the largest bilateral creditors, with 60% and 10% of the bilateral outstanding debt. Commercial debt amounted to $348 million in nominal terms, with Samsung of Korea the largest creditor with 37% of the outstanding commercial debt in nominal terms in 2000. Contracted by the Tema Oil Refinery, this debt is collateralized against the company’s assets.

Ghana reached the decision point under the enhanced HIPC Initiative in February 2002. An estimated $2,186 million in debt relief is required to bring the net present

Table 5.6
Estimated medium-term impact of enhanced HIPC Initiative debt relief

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt service ratio before debt relief (%)</td>
<td>n.a.</td>
<td>15.7</td>
<td>15.2</td>
<td>14.3</td>
<td>13.0</td>
</tr>
<tr>
<td>Debt service ratio after traditional debt relief (%)</td>
<td>20.3</td>
<td>14.5</td>
<td>13.0</td>
<td>2.4</td>
<td>11.3</td>
</tr>
<tr>
<td>Debt service ratio after enhanced HIPC relief (%)</td>
<td>8.9</td>
<td>5.0</td>
<td>4.1</td>
<td>3.4</td>
<td>3.4</td>
</tr>
<tr>
<td>Exports of goods and services (US$ billions, projected)</td>
<td>2.42</td>
<td>2.59</td>
<td>2.83</td>
<td>3.06</td>
<td>3.26</td>
</tr>
</tbody>
</table>

n.a. Reliable data not available.

Source: Economic Commission for Africa, from official sources.
value of the debt to revenue ratio below the critical value of 250%. In 2002 the projected debt relief for Ghana was $273 million, with 20% to be used for domestic debt reduction and the remaining 80% earmarked for poverty reduction programmes and activities. To reach its completion point, Ghana is expected to undertake certain actions and achieve specified targets (box 5.3).

**Box 5.3**

**Ghana’s HIPC Initiative relief triggers**

**Poverty Reduction Strategy**
- Formulate and satisfactorily implement the Ghana Poverty Reduction Strategy for at least one year.
- Maintain macroeconomic stability.
- Ensure appropriate use of budgetary savings from HIPC relief.

**Governance**
- Establish a procurement regulatory and oversight body to implement the new governance code.
- Develop internal audit capacity through full staffing of internal audit positions.

**Public expenditure management**
- Publish regular reports on cash expenditures and commitments by ministries, departments, and agencies.
- Install a computer-based financial management information system on a pilot basis in the Ministry of Finance, Controller and Accountant General’s Department, and at least two key sector ministries.

**Social indicators**
- Increase gross primary enrolment rates for girls from 72% in 2002 to 74%.
- Increase the percentage of rural households with access to safe water from 40% in 2000 to 46%.
- Increase district and subdistrict share in recurrent health expenditures from 42% in 2000 to 45%.

**Decentralization**
- Submit a Local Government Services Bill to Parliament.
- Develop a monitoring system to provide regular data on local government activities.
- Develop district composite budgets in pilot districts.

**Energy**
- Maintain an automatic pricing formula in petroleum, allowing for cross-subsidization of products.
- Move to full economic pricing in the electricity sector, with lifeline provision to allow access to electricity by low-income consumers.

*Source: Economic Commission for Africa, from official sources.*
Promoting export-led growth

Ghana can also reduce its debt service ratio and boost growth by increasing exports (boxes 5.4 and 5.5). Nontraditional exports, with a value of more than $400 million in 2001, are receiving more government support through the Export Promotion Council (figure 5.8). There has also been a strong campaign to take advantage of the U.S. African Growth and Opportunities Act (AGOA) in Ghana, with a Presidential Special Initiative on garments.

The Export Action Programme for Garments and Textiles aims to develop a critical mass of high growth-oriented, internationally competitive exporting firms targeting U.S. and European markets. It supports training schemes for companies to improve

Box 5.4
The false seduction of protection

Ghana has tried to use import tariffs to protect local producers, a response to some policymakers who believe that they should have more flexibility to respond to emerging “needs” for protection. The garment and textile industry illustrates some of the difficulties.

Garments, a basic good for all Ghanaians, are subject to an import tariff of 25%, intended to assist local producers. But the magnitude of the tariff, together with the size of the local market, serves as a magnet to smugglers. Two of the most important forms of smuggling are transit shipments and imports of “used” clothing.

Assume that 10 containers enter Ghana for transshipment to a neighboring country. As transit shipments they are exempt from import duty. The goods are accompanied by customs officials while in transit to the neighboring country and are documented as being cleared out of Ghana. In reality, through collusion by dishonest traders and customs officials, only one of the containers (at most) actually leaves Ghana, with the contents of the remainder sold in the local market. This is good for local consumers, for the traders, and for the customs officials involved. But it severely reduces government revenue and the protection provided to local garment producers by the 25% tariff.

Without smuggling the 25% tariff on garments would raise domestic prices 25% above world prices. If the tariff also raised the price of cloth, the main input, by 25%, the garment industry would benefit from substantial effective protection of about 25%. However, with widespread smuggling and undervalued imports of used clothing, the tariff is unlikely to raise the prices of garments by much more than 10%. This would make the effective protection for garments negative, probably −35%. Heavy protection of textiles is harmful to garment producers. So, despite earnest efforts to protect all segments of the garment and textile industry, the government has been more successful in subsidizing smuggling and negatively effecting protection to garments, the most labor-intensive sector of the industry—certainly not the government’s intention.

A much simpler and more uniform tariff structure, starting with a maximum rate of no more than 10%, would provide more neutral protection, reduce smuggling, contribute to government revenues, and likely reduce the local price of clothing.

Source: Economic Commission for Africa, from official sources.
quality and provides financial assistance and other support. Small industrial villages have been established to make garments for export to the United States. Fourteen garment and textile companies benefited from training schemes to improve their standards in 2002. Nontraditional exports to the United States increased from $35 million in 2001 to an estimated $42 million in 2002. The initiative is expected to inject $3 billion into the economy and create 90,000 full-time jobs for Ghanaians.

**Box 5.5**

*The dangers of using tariffs for income redistribution*

It is tempting to try to use import tariffs to achieve redistribution goals, taxing imports of luxury goods at relatively high rates and exempting or zero-rating imports of basic goods. Ghana does this to some extent already. Bicycles, a basic good, face a zero rate of import duty; television sets are taxed at 10%, video-cassette recorders at 25%. (But footwear and garments are taxed at 25%, a high rate for such basic goods.)

Using import tariffs for this purpose ignores two important side effects of protection:

- Tariffs distort investment decisions, thus diminishing the efficiency with which a country uses its capital resources and reducing the long-run rate of development.
- Tariffs affect the demand for labor and other primary inputs, thus influencing the distribution of income at its source.

Placing high tariffs on luxury goods, for which demand is relatively small in a poor country like Ghana, provides an artificial incentive to invest in industries producing such goods. But providing low or negative protection to basic goods, such as bicycles, prevents the development of labor-intensive industries whose products are in high demand.

Facing a zero rate of import duty, bicycles are also zero rated for VAT purposes, which means that local bicycle producers would not be able to get any tax credit on their inputs, putting them at a disadvantage relative to imports of VAT-exempt bicycles. As might be expected in these circumstances, no domestically produced or assembled bicycles are available in the market. The Tariff Book has recently been amended to add an item to chapter 98 zero rating (for import duty purposes) parts and components used in the production or assembly of bicycles. At best this will make the tariff system neutral for bicycle production.

Meanwhile, high tariffs on luxury goods encourage smuggling or (worse) the establishment of inefficient industries assembling goods with little demand in the local market.

Penalizing low-skill, labor-intensive industries and subsidizing higher tech, more capital-intensive industries reduce demand for the poorest workers in Ghana and impede development of industries in which Ghana might have a strong comparative advantage. This does not serve the redistribution purpose for which such measures were designed. And it reduces Ghana’s long-term development potential.

The answer is not, of course, to give high protection to basic goods either. Difficulties with this approach can be seen in the garment industry. The lesson is that the tariff regime should be as neutral as possible—through low and uniform rates.

*Source: Economic Commission for Africa, from official sources.*
The Integrated Action Programme for Cassava Starch Production and Export is aimed at job creation and poverty reduction in rural communities. A Presidential Special Initiative on cassava promotes the production and export of cassava starch. A $4 million starch processing plant, the second of its kind in Africa, has been commissioned at Bawjiase in the central region to process about 20,000 tons of starch annually for domestic use and export. The government is also planning processing plants for salt and palm oil, to be launched in 2003.

A new Export Development and Investment Fund provides financial support through designated commercial banks to enterprises engaged in export or export production. In 2002 about 23 corporate exporters and export producers benefited from this scheme, but disbursements have been slow. In 2002 it granted about 10.3 billion cedis ($12.5 million), less than a fifth of the total available facility of 56.1 billion cedis ($68 million). Two more rural-based initiatives are to be launched in 2003 in oil palm and salt production.

As part of a policy to reduce reliance on donor resources, the government has intensified efforts to attract foreign direct investment. But according to the Ghana Investment Centre, registered foreign direct investments declined from $637 million in 1997 to $234 million in 1999, and further to $180 million in 2001. The main sources are Britain, India, China, the United States, and Germany, in that order. Other sources include Malaysia, Nigeria, and South Africa. From January to June 2002, 26 investment projects were approved, amounting to $12 million, with manufacturing accounting for 50% and services 25%.

**Figure 5.8**

*Nontraditional exports on the rise*

*Value and share of nontraditional exports in total exports, 1993–2000 (US$ millions and %)*

---

**Source:** Economic Commission for Africa, from official sources.
The National Science and Technology Policy aims to increase public funding of scientific research from 0.3% of GDP to 1.0%. Under the policy the Council for Scientific and Industrial Research will spearhead the country’s scientific and technological advancement. The research activities of the institutes that make up the council are being revamped, involving the institutes in private sector programmes. The Cocoa Research Institute of Ghana is propagating new agronomic technology that will boost productivity from 400 kilograms per hectare to 1,350 kilograms in five years, compared with Côte d’Ivoire’s 850 kilograms per hectare.

The financing of these projects is still a concern, making it important to ensure their long-term viability by not oversubsidizing them.

Social developments

Between 1991 and 1999 the incidence of poverty declined by 12%. Life expectancy improved from 49 years to 57. And between 1970 and 2000 literacy increased from 51% to 72%, with youth literacy rising from 75% to 91%.

But the country still ranks among the lowest quartile on the UNDP global Human Development Index (UNDP 2002b). And between 1992 and 1999 poverty increased in 3 of the country’s 10 regions: central, northern, and upper east. With population growth at 2.8% a year, a GDP of 2.7–5.0% annually since 1985 has generated only marginal growth in per capita income. Government expenditures per capita on health and education have been low, a result of revenue limitations imposed by more than 30 years of stagnation in real per capita GDP and the continuing expansion of the underground economy. But they have more than doubled over the past five years (table 5.7).

Poverty reduction—2 million lifted out of poverty in the last decade

The incidence of poverty declined from about 52% in 1992 to about 40% in 1999 (Ghana Statistical Service 2000). Much of this decline was due to increases in agricultural production and in the producer price of cocoa. The incidence of poverty has historically

Table 5.7
Expenditure shares of education and health, 1998–2002 (%)

<table>
<thead>
<tr>
<th>Item</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social services</td>
<td>14.0</td>
<td>22.2</td>
<td>18.3</td>
<td>25.2</td>
<td>34.7</td>
</tr>
<tr>
<td>Education</td>
<td>10.6</td>
<td>14.5</td>
<td>12.8</td>
<td>17.5</td>
<td>24.1</td>
</tr>
<tr>
<td>Health</td>
<td>2.7</td>
<td>6.1</td>
<td>4.2</td>
<td>6.8</td>
<td>9.3</td>
</tr>
<tr>
<td>Recurrent budget (billions of cedis)</td>
<td>2,862</td>
<td>3,226</td>
<td>4,487</td>
<td>5,034</td>
<td>6,848</td>
</tr>
</tbody>
</table>

a. Estimated.

Source: Economic Commission for Africa, from official sources.
been higher in rural areas, and poverty reduction has been faster in urban areas as well. The ratio of rural to urban poverty, 2.29 in 1992, leapt to 2.55 in 1999, showing that urban areas benefited more from the economic growth.

Between 1992 and 1999 poverty incidence declined in all regions except the central, northern, and upper east, falling sharply in the western region, Bronga-Ahafo, and Greater Accra (figure 5.9). Poverty is much more prevalent in Ghana’s savannah zone (northern and upper regions) than in the southern part of the country (figure 5.10). The north has not yet benefited much from the improved macro environment.

Differences in access to basic infrastructure and health services may explain the geographical variation, with the distance from the coast and the center of economic and political power costing dearly. The pervasive poverty in the north can also be attributed to the decline in rice production in the region with the removal of government support.

**Figure 5.9**

*Geography matters for poverty in Ghana*

*Poverty incidence by region in 1999 and change in incidence since 1992 (%)*

<table>
<thead>
<tr>
<th>Region</th>
<th>Poverty Incidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Northern</td>
<td>5.80</td>
</tr>
<tr>
<td>Volta</td>
<td>–29.20</td>
</tr>
<tr>
<td>Ashanti</td>
<td>–13.50</td>
</tr>
<tr>
<td>Western</td>
<td>–32.30</td>
</tr>
<tr>
<td>Eastern</td>
<td>–4.30</td>
</tr>
<tr>
<td>Central</td>
<td>4.10</td>
</tr>
<tr>
<td>Greater Accra</td>
<td>–20.60</td>
</tr>
<tr>
<td>ACCRA (Capital city)</td>
<td>–32.30</td>
</tr>
</tbody>
</table>

**Note:** Numbers on map indicate change in poverty incidence between 1992 and 1999.

**Source:** Economic Commission for Africa, from official sources.
support for irrigation and processing facilities. Local rice now accounts for less than 20% of national consumption, compared with 60% in the 1970s and 1980s. Poor people in rural areas lack access to alternative employment opportunities and credit facilities.

The regional disparity in poverty also reflects the absence of a concerted national programme to improve livelihoods for disadvantaged regions or vulnerable groups. The northern and upper savannah regions should be most favoured for targeting roads, infrastructure, health services, and education. What happens to poverty in Ghana’s north matters for overall poverty reduction because more of Ghana’s poor live in that region. The Ghana Poverty Reduction Strategy attempts to address this regional imbalance in the distribution of basic services (box 5.6).

### Education and employment—primary enrolment up, secondary and higher education down

The government has a programme to establish and rehabilitate primary schools in every rural community. Under its nonformal education programme, the government has focused on improving the literacy of the adult population in rural areas, especially of young women.

Between 1989 and 1992 there was a broad increase in primary enrolment, especially among girls, with total enrolment climbing from 79% to 88%. But by 1998 enrolment had slipped to 84%, with female enrolment at 71%. This decline is generally attributed

**Figure 5.10**

**Poverty higher in rural and savannah areas**


[Graph showing poverty incidence in different regions of Ghana]

*Source: Economic Commission for Africa, from official sources.*
to budgetary constraints and the perceived lower quality of public schools relative to private schools. Under the Free and Compulsory Universal Basic Education policy, launched in 1995, the government is seeking to enrol every child of primary school age by 2005.

**Box 5.6**

*Key pillars of Ghana’s Poverty Reduction Strategy*

**Supply-side objectives**

*Macroeconomic environment*
- Lower inflation and maintain competitive exchange rate.
- Reduce public domestic debt, bring down interest rates, and facilitate credit to small enterprises.
- Adjust prices and restructure enterprises consistent with poverty reduction.

*Increased production and employment*
- Promote agriculture, agro-processing, nontraditional exports, and employment.
- Improve environment for private sector development.
- Provide skills training and entrepreneurship development for youth.

**Governance and institutional reform**
- Enhance the cost effectiveness of public expenditure through improved budget preparation and expenditure management.
- Reform government administration by enhancing the capacity of the civil service and rationalizing the structures of central management agencies.
- Ensure wider participation of local communities in decisionmaking by increasing the leadership role of district assemblies.
- Strengthen transparency and accountability, with zero tolerance of corruption.

**Disparities in access to services**

*Equitable human resources development*
- Increase access to education by improving school quality and infrastructure in the poorest regions and establishing partnerships with nongovernment actors.
- Improve health care by bridging equity gaps in access to health and nutrition services, ensuring sustainable financing arrangements that protect the poor, and enhancing efficiency in service delivery.
- Reduce the incidence of HIV/AIDS and provide support for people living with HIV/AIDS and their families.
- Increase access to safe water and strengthen environmental health.

*Programmes for the excluded and vulnerable*
- Expand the coverage and effectiveness of essential services for the poorest groups and geographical areas.
- Develop systems that enforce protection of rights, especially for children and women.
- Increase partnerships with nongovernmental organizations.

*Source: Ghana 2001a.*
There is significant inequality in the distribution of educational facilities among the 10 regions and between rural and urban areas. Literacy and enrolment rates are lowest in the northern regions, where few parents can meet the costs of schooling. Poor conditions in the schools, perceived low quality and relevance of school curriculum, and lack of teachers also contribute to low enrolments (box 5.7).

Access to secondary and higher education is declining, because of inadequate classrooms and residential facilities (box 5.8). At the higher education level less than 40% of qualified applicants were admitted in 2001, compared with 60% in the early 1990s.

Incomes are higher in the industrial sector than in agriculture or services, but access to employment in this sector is limited to the educated. Of the 950,000 people registered as unemployed in a November 2001 survey, more than 60% had a basic education or less. Of the rest 1% had a higher education degree, 16% were postsecondary technical or vocational graduates, and 19% were “O” level, commercial school certificate, or senior secondary school certificate holders.

About 15% of primary schools are privately owned, though they are concentrated in the more urban regions: Greater Accra, Ashanti, and western. In the Greater Accra region about 42% of primary schools are privately owned, while in the three poor northern regions (northern, upper east, and upper west) only 2% of schools are privately owned. The concentration of private primary schools in urban areas reflects the greater ability to pay. Another factor is the lack of social infrastructure in northern areas, which makes them unattractive to teachers and other educational workers.

**Box 5.7**

*A tradeoff between child labor and school attendance?*

There are claims that eliminating child labor would improve economic performance in poor countries by improving human resource development. A recent study uses cross-section data from Ghana on 3,374 households to address the question. It finds that after accounting for differences in effects by region (given the different climatic patterns of northern and southern Ghana) and time of year, there is a significant tradeoff between child labor and schooling. An hour of child labor reduces school attendance by approximately 0.38 hours. This tradeoff is more pronounced for boys than for girls.

To see whether poverty is important in determining child labor, the authors divided the sample into three income groups. The analysis suggests that poverty does not determine child labor.

The policy implication for Ghana is that a program such as the Food for Education Program in Bangladesh (which feeds school children to encourage parents to send them to school instead of work) may not be the first-best policy. The study does not try to explain why households make these decisions—for example, because of poor school quality (low demand) or lack of functioning labour markets. These questions are left for future research.

*Source: Boozer and Suri 2001.*
Private secondary schools, though increasing steadily, still account for only a small share of enrolment. The proportion of students enrolled in private secondary schools increased from 1% in 1992 to 7% in 1998. Private provision is highest in technical and vocational education, where government provision is limited. The private sector has been active in general education, but suffering from government intrusion, many private schools folded up.

Over the last 10 years the number of private universities has increased from zero to four, with three others waiting for accreditation. In addition, privately owned institutes have been accredited to run degree courses for foreign-based universities. The National Accreditation Board has been strengthened to oversee activities in private higher education.

Health, nutrition, and HIV/AIDS—urban bias in health provision
Ghana’s health sector policy seeks to improve service delivery, establish sustainable financing arrangements that protect the poor, and promote equity, with a special focus on reducing geographical disparities and addressing diseases that affect the poor. Health expenditures are low at 1.8% of GDP, but life expectancy, infant and adult mortality rates, and child immunization rates are much better than the average for Sub-Saharan Africa. For instance, the maternal mortality ratio is 210 per 100,000 live births, compared with 530 or more for most countries in the region.

Box 5.8
Numeracy and literacy decline

Ghanaian policymakers have appreciated the importance of education for economic development. For example, the 1987 Education Sector Reform Program was established to improve the efficiency, quality, and relevance of Ghanaian education. Part of the reform was an increase in access to education and a shortening of pre-university education from 17 years to 12. Additional reforms were outlined in Ghana—Vision 2020. Among specific education goals are achieving universal primary education and increasing access to secondary and higher education. To turn the Vision 2020 into reality the government launched the basic education sector improvement program in 1996. The focus is on promoting education by increasing education expenditures with special attention to school facilities and teacher housing in rural areas.

Have these policy interventions had the desired effect? No. A recent empirical study finds school quality increasing initially but then declining. The study finds evidence that cultural norms and religious background are important determinants of schooling. Ghanaians with Christian backgrounds are more likely to be literate than Ghanaians with other religious backgrounds. The study finds evidence of gender bias, with women less likely to be literate than men, and asymmetries in literacy and cognitive skills between rural and urban areas and across regions. The findings suggest that future policy design should be particularly targeted at girls and at groups with non-Christian religious backgrounds in rural areas.

Source: Blunch 2002.
Between 1970 and 2000 infant mortality fell by half and under-five mortality by 40%, while life expectancy at birth increased by 14%, but the gains have not been evenly distributed. Health infrastructure is concentrated in urban areas in the south, a bias that is reflected in weaker health and nutrition outcomes in the north. In northern Ghana under-five mortality is three times as high as the national average, and the proportion of undernourished children is 34-38%, well above the 25% national average.

Malaria is still the leading cause of illness, but its incidence declined from 44% in 1990 to 41% in 1998. Various programmes have been launched since 1993 to prevent and treat malaria including the five-year National Malaria Control Programme (1993–97) and the Accelerated Malaria Programme (1997) launched in 30 districts to focus on case management.

HIV/AIDS prevalence has been on the rise. Among women tested for HIV at antenatal clinics, 3% were positive in 1998, compared with 1% in 1990. In 1999 an estimated 3.6% of the adult population tested were HIV-positive, with the eastern, western, and upper east regions having the highest number of cases. Of the reported cases, 62% were women.

To improve health delivery, a community-based Health Planning and Services Strategy is moving health facilities to community locations, developing sustainable voluntarism and community health action programmes, empowering women and vulnerable groups, and improving interaction among health providers, households, and the community.

To increase access to health care in rural areas under direct management of district assemblies, the government has also launched the National Health Insurance Scheme, on a pilot basis, in 42 of the 110 districts (box 5.9).

A major issue is the exodus of trained medical and nursing staff, particularly to the United Kingdom and the United States, due to low pay and poor facilities. The budget allocation to the health sector has been very small, if increasing in recent years. In 2002 the health sector took 9.3% of public expenditure, up from only 2.7% in 1998. Even so, drastic means are needed to sustain the sector. The two teaching hospitals in Accra and Kumasi, as well as the 10 regional hospitals, need financial injections to rehabilitate old structures and build new ones.

Without any deliberate policy, the public and private sectors in Ghana have shared health service provision for a long time. Private providers include individual health operators, generally clinics and church missions that establish clinics and larger hospitals.

As with education, private participation in the health sector is concentrated in the urbanized regions, although mission hospitals and clinics focus on poorer regions.
Institutional reforms—public service in crisis

A major impediment to effective economic performance in the last decade or so has been poor management of public finances. Lack of accurate and timely information on budget allocations, commitments, and actual expenditures has undermined the efficient allocation of scarce resources (IMF and IDA 2002). It has also impaired control of expenditures by the numerous government ministries, departments, and agencies. In 2000, for example, the Controller and Accountant-General’s Department failed to capture expenditures equivalent to about 6.6% of GDP (CEPA 2002).

Several attempts to improve the situation have had little impact, largely because of the lack of political commitment and capacity (box 5.10). In 1995 the Ministry of Finance initiated the Public Financial Management Reform Programme and later such related processes as the integrated payroll and personnel database, the medium-term expenditure framework, and the budget and public expenditure management system. But at the end of 2002 the government was still grappling with the same issues as in 1995: weak capacity, inaccurate data, lack of reconciliation of fiscal and banking data, lax internal audit systems, ghost names on the payroll, substantial payment arrears, and weak coordination between government units and the Controller and Accountant-General’s Department.

Box 5.9
Mutual health insurance scheme in Ghana

Poor health is implicated in Ghana’s high incidence of poverty. In rural areas the average number of outpatient contacts per person per year is 0.19–0.23, compared with the national average of 0.34–0.44. The low level of health care use in rural areas contributes to the high national burden of preventable disease. Over the long term, health investments that increase the use of health care will improve health and productivity, increasing incomes and reducing poverty.

The government is seeking to increase health care, especially among the poor. As part of the Ghana Poverty Reduction Strategy local health insurance schemes will be established, each targeting households in defined poor communities, such as villages or districts. Households will make regular payments into a government-managed fund, with payouts made to finance health care for members. The aim is to limit illness related to income shocks in poor households.

The scheme has kicked off in a few pilot sites. Early evidence is mixed. The scheme has succeeded in pooling a significant number of people and thus promises to increase access to health care. However, problems exist. Administrative and financial capacity is a problem. Most of the target population is poor, with low or irregular incomes, thus resource mobilization remains low. In many African communities, risks co-vary, with further implications for the sustainability of the scheme. It is very unlikely, therefore, that the scheme will succeed in providing universal (or near universal) coverage for Ghanaians any time soon.

Source: Arhin-Tenkorang 2002.
The Financial Administration Bill presented to parliament in 2002 attempts to strengthen enforcement of expenditure rules (Budget Statement 2003). But the poor public financial management has to be dealt with expeditiously. Ghana faces deep constraints in revenue generation and cannot afford such egregious inefficiencies in public resource use. The public service in Ghana, too weak to support the government’s development agenda, appears to be in crisis.

**Box 5.10**  
*Why so little to show for 20 years of reforms?*

Over the past 20 years Ghana has not been able to accelerate growth beyond an average of 4% despite huge transfers of resources from the developed world. Per capita official development assistance averaged $30 a year in the 1980s and 1990s, compared with less than $10 in the 1960s. But real GDP growth exceeded 5% in only 3 of the 22 years after 1980—8.3% in 1984, reflecting mainly the recovery of agriculture following a year of drought in 1983, and in 1988 and 1991. Manufacturing’s contribution to GDP has shrunk by about 40%, from 15% in the 1970s to 9% in 2000.

Only a few reforms have shown positive results. Reforms in the cocoa sector have helped reverse declining production, while banking reforms have reduced excessive exposure. But other strategic interventions—such as trade liberalization, privatization, and industrial policy—have not had the desired effects on poverty reduction, employment, the structure of industry, and the long-term sustainable development of the economy.

Why has economic growth not taken off after 20 years of reform and external assistance? Indeed, why has the quality of growth been so poor, with little tangible benefit for the population? One compelling reason is that growth has been driven largely by capital accumulation from public sources and not by private investment. The increase in capital was not accompanied by significant improvements in total factor productivity—a key determinant of growth. The lack of improvement in total factor productivity means that the capital was inefficiently allocated. High inflation, excessive government spending, and deficit financing through high-yielding treasury bills all acted together to further depress investment and growth.

Weak government commitment is another reason. Since 1992 the pace of the reform process has been influenced by the electoral cycle, slowing in election years and picking up in the post-election period.

The undeveloped aggregate supply capacity of the economy has been another binding constraint, one the reforms have yet to deal with directly. Agriculture, which accounts for about 36% of GDP, is largely rain-fed, and at least one-quarter of production is lost because of inadequate storage facilities. The average age of industrial equipment is 30 years, while transportation networks, energy supply, and telecommunication services are inadequate. Persistently high interest rates constrain access to credit. And the weather still determines the contribution that 70% of the major sources of GDP make to growth annually: rain affects the supply of electricity from the Volta River Authority, with detrimental affects on manufacturing and some service industries.

*Source: Economic Commission for Africa, from official sources.*

Ghana—The Danger of Fiscal Exuberance  181
Two excerpts from the Ghana Poverty Reduction Strategy reinforce this assessment (2001, p. 109):

It would appear that the totality of the public sector reform program might be beyond the capacity of the available human and financial resources to plan and implement. . . .

However, the reform process cannot proceed effectively without sustained and palpable political commitment, the enforcement of agreed proposals for reform from a political and official level, and provision of adequate resources.

Low compensation and ineffective management of the public service—including the absence of a strategy for human resources development, use, and retention—were singled out as the prime causes of the malaise.

In economic management and coordination the institutional structures for policymaking are fragmented among the Ministry of Finance, the Ministry of Economic Planning and Regional Integration, the National Development Planning Commission, and the Economic Management Team of the cabinet. This has led to duplication of roles and functions and unclear decisionmaking, creating tensions, misunderstanding, and inconsistency. Even responsibility for such programs as those funded under HIPC debt relief is unclear.

Oversight is also diffused and ambiguous. Financial monitoring and evaluation functions clearly belong to the Ministry of Finance. But the ministry also has a monitoring and evaluation unit for all development projects implemented across all sectors of the economy, including highways, which is clearly inappropriate. Monitoring and evaluation of development projects and programmes, including District Assembly plans, should be strengthened in the sectoral ministries, with oversight by the Ministry of Economic Planning and Regional Integration, which now has an understaffed Monitoring and Evaluation Unit.

Further diffusing oversight responsibility are the monitoring and evaluation responsibilities of the National Oversight Committee in the Office of the Vice President, apparently responsible for the National Institutional Renewal Program. The planned Office of Policy Coordination, Monitoring, and Evaluation in the Office of the President, under the Chief of Staff, will only worsen the fragmentation and diffusion.

Ad hoc approaches to planning and budgeting and lack of coordination and consultation weaken economic policy formulation. Particularly problematic is the ineffectiveness of the Economic Management Team. One of four main committees of the team is charged with matters relating to the economy and finance. Chaired by the senior minister, it includes 14 ministers with core economic and finance portfolios or sectoral responsibilities. Meeting at least once a week, the team is responsible for economic policy coordination and management through peer examination of proposals. The cabinet secretary and three administrative officers provide the only secretariat support.
Given its structure and composition, the Economic Management Team cannot debate key economic and financial strategies and policies of government. Nor is it the right place for tracking key developments and trends, including monitoring the implementation of World Bank and IMF programs and World Trade Organization-related matters. With no clear terms of reference and no administrative instructions, it operates in a loose de facto mode. Combined with weak technical support, these factors hamper its effectiveness, leaving major policy outputs of the government in a state of limbo or in contradiction, with no apex agency to coordinate and reconcile positions.

Macroeconomic scenarios for the medium-term expenditure framework program, under the Ministry of Finance, are operationalized before being reconciled with the Poverty Reduction Strategy macro-framework under the Ministry of Economic Planning and Regional Integration. A last-minute recognition of this failure forced an eleventh hour first-ever meeting of economists from the two ministries in 2002. But the Bank of Ghana was not party to setting macro-targets, including the inflation target for the budget. Nor was it part of the Poverty Reduction Strategy process, except towards the end when project costs were required. There is thus a potential clash of medium-term expenditure framework and Poverty Reduction Strategy objectives, targets, and commitments.

Medium-term prospects

The medium-term outlook is cautiously optimistic because of the government’s demonstrated commitment to establishing the conditions for faster growth, as reflected in greater fiscal discipline and export development over the past two years. The rising external inflows, from cocoa, gold, and remittances, will also help stabilize the external balance and the exchange rate.

What about the downside risks? There is danger of lax monetary and fiscal policies in the runup to the next general election in 2005. The loss of macroeconomic credibility, due to the high levels of domestic debt and the failure to meet convergence criteria, could crowd out private investment. Regional contagion due to conflict in neighboring Côte d’Ivoire could increase the risk premium for foreign and domestic investment. Also tied to conflict are the possible inflow of thousands of refugees across the western border and the loss of incomes and employment to the thousands of Ghanaians resident in Côte d’Ivoire.

The overall impact of the Côte d’Ivoire crisis on the Ghanaian economy could be favourable, however, since many small and medium-size enterprises in Côte d’Ivoire might relocate to Ghana. Already, Ghana is benefiting as a new transit port for such landlocked countries as Burkina Faso and Mali. Growth of real GDP is projected to increase to 4.9% in 2003, largely due to continuing good performance in agriculture and increased real estate development and construction activities.
But the medium-term prospects for macroeconomic stability may deteriorate, due to the pressures on domestic prices from the recent increases in petroleum prices. Inflation is projected to rise to about 18% in 2003, well above the target of 8%, and fall back to the 2002 level of 13% by 2004. The external accounts may deteriorate, partly reflecting the oil price increase, with the current account balance projected to deteriorate to about 5–6% of GDP in 2003.

A major challenge is dealing with the debt overhang of the Tema Oil Refinery, which is compromising financial stability. The debt is largely responsible for the 93% increase in petroleum prices in January 2003. Emanating from the petroleum prices is the more serious challenge of containing inflation by sustaining confidence in the economy and reducing inflationary expectations. The minimum wage rate was increased 23%, to 9,200 cedis in February 2003, to accommodate the expected rise in the cost of living from the petroleum price increases. The impact of higher petroleum prices on the rural poor still has to be addressed.

The public services reform programme, particularly for the public financial management system, must be vigorously pursued, to promote a stable fiscal environment for private sector development and enhance implementation capacity for the country’s poverty reduction and related social programmes.

Notes

1. For example, government expenditure per university student declined from $2,300 a year in 1990 to $900 in 1999, and to $400 in 2000, and spending per polytechnic student declined from $180 to $74 (World Bank 2001).

2. The other cell phone operators are Mobitel Ghana, Spacefon, and Ghana Telecom (One Touch).

3. The Monetary Policy Committee is made up of the governor, as chairman, the first and second deputy governors, the director of research, and the director of the banking department, all of the Bank of Ghana; Dr. Nii Kwaku Sowa of the Centre for Policy Analysis (CEPA), Ghana; and Dr. Bartholomew Armah of the Institute of Economic Affairs, Ghana.

References


Egypt—Economy Slows as Reforms Lose Steam

The Egyptian economy slowed considerably in 2001/02. Real GDP grew at about 3%, down from more than 5% in 1999/2000. Domestic investment stagnated, while unemployment, about 10%, remained high. The slowdown in investment and output is a consequence of global, regional, and domestic factors. Tourism declined sharply after the September 11 terrorist attacks. Security concerns in the region heightened against the backdrop of the Israeli-Palestinian conflict. With a poorly functioning exchange rate regime, the growth benefits of the range of reforms begun in 1991 were exhausted (box 6.1). The government is pushing forward new reforms, but political, constitutional, and strategic considerations constrain them. Sound and faithful implementation remains a challenge.

Monetary policy was sound in 2002. Inflation rose marginally, from 2.2% in 2001 to 3% by the end of 2002, as the Central Bank pursued an expansionary monetary policy stance to stimulate the economy. But the fiscal deficit has been rising steadily since 1998/99, reaching nearly 6% of GDP in 2001/02. The budget proposals for 2002/03 project a 12% increase in expenditure, with the wage bill a big part of the increase. Some mega projects, notably the Toshka agricultural and land reclamation project, also contribute to the rise.

The rising share of domestic debt service obligations has amplified pressure on the deficit. The government allocates more budget resources to pay interest on public debt than to the social sector. Domestic debt service is now the largest single expenditure item, accounting for 6–7% of GDP in 2001/02. With economic growth slowing and domestic interest rates high and rising, the debt to GDP ratio is likely to continue to rise.

The poorly functioning exchange rate regime has hobbled economic performance. The fixed peg, in use until 2000, led to significant real appreciation of the Egyptian pound, eroding the country’s export competitiveness and adding to balance of payments problems, accentuated in the late 1990s when external shocks widened the current account deficit. In addition, premature capital account liberalization forced higher domestic interest rates and tighter monetary policy as efforts were made to defend the pound.

The trade and current account deficits have since declined to 7.8% and 0.4% of GDP in 2001/02, more the consequence of economic slowdown and import restrictions than of sustained export expansion. Reforming the exchange rate regime is thus critical to...
Box 6.1
The ebb and flow of reforms in the last decade

Under the Economic Reform and Structural Adjustment Program begun in 1991, Egypt has taken major steps to make its economy market-driven and outward-oriented. In recent years the reform program has slowed somewhat due to political and administrative constraints and fears that free market reforms could adversely affect social sectors. Reforms have included the following components:

Macroeconomic stabilization
The budget deficit was reduced through expenditure cuts, improvements in tax administration and tax collection, a new sales tax, and increased user fees for petroleum and electricity. By June 1993/94 the fiscal deficit had fallen to 2.1% of GDP, from 20% in 1991.

Monetary policy reform focused on reducing the growth rate of broad money and providing credit to the private sector to promote investment. Inflation was reduced from nearly 20% in 1991 to less than 5% by 1997.

Economic liberalization
This included liberalization of the trade regime and accession to the World Trade Organization in 1995. A privatization programme was initiated, and the state reduced its role in the economy. In the financial sector interest rate ceilings on domestic currency deposits were lifted, rules discriminating against private banks were eliminated, foreign banks were allowed to operate in local currency, and restrictions on bank fees and commissions were removed. In addition, banking sector supervision requirements were strengthened.

In June 1998 parliament ratified amendments to the banking and insurance laws to allow full private sector ownership. But banking privatization remained controversial, and none of the four big state banks has yet been sold. Corporate and commercial laws and the labour code were revised to attract investment and support privatization. But attempts to increase labour market competitiveness have been constrained by political opposition and concerns about possible negative social impacts.

Public sector reform
The Egyptian government has drawn up a comprehensive fiscal reform program, with a view to enhancing the business environment. A broad tax reform program was launched by the Ministry of Finance, including the transformation of the general sales tax into a value-added tax. Improvements were made to public sector budgeting and financial processes. But reform of the public sector is politically controversial, especially if it involves labour shedding. In addition, efforts to improve efficiency and transparency have been hampered by skills constraints within ministries.

In November 2002 the government introduced major reforms in monetary and fiscal policies and the exchange rate regime, with the hope of addressing the policy inertia and getting the economy moving again.

Source: Economic Commission for Africa, from official sources.
restoring growth and stability. How the recent move to a floating regime will work in practice and how it will affect the overall orientation of macroeconomic policy remain to be seen.

Strong growth in the 1990s reduced poverty for significant segments of the population and supported an expanding middle and professional class, helping transform Egypt into an emerging modern economy (box 6.2) Despite these gains, poverty remains or has even increased for large segments of the population, particularly those in rural and southern areas. Egypt lags behind many middle and low income countries in literacy rates, average years of schooling, and life expectancy at birth.

**Box 6.2**

*Egypt—an emerging modern economy*

Egypt has made considerable progress in transforming itself into a more diversified, emerging modern economy. Although enormous challenges remain, significant improvements are evident:

- Electricity consumption per capita, 350 megawatts in 1977, rose to 1,500 megawatts in 2002.
- Telephone lines per 100, 1.3 in 1977, rose to 7.5 in 1999.
- Privately owned cars, 312,000 in 1977, rose to 2 million in 2000.
- The fertility rate, 5.3 in 1977, dropped to 3.4 in 2000.
- Infant mortality, 120 deaths per 1,000 in 1977, fell to 37 in 2000.
- Adult illiteracy fell to 45% in 2000.
- Gross national income (GNI) per capita rose from $410 in 1977 to $1,490 in 2000.

The economy has become more diversified in recent decades, though the process stabilized in the 1980s and 1990s (see table). Key sectors driving the diversification include food products, textiles, aluminium, cement, and transport equipment. In addition, services such as tourism have become increasingly important. The economy’s growing diversification suggests that Egypt is less vulnerable to sectoral shocks today than it was 30 years ago.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>0.22</td>
<td>0.21</td>
<td>0.15</td>
<td>0.14</td>
<td>0.16</td>
<td>0.14</td>
</tr>
<tr>
<td>Investment</td>
<td>0.19</td>
<td>0.21</td>
<td>0.15</td>
<td>0.14</td>
<td>0.12</td>
<td>0.09</td>
</tr>
<tr>
<td>Employment</td>
<td>0.33</td>
<td>0.29</td>
<td>0.22</td>
<td>0.23</td>
<td>0.21</td>
<td>0.19</td>
</tr>
</tbody>
</table>

**Note:** A value of zero indicates complete diversification and a value of one, complete concentration.

**Source:** Kheir El-Din 2001.

**Source:** UNDP 2002; World Bank 2003; Economic Commission for Africa, from official sources.
The medium-term outlook is bright but fragile. On the upside, GDP growth is likely to recover to around 4%, reflecting a rebound in transport and tourism (after the war in Iraq) and the Toshka project’s boost to agriculture. Manufacturing growth is also expected to pick up if the depreciation of the Egyptian pound spurs demand for Egypt’s exports. But the downside risks are significant. These include poor business confidence, clouded by confusion over the conduct of exchange rate policy, and the monetary and fiscal stance. The Middle East political situation poses another large downside risk. And the high tariff and nontariff barriers, even after substantial tariff reductions in the 1990s, are unlikely to inspire investor confidence in the economy.

The Egyptian economy thus stands at a crossroads. Either it will resume growth at higher rates than in the past few years. Or it will succumb to the inertia and vagaries of global and regional economic and political environments. More than 10 years of macroeconomic and structural reforms, which have transformed Egypt into a more diversified economy, seem to have run their course.

The first priority is to bring greater clarity to the conduct of macroeconomic policy. The contradictions apparent in recent years, particularly in monetary and exchange rate management, need to be resolved to reinstate macroeconomic stability and build investor confidence. The greater flexibility of the exchange rate regime may help, but considerable uncertainty surrounds the likely effects of the recent flotation. A coherent trade and industrial policy to drive productivity improvements in emerging sectors is required to boost exports. This will require reinvigorating the private sector and expanding state capacity, both in economic policymaking and in political management to overcome vested interests and build a strong constituency to move forward. In addition, Egypt’s success in enhancing its international competitiveness and in moving from a resource-based to an investment-driven economy depends on progress in the social sectors, particularly in education.

Recent economic developments

Egypt’s economic performance has weakened sharply, a trend that continued in 2001/02. Contributing are constraints to agricultural development, industry’s lack of competitiveness, vulnerability of services to regional instabilities, and a slowdown in investment growth.

**Overall performance—growth stagnates**

After averaging 5.4% a year in 1995–99, growth slowed to 5.1% in 1999/2000 and 3.5% in 2000/01 (figure 6.1). Real GDP growth is estimated at about 3% for 2001/02, though the final figure may be even lower.

Global, regional, and local factors all contributed to the slowdown, including the effects of the attacks on the World Trade Center in New York on September 11, 2001, and
the heightened security concerns in the region, which hit key sectors such as tourism. Macroeconomic policy also came under pressure because of problems with the exchange rate regime.

During 2002 there were signs of declining or stagnant production, falling capacity use, and lower investment and employment growth, particularly in manufacturing and construction but also in such services as restaurants and finance. According to the biannual business survey of the Egyptian Center for Economic Studies, 70% of firms said that production had declined or stagnated in the first half of 2002, 31% that domestic sales were lower, with 41% reporting no change in sales (ECES 2002). In addition, 77% of firms reported that capacity use stayed the same or declined, and 88% that employment had stagnated or declined. Expectations for the last half of 2002 improved marginally. Although most firms did not expect dramatic improvements in the economy, they seemed more optimistic than in recent years.

Among domestic factors the overvalued exchange rate and the high interest rates required to defend the pound led to a deterioration in productive activities, particularly in tradable goods. The government recently announced a shift to a freely floating exchange rate, continuing the gradually increasing flexibility of recent years. The details of the policy framework remain unclear, however. The coming months will thus be critical in fostering business confidence by reestablishing credibility and consistency among the different elements of economic policy. The regional political situation poses further risks for the economy. The government estimates that the Iraq conflict may have cost the economy up to $5 billion.

![Figure 6.1](image)

**Figure 6.1**

*Growth slowing*

*Real GDP growth, 1997/98–2001/02 (%)*

<table>
<thead>
<tr>
<th>Year</th>
<th>Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997/98</td>
<td>4.5%</td>
</tr>
<tr>
<td>1998/99</td>
<td>6.0%</td>
</tr>
<tr>
<td>1999/2000</td>
<td>5.2%</td>
</tr>
<tr>
<td>2000/01</td>
<td>3.8%</td>
</tr>
<tr>
<td>2001/02</td>
<td>2.6%</td>
</tr>
</tbody>
</table>

*Source: Economic Commission for Africa, from official sources.*
Agriculture—constraints to development of full potential

Agriculture remains a key sector of the Egyptian economy, accounting for some 17% of GDP, 28% of employment, and 20% of commodity exports (table 6.1 and figure 6.2). It grew at 3.4% in 2001/02, broadly in line with GDP. All agricultural prices have been decontrolled, except for cotton and sugarcane. And almost all subsidies for fertilizer, pesticides, and seeds have been removed. Energy continues to be provided at reduced rates, and water is provided to farmers free of charge. The sector has responded strongly to a combination of improved incentives and increased use of high-yielding varieties, registering growth of 3–4% in recent years. As a result, Egypt has partially closed the gap between food demand and supply while increasing exports, though it remains a major importer of wheat.

Table 6.1
Sectoral shares of GDP, 1997/98–2001/02 (%)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>17.3</td>
<td>16.8</td>
<td>16.5</td>
<td>16.5</td>
<td>16.6</td>
</tr>
<tr>
<td>Industry and mining</td>
<td>18.6</td>
<td>19.2</td>
<td>19.7</td>
<td>19.9</td>
<td>20.1</td>
</tr>
<tr>
<td>Crude oil and oil products</td>
<td>6.3</td>
<td>5.9</td>
<td>5.6</td>
<td>4.8</td>
<td>4.8</td>
</tr>
<tr>
<td>Electricity</td>
<td>1.8</td>
<td>1.8</td>
<td>1.9</td>
<td>1.9</td>
<td>1.9</td>
</tr>
<tr>
<td>Construction and building</td>
<td>5.4</td>
<td>5.2</td>
<td>5.1</td>
<td>5.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Services sectors</td>
<td>32.4</td>
<td>32.8</td>
<td>33.3</td>
<td>33.5</td>
<td>32.7</td>
</tr>
<tr>
<td>Transportation, Suez Canal</td>
<td>9.5</td>
<td>9.3</td>
<td>9.2</td>
<td>9.2</td>
<td>9.2</td>
</tr>
<tr>
<td>Trade, finance, and insurance</td>
<td>21.6</td>
<td>22.0</td>
<td>22.2</td>
<td>22.6</td>
<td>22.4</td>
</tr>
<tr>
<td>Hotels and restaurants</td>
<td>1.3</td>
<td>1.5</td>
<td>1.9</td>
<td>1.7</td>
<td>1.2</td>
</tr>
<tr>
<td>Social services sectors</td>
<td>18.3</td>
<td>18.2</td>
<td>17.9</td>
<td>18.3</td>
<td>18.8</td>
</tr>
<tr>
<td>Real estate</td>
<td>1.8</td>
<td>1.9</td>
<td>1.9</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Public utilities</td>
<td>0.4</td>
<td>0.4</td>
<td>0.4</td>
<td>0.4</td>
<td>0.5</td>
</tr>
<tr>
<td>Social insurance</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Government services</td>
<td>7.9</td>
<td>7.6</td>
<td>7.6</td>
<td>7.7</td>
<td>8.0</td>
</tr>
<tr>
<td>Personal and social services</td>
<td>8.1</td>
<td>8.3</td>
<td>8.0</td>
<td>8.1</td>
<td>8.3</td>
</tr>
</tbody>
</table>

Source: Economic Commission for Africa, from official sources.

Figure 6.2
Agriculture still significant
Sectoral shares of GDP, 2001/02

Source: Economic Commission for Africa, from official sources.
Despite this strong performance, the sector’s full potential has yet to be realized. There is good scope for greater production for domestic consumption and export, benefiting employment, rural incomes, and foreign exchange earnings. According to a recent study, raising agricultural growth from 2.8% a year to 4.8% would create an additional 300,000 jobs a year (DAI 2002).

Severely constraining the further development of agriculture is the availability of water. The Toshka mega project, one of the main efforts to address this, involves the reclamation of 500,000 acres of arid land at the southwestern edge of the western desert using water from Lake Nasser. Part of the land area will be operated by a private enterprise producing fruits and vegetables for export, expected to generate 40,000 jobs by 2010.

Realizing agriculture’s greater potential requires further reforms to reduce the cost of production and marketing, expand the area under cultivation, improve the efficiency of resource use, and increase the use of high-yielding varieties. Egypt has good potential to increase agricultural production and boost horticultural exports, particularly following the signing of the European Union Association Agreement, a wide-ranging initiative including provisions allowing easier access for Egyptian goods into European markets. The challenge is to ensure that the appropriate policy and institutional measures are implemented to take full advantage of Egypt’s comparative advantage in this sector.

Industry—lacking international competitiveness
Industrial sectors contribute around 20% of GDP and about 14% of employment. Between 1996 and 2000 industry excluding mining expanded at 8% a year in real terms. In the last decade manufacturing has been transformed by the privatization of state-owned enterprises and general liberalization. But its performance has lagged behind that in other emerging lower middle income economies in growth and the contribution to GDP and exports (table 6.2). The sector is concentrated on a few key activities such as textiles and clothing, food and beverages, furniture, and metallurgy. However,

Table 6.2
Manufacturing growth, 1990 and 2000 (average annual %)

<table>
<thead>
<tr>
<th>Country/group</th>
<th>1990–2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Egypt</td>
<td>6.3</td>
</tr>
<tr>
<td>Lower middle income</td>
<td>8.9</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Indicator</th>
<th>1990</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing value added (% of GDP)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Egypt</td>
<td>18</td>
<td>19</td>
</tr>
<tr>
<td>Lower middle income</td>
<td>27</td>
<td>27</td>
</tr>
<tr>
<td>Share of manufactures in total exports (% of total)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Egypt</td>
<td>42</td>
<td>37</td>
</tr>
<tr>
<td>Lower middle income</td>
<td>59</td>
<td>59</td>
</tr>
</tbody>
</table>

Source: Economic Commission for Africa, from official sources.
several other activities are growing rapidly, in particular pharmaceuticals, automotive assembly, and electronics.

Small and medium-size enterprises account for more than 90% of firms (Mobarak 2001). There is also a large and dynamic informal sector, estimated to account for 25–30% of industrial output. The dominance of smaller firms in Egypt’s manufacturing reflects regulatory and institutional constraints that discourage the growth of larger firms—including a lack of finance to facilitate expansion. Overall, the small and medium-size firms have not yet realized their full potential as an engine for growth and employment. Key issues relate to the business and institutional environment—improving the transparency and credibility of public policy, strengthening regulatory structures, and removing the anti-export bias of overall policy.

Services—vulnerable to regional instabilities

Services make the largest contribution to GDP at around 50%, topped by tourism, financial services, and receipts from the Suez Canal. Tourism receipts account for about 5% of GDP, but unofficial estimates indicate that indirect effects boost the contribution to 15% of GDP and 8% of employment (American Chamber of Commerce in Egypt 2002). The fastest growing services over the last five years were finance and trade (8.4% a year) and restaurants and hotels (6% a year).

A key characteristic of the services sector is its sensitivity to external shocks and political tensions in the region. The September 11 attack on the United States and the Middle East crisis had a major impact, spilling over to the whole economy, particularly tourism. Tourism arrivals from Western Europe and North America fell significantly in 2001. Though this decline was slightly offset by arrivals from the Middle East and other countries, government revenue suffered because tourists from Western Europe and North America spend more on average.

Overall, the growth of trade, tourism, finance, and transportation slowed to an estimated 4.8% in 2001/02, down from more than 11% in 1998/99.

Employment and wages—unemployment persistently high

Unemployment rose slightly from 8.8% in 1996/97 to 9% in 2001/02, well above the 7.3% targeted in the fourth five-year plan of 1997/98–2001/02. Unemployment is particularly high for young people (20.1% for those ages 15–29 years) and the educated. According to the 1996 population census, the female unemployment rate was 20.3%, a very significant gender imbalance. Official data are likely to grossly underestimate unemployment—most analysts put the true rate at about twice the official figure, around 15% (El-Issawy forthcoming).

In Egypt’s segmented labour market, wages in the public sector are subject to fiscal constraints, while those in the private sector are determined largely by supply and demand. Over time, however, the boundaries separating the public and private spheres
of employment have diminished (table 6.3). During 1996/97–2001/02 the share of the government and other public sector enterprises in employment fell from 34.5% to 30% and the share of the private sector rose from 65.5% to 70%. The labour market as a whole has become more competitive, with wage determination more flexible, but the supply of labour is increasing faster than the demand.

**Consumption and investment—investment growth tailing off**

High interest rates and uncertainties about monetary and exchange rate policy held back capital formation by both the government and the private sector. Domestic investment fell from 20% of GDP in 1997/98 to 16% in 2001/02, significantly lower than the rate targeted in the fourth five-year plan (figure 6.3). Private consumption also lagged behind targeted levels, reflecting a lack of consumer confidence in a climate of economic uncertainty.

During 1995–99, however, investment expenditure grew much faster than GDP in real terms, with gross fixed capital formation expanding at an average annual rate of more than 9% (World Bank 2002b). For public investment this may have been the consequence of a relaxation of fiscal targets and investment allocations outside of the budget. For private investment the increase may be explained by macroeconomic stability until the late 1990s and the greater availability of credit in the mid-1990s. Most investment was for production for the local market rather than for export, perhaps reflecting the absence of structural reform, the lack of an industrial policy, and the incentives flowing from real appreciation of the currency.

**Macroeconomic policy and trends**

The move to a more flexible exchange rate may provide greater scope for monetary policy to stimulate economic growth. Financial sector reform of both banks and capital

<table>
<thead>
<tr>
<th>Sector</th>
<th>1996/97</th>
<th>2001/02</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number of workers (millions)</td>
<td>Share (%)</td>
</tr>
<tr>
<td>Public</td>
<td>5.7</td>
<td>34.5</td>
</tr>
<tr>
<td>Government</td>
<td>3.6</td>
<td>22.6</td>
</tr>
<tr>
<td>Public economic authorities</td>
<td>1.0</td>
<td>6.4</td>
</tr>
<tr>
<td>Public business sector</td>
<td>0.9</td>
<td>5.5</td>
</tr>
<tr>
<td>Private</td>
<td>10.4</td>
<td>65.5</td>
</tr>
<tr>
<td>Private agricultural</td>
<td>4.7</td>
<td>29.5</td>
</tr>
<tr>
<td>Private nonagricultural</td>
<td>5.7</td>
<td>36.0</td>
</tr>
</tbody>
</table>

*Source: Economic Commission for Africa, from official sources.*
As Egypt moves to a more flexible exchange rate, monetary policy will have more scope to stimulate the economy.

Markets is needed to boost investment. Fiscal policy needs to rein in deficits and reduce the debt burden to avoid stifling growth.

**Monetary policy—complicated by exchange rate regime**

The central bank loosened monetary policy in 2001/02 to stimulate the economy (box 6.3). M1 grew 7.6% in 2000/01 and 12.1% in 2001/02.\(^1\) And overall domestic liquidity (M2) growth reached 11.6% in 2000/01 and an estimated 15.4% in 2001/02 (table 6.4).\(^2\) Before 2001 monetary policy was restrictive, protecting an overvalued currency. Money supply, M1, rose a modest 1.8% in 1999/2000, significantly less than the 11% nominal growth in GDP. Interbank interest rates, more sensitive to market conditions than deposit rates, shot up to nearly 15% by the beginning of 1999/2000. Over 2000/01 and 2001/02 interbank rates continued to show a high degree of volatility and have remained high, frequently peaking above 10% (figure 6.4). This tight monetary policy, coupled with external shocks in the late 1990s, took the growth momentum out of the Egyptian economy.

Since the mid-1990s inflation has declined considerably, thanks largely to the price anchor provided by the fixed exchange rate in place until the summer of 2000 (figure 6.5). Inflation rose marginally, from 2.2% in 2001 to 3% at the end of 2002, with the policy switch to monetary expansion.

Under the fixed exchange regime the effectiveness of monetary policy was severely limited. The widening current account deficit after 1998 generated tensions in macroeconomic policy, because monetary authorities had to pursue restrictive policies to

**Figure 6.3**

*Investment slides downward*

*Total investment, amount and share of GDP, 1997/98–2001/02*

<table>
<thead>
<tr>
<th>Year</th>
<th>Investment expenditure (US$ billions)</th>
<th>Investment as % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997/98</td>
<td>21</td>
<td>21</td>
</tr>
<tr>
<td>1998/99</td>
<td>18</td>
<td>18</td>
</tr>
<tr>
<td>1999/2000</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>2000/01</td>
<td>12</td>
<td>12</td>
</tr>
<tr>
<td>2001/02</td>
<td>9</td>
<td>9</td>
</tr>
</tbody>
</table>

**Source:** Economic Commission for Africa, from official sources.
defend an overvalued currency, and the resultant increases in interest rates put pressure on fiscal deficits and discouraged investment. The overvalued currency eroded the country’s competitiveness and harmed the export sector.

**Box 6.3**

*Monetary policy reform—towards more liquidity*

The government has taken steps to re-orient monetary policy to provide greater liquidity to the economic system. Key recent measures:

- Reducing the reserve requirement ratio for local currency deposits from 15% to 14% in September 2001.
- Including treasury bills with maturities of less than 15 days in calculations for up to 10% of the reserves of each bank in September 2001.
- Excluding saving instruments of three years or more from the denominator of the reserve requirement ratio in April 2001.
- Reducing the rediscount rate twice—from 12% to 11.5% in April 2001 and to 10% in November 2002.
- Establishing a new interbank rate guideline system (Cairo Interbank Offering Rate) in September 2000. Most (around 90%) of the banking sector participates in the system.

In addition, monetary reforms were announced in November 2002 by the central bank to pave the way for floating the currency. Key measures included overnight loans and deposits at the central bank and greater use of the discount rate in monetary management.

*Source: Economic Commission for Africa, from official sources.*

**Table 6.4**

*Recent monetary aggregates, end-June 1999–2002 (billions of Egyptian pounds)*

<table>
<thead>
<tr>
<th>Monetary aggregate</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Money supply, M1</td>
<td>48.8</td>
<td>49.7</td>
<td>53.5</td>
<td>60.0</td>
</tr>
<tr>
<td>Growth (year on year, %)</td>
<td>11.9</td>
<td>1.8</td>
<td>7.6</td>
<td>12.1</td>
</tr>
<tr>
<td>Currency in circulation outside banks</td>
<td>32.9</td>
<td>35.0</td>
<td>38.2</td>
<td>42.3</td>
</tr>
<tr>
<td>Demand deposits in Egyptian pounds</td>
<td>16.0</td>
<td>14.7</td>
<td>15.3</td>
<td>17.5</td>
</tr>
<tr>
<td>Quasi money</td>
<td>185.7</td>
<td>205.5</td>
<td>231.4</td>
<td>268.9</td>
</tr>
<tr>
<td>Time and saving deposits in Egyptian pounds</td>
<td>145.3</td>
<td>157.8</td>
<td>170.8</td>
<td>192.7</td>
</tr>
<tr>
<td>Time &amp; Saving Deposits in foreign exchange</td>
<td>4.2</td>
<td>5.1</td>
<td>6.7</td>
<td>8.3</td>
</tr>
<tr>
<td>Domestic liquidity, M2 (M1 + quasi money)</td>
<td>234.6</td>
<td>255.3</td>
<td>284.9</td>
<td>328.7</td>
</tr>
<tr>
<td>Growth (year on year %)</td>
<td>11.4</td>
<td>8.8</td>
<td>11.6</td>
<td>15.4</td>
</tr>
</tbody>
</table>

*Source: Economic Commission for Africa, from official sources.*
As Egypt moves to a more flexible exchange rate, monetary policy will have more scope and power, raising the question of the most relevant monetary target. The central bank has announced that, with the floating exchange rate, inflation will be the new monetary policy target, beginning in the second half of 2003. In the meantime the central bank will use a money supply target. Designing a coherent targeting framework is likely to be

**Figure 6.4**

*Volatile interbank rates, with peaks above 10%*

*Trends in overnight interbank interest rates, 2000–03 (%)*

**Figure 6.5**

*Inflation tamed*

*Inflation (Consumer Price Index), year on year change, 1992–2002 (%)*

*Source: Bloomberg, 6 March 2003.*

*Source: Economic Commission for Africa, from official sources.*
hampered by a lack of necessary data, expertise, and central bank power. This calls for clarifying the objectives of monetary policy and improving the quality of data. Monetary policy will also benefit from new open-market operations and secondary markets in government securities. The greater use of repos by the central bank is welcome.

**Financial sector policies**

Egypt’s banking sector has more than 60 banks, including 28 commercial banks and 31 merchant and investment banks. The four public sector commercial banks dominate the market, with around half of total assets, though their share has been declining as private entry increased competition. Financial reform initially focused on developing indirect instruments of liquidity management, interest and credit liberalization, and opening to foreign banks, with credit allocations shifting in favour of the private sector. The emphasis of ongoing reforms is to continue to increase the competitiveness of financial markets by divesting the remaining state shares in joint-venture and public banks and by increasing private involvement. With foreign entry increasing competition, the central bank is promoting the merger of small and medium-size banking institutions to create stronger banking entities capable of competition with foreign banks in the Egyptian market.

High levels of nonperforming loans, which rose from 12% in June 1999 to 15% in September 2000, are a drag on performance. The bad loans are a consequence of the lack of clear financial boundaries between government-owned banks and other state institutions, such as ministries and public enterprises—and of lending based on social and political connections rather than financial viability. Long-term solutions must establish clearer lines of division and accountability between the public sector and financial institutions.

A key plank of banking reform concerns the independence of the central bank (box 6.4). A bill boosting its independence and clearly defining its role in monetary policy is being discussed, but parliament has yet to enact it into law (box 6.5). This move, closely connected to efforts to improve supervision, must be seen within the context of the broader requirement for increased transparency and accountability. A number of uncertainties remain about how the central bank will operate under the direct supervision of the president.

Nonperforming loans have also complicated attempts to restructure the financial sector by privatizing banks, though the key obstacle is the controversy surrounding bank sell-offs. In June 1998 parliament approved legislation permitting full privatization of the four public sector banks. One bank has been evaluated in preparation for privatization, but the sale has yet to take place. Divestiture of government stakes in the joint-venture banks is largely complete, with only one still having public ownership above 20%.

**Capital markets—positive recent developments**

Egyptian capital markets have long suffered from limited liquidity and patchy performance, with the fortunes of the stock exchange closely linked to privatization and foreign participation. The heyday of activity was January 2000. The market has been on the decline ever since, reflecting waning privatization efforts, slowing of the economy,
Box 6.4

Double-edged reforms

Various reforms are under consideration in a broad range of areas. Although this shows the resolve of government to move ahead with reform, there are several risks if the reforms are not managed carefully:

- Current moves to strengthen the central bank include placing it under the direct supervision of the president. It is not clear how this shift will affect the operation of monetary policy. Although placing the bank under the president’s authority could help to insulate it from bureaucratic pressures, there is also a chance that the move could politicize the bank’s operations, weakening its credibility.

- A proposed income tax law would increase tax exemptions for low-income groups, which could increase the fiscal deficit and the risk of macroeconomic instability. The law also contains exemptions for certain commercial activities, which could increase the scope for rent-seeking by firms.

- The proposed bank bill would allow the government to provide loans to bridge the seasonal deficit in public sector institutions, which can amount to as much as 10% of government deposits. This could slow privatization and increase the size of the government sector.

- The proposed competition and antimonopoly bill could be used to investigate more than 90 mergers between Egyptian and foreign companies. Although a credible competition regime is essential as Egypt moves towards a more market-based economy, these provisions in the new law have the potential to increase business uncertainty.

Source: Economic Commission for Africa, from official sources.

Box 6.5

Strengthening the financial sector’s institutional framework

New legislation under discussion aims at strengthening the central bank and fostering better transparency in the financial sector. Its key provisions:

- The central bank is to be responsible directly to the president.
- The central bank is to be given greater responsibility in the formulation of monetary, credit, and banking policies.
- The central bank’s capital is to be raised from 100 million Egyptian pounds to 1,000 million Egyptian pounds.
- Banks’ minimum paid-up capital is to be raised from 100 million Egyptian pounds to 200 million Egyptian pounds.
- The maximum exposure of banks to a single customer is to be reduced from 30% to 15% of the bank’s capital base.

Source: Economic Commission for Africa, from official sources.
and mounting pressure on the pound. The trends were partly in line with the global decline of the stock markets in the wake of the September 11, 2001 attacks, but they also reflect the local economic slowdown and faltering privatization efforts.

National pension funds and insurance companies have recently begun to invest in the stock market, which should deepen the market and increase liquidity. In addition, the recent placement of global depository receipts (GDRs) on world financial markets will strengthen the link between Egypt’s capital market and global markets.4 Nine Egyptian companies have issued GDRs on international markets. At year-end 2001 those GDRs represented about 7% of market capitalization on the Egyptian stock exchange. This link was further strengthened by the launch of Egypt’s dual tranche inaugural bond on June 29, 2001.

Despite the significant development of Egypt’s capital market over the 1990s, enforcing disclosure requirements and combating insider trading are badly needed to enhance transparency and to combat destabilizing speculative behavior. Further deepening and expansion of the market depend on banking reforms and progress with privatization.

**Developments in the fiscal sector—deficit on the rise**

The fiscal deficit has been rising steadily since 1998/99, reaching over 5% of GDP by 2001 and 5.8% in 2002 (figure 6.6).5 A number of mega projects, notably the Toshka agricultural and land reclamation project, have required substantial resources. Ongoing trade liberalization has placed downward pressure on customs revenues. Inherited social commitments, such as bread subsidies and the social safety net, impose huge claims on the budget. And domestic debt servicing has further drained the expenditure side of the budget.

**Figure 6.6**

*Deficit rising*

*Fiscal balance, 1995/96–2001/02 (% of GDP)*

Source: Economic Commission for Africa, from official sources.
The budget proposals for 2002/03 project a 12% increase in total expenditure (appendix table). The wage bill, at 32% of planned current expenditure and 25% of total expenditure accounts for a significant proportion to this increase. In addition, interest payments on domestic debt now account for 24% of planned current expenditure and 18% of total expenditure. These expenditure items account for roughly half of total actual spending. Cutting the wage bill would be politically difficult. Delays in the repayment of domestic public debt have added to the macroeconomic problems, making the government likely to try to meet its obligations. The high proportion of these items in total expenditure seriously reduces the authorities’ room to manoeuvre in fiscal management.

Domestic debt is the subject of much public debate, with growing concerns about rising debt service payments. The fiscal deficit has been fully financed from domestic sources, not by seigniorage but by issuing treasury bills and delaying payment to companies involved in major projects—a reflection of Egypt’s resolve to reduce the burden of external debt. Growth in debt has tended to outpace GDP growth, pushing up the debt to GDP ratio (table 6.5). Interest payments on domestic debt are crowding out budget allocations for investment and social expenditure. With the growth of the economy slowing and domestic interest rates still high, the debt to GDP ratio is likely to continue to rise.

Persistent deficits are a product of long-term political factors. Vested interests have constrained reform of the public economic authorities and unprofitable state-owned industries, a major drain on the budget. In addition, the government has repeatedly stated

Table 6.5
Public domestic debt, 1999/2000–2001/02 (US$ millions)

<table>
<thead>
<tr>
<th>Debt component</th>
<th>1999/2000</th>
<th>2000/01</th>
<th>2001/02</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total public debt</td>
<td>58,970</td>
<td>61,961</td>
<td>59,070</td>
</tr>
<tr>
<td>Government</td>
<td>48,008</td>
<td>51,046</td>
<td>49,808</td>
</tr>
<tr>
<td>Securities</td>
<td>22,688</td>
<td>34,993</td>
<td>37,354</td>
</tr>
<tr>
<td>T-bonds</td>
<td>11,924</td>
<td>24,062</td>
<td>21,241</td>
</tr>
<tr>
<td>T-bills</td>
<td>7,416</td>
<td>7,686</td>
<td>10,583</td>
</tr>
<tr>
<td>Social security</td>
<td>885</td>
<td>794</td>
<td>450</td>
</tr>
<tr>
<td>Housing bonds</td>
<td>41</td>
<td>36</td>
<td>31</td>
</tr>
<tr>
<td>Banks recapitalization bonds</td>
<td>2,104</td>
<td>2,109</td>
<td>2,118</td>
</tr>
<tr>
<td>Other</td>
<td>319</td>
<td>306</td>
<td>285</td>
</tr>
<tr>
<td>Government borrowing from the National Bank</td>
<td>25,976</td>
<td>26,498</td>
<td>25,618</td>
</tr>
<tr>
<td>Credit balances with banking sector</td>
<td>–665</td>
<td>–10,445</td>
<td>–13,164</td>
</tr>
<tr>
<td>Public economic authorities</td>
<td>10,962</td>
<td>10,915</td>
<td>9,263</td>
</tr>
<tr>
<td>Balances with banking sector</td>
<td>–1,151</td>
<td>–868</td>
<td>–1,347</td>
</tr>
<tr>
<td>Balances with the National Investment Bank</td>
<td>12,112</td>
<td>11,783</td>
<td>10,610</td>
</tr>
<tr>
<td>Public debt to GDP (%)</td>
<td>59</td>
<td>66</td>
<td>69</td>
</tr>
</tbody>
</table>

Source: Economic Commission for Africa, from official sources.
the need to maintain social spending and consumer subsidies in order to avoid social discontent, particularly in the light of fears that poverty could stoke support for Islamist groups.

These structural problems have made fiscal policy inflexible, eroding its role in fine-tuning the economy. The government is taking steps to address some of the problems. A Public Debt Management Department was recently established in the Ministry of Finance to minimize the cost of public debt—rescheduling some existing debt, replacing high-cost with low-cost debt, replacing short-term with long-term debt, and enhancing the operation of primary and secondary markets in government securities.

Fiscal reform is also making the budget more transparent and comprehensive, expenditure priorities more explicit, and the budget process more results oriented and performance based. With public expenditure at 27% of GDP in 2002, efforts to improve its quality are critical. The share of state spending in GDP, at 31% in 1998, is higher than the average of 19% for lower middle income countries. Budget comprehensiveness is being improved through the use of a multiyear medium-term expenditure framework. The tax reform agenda includes improving income tax administration and combating tax evasion, so as to create a more transparent and equitable system. Coverage of indirect taxes is being extended, and registration and collection procedures are being strengthened.

Overall, this reform agenda is very ambitious and likely to run up against significant human and other resource constraints within ministries. More fundamentally, it will be difficult to push fiscal reform forward without a significant constituency for such reform. Without strong political commitment, interest group resistance may stifle these efforts.

The external sector

The widening current account deficit from the late 1990s put pressure on the fixed exchange rate because of relatively free capital flows. Recent moves towards a more flexible exchange rate regime may help to reduce tensions between different policy targets. Egypt has made progress on trade liberalization, but nonoil export performance has been disappointing. The external debt stock has fallen over the last decade because of debt write-offs and the government’s reliance on domestic financing.

**Exchange rate outlook uncertain—current account deficit narrows**

Over the 1990s Egypt’s dollar exchange rate peg was an important part of the government’s anti-inflation strategy. But following deterioration in the balance of payments in 1998, the currency has come under consistent downward pressure, complicating the conduct of macroeconomic policy. The central bank’s initial response to the sudden deterioration in the external balances was to assume that the pressure on the current account was only temporary. Attempts to defend the currency peg first by administrative
controls—and then by drawing down international reserves and widening interest rate differentials—were insufficient, as balance of payments problems continued to put pressure on the currency. The problems eventually led to a major policy shift towards the end of 2000, when the government started moving towards a more flexible exchange rate.

In a continuing trend towards greater flexibility, the government announced a move to float the currency from the end of January 2003. The Egyptian pound quickly fell to around 5.50 to the dollar at the beginning of February 2003, from the December 2002 average of 4.63. Details of the new policy framework remain unclear. If credibility is established quickly, the move could bring greater clarity to macroeconomic policy. But liberalized capital flows bring several risks. Any rapid depreciation of the currency with relatively free capital flows could constrain the interest rate reductions needed to support domestic investment and growth—a particular danger in the uncertain regional context. Egypt’s limited financial development and thin capital markets could add to exchange rate volatility. High interest rates would then have implications for fiscal policy, putting upward pressure on the deficit as a result of high interest repayments on domestic debt.

For the currency regime to support the real economy, the real exchange rate must be allowed to maintain the country’s competitiveness among its main trading partners. Egypt’s fixed rate regime led to gross misalignments of the exchange rate: the pound was allowed to appreciate even in nominal terms against the currencies of key trading partners such as the European Union and Japan. For the European Union, Egypt’s largest trading partner, this occurred even against the background of a trade deficit with EU countries in 1996–2000.

Even the increased flexibility of the crawling peg regime, introduced at the end of January 2001, did not reverse the misalignment. The central bank announced a central rate of 3.85 pounds to the dollar, with transactions allowed within a 1% band around the central rate. The central rate was revised several times, and the band was subsequently widened. By November 2002 the pound had fallen to 4.65. This depreciation against the dollar came after a long period of real appreciation over the 1990s, so it is doubtful whether the depreciation under the crawling peg regime was sufficient to correct for the real appreciation before 2001 (box 6.6 and figure 6.7).

These tensions have underpinned the ambiguous and often muddled conduct of exchange rate management in recent years. They emerged more starkly as shocks in 1997–98 put more pressure on the exchange rate peg—the slump in tourism after the Luxor massacre, the decline in Suez canal receipts during the East Asian crisis, and the collapse in oil prices.

These events pushed the current account into significant deficit in 1998 for the first time since the 1980s (figure 6.8). Egypt has long run trade deficits, driven by imports under the “open door” policy of the 1970s unaccompanied by adequate increases in exports. This was sustainable in the 1970s and 1980s because of high oil revenues and substantial foreign aid, but these inflows became more unstable over the 1980s and 1990s. The trade
deficit exceeded 14% of GDP in 1997/98–1998/99 as exports were hurt by falling oil prices and limited expansion in nonoil exports. Transfer flows and service exports brought the current account deficit to a tolerable 2% of GDP on average. The trade deficit

Box 6.6
Exiting from a fixed rate regime

In an era of increasing capital mobility many developing countries are moving towards more flexible exchange rate regimes, including Egypt. The increased geographic diversification of developing countries’ trade has posed particular problems for single currency pegs, a problem illustrated vividly in Egypt’s case. But the choice of exchange rate regime is not between completely fixed and completely floating. There is a spectrum of possible arrangements between these extremes, such as managed or “dirty” floats and systems based on bands or adjustable pegs. But analysts have pointed out the vulnerability of intermediate exchange rate systems to speculative attack and argue for either free floating or hard-peg regimes (Obstfeld and Rogoff 1995).

A shift from a pegged regime, as in Egypt, does not imply a sudden move to a completely floating regime. Very few countries allow completely unfettered movements in their exchange rates. For developing countries whose capital and foreign exchange markets are typically underdeveloped, a pure floating regime would lead to sharp and undesirable increases in volatility. For countries exiting from a fixed peg, this means that some form of exchange rate management is likely to continue to be important. Even so, the shift to a more flexible regime means that monetary policy no longer needs to be closely tied to the needs of exchange rate stabilization.

Developing countries have typically exited from pegs as their currencies came under downward pressure, reserves were declining, and growth was slowing. Following exits, exchange rate volatility often increased, the value of currencies fell sharply while prices shot up, and output remained depressed for some time.

Chile and Poland managed to exit when their currencies were subject to upward pressures and there was macroeconomic stability. So exit did not come within a context of crisis or serious concerns about policy credibility. Major economic instability was therefore avoided.

In Egypt the ideal conditions for an orderly exit are not in place: the currency has been under consistent downward pressure, there are signs of capital flight, concerns surround the government’s policy credibility, and the external environment is not favourable while regional political instabilities are increasing.

A number of challenges are therefore raised by the shift to the new exchange rate regime. First, policy credibility needs to be established quickly. In particular, as the exchange rate ceases to act as an anchor for monetary policy, a new policy anchor needs to be established and made credible. For Egypt it will be particularly important for the central bank to build up institutional credibility and to develop the expertise necessary to manage a more independent monetary policy. Second, more transparent and disciplined budget management will help to stem any rapid depreciation of the currency early in the float. Third, adequate regulation of the financial system will be essential under the new regime.

Source: Draws on Eichengreen and Masson 1998.
narrowed to 7.8% of GDP in 2001/02 and the current account deficit to 0.4%. But the reduction was primarily the result of economic slowdown and restrictions on imports and foreign exchange imposed by the government, not of sustained export expansion.

Egypt’s recent experience seems to support the long-held hypothesis that under a fixed exchange rate regime capital mobility undermines the possibility of orienting monetary

**Figure 6.7**

*Did the crawling peg correct for the real appreciation before 2000?*

*Pound to dollar exchange rate and real effective exchange rate, 1990–2002 (1997=100)*

![Exchange rate and real effective exchange rate chart](chart1.png)

*Source: EIU 2002, based on a trade-weighted basket of currencies.*

**Figure 6.8**

*Deficits widening then narrowing*

*Historical trends in trade and current account balances, 1990–2001 (US$ billions)*

![Trade and current account balances chart](chart2.png)

*Source: Economic Commission for Africa, from official sources.*

policy towards the needs of the domestic economy. With a widening current account deficit, the central bank maintained capital mobility in pursuit of a good sovereign investment rating. In a delicate balancing act, interest rate reductions have been constrained by the virtually free movement of capital in and out of Egypt, given the aim of stabilizing the exchange rate. This led to a substantial reduction in international reserves (figure 6.9) partly to finance capital outflows (figure 6.10). Liberalization of the capital account has therefore complicated foreign exchange policy (box 6.7).

**Figure 6.9**  
*Running down foreign reserves...*  
*International reserves, foreign exchange plus gold, 1995–2002 (US$ billions)*

![Bar chart showing international reserves, foreign exchange plus gold, 1995–2002 (US$ billions).](chart)

*Source: Economic Commission for Africa, from official sources.*

**Figure 6.10**  
*...To finance capital flight*  
*Capital flows, 1990–2002 (US$ billions)*

![Bar chart showing capital flows, 1990–2002 (US$ billions).](chart)

*Source: EIU, based on IMF data.*
Box 6.7
Capital account liberalization: lessons from Egypt

Egypt’s capital account was largely liberalized in 1994. Since the Asian crises there has been increasing ambivalence about the desirability of fully liberalized capital accounts for developing countries and greater awareness of the need for appropriate sequencing of reforms to reap the potential benefits. A number of benefits and costs have been identified in relation to such liberalization (Gilbert and others 2000):

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Promotes allocative efficiency in the use of capital globally</td>
<td>Complicates macro policy as capital flows restrict monetary policy</td>
</tr>
<tr>
<td>Allows portfolio diversification and so risk spreading by investors</td>
<td>Generates considerable economic risks</td>
</tr>
<tr>
<td>Promotes macro discipline as the potential for inflows and outflows of capital force governments to adopt good policies</td>
<td>Makes pegged exchange rates unviable</td>
</tr>
<tr>
<td>Promotes financial market discipline as capital mobility necessitates building robust financial systems</td>
<td>Reduces tax base through capital outflows</td>
</tr>
<tr>
<td>Reduces corruption opportunities as officials do not have the power of discretion over financial flows in liberalized systems</td>
<td>Provides only limited growth benefits, according to econometric evidence</td>
</tr>
</tbody>
</table>

For transition and developing economies, the Asian crises have taught two main lessons for capital account liberalization:

- Poorly regulated financial sectors can generate serious problems under liberalized capital regimes.
- Continuing with a fixed exchange regime under capital liberalization is problematic and increases the possibility of financial crises.

Sequencing is thus an important issue for developing countries. McKinnon (1991) has argued that financial liberalization should come only after fiscal reform and the achievement of manageable levels of inflation and liberalization of the domestic capital market and the current account. When domestic markets remain protected and supporting supervisory and regulatory institutions are weak, the benefits from capital account liberalization are likely to be limited and the potential costs high. For Egypt capital account liberalization also complicated macroeconomic management under a fixed exchange rate. Although the situation was far from a dramatic Asian-style crisis, the sequencing of reforms may not have been optimal. Capital flows meant that monetary policy became delinked from the needs of the domestic economy to defend the exchange rate.

**Trade liberalization and export promotion—faster diversification needed**

Egypt has moved quickly on trade liberalization through commitments under the General Agreement on Tariffs and Trade and the World Trade Organization (WTO) and through bilateral and regional trade agreements. Tariffs have been reduced, while quotas and other nontariff restrictions have been removed. Import tariffs have come down from a range of 0.7–120% in May 1991 to 5–40%. And as part of WTO commitments, Egypt eliminated the import ban on textiles and clothing. But these reforms did not do enough to promote exports (table 6.6). Rather than attract resources to exportables, the reduction in protection of import-substituting activities led to a reallocation of resources to nontradables, particularly with the overvalued exchange rate.

Industrial protection without disciplining mechanisms to enhance productivity and competitiveness will make future success in the global market more difficult. The rent-seeking of protected industries, which prefer to produce for the shielded local market, will need to be addressed to enhance the export potential of the country. This challenge is as much political and economic as administrative. The modest level of educational attainment and human capital and skill constraints greatly reduce the country's capacity to benefit from skill-intensive higher value-added exports.

Against this background the government declared export expansion critical for strengthening the economy, and the Ministry of Foreign Trade announced an export promotion strategy for 2001–03. The strategy seeks to nearly double exports of five priority sectors, from $2,661 million in 2000 to $5,107 million in 2003: textiles and readymade garments; agricultural products such as rice and oranges; chemical, pharmaceutical, and medical supplies; building and construction materials and iron and steel; and processed food. Together, these items account for about 50% of merchandise exports in 2002. The strategy includes new institutional infrastructure for exports, international action to promote Egyptian exports, and sectoral policies. Given the deep structural constraints underlying Egypt's poor export performance, the targets appear optimistic.

### Table 6.6

**Exports by commodity type, 2002 (US$ millions)**

<table>
<thead>
<tr>
<th>Export</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total exports</td>
<td>4,697</td>
</tr>
<tr>
<td>Fuel and oil products</td>
<td>1,530</td>
</tr>
<tr>
<td>Nonoil</td>
<td>3,167</td>
</tr>
<tr>
<td>Raw cotton</td>
<td>330</td>
</tr>
<tr>
<td>Raw materials</td>
<td>282</td>
</tr>
<tr>
<td>Semimanufactured goods</td>
<td>585</td>
</tr>
<tr>
<td>Finished goods</td>
<td>1,537</td>
</tr>
<tr>
<td>Free-zone goods</td>
<td>433</td>
</tr>
</tbody>
</table>

*Source: Economic Commission for Africa, from official sources.*
External debt—remains manageable

Egypt’s external debt stands at about $28 billion in 2002/03, down from the alarming $50 billion reached in 1990 (table 6.7). The reduction was largely the result of debt write-offs through a 1991 Paris Club deal. Half the debt is owed to bilateral donors. Around 90% of Egypt’s current external debt stock is medium- and long-term public and publicly guaranteed. Medium- and long-term private nonguaranteed debt amounts to 1.9%, and short-term debt to only 7.5%.

The net present value of Egypt’s external debt fell to 23% of gross national income (GNI) in 2000 and 107% of exports of goods and services, well below the thresholds for debt sustainability under the Heavily Indebted Poor Countries Initiative. In the same year debt service amounted to 1.8% of GDP and 8.4% of exports of goods and services (World Bank 2002b). Over the 1990s the government has been cautious about taking on new borrowing, wary of falling back into the debt problems of the 1980s. Servicing external debt took up only 2% of total public expenditure in 2001/02, with interest payments on domestic debt now dwarfing those for foreign debt.

Structural reforms and impacts

Although efforts have been made to improve the efficiency of institutions, many weaknesses remain and further reform will be difficult. Privatization has slowed. The private sector has expanded but remains uncompetitive internationally. Industrial upgrading and technology transfer are now priorities.

Table 6.7

Public external debt, 1999/2000–2002/03 (US$ millions)

<table>
<thead>
<tr>
<th>Debt component</th>
<th>1999/2000</th>
<th>2000/01</th>
<th>2001/02</th>
<th>2002/03 Q1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total external debt</td>
<td>27,783</td>
<td>26,560</td>
<td>28,660</td>
<td>28,251</td>
</tr>
<tr>
<td>Rescheduled bilateral debt</td>
<td>16,292</td>
<td>14,779</td>
<td>15,336</td>
<td>15,012</td>
</tr>
<tr>
<td>Official development assistance</td>
<td>7,969</td>
<td>7,345</td>
<td>7,456</td>
<td>7,332</td>
</tr>
<tr>
<td>Other</td>
<td>8,323</td>
<td>7,434</td>
<td>7,881</td>
<td>7,680</td>
</tr>
<tr>
<td>Other bilateral debt</td>
<td>4,226</td>
<td>3,894</td>
<td>4,057</td>
<td>4,006</td>
</tr>
<tr>
<td>Paris Club countries</td>
<td>3,677</td>
<td>3,353</td>
<td>3,405</td>
<td>3,059</td>
</tr>
<tr>
<td>Other countries</td>
<td>549</td>
<td>541</td>
<td>652</td>
<td>946</td>
</tr>
<tr>
<td>International and regional institutions</td>
<td>4,275</td>
<td>4,310</td>
<td>4,697</td>
<td>4,679</td>
</tr>
<tr>
<td>Supplier and buyer credits</td>
<td>981</td>
<td>896</td>
<td>924</td>
<td>1,184</td>
</tr>
<tr>
<td>Sovereign bonds</td>
<td>—</td>
<td>—</td>
<td>952</td>
<td>857</td>
</tr>
<tr>
<td>Short-term debt</td>
<td>1,628</td>
<td>2,207</td>
<td>2,150</td>
<td>2,201</td>
</tr>
<tr>
<td>Deposits</td>
<td>657</td>
<td>1,311</td>
<td>1,339</td>
<td>1,357</td>
</tr>
<tr>
<td>Other short-term facilities</td>
<td>972</td>
<td>896</td>
<td>812</td>
<td>844</td>
</tr>
<tr>
<td>Private sector debt (nonguaranteed)</td>
<td>381</td>
<td>473</td>
<td>542</td>
<td>311</td>
</tr>
</tbody>
</table>

Source: Economic Commission for Africa, from official sources.
Institutional change—made difficult by vested interests

Political factors have constrained institutional reform. For example, a proposed competition and antimonopoly bill has been the subject of intermittent discussion for almost 10 years. Although several versions of the bill have been publicized, the legislation has not yet been submitted to the People’s Assembly, on the strength of business opposition. This is a vital piece of unfinished business to enhance institutional reforms, promote governance, and improve resource allocation. Similarly, a proposed labour bill would significantly change the labour code, establishing employers’ right to hire and fire. After nearly a decade of lobbying by various interest groups, and stiff opposition from labour unions, the bill never passed.

Such deeply rooted institutional ossification can only undermine the country’s international competitiveness. This is illustrated most recently in the country’s declining ranking in the Growth Competitiveness Index from 40 in 2000 to 44 in 2001 and in the Current Competitiveness Index ranking from 39 to 40 (World Economic Forum 2001).

Despite the barriers some measures have been taken to improve the institutional environment, especially in its effect on business operations and economic performance. To address inefficiencies in the legal system and in the bureaucracy, the Ministry of Justice recently set up a Judicial Reform Commission, which in collaboration with other government bodies is reviewing legislative changes to the commercial and business legal framework. New laws on intellectual property rights, money laundering, and special economic zones were passed in 2002.

But only limited progress has been made in cutting red tape and streamlining the cumbersome regulations holding back investment and operations. Much remains to be done to improve the entrenched and overstuffed bureaucracy. A new ministry in charge of civil service reform was established in 1997, with a mandate to recommend measures to improve the efficiency of civil service through training, evaluation, and performance-related schemes. This was perhaps ill-advised, because the new ministry only added to an already bloated bureaucracy instead of fighting it.

Regional and subregional integration—strengthening links with the rest of Africa

Egypt has strengthened its economic and trade ties with the rest of Africa, especially with countries south of the Sahara. The most significant step in this direction was the decision to join the Common Market for Eastern and Southern Africa (COMESA) in 1998, in pursuit of economic and strategic objectives. This was shortly followed by accession to COMESA’s free trade area. As of August 2000 Egypt had achieved a 90% tariff reduction on imports from COMESA members. But trade with COMESA countries accounted for only 1.1% of exports and 1.3% of imports in 2000. The United States and Europe remain Egypt’s main trading partners.
Bilateral and regional free trade agreements have become a feature of Egypt’s foreign trade policy in recent years. Bilateral agreements were signed with Libya and Syria in 1990; with Jordan, Lebanon, Morocco, and Tunisia in 1998; and with Iraq and Saudi Arabia in 2001. Egypt is a founding member of the Arab Common Market and a member of the Greater Arab Free Trade Area, initiated in 1998, to be completed in 10 years. More recently, Egypt and the European Union initialed the Egypt-EU Partnership Agreement in June 2001, establishing a free trade area over a 12-year period.

As a result of this web of trade arrangements, Egypt’s customs and trade regime has become cumbersome and unwieldy. Various agreements stipulate different tariffs, rules of origin, and exemptions, adding to transaction costs. There is thus scope for simplifying Egypt’s trade regime to eliminate inconsistencies and ambiguities and to reduce transaction costs.

The private sector

Strengthening the private sector is a major plank in Egypt’s reform agenda. The Economic Reform and Structural Adjustment Programme framework of 1991 had a strong private sector reform component, with measures to eliminate discrimination against the private sector in obtaining licenses, purchasing inputs and energy, and obtaining credit. This shifted economic activity towards the private sector, but the sector has yet to build up international competitiveness. Nonoil exports remain weak. And recent efforts to strengthen the sector face such constraints as the lack of relevant skills in the workforce, poor transparency in the business and legal spheres, and often confusing and contradictory government polices towards private enterprise.

Privatization. Egypt’s privatization program gathered steam in 1995, four years after the introduction of the adjustment program. In the first quarter of 2002 close to 60% of state-owned companies subject to the privatization enabling law, had shifted to private hands. Altogether 188 entities (of 314) have been privatized since 1995, with proceeds of 16.9 billion pounds. The privatization effort peaked in 1997–2000, with an average of 25–30 transactions worth 2.5–3.5 billion pounds annually. But the process slowed in 2001, with only 13 privatization transactions, generating proceeds of 1.1 billion pounds. It appears that the privatization process has reached its limits because of political inertia. In an attempt to reignite the privatization process, the Public Enterprise Office introduced alternative methods for privatization, including asset unbundling and leasing with an option to buy.

Despite the slowdown, privatization has increased the contribution of the private sector to GDP, investment, and employment in nonagricultural activities (table 6.8). In the medium and long terms this will improve the economy’s competitiveness.

The government has outlined a National Strategy for Economic and Social Development for 1997/98–2016/17, according a central place to the private sector in commodities and services. The premise is that a market economy requires a central role for the private sector in investment and production, even in areas traditionally the
domain of the government, such as roads, ports, and power. The ambitious target for
private investment is at least 80% of total investments.

But simply rolling back the state in favour of the private sector is not a panacea. The crit-
icial reform challenge is to reinvigorate the state in its interactions with the private sector,
 focusing more on enhancing quality. Facilitating private activities through deeper legal and
regulatory reforms and less red tape is crucial for private sector development (box 6.8).

Limited financing to small and medium-size enterprises. Private manufacturing in Egypt
is mostly by small and medium-size enterprises. In 1996 more than 90% of manufac-
turing entities in the private sector were sole proprietorships. Bank credit to small and
medium-size enterprises has traditionally been limited, especially for startups. Financ-
ing is thus essentially the equity the single owner can provide. Several initiatives
have been introduced to deal with this single most binding constraint to developing
the private sector in Egypt. The Credit Guarantee Company guarantees bank loans to
small enterprises in all business activities except trade. Three venture capital compa-
nies have been established, all still at an early stage of development. And the Social
Fund for Development has also been providing finance to small enterprises.

Strategic actions for technology development and transfer
In addition to capital deepening and more efficient resource use in existing sectors,
 faster growth depends on entering into higher productivity sectors and activities.
Success is likely to depend on institutional and political restructuring, to shift influ-
ence from vested interests likely to oppose moves to a more efficient and productive
industrial base through reforms that will generate winners and losers.

A recent report on science and technology has identified two main areas for strategic
action: supporting competitiveness and innovation as a basis for exports, and accelerating
technology transfer to Egypt through foreign direct investment, with several sectors
identified as promising (box 6.9).

Table 6.8
Public and private shares in GDP, investment, and employment in
nonagricultural activities, selected years (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP Public</th>
<th>GDP Private</th>
<th>Investment Public</th>
<th>Investment Private</th>
<th>Employment Public</th>
<th>Employment Private</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969/70</td>
<td>60.0</td>
<td>40.0</td>
<td>87.8</td>
<td>12.2</td>
<td>52.4</td>
<td>47.6</td>
</tr>
<tr>
<td>1975</td>
<td>58.8</td>
<td>41.1</td>
<td>85.0</td>
<td>15.0</td>
<td>53.9</td>
<td>46.1</td>
</tr>
<tr>
<td>1980/81</td>
<td>64.1</td>
<td>35.9</td>
<td>68.7</td>
<td>31.3</td>
<td>53.5</td>
<td>46.5</td>
</tr>
<tr>
<td>1984/85</td>
<td>52.3</td>
<td>47.7</td>
<td>60.4</td>
<td>39.6</td>
<td>51.4</td>
<td>48.6</td>
</tr>
<tr>
<td>1989/90</td>
<td>41.4</td>
<td>58.6</td>
<td>54.9</td>
<td>45.1</td>
<td>48.9</td>
<td>51.1</td>
</tr>
<tr>
<td>1994/95</td>
<td>42.8</td>
<td>57.3</td>
<td>59.4</td>
<td>40.6</td>
<td>47.4</td>
<td>52.6</td>
</tr>
<tr>
<td>1999/2000</td>
<td>32.2</td>
<td>67.8</td>
<td>32.9</td>
<td>67.1</td>
<td>42.1</td>
<td>57.9</td>
</tr>
</tbody>
</table>

Egypt’s potential for attracting foreign direct investment to develop information technology, software, and support services rests on a large and growing domestic market, reasonable infrastructure, and good human resources. The country has a potential comparative advantage in Arabic software applications. But realizing that potential requires

**Box 6.8**

**Measures to support the private sector**

The main areas for developing the private sector include:

- Deeper regulatory reform.
- A broader privatization effort that includes the economic authorities. There are 62 public economic authorities in Egypt. The proposed reform is to corporatize them, starting with the most viable.
- Reforming the commercial judicial system.
- Simplifying labour codes (with special emphasis on labour mobility).
- Devising innovative schemes to secure long-term credit to the private sector and formal credit to micro and small enterprises.
- Streamlining bureaucratic procedures throughout local and central government.
- Devising market-driven mechanisms for technological improvement and quality control.
- Building a system for gathering and disseminating basic, reliable, and timely economic data and information relevant to private business planning.

In addition, specific steps have been taken in the past few years to encourage the private sector, both domestic and foreign. The most important:

- A new Investment Guarantees and Incentives Law makes tax incentives automatic, streamlines procedures, and offers greater tax incentives for designated priority regions and activities (such as infrastructure, auto parts, software and tourism).
- A new government procurement law aims at improving predictability and encouraging competition in procurement, thereby opening up more space for the private sector.
- New legislation allows build-operate-transfer contracts for electricity distribution companies and power stations. A regulatory authority was also established to supervise these operations.
- The National Telecommunications Authority has been corporatized, transforming it to a joint stock company, the Egyptian Telecommunications Company (Egypt Telecom). A telecommunications regulatory agency was set up. The private sector was licensed to provide mobile phone services.
- General and specialized ports, as well as platforms in existing ports, may now be established and operated through build-operate-transfer contracts and concessions to the private sector. In addition, build-own-operate-transfer contracts were awarded for airport projects in Marsa Alam, Hurghada, and Alamein and for the Fayoum–Alexandria and Fayoum–Dayrout road projects.

*Source:* Economic Commission for Africa, from official sources.
a coherent strategy to attract foreign investment. Greater attention also has to go to improving the quality and delivery standards of local firms—and to improving the skills base of the workforce. Strategic alliances with transnational companies will continue to be essential for developing subcontracting and other linkages.

Developments in the social sector

Judged solely by per capita income, Egypt is a lower middle income country as defined by the World Bank. Although it has made significant progress in improving social conditions, much remains to be achieved. Large segments of the population still live in extreme poverty, and a great many cannot read and write. In addition, there is strong gender imbalance in unemployment rates, average years of schooling, and adult illiteracy. The inability to exploit the full potential of its citizens limits Egypt’s competitiveness in the global marketplace.

Box 6.9
Potential high-growth emerging sectors

**Information technology**
The decision to target information technology as one of the strategic action areas rests on the fact that Egypt is the largest market for information technology products in the Middle East. The United Nations Industrial Development Organization (UNIDO) estimates that the hardware market is growing faster in Egypt than in the world market. A new Ministry of Telecommunications and Information Technology was established in 1999, and there are plans to establish a technology valley in the Sinai, east of Ismailia.

This potential, along with the government’s declared policy of targeting this sector, has attracted a number of transnational corporations to Egypt. Xerox has built a plant in the new 6th of October industrial city to manufacture and assemble office equipment for the local and regional markets. In 1997 Xerox Egypt exported a large proportion of its production to European and Middle Eastern countries. The company supports its business growth by investing in human resources development, through a training center offering managerial and technical training.

**Software and support services**
Egypt has great, but largely untapped, potential as an attractive location for multinational software companies. IBM has located one of its regional scientific centers in Cairo to promote information technology in Egypt and to preempt piracy. Microsoft organizes training courses in collaboration with the Information and Decision Support Center through the Information Technology Institute. It also has agreed to make original software available to Egyptian colleges and universities and government departments on attractive terms. Oracle, in its bid to become the largest multinational software company in the country, is targeting government defense and security, oil and natural gas, private business, and banking and finance.

Source: Economic Commission for Africa, from official sources.
Health—improvements despite low public outlays

Public expenditure on health as a proportion of GDP is lower in Egypt than in other middle income countries, at 1.8% of GDP compared with 2.3%. But Egypt has seen faster improvements in some key health indicators than comparator countries (table 6.9). Life expectancy increased from 56 to 67 years between 1980 and 1999, an improvement of almost 20%, compared with the average of less than 5% for lower middle income countries. Infant mortality fell from 120 per 1,000 live births in 1980 to 47 in 1999, a 61% improvement, partly the result of reductions in diarrhea-related deaths through the use of oral rehydration therapy (EIU 2002). Child immunization is now nearly universal.

But access to health services remains uneven, with an urban bias in health care facilities creating barriers for poor and rural segments of the population. Fast population growth and inadequate health care funding have resulted in congestion. The government continues to be the main provider and financier of health care, though private provision and financing are increasing.

There is also an urban bias in other public services required for good health. Of the nonpoor, 82% had access to indoor drinking water, compared with 61% of the poor in 1999/2000. The gap is even wider for access to sewerage (World Bank 2002a). There is also a clear regional disparity, with the lowest access in southern and rural areas.

Education—mismatch with labour market requirements

Egypt fares poorly in education, too. At 5.8% of GDP public expenditure on education is below the average for lower middle income countries. This low expenditure is reflected in a number of indicators. Adult literacy in 2000 was 55%, but higher for men than for women. Primary enrolment rates in 2000 were 99%, but secondary enrolment

Table 6.9
Comparative health outcomes, Egypt and lower middle income countries, selected years

<table>
<thead>
<tr>
<th>Health indicators</th>
<th>Egypt</th>
<th>Lower middle income</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1980</td>
<td>1999</td>
</tr>
<tr>
<td>Life expectancy (years)</td>
<td>56</td>
<td>67</td>
</tr>
<tr>
<td>Infant mortality (per 1,000 live births)</td>
<td>120</td>
<td>47</td>
</tr>
<tr>
<td>Child immunization, measles (%)</td>
<td>96</td>
<td>87</td>
</tr>
<tr>
<td>Child immunization, DPT (%)</td>
<td>95</td>
<td>87</td>
</tr>
<tr>
<td></td>
<td>1990−98</td>
<td>1990−98</td>
</tr>
<tr>
<td>Public health spending (% of GDP)</td>
<td>1.8</td>
<td>2.3</td>
</tr>
<tr>
<td>Health spending per capita ($)</td>
<td>48</td>
<td>62</td>
</tr>
</tbody>
</table>

Source: Economic Commission for Africa, from official sources.
rates were just 51%. The system appears not to have coped well with the huge expansion of the education system, in terms of the quality of schooling.

In higher education Egypt has made considerable progress in expanding enrolment, giving it one of the largest university systems in Africa and the Middle East (table 6.10). There are 12 government universities, with 8 affiliated branches and 20 campuses. All but 1 of the 25 governorates have a university presence. The number of admitted students rose from 58,400 in 1973/74 to 200,600 in 1999/2000, total enrolment from 239,340 to 1,175,160, and the number of graduates from 32,030 to 195,200 a year. In 1998/99 women made up 44% of enrolment, up from 36% in 1992/93, as female enrolment tripled while male enrolment doubled. The gap between male and female enrolment is closing very quickly.

Government policy is to admit all high school graduates, and the expansion of secondary education in the 1980s increased demand for university places. There are also many repeaters. These factors, coupled with limited opportunities to study abroad, increased total enrolment.

Despite the growth in higher education, the system is failing to provide the skills most relevant to the labour market, which has long been unable to absorb the many university students graduating each year. Labour market demand for secondary school-educated workers is especially low, constituting only 4% of the total, partly reflecting their lack of skills. Around 55% of the unemployed have a secondary education. A recent survey shows that business owners prefer workers with practical business training rather than institutional certification (Evans-Klock and Lin Lean Lim 1997).

Educational attainment across different segments of the population appears to be closely connected to regional disparities in living standards and poverty. Reductions in poverty are strongly correlated with increases in education (table 6.11), although not uniformly

Table 6.10

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total enrolment</td>
<td>467,611</td>
<td>597,964</td>
<td>755,606</td>
<td>1,175,155</td>
</tr>
<tr>
<td>Male students</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number</td>
<td>302,838</td>
<td>355,876</td>
<td>431,838</td>
<td>626,843</td>
</tr>
<tr>
<td>%</td>
<td>65.0</td>
<td>59.5</td>
<td>57.2</td>
<td>53.3</td>
</tr>
<tr>
<td>Female students</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number</td>
<td>164,773</td>
<td>242,088</td>
<td>323,768</td>
<td>548,312</td>
</tr>
<tr>
<td>%</td>
<td>35.0</td>
<td>40.5</td>
<td>42.8</td>
<td>46.7</td>
</tr>
<tr>
<td>Ratio of female to male students (%)</td>
<td>54.4</td>
<td>68.0</td>
<td>75.0</td>
<td>87.5</td>
</tr>
</tbody>
</table>

Source: Economic Commission for Africa, from official sources.
across regions. In northern and urban Egypt the returns to education seem to have increased over the 1990s, whereas in southern areas education shows lower returns, reflecting regional disparities in the pace of development (World Bank 2002a). A gender gap in education was also apparent: the illiteracy rate in 1999/2000 for 12- to 15-year-olds was twice as high for girls as boys, though this was less marked in urban areas.

As Egypt seeks to upgrade its industrial base and diversify the economy to compete effectively in global markets, it is vitally important that its educational institutions address the skills gap (box 6.10). Moreover, the regional and gender inequalities in education need to be addressed as a priority.

### Inequality and poverty alleviation

Poverty is higher in Egypt than the average for Arab countries. Around 20% of the population fell under the $2 a day poverty line in 1999/2000, compared with 7% in Jordan in 1997 and 15% in Algeria in 1995 (World Bank 2002a). Even so, 2.7% of the population came out of poverty between 1995/96 and 1999/2000, aided by rapid growth of the economy and expansionary fiscal policies. But the economic slowdown in recent years is likely to reverse some of these gains. There are also indications that income disparities have grown wider, with per capita expenditures of the bottom 20% of the population growing less than average between 1995/96 and 1999/2000, perhaps the result of some free market reforms (World Bank 2002a).

Widespread deprivation and social discontent are evident in stagnant living standards for broad segments of the population—both a political and a social problem for the government, especially with the threat of Islamic insurgency. The high rate of unemployment and underemployment is a critical socioeconomic problem.

Poverty has a strong regional dimension, with southern and rural areas traditionally having much lower living standards than northern and urban areas (figures 6.11, 6.12, and 6.13). The incidence of poverty in rural northern Egypt is lower than the incidence of poverty in urban southern Egypt.

### Table 6.11

**Educational attainment, by poverty level, 1999/2000 (%)**

<table>
<thead>
<tr>
<th>Educational attainment</th>
<th>Nonpoor</th>
<th>Poor</th>
<th>All</th>
</tr>
</thead>
<tbody>
<tr>
<td>Illiterate</td>
<td>28.4</td>
<td>45.7</td>
<td>31.1</td>
</tr>
<tr>
<td>Read and write</td>
<td>15.9</td>
<td>17</td>
<td>16.1</td>
</tr>
<tr>
<td>Basic education</td>
<td>22.5</td>
<td>23.4</td>
<td>22.6</td>
</tr>
<tr>
<td>Secondary</td>
<td>21.3</td>
<td>11.9</td>
<td>19.8</td>
</tr>
<tr>
<td>Diploma</td>
<td>2.9</td>
<td>0.8</td>
<td>2.6</td>
</tr>
<tr>
<td>University</td>
<td>8.8</td>
<td>1.1</td>
<td>7.5</td>
</tr>
<tr>
<td>Post-university</td>
<td>0.3</td>
<td>0.0</td>
<td>0.3</td>
</tr>
</tbody>
</table>

Source: Economic Commission for Africa, from official sources.
Even as absolute poverty declined overall, it increased in southern Egypt between 1995/96 and 1999/2000, largely a result of the concentration of such high-growth sectors as manufacturing, construction, and trade in northern and urban areas (World Bank 2002a). It also appears that the share of high-return crops, such as rice and tomatoes, in the agricultural sector in southern Egypt declined between 1995 and 1999, with a larger share going to the north. It is thus clear that antipoverty programs should focus on southern Egypt.

The social insurance system and the social assistance programmes, under the Ministry of Insurance and Social Affairs, are intended to alleviate poverty. But the average monthly benefit from the pension and social assistance schemes was a trickle, at just 8% of average household expenditure in the low-expenditure group in 1999/2000 (Korayem 2002). In addition only 20% of the extreme poor in Egypt receive assistance through the government social assistance schemes (ILO 1999). Some measures seem to have had more of an impact. For example, the bread subsidy may have taken some 730,000 people out of poverty (World Bank 2000a). But access to key public services is regressive, with large gaps between the poor and nonpoor in access to water, sewerage, and sanitation.

**Box 6.10**

**Key challenges facing higher education**

The government is exploring ways to link universities to the labour market and to the private sector to make students more employable. It is also considering a national apprenticeship program, in view of the high dropout rate in higher education. Other challenges:

*Legislative reform.* Universities need more autonomy and independence. They should be able to recruit and fire staff and to respond quickly to a rapidly changing international education environment without always obtaining permission from the Ministry of Higher Education.

*Resource allocation.* There is a need to improve allocative efficiency within the education system. For example, higher education institutions should be allowed to divert funding from low enrolment courses to areas of higher need.

*Quality assurance.* The huge expansion of access has eroded quality. The government needs to consider whether further expansion of access is necessary before quality assurance programs are fully implemented. Under the system being contemplated, the Supreme Council of Universities will be responsible for assuring quality.

*Infrastructure and information technology.* The size of the higher education system is a challenge for reform and the use of information technology. The system of short-term funding and the lack of an articulated information technology acquisition and replacement plan has led to an inconsistent and unproductive approach to implementation. Within individual universities there is a shortage of modern information technology for teaching, libraries, and research. Information technology has not been directly integrated into the course curriculum and used to promote enhanced delivery of the course material or to extend delivery beyond the lecture hall.

*Source:* Economic Commission on Africa, from official sources.
Medium-term prospects—clouded by external environment

GDP growth is likely to recover to around 4%, reflecting a rebound in tourism and transport and a boost to agriculture with the inauguration of the Toshka project. Manufacturing growth should also pick up, as depreciation of the Egyptian pound spurs export demand. But business confidence is a large uncertainty for this forecast because of confusion over policy directions. Much depends on the future conduct of exchange rate policy and monetary and fiscal policy.

If security in the Middle East deteriorates, this could hurt the Egyptian economy, particularly tourism. Predictions about external imbalances are highly uncertain, but the current account deficit is likely to increase over the next two years to around 1% of GDP.

Sheer inertia and the large domestic public debt may widen the fiscal deficit. Because the real domestic interest rate is higher than the GDP growth rate, interest payments may continue to claim a rising proportion of public expenditure, thus fueling a widening budget deficit. The recently established Public Debt Management Department, if effective, may eventually arrest the rapid growth of domestic debt. In the medium term, however, the budget deficit is likely to stay high, approaching 6% of GDP over the next two years.

Figure 6.11
Poverty higher in southern and rural areas
Poverty incidence by governorate, 1999–2000 (%)
Egypt faces two broad policy challenges. The first is to bring greater clarity to the conduct of macroeconomic policy in the medium term. The contradictions apparent in recent years, particularly in monetary and exchange rate management, need to be

**Figure 6.12**
*Consumption growing fastest in metropolitan areas, slowest in southern urban areas*

*Annual real growth in per capita expenditures, 1995–2000 (%)*

![Graph showing annual real growth in per capita expenditures](chart)


**Figure 6.13**
*Poverty down most in metropolitan areas, but rising in southern rural and urban areas*

*Regional poverty incidence, 1995/96 and 1999/2000 (%)*

![Graph showing regional poverty incidence](chart)

resolved. The flexible exchange rate may help, but the recent flotation of the pound could bring short-term exchange rate volatility, particularly with Egypt’s shallow capital markets and regional political instability.

The second policy challenge is institutional renewal, particularly for the relationship between the state and the private sector. Simplistic calls for rolling back the state are not the solution. Instead, the relationship between the state and the private sector needs to be considered in innovative ways. If the government is to push strategic sectors identified in the recently introduced export promotion strategy and National Strategy for Economic and Social Development, it must avoid creating a raft of protected, uncompetitive firms.

Institutional, legal, and regulatory mechanisms need to be put in place to create an enabling environment for the private sector to operate. This will require political courage from the government. In addition, weaknesses in various sectors will have to be dealt with if developmental dividends are to materialize, by diversifying and upgrading the industrial base, leading to better export performance, higher and more sustained growth, and improved living standards. In particular, a big push is needed in education, to foster skills and business-oriented knowledge.

Notes

1. M1 is local currency outside the banking system and local currency demand deposits.

2. M2 is M1 plus local currency time and savings deposits plus foreign currency deposit, time, and savings accounts.

3. An agreement with a promise by the seller to buy a security back from the purchaser at a specified price at a designated future date.

4. Global depository receipts are globally traded receipt representing ownership of shares in a foreign company.

5. Including the operations of the National Investment Bank and the General Authority for the Supply of Commodities brings the 2002 deficit to 7.2% of GDP.

6. The law did not apply to all companies, such as those in the banking and insurance sectors.
Appendix

Budget proposals, 2001/02 and 2002/03 (US$ billions)

<table>
<thead>
<tr>
<th>Item</th>
<th>2001/02</th>
<th>2002/03</th>
<th>% change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current spending</td>
<td>22.1</td>
<td>23.3</td>
<td>10</td>
</tr>
<tr>
<td>Wages</td>
<td>7.2</td>
<td>7.5</td>
<td>9</td>
</tr>
<tr>
<td>Other</td>
<td>14.9</td>
<td>15.7</td>
<td>10</td>
</tr>
<tr>
<td>Pensions</td>
<td>2.3</td>
<td>2.5</td>
<td>13</td>
</tr>
<tr>
<td>Education</td>
<td>4.4</td>
<td>4.6</td>
<td>9</td>
</tr>
<tr>
<td>Health care</td>
<td>1.6</td>
<td>1.7</td>
<td>12</td>
</tr>
<tr>
<td>Subsidies</td>
<td>1.4</td>
<td>1.4</td>
<td>8</td>
</tr>
<tr>
<td>Interest on domestic debt</td>
<td>5.2</td>
<td>5.6</td>
<td>14</td>
</tr>
<tr>
<td>Interest on foreign debt</td>
<td>0.5</td>
<td>0.5</td>
<td>4</td>
</tr>
<tr>
<td>Capital spending</td>
<td>6.5</td>
<td>7.3</td>
<td>18</td>
</tr>
<tr>
<td>Investment</td>
<td>3.4</td>
<td>4.2</td>
<td>26</td>
</tr>
<tr>
<td>Other capital spending</td>
<td>3.0</td>
<td>3.2</td>
<td>8</td>
</tr>
<tr>
<td>Total spending</td>
<td>28.6</td>
<td>30.6</td>
<td>12</td>
</tr>
<tr>
<td>Current revenue</td>
<td>21.2</td>
<td>21.1</td>
<td>3</td>
</tr>
<tr>
<td>Tax revenue</td>
<td>15.6</td>
<td>15.6</td>
<td>4</td>
</tr>
<tr>
<td>General income tax</td>
<td>6.6</td>
<td>6.7</td>
<td>5</td>
</tr>
<tr>
<td>Custom duties</td>
<td>3.1</td>
<td>3.0</td>
<td>0</td>
</tr>
<tr>
<td>Sales tax</td>
<td>4.5</td>
<td>4.4</td>
<td>4</td>
</tr>
<tr>
<td>Other duties</td>
<td>0.0</td>
<td>1.4</td>
<td>—</td>
</tr>
<tr>
<td>Non tax revenue</td>
<td>5.7</td>
<td>5.5</td>
<td>1</td>
</tr>
<tr>
<td>Petroleum authority</td>
<td>1.1</td>
<td>1.0</td>
<td>–4</td>
</tr>
<tr>
<td>Suez canal authority</td>
<td>0.8</td>
<td>0.9</td>
<td>11</td>
</tr>
<tr>
<td>Central Bank of Egypt</td>
<td>1.1</td>
<td>1.0</td>
<td>–4</td>
</tr>
<tr>
<td>Economic authorities</td>
<td>0.2</td>
<td>0.1</td>
<td>–14</td>
</tr>
<tr>
<td>Capital revenue</td>
<td>2.7</td>
<td>3.0</td>
<td>17</td>
</tr>
<tr>
<td>Investments</td>
<td>0.9</td>
<td>1.4</td>
<td>54</td>
</tr>
<tr>
<td>Capital transfers</td>
<td>1.7</td>
<td>1.6</td>
<td>–3</td>
</tr>
<tr>
<td>Total revenue</td>
<td>23.9</td>
<td>24.1</td>
<td>5</td>
</tr>
<tr>
<td>Total balance</td>
<td>–4.7</td>
<td>–6.5</td>
<td>45</td>
</tr>
</tbody>
</table>

Source: EIU 2002.

References


Gabon—Struggling to Diversify from the Oil Sector

Gabon’s economy contracted 0.3% in 2002 due largely to oil’s poor performance. Oil GDP declined an estimated 2.4%, partially offset by a slight increase in nonoil GDP of 0.6%, leading to a marginal contraction in overall GDP. As the government intensifies economic reforms and higher oil prices boost oil GDP, overall real GDP is expected to recover by 0.7% in 2003 and 1.7% in 2004.

The fiscal balance remained positive but deteriorated from a surplus of 7.6% of GDP in 2001 to 5% in 2002, reflecting the 38% decline in oil revenues. Nonoil revenues increased 27%, topping oil revenues for the first time since the early 1970s.

The tight monetary policy of the central bank, coupled with the government’s fairly strict fiscal stance, kept inflation at about 2% a year during 2000–02. Because Gabon imports mainly from Europe and Cameroon, the appreciation of the CFA franc against the dollar did not affect domestic prices.

Government borrowing from the banking system was down 14%, compared with a phenomenal increase of more than 100% the previous year. This enabled the government to redress its assets coverage ratio with the central bank and thus improve its position in the operations account, severely depleted in 2001 by excessive and unbudgeted government borrowing. The reduction in government credit from the banking system also made more credit available to the private sector, resulting in an increase of 23% in 2002, more than twice the 11% increase in 2001. Overall, net domestic assets increased by a modest 8.2% in 2002, while net foreign assets improved from $10.9 million in 2001 to $29.7 million in 2002.

The overall balance of payments is estimated to have improved significantly in 2002, mainly from higher inflows of foreign investment and a reduction in the government’s external debt. Even so, the level of debt stood at $4 billion in 2002, about 109% of export earnings, with debt service payments equivalent to 37% of government revenue.

Because of mounting debt problems, social infrastructure and urban services have deteriorated. About 80% of the population in the largest city—Libreville—lives in poor neighborhoods without adequate water, sanitation, and health facilities. Rural areas were equally affected, as transfers and government services both declined.
Poverty remains deep, with 60% of the population living below the poverty line, a level that has not changed much since independence in 1960, though the number of the extremely poor has declined significantly. At the same time, income inequality is high, with a Gini coefficient of 0.45 for the two major cities—though probably lower for rural areas.

The Gabon development experience is a classic example of the Dutch disease. Revenues from large oil exports led to distortions in the economy, resulting in contraction of the nonoil tradable sector as relative prices shifted in favour of the nontradable sector. With the nontradable sector expanding, traditional sectors, particularly agriculture, stagnated because they had become unattractive for investment. That led to a large influx of workers—especially youths—to urban areas, swelling the urban population and unemployment.

After the first oil boom of 1973 oil replaced forestry, uranium, and manganese as the dominant sector and the driving force of economic growth. Its share of GDP reached a peak of 55% during 1980–84 (figure 7.1), and it contributed 85% of export earnings. Although oil’s dominance of the economy has declined in recent years, it remains the main source of growth, contributing about 41% of GDP, 78% of export earnings, and 66% of fiscal revenues in 2000/01. Gabon is the third largest producer and exporter of crude oil in Sub-Saharan Africa.

Although the government has long recognized the need for diversification, little has been done to advance it. Unlike other commodity-dependent economies, Gabon has many unexploited opportunities in agriculture, fishing, forestry, and mining. The

Figure 7.1
Oil on the decline
Contribution to GDP of selected sectors, 1960–2000/01 (% of GDP)
government’s failure to take advantage of these opportunities will prove costly as oil production continues to decline—with output expected to be exhausted in 10–15 years unless new deposits are discovered. Oil earnings in the short term will delay economic stagnation, but with consequences for growth, employment, and poverty. Gabon thus appears primed for an economic setback in the medium term—and the government seems unprepared for the impending crisis. The impact of the decline in the oil sector will be felt largely through a tightening of domestic and external financing.

To address the economic challenges, the government started a major reform programme in 1994, underpinned by the 50% devaluation of the CFA franc. Key reforms included privatization, reductions in fiscal spending, liberalization of the economy, and encouragement of foreign direct investment. There has been some progress, but the government has not been consistent in implementing the needed reforms. As a result, the programme agreed with the International Monetary Fund (IMF) in 2000 was allowed to lapse in April 2002 due to delays in structural reforms and fiscal slippages.

As oil production continues to decline, the outlook for the economy remains bleak. These concerns have been echoed by ratings agencies, which recently downgraded Gabon’s financial standing. And the failure to diversify means that the nonoil sector will be unable to pick up the slack. Gabon therefore urgently needs to implement structural measures required for diversification, promote private investment, and guard against macroeconomic instability associated with fiscal mismanagement.

Recent economic developments

A notable feature of Gabon’s economy is its extreme dependence on natural resources, which account for about 50% of GDP. Primarily due to oil, Gabon is a middle income country with a per capita income of about $3,800—about 10 times the Sub-Saharan average. Yet inequality is high, and a large proportion of the population remains poor.

Economic performance—weak overall growth

Gabon’s overall economic performance has been weak and erratic (table 7.1 and figure 7.2). Following a profound recession in 1999, when real GDP contracted 9.6%, the economy improved slightly in 2000 but not enough to turn positive. After a modest recovery to 2% in 2001, the economy contracted 0.3% in 2002. The poor growth performance was also due to an unfavourable business environment, weak and inefficient infrastructure, and a huge and growing external debt, at more than 100% of GDP.

The slight recovery in 2001 was helped by higher oil prices and higher than expected oil production. Oil GDP is estimated to have contracted 2.4% in 2002, while the nonoil
sector grew 1.7% in 2000, 4.6% in 2001, and an estimated 0.6% in 2002. Behind this growth was the improved economic environment—as key structural reforms began to take effect and the fiscal situation improved following the government’s efforts to reduce its debt and arrears, both domestic and external. This boosted private investment in services, agriculture, and wood processing.

The central bank’s monetary policy, coupled with the government’s fiscal stance, kept inflation firmly under control at 2% a year during 2000–02. With Gabon importing mainly from the Euro area and Cameroon, the appreciation of the CFA franc against the dollar did not affect domestic prices. With the global economic recovery and high oil prices, real GDP is expected to recover by 1% in 2003 and 1.7% in 2004.

Table 7.1

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross domestic product</td>
<td>6,493</td>
<td>6,718</td>
<td>6,076</td>
<td>5,959</td>
<td>6,078</td>
<td>6,065</td>
</tr>
<tr>
<td>Primary sector</td>
<td>2,632</td>
<td>2,577</td>
<td>2,375</td>
<td>2,172</td>
<td>2,086</td>
<td>2,060</td>
</tr>
<tr>
<td>Agriculture, animal husbandry, and fishing</td>
<td>351</td>
<td>367</td>
<td>372</td>
<td>382</td>
<td>392</td>
<td>402</td>
</tr>
<tr>
<td>Timber industry</td>
<td>129</td>
<td>118</td>
<td>139</td>
<td>150</td>
<td>143</td>
<td>143</td>
</tr>
<tr>
<td>Crude oil</td>
<td>2,030</td>
<td>1,939</td>
<td>1,721</td>
<td>1,505</td>
<td>1,424</td>
<td>1,390</td>
</tr>
<tr>
<td>Mining</td>
<td>122</td>
<td>153</td>
<td>143</td>
<td>134</td>
<td>127</td>
<td>125</td>
</tr>
<tr>
<td>Secondary sector</td>
<td>1,037</td>
<td>1,140</td>
<td>960</td>
<td>943</td>
<td>977</td>
<td>973</td>
</tr>
<tr>
<td>Industry</td>
<td>378</td>
<td>433</td>
<td>418</td>
<td>418</td>
<td>442</td>
<td>464</td>
</tr>
<tr>
<td>Agro-food industry</td>
<td>138</td>
<td>159</td>
<td>151</td>
<td>149</td>
<td>155</td>
<td>163</td>
</tr>
<tr>
<td>Timber industry</td>
<td>22</td>
<td>40</td>
<td>52</td>
<td>39</td>
<td>52</td>
<td>54</td>
</tr>
<tr>
<td>Other industry</td>
<td>218</td>
<td>234</td>
<td>216</td>
<td>231</td>
<td>235</td>
<td>247</td>
</tr>
<tr>
<td>Refinery</td>
<td>116</td>
<td>119</td>
<td>121.6</td>
<td>127</td>
<td>130</td>
<td>124</td>
</tr>
<tr>
<td>Electricity and water</td>
<td>124</td>
<td>127</td>
<td>137</td>
<td>138</td>
<td>143</td>
<td>135</td>
</tr>
<tr>
<td>Construction and public works</td>
<td>385</td>
<td>412</td>
<td>251</td>
<td>204</td>
<td>206</td>
<td>194</td>
</tr>
<tr>
<td>Research and oil services</td>
<td>35</td>
<td>48</td>
<td>31</td>
<td>56</td>
<td>56</td>
<td>56</td>
</tr>
<tr>
<td>Tertiary sector</td>
<td>2,508</td>
<td>2,684</td>
<td>2,496</td>
<td>2,662</td>
<td>2,494</td>
<td>2,675</td>
</tr>
<tr>
<td>Transport and telecommunications</td>
<td>406</td>
<td>429</td>
<td>365</td>
<td>415</td>
<td>344</td>
<td>425</td>
</tr>
<tr>
<td>Services</td>
<td>785</td>
<td>875</td>
<td>841</td>
<td>912</td>
<td>849</td>
<td>916</td>
</tr>
<tr>
<td>Trade</td>
<td>511</td>
<td>537</td>
<td>415</td>
<td>449</td>
<td>441</td>
<td>453</td>
</tr>
<tr>
<td>Bank and insurance services</td>
<td>76</td>
<td>67</td>
<td>53</td>
<td>57</td>
<td>54</td>
<td>53</td>
</tr>
<tr>
<td>Nonmarketed services</td>
<td>731</td>
<td>777</td>
<td>822</td>
<td>829</td>
<td>806</td>
<td>828</td>
</tr>
<tr>
<td>Import duty and other taxes</td>
<td>316</td>
<td>318</td>
<td>245</td>
<td>353</td>
<td>287</td>
<td>357</td>
</tr>
<tr>
<td>Oil GDP</td>
<td>2,181</td>
<td>2,107</td>
<td>1,874</td>
<td>1,687</td>
<td>1,610</td>
<td>1,572</td>
</tr>
<tr>
<td>Nonoil GDP</td>
<td>4,312</td>
<td>4,612</td>
<td>4,202</td>
<td>4,271</td>
<td>4,468</td>
<td>7,795</td>
</tr>
<tr>
<td>GDP growth (%)</td>
<td>5.7</td>
<td>3.5</td>
<td>-9.6</td>
<td>-1.9</td>
<td>-2.0</td>
<td>-0.3</td>
</tr>
</tbody>
</table>

* a. Estimated.

Source: Economic Commission for Africa, from official sources.
**Employment—sluggish**

Overall employment in the public and private formal sector increased 2%, from 107,334 workers in 2000 to 109,521 in 2001. The increase was attributable to better performance in the oil sector, with prices and output higher than projected, and greater activity in the private and quasi-public sectors (timber, services, agriculture, transport, and telecommunications).

Despite the increase, the labor market has deteriorated considerably. According to the National Labour Office, 20% of the economically active population is out of work. This trend will only worsen as the supply of labor grows 2.8% a year (12,600 job seekers in 1998) while the labor market can absorb only 4,000 job seekers a year. The imbalance between supply and demand is attributable to a mismatch between the skills and training of the labor force and the requirements of employers. Government estimates show that 80% of the unemployed are unskilled. There is also little real tradition of entrepreneurship.

**Sectoral performance—stunted by Dutch disease**

Although the government has long recognized the need for diversification, as evidenced in many policy announcements, implementation has lagged far behind. The average diversification index stood at 0.853 during 1980–90 and 0.917 during 1990–95, showing little progress since 1980. After devaluation of the CFA franc in 1995, the index improved slightly, but it has been declining since with the rising share of services and the persistently low share of all industrial sectors (IMF 2002). The most critical challenge for Gabon in thus to expand the nonoil sector.

---

**Figure 7.2**

**GDP tracks oil—down, then up slightly**

*Real GDP growth, 1995–2002 (%)*

![Graph showing GDP tracks oil: down, then up slightly](image)

*a. Estimated.*

*Source: Economic Commission for Africa, from official sources.*

---

Gabon—Struggling to Diversify from the Oil Sector
Oil—a slight reprieve as small fields cushion projected decline in production

Oil continues to be the key driving force of economic activity since the first oil boom in the early 1970s. In 2000/01 oil contributed 66% of government revenues, 78% of export earnings, and 41% of GDP. But in direct employment it lags behind agriculture and forestry, which provide more than 70% of primary sector employment. Oil has remained largely an enclave, with little impact on the nonoil sector except through oil taxes, equivalent to a foreign transfer (IMF 2002).

Until the mid-1990s the government’s main concern was oil’s vulnerability to fluctuations in prices and world demand. This changed in 1997 when production started to decline, from 18.5 million tons in 1997 to an estimated 13 million tons in 2001. Unless new reserves are found, production is set to fall by half by 2005.

The decline in oil production will deal a major blow to the economic reform and development programme and will have ripple effects throughout the economy. Given the heavy dependence on oil tax revenue—which averaged about 56% of total receipts over the last five years—the decline will precipitate major cuts in investment in physical and social infrastructure. The problem will be compounded by the high indebtedness and the need to repay accumulated arrears.

The government’s immediate response has been to encourage more oil exploration, not to implement the reforms required to boost nonoil sectors. The government revised its production sharing contracts to attract new investors and increased the number of permits issued. In the ninth licensing round, 27 blocks were offered, 13 onshore, 9 in deep waters, and 5 in shallow waters. But the response was disappointing. Despite extensive exploration, no large new oil fields have been discovered to compensate for the declining output. Some smaller discoveries raise the country’s oil reserves to about 2.5 million barrels, helping to slow the decline in production and earnings. But most of these small wells are low yielding—and cannot be economically exploited unless oil prices rise. The government must confront the prospects of a future without oil, with reserves exhausted in the next 10–15 years if current exploration efforts do not bring success.

Agriculture and fishing—underdeveloped

For a country endowed with adequate rainfall and arable land, the contribution of agriculture to the economy is unusually low—declining from 10.8% of nonoil GDP to 9.7% between 1990 and 2001. The 800 kilometre coastline and interior water resources provide abundant fishing opportunities, which if fully exploited could meet domestic needs and produce a surplus for export. In 2001 and 2002 agriculture and fishing grew only 2.5%.

The dismal performance of agriculture is attributable to the Dutch disease that came with oil. Before the first oil boom, Gabon produced significant amounts of food and cash crops, such as cocoa and coffee. But with agriculture neglected, production stagnated. And today the country depends on imported food from Europe and from other African countries.
Weak and inefficient infrastructure makes it costly to market agricultural produce. Production costs, especially for labor, are high. And productivity is low because of traditional farming methods and poor support services to farmers. A revival of the sector could go a long way towards improving the depressed incomes of rural dwellers, about 25% of the total population.

To increase domestic food production and reverse dependence on imports, the government prepared a rural development programme to:

- Increase food production and reduce imports.
- Improve the production of cash crops.
- Renew the rural population with young settlers.
- Diversify agricultural production to increase sources of income.
- Improve production and marketing strategies.
- Reorganize and strengthen agricultural research and training.
- Train farmers in cash crop production.

**Forestry—potential untapped**

About 80% of Gabon is covered with virgin tropical forest containing species highly valued in international markets. And forestry remains among the top sectors in the economy, in recent years contributing about 3.8% of nonoil GDP, 12% of exports, and 8% of employment. Between 1998 and 2000 the primary timber industry grew 27% in real terms, and after declining in 2001 it is estimated to have increased by 0.5% during 2002, thanks to strong world prices and reforms to improve the incentives for private participation (see table 7.1).

Gabon’s main timber importers—Asian countries—are very price sensitive, and they can easily substitute cheaper, low quality products for high quality Gabonese wood. During the Asian crisis Gabon saw a dramatic 43% decline in exports. And there is stiff competition from neighbouring countries, particularly Equatorial Guinea. Although exports rebounded strongly in 1999 and 2000, they declined 15% in 2001, due mainly to lower world demand. One export species, okoume, dominates with about 70% of the total. Most timber is exported unprocessed, resulting in very low valued added from forestry.

The private sector is a key player in logging, but so is the government, with 51% ownership of the Société National des Bois du Gabon (SNBG), which has monopoly export rights for okoume. SNBG has been facing serious financial and management problems, with adverse ripple effects on private suppliers, interrupting production and shipments of okoume and ozigo. The government has allowed partial liberalization of these two types of wood, permitting private operators to export up to half of their production in 2001.

Forestry offers great opportunities for diversification as Gabon grapples with the realities of dwindling oil reserves. If managed well, forestry can increase export earnings and employment—and thus benefit the majority of the population, especially the poor,
while preserving biodiversity. According to World Bank estimates, 1.7 jobs are required per year to exploit 1,000 cubic meters of timber and an additional 2 jobs per year for processing, thus potentially making forestry a leading source of employment. To realize the potential, the government is enacting legislation to encourage local processing, while emphasizing sustainable exploitation.

Mining—weak performance
Mining started to decline after 1999, with the closure of the Mounana uranium mine. Mining output, down by 17% in real terms between 1998 and 2001, is projected to remain flat in 2002 (see table 7.1). Significant for export earnings, its contribution to GDP is still low—at 2.7% of nonoil GDP in 2001.

Gabon is the fourth largest producer of manganese, with the main mine having 200 million tons, 25% of the world’s reserves of high concentrate ore. Manganese exports were about 4.5% of the total in 2001, making it the third largest export earner.

The potential for future development is high, with unexploited reserves of iron ore, phosphate, niobium, and titanium. The main obstacles to further exploitation of mineral wealth are inadequate infrastructure and unfavorable mining, labor, and investment codes. Legislation was recently passed providing tax and other incentives.

Industry—growth impeded by delays in privatization
Industry grew about 5% in real terms in 2002, from $442 million in 2001 to $464 million (see table 7.1). Agribusiness contributed 2.3% of nonoil GDP in 2001, and wood processing 1.1%. Growth has been hampered by inefficient and poorly managed state marketing enterprises for vegetable oil, soap, coffee, and sugar, all enjoying monopolies on marketing imported and domestic products, crowding out private involvement. Further support is provided through tariff and nontariff protection.

Despite the support to agribusiness, prices for consumers are high, so the government embarked on a comprehensive programme of privatization and liberalization. Progress in privatizing the key state enterprises has been slow, however, because few policy intentions are implemented.

As part of efforts to diversify the economy away from oil and create employment, legislation for the duty-free zone of Port-Gentil was enacted in October 2002 after 10 years of deliberation. The duty-free zone extends over 1,500 hectares on Mandji Island near Port-Gentil, Gabon’s oil center, with a deepwater port. The state owns a 20% stake, and a foreign technical partner will manage it.

The main incentives of the zone are no minimum investment; no restrictions on the origin of investment or the numbers of employees, though after five years 95% of staff must be Gabonese; no stamp duties during the first 10 years of operations; no customs duties on imports or exports; no duties on primary, intermediate, and semifinished
goods coming from Gabon to free-zone enterprises; and no price controls, import and export quotas, or import and export licenses.

Macroeconomic developments

Although the economy contracted slightly during 2001–02, the overall macroeconomic situation has improved significantly since 1999, with the recovery from the breakdown of financial management in 1998. The fiscal slippages in 1998 have been largely corrected through measures to strengthen expenditure control and monitoring, improve transparency and governance in financial operations, and reorganize the Ministry of Finance. Financing remains fragile, however, because the government must generate resources for development, debt repayments, and reductions in arrears.

Fiscal developments—need for balance between fiscal consolidation and increased spending in priority sectors

Since the fiscal crisis of 1998 the government has been preoccupied with maintaining a high primary budget surplus to service obligations, clear arrears, and reestablish confidence with creditors—while ensuring sufficient revenues to finance priority sectors and provide adequate liquidity for the private sector. Helped by higher oil prices, the primary surplus was 16.5% of GDP in 2001, still short of the target because of transfers and net loans to meet the cost of restructuring state enterprises. In 2002 the primary surplus declined slightly, to 10.2% of GDP, mainly because of the 38% decline in oil revenues. The fiscal adjustment was achieved mainly through reductions in capital and current expenditures (table 7.2). As a result, the overall balance remained in surplus, but was down by 40% between 2001 and 2002.

In the budget framework for 2002 the government took measures to strengthen fiscal consolidation and reinvigorate growth. Allocations to social services and physical infrastructure were higher. Taxes were increased on petroleum, beer and soft drinks, logs, and manganese. The government also implemented measures to increase transparency and efficiency in fiscal management, including a 1% of GDP limit on subsidies to state enterprises and a reduction in the wage bill through civil service reform. The government also undertook to accelerate privatization. But the fiscal measures are unlikely to result in significant savings unless further debt rescheduling is forthcoming in 2003.

To stimulate growth and reduce poverty, spending on social and physical infrastructure needs to increase. Also needed is generating enough savings to repay debt and increase liquidity for the private sector.

Financial sector—generally stable

Monetary developments in 2002 were marked by a 14% reduction in government borrowing from the banking system, after a phenomenal 100% increase the previous year. That enabled the government to redress its asset coverage ratio with the central bank...
and begin to restore its severely depleted operations account. The reduction in govern-
ment borrowing also made more credit available to the private sector, with a 23%
increase in 2002 compared with 11.2% in 2001. Net domestic assets increased 8.2% in

Past fiscal laxity generated government arrears to the banking sector and to the banks’
clients. The government was to stick to the statutory ceiling set by the central bank at
3% of GDP in 2001, but fiscal slippages eroded much of that margin. The government
concentrated on strengthening public finances and reducing its indebtedness to the
banking system, to avoid new arrears to banks and suppliers. A public debt manage-
ment strategy, including sales of treasury bills, was proposed to help mitigate the risks.

With a shrinking oil economy, weaknesses in the banking sector required diversifica-
tion, internationalization, and better risk monitoring by the regional supervisory agency,
the Central African Banking Commission (COBAC). The government retains a strong
role in the financial sector, both as owner and as client, either directly or through state

Table 7.2
Financial operations of the central government, 1998–2002 (US$ millions)

<table>
<thead>
<tr>
<th>Item</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002a</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total receipts</td>
<td>1,545.9</td>
<td>1,323.6</td>
<td>1,700.9</td>
<td>1,624.9</td>
<td>1,374.9</td>
</tr>
<tr>
<td>Oil earnings</td>
<td>844.6</td>
<td>599.9</td>
<td>1,147.5</td>
<td>1,066.8</td>
<td>665.0</td>
</tr>
<tr>
<td>Nonoil earnings</td>
<td>701.3</td>
<td>723.7</td>
<td>553.4</td>
<td>558.1</td>
<td>707.3</td>
</tr>
<tr>
<td>Grants</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>2.6</td>
</tr>
<tr>
<td>Total expenditure</td>
<td>2,172.2</td>
<td>1,267.7</td>
<td>1,107.0</td>
<td>1,275.5</td>
<td>1,156.9</td>
</tr>
<tr>
<td>Current expenditure</td>
<td>1,557.3</td>
<td>1,074.3</td>
<td>950.3</td>
<td>1,051.2</td>
<td>850.9</td>
</tr>
<tr>
<td>Salaries and allowances</td>
<td>347.3</td>
<td>348.0</td>
<td>305.1</td>
<td>291.3</td>
<td>272.6</td>
</tr>
<tr>
<td>Goods and services</td>
<td>346.1</td>
<td>202.0</td>
<td>180.7</td>
<td>185.0</td>
<td>180.8</td>
</tr>
<tr>
<td>Transfers</td>
<td>522.2</td>
<td>205.7</td>
<td>165.9</td>
<td>161.5</td>
<td>166.9</td>
</tr>
<tr>
<td>Interest payments</td>
<td>341.7</td>
<td>318.6</td>
<td>298.6</td>
<td>413.4</td>
<td>230.6</td>
</tr>
<tr>
<td>Capital expenditure</td>
<td>614.9</td>
<td>193.4</td>
<td>148.0</td>
<td>190.0</td>
<td>278.2</td>
</tr>
<tr>
<td>Loans and advances (net)</td>
<td>0.0</td>
<td>0.0</td>
<td>8.7</td>
<td>34.3</td>
<td>27.8</td>
</tr>
<tr>
<td>Primary balance</td>
<td>−284.6</td>
<td>374.5</td>
<td>892.4</td>
<td>762.7</td>
<td>448.6</td>
</tr>
<tr>
<td>Overall balance, commitment basis</td>
<td>−626.3</td>
<td>55.9</td>
<td>593.8</td>
<td>349.4</td>
<td>217.9</td>
</tr>
<tr>
<td>Change in arrears</td>
<td>137.3</td>
<td>4.9</td>
<td>−389.0</td>
<td>−57.2</td>
<td>−40.2</td>
</tr>
<tr>
<td>Overall balance, cash basis</td>
<td>−489.0</td>
<td>60.8</td>
<td>204.8</td>
<td>292.2</td>
<td>177.8</td>
</tr>
<tr>
<td>Financing</td>
<td>489.0</td>
<td>−60.8</td>
<td>−204.8</td>
<td>−292.2</td>
<td>−177.8</td>
</tr>
<tr>
<td>External</td>
<td>489.0</td>
<td>−60.8</td>
<td>−204.8</td>
<td>−292.2</td>
<td>−177.8</td>
</tr>
<tr>
<td>Nominal GDP</td>
<td>4,483.1</td>
<td>4,618.6</td>
<td>5,038.0</td>
<td>4,623.9</td>
<td>4,390.9</td>
</tr>
</tbody>
</table>

a. Estimated.

Source: Economic Commission for Africa, from official sources.
enterprises. Efforts to promote broader access to credit and financial markets—through Banque Nationale de Crédit Rural and Fonds d'Expansion et de Développement—have had little effect.

Gabon and the six other African countries of the Central African Economic and Monetary Community (CEMAC) share a common currency, the CFA franc, issued by the Bank of Central African States (BEAC) and pegged to the euro at a fixed exchange rate. BEAC and COBAC undertake monetary policy and banking supervision. The fixed exchange rate restricts the independent use of monetary instruments for economic management. Performance indicators, as monitored by COBAC, show that financial institutions as a whole are relatively healthy. But there are differences in the compliance of individual banks with prudential ratios. Gross nonperforming loans averaged 3.5% of assets over the past five years. Two banks were not adequately capitalized, three did not meet risk diversification requirements, and two held marginally insufficient liquidity (BEAC 2001).

**External sector—relatively healthy**
Developments in Gabon’s external sector are driven largely by the price and output of oil. In 2002 the current account balance continued to worsen, with a deficit of $212.7 million, up from $48.6 million in 2001. A 24% decline in oil export earnings in 2002

![In 2002 the current account balance continued to worsen, with a deficit of $212.7 million, up from $48.6 million in 2001.](image)

**Table 7.3**
Trends in money and credit, 1998–2002 (US$ millions, end of period)

<table>
<thead>
<tr>
<th>Item</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net foreign assets</td>
<td>–81.8</td>
<td>–67.4</td>
<td>251.4</td>
<td>–10.9</td>
<td>29.7</td>
</tr>
<tr>
<td>Central bank</td>
<td>–96.8</td>
<td>–64.5</td>
<td>103.3</td>
<td>–61.8</td>
<td>18.2</td>
</tr>
<tr>
<td>Deposit money banks</td>
<td>14.9</td>
<td>–2.9</td>
<td>148.1</td>
<td>50.9</td>
<td>11.5</td>
</tr>
<tr>
<td>Net domestic assets</td>
<td>899.5</td>
<td>751.8</td>
<td>496.8</td>
<td>772.3</td>
<td>835.7</td>
</tr>
<tr>
<td>Credit to government (net)</td>
<td>585.4</td>
<td>466.3</td>
<td>183.0</td>
<td>367.6</td>
<td>315.0</td>
</tr>
<tr>
<td>Central bank</td>
<td>354.0</td>
<td>267.6</td>
<td>162.0</td>
<td>300.4</td>
<td>242.3</td>
</tr>
<tr>
<td>Deposit money banks</td>
<td>227.0</td>
<td>195.1</td>
<td>15.5</td>
<td>64.1</td>
<td>69.4</td>
</tr>
<tr>
<td>Post office savings</td>
<td>4.5</td>
<td>3.7</td>
<td>5.5</td>
<td>3.1</td>
<td>3.4</td>
</tr>
<tr>
<td>Credit to public agencies (net)</td>
<td>–24.4</td>
<td>–27.4</td>
<td>–43.0</td>
<td>–43.8</td>
<td>–47.4</td>
</tr>
<tr>
<td>Credit to the economy</td>
<td>563.0</td>
<td>489.5</td>
<td>506.3</td>
<td>563.2</td>
<td>692.4</td>
</tr>
<tr>
<td>Other items (net)</td>
<td>–224.5</td>
<td>–176.6</td>
<td>–149.5</td>
<td>–114.7</td>
<td>–124.3</td>
</tr>
<tr>
<td>Broad money</td>
<td>817.5</td>
<td>684.7</td>
<td>748.1</td>
<td>761.4</td>
<td>865.4</td>
</tr>
<tr>
<td>Currency outside banks</td>
<td>221.8</td>
<td>161.3</td>
<td>164.8</td>
<td>172.2</td>
<td>195.7</td>
</tr>
<tr>
<td>Demand deposits</td>
<td>281.8</td>
<td>250.6</td>
<td>289.8</td>
<td>274.1</td>
<td>311.6</td>
</tr>
<tr>
<td>Time deposits</td>
<td>313.9</td>
<td>272.9</td>
<td>293.5</td>
<td>315.1</td>
<td>358.1</td>
</tr>
<tr>
<td>Velocity of broad money</td>
<td>4.1</td>
<td>3.9</td>
<td>3.5</td>
<td>3.4</td>
<td>3.5</td>
</tr>
<tr>
<td>Exchange rate (CFA francs per dollar)</td>
<td>562.2</td>
<td>653.0</td>
<td>705.0</td>
<td>744.3</td>
<td>687.2</td>
</tr>
</tbody>
</table>

a. Estimated.

*Source: Economic Commission for Africa, from official sources.*
was partially compensated for by a 7% increase in nonoil exports (mainly manganese and wood products). Government imports rose by more than 50%, contributing to import growth of 5.3%.

In the capital account, long-term capital flows improved from a deficit of $419 million in 2001 to a surplus of $42 million in 2002, with a decline in government external borrowing and an improvement in the net services balance. The overall balance improved to a deficit of $98.9 million (2.3% of GDP), after a huge deficit of $315 million in 2001.

Gabon’s exchange system is basically open and free of administrative and quantitative restrictions on payments and transfers for current international transactions—except for sugar, whose quota will be eliminated at the end of 2003. As a member of CEMAC, Gabon applies a common external trade tariff at four levels (5%, 10%, 20%, and 30%). But it has problems meeting World Trade Organization (WTO) commitments because about 40% of its tariffs lines under the common external tariff exceed the agreed 15% WTO ceiling.

It would be to Gabon’s advantage to consider further liberalization of services.

### Table 7.4

<table>
<thead>
<tr>
<th>Item</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current transactions</strong></td>
<td>-839.0</td>
<td>-408.4</td>
<td>163.0</td>
<td>-48.6</td>
<td>-212.7</td>
</tr>
<tr>
<td>Exports, fob</td>
<td>1,906.4</td>
<td>2,504.5</td>
<td>3,218.6</td>
<td>2,633.7</td>
<td>2,181.2</td>
</tr>
<tr>
<td>Oil</td>
<td>1,412.5</td>
<td>1,859.2</td>
<td>2,574.4</td>
<td>2,060.2</td>
<td>1,570.0</td>
</tr>
<tr>
<td>Nonoil sector</td>
<td>493.9</td>
<td>645.3</td>
<td>644.2</td>
<td>573.5</td>
<td>611.1</td>
</tr>
<tr>
<td>Imports, cif</td>
<td>-1,102.7</td>
<td>-847.9</td>
<td>-926.9</td>
<td>-998.5</td>
<td>-1,051.9</td>
</tr>
<tr>
<td>Oil</td>
<td>-302.4</td>
<td>-291.4</td>
<td>-402.0</td>
<td>-409.8</td>
<td>-386.7</td>
</tr>
<tr>
<td>Nonoil private sector</td>
<td>-460.2</td>
<td>-475.9</td>
<td>-472.1</td>
<td>-511.8</td>
<td>-545.6</td>
</tr>
<tr>
<td>Government</td>
<td>-340.2</td>
<td>-80.7</td>
<td>-52.8</td>
<td>-76.9</td>
<td>-119.6</td>
</tr>
<tr>
<td>Trade balance</td>
<td>803.7</td>
<td>1,656.5</td>
<td>2,391.7</td>
<td>1,635.2</td>
<td>1,129.2</td>
</tr>
<tr>
<td>Services (net)</td>
<td>-1,445.9</td>
<td>-1,883.1</td>
<td>-2,079.0</td>
<td>-1,638.2</td>
<td>-1,301.2</td>
</tr>
<tr>
<td>Transfers (net)</td>
<td>-196.8</td>
<td>-181.8</td>
<td>-49.7</td>
<td>-45.6</td>
<td>-40.8</td>
</tr>
<tr>
<td>Movement of medium and long-term capital</td>
<td>-69.7</td>
<td>-98.6</td>
<td>-37.2</td>
<td>-419.1</td>
<td>42.7</td>
</tr>
<tr>
<td>Government</td>
<td>-275.8</td>
<td>-268.8</td>
<td>-309.0</td>
<td>-399.5</td>
<td>-233.7</td>
</tr>
<tr>
<td>Direct and portfolio investment</td>
<td>159.0</td>
<td>162.8</td>
<td>193.7</td>
<td>-112.9</td>
<td>190.1</td>
</tr>
<tr>
<td>Private debt</td>
<td>47.1</td>
<td>7.5</td>
<td>78.2</td>
<td>93.2</td>
<td>86.2</td>
</tr>
<tr>
<td>Short-term capital</td>
<td>242.5</td>
<td>98.1</td>
<td>-215.4</td>
<td>152.4</td>
<td>71.1</td>
</tr>
<tr>
<td>Errors and omissions</td>
<td>-53.4</td>
<td>279.7</td>
<td>22.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Overall balance</td>
<td>-666.1</td>
<td>-408.8</td>
<td>-89.6</td>
<td>-315.4</td>
<td>-98.9</td>
</tr>
<tr>
<td>External debt to GDP ratio (%)</td>
<td>74.4</td>
<td>79.2</td>
<td>62.9</td>
<td>56.8</td>
<td>0.0</td>
</tr>
<tr>
<td>Debt service to exports ratio (%)</td>
<td>29.8</td>
<td>22.1</td>
<td>17.3</td>
<td>27.4</td>
<td>0.0</td>
</tr>
</tbody>
</table>

*a. Estimated.*

Source: Economic Commission for Africa, from official sources.
The government plans to renegotiate its bound tariffs to remove these inconsistencies. In addition, the 20% CEMAC surcharge, to have been eliminated by mid-2000, is still being applied to 25 tariff lines. Given Gabon’s high degree of openness, it would be to Gabon’s advantage to consider further liberalization of services through stronger commitments under the General Agreement on Trade in Services in order to attract more foreign direct investment and make services available at more competitive prices.

**Structural and institutional reforms—slow pace with mixed results**

Structural reforms in Gabon were part of a comprehensive economic recovery strategy initiated in 1994, when the CFA franc was devalued 50% relative to the French franc, to improve international competitiveness and revive growth. The devaluation brought the government face to face with economic reality and prompted a redefinition of the government’s role in the economy.

The government embarked on a broad range of structural reforms to unlock Gabon’s growth potential in the nonoil sector. The reforms were to improve the efficiency and financial performance of public enterprises and reform the civil service. The legal and institutional framework was to be liberalized by revising the labour code, enacting a competition law, updating business legislation, and adopting a new investment code. The government also committed to privatize and restructure key public utilities and to finalize privatization plans for agricultural and commercial public enterprises. These measures were to be underpinned by a sound macroeconomic framework, reducing internal and external debt to release more resources to the private sector.

While there has been some progress in the reforms, the government has not been consistent in implementation, leading to an on-and-off relationship with the IMF and the World Bank, creating uncertainty, and reducing the credibility of the government commitment to reform. The most recent programme, agreed with the IMF in 2000, lapsed in April 2002 because of delays in structural reforms and fiscal slippages. The weak commitment to structural reforms has discouraged private investment, particularly the foreign direct investment essential for Gabon to revive its economy (box 7.1).

There has been little tangible progress in governance reform. Good political and economic governance are the cornerstone for economic growth and poverty reduction. The main governance issues are to eradicate corruption and to implement sound public financial management. Democracy and political freedom are important parts of good governance.

The constitution recognizes and guarantees the inviolability of human rights. Despite attempts to democratize the political process, the 20% voter turnout suggests a lack of confidence in the process. But with a weak and divided opposition, the country remains
Box 7.1
Fiscal reforms—agenda and recent progress

The government has undertaken to implement the following structural reforms:

- The integrated budget information system (CRYSTAL) was operational in early 2002, covering financial transactions by all ministries and government agencies and all treasury operations, special funds, and domestic debt operations. Although transactions on special funds were to be covered by CRYSTAL from early 2002 on, the special funds had not yet been fully integrated into the government budget. The authorities undertook to overhaul all special funds and to incorporate any remaining ones in the budget starting with the 2003 budget.

- The authorities committed to address the shortcomings identified in the public investment review undertaken with the World Bank and other donors in July 2001. The preliminary report identified institutional weaknesses in the formulation and execution of the investment budget, including an irregular updating of sectoral strategies, a lack of coordination between the Ministry of Finance and sectoral ministries, and delays in the communication of budget appropriations to spending ministries, leading to the circumvention of normal procurement procedures and the accumulation of arrears.

- A decree introducing the new procurement code is to be adopted shortly, and a national commission on government contracts (and its secretariat) established. A new directorate of public procurement will be created within the Ministry of Finance. Purchases above 25 million CFA francs would require international bids. The authorities estimate possible savings of at least 1% of GDP under the code. Steps have been taken to strengthen financial control by the Ministry of Finance. The Directorate General of Financial Control was strengthened by the creation of the unit to control services rendered. Financial controllers were redeployed from the Ministry of Finance to the spending ministries in the second quarter of 2002. The draft legislation relating to the introduction of the General Inspectorate of Finance was finalized, and the government was to adopt it thereafter.

- The Ministry of Finance has initiated the preparation of a detailed expenditure classification scheme (economic, administrative, and functional), with technical assistance from Canada. The new classification scheme was adopted in the context of the 2003 budget law. As a first step, budgetary spending items have been systematically classified under a common administrative heading system, including those previously recorded under the lump-sum category of “common outlays”.

- The financial audits of three small oil companies were completed in late 2001. The audits of the two major companies under the concession regime (with more than two-thirds of production) were initiated in March 2002 and are to be completed with the help of external auditing firms.

- The Direct and Indirect Tax Department, now being restructured and strengthened, will incorporate the unit in charge of the government estates (domaines, including oil royalties and dividends). This restructuring will entail a significant increase in the number of tax assessors and controllers. The staff has recommended that the new tax directorate maintain and further strengthen the Large Enterprise Unit.

dominated by one party. In the political elections of December 2001 the ruling party and its allies won 107 of the 120 seats. And in the municipal elections of December 2002, some opposition leaders claim that voter turnout was below 10%. With a divided and weak opposition, the country remains dominated by one party. But unlike many other African countries, and despite the political and economic problems, Gabon has remained fairly peaceful and stable since independence in 1960.

Corruption, a serious problem in Gabon, is largely responsible for the poor performance of the economy—despite the massive oil resources. Perceived to be high, it works through a number of channels, including overpricing of government contracts, fictitious contracts, lax tax assessments, agency fees, and commissions to interest groups linked to the oil sector. With low or negative growth in recent years, the social and economic infrastructure is dilapidated, and levels of poverty have remained very high.

The effects of corruption on growth and development in Gabon are well documented (Soderling 2002; U.S. Senate 1999). As part of the institutional reforms the Gabon Senate adopted a watered down anticorruption law, after rejecting the one adopted by the National Assembly. As with other institutional reforms, there has been lack of political will and commitment to implement the legislation.

Poverty and the social sectors

Typical of other poorly managed resource-rich economies, Gabon is a middle income country with poverty levels comparable to those of low-income Africa. Education and health indicators have improved, but outcomes are still poor and resources are inefficiently used.

Trends in poverty—the paradox of oil wealth

Gabon has a per capita GDP of about $3,800, making it one of the richest countries in Africa. But the high income has not translated into significant reductions in poverty and inequality. Two measures of the poverty line for Gabon (one at the minimum wage level and the other at two-thirds of average consumption) show that the number of poor people remained high between 1960 and 1994. But extreme poverty (intensity) fell significantly between 1960 and 1992, worsening slightly thereafter (table 7.5). Inequality declined slightly between 1960 and 1975, from a Gini coefficient of 0.68 to 0.60, where it has remained. But inequality remains severe, especially between urban and rural areas.

Other indicators confirm the disturbing trend in poverty. The UNDP Human Development Index was 52.5 in 1992, giving Gabon a ranking of 91 out of 173 countries. In 2000, the index was 52.4 and the ranking 123. In both cases, the ranking for Gabon was more than 40 positions below that of countries with similar GDP per capita, indicating that Gabon’s wealth has done little to raise the living standards of the majority of the people.
The government has had little success in combating poverty. To distribute the benefits of the oil wealth, it invested massively in social and physical infrastructure resulting in substantial increases in employment and wages in the public sector, including state enterprises. But the projects were undertaken without careful analysis of their rates of return—and thus their long-term viability. Moreover, the expansionary budgetary policy led to higher costs of living and hindered the development of agriculture and small enterprises, undermining the country’s external competitiveness. With the collapse of the oil sector after the 50% price decline in 1986, unemployment spiked to 30%.

In 2000 the government renewed its commitment to significantly reduce poverty. Given the importance of social security in assisting the poor, the government has undertaken to restructure two key social programme funds and strengthen their financial and management standing. To this effect, a new restructuring legislation for the social guarantee fund was initiated in 1995 to ensure regular and sufficient funding. The restructuring of the social security fund was begun in 2001 and completed by end 2002.

Although Gabon is not eligible for assistance under the Heavily Indebted Poor Countries Initiative, the government has been working with the IMF and the World Bank to develop a comprehensive poverty reduction strategy. Consultations have been started with the key stakeholders, and a Poverty Reduction Strategy is to be completed by the end of 2003 (box 7.2).

Table 7.5
Income inequality and poverty, 1960–94

<table>
<thead>
<tr>
<th>Year</th>
<th>Gini coefficient</th>
<th>Minimum wage</th>
<th>Poverty line</th>
<th>$1 a day</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Incidence</td>
<td>Intensity</td>
<td>Severity</td>
</tr>
<tr>
<td>1960</td>
<td>0.68</td>
<td>87</td>
<td>60</td>
<td>47</td>
</tr>
<tr>
<td>1968</td>
<td>0.64</td>
<td>89</td>
<td>61</td>
<td>46</td>
</tr>
<tr>
<td>1975</td>
<td>0.60</td>
<td>86</td>
<td>54</td>
<td>38</td>
</tr>
<tr>
<td>1985</td>
<td>0.60</td>
<td>85</td>
<td>53</td>
<td>38</td>
</tr>
<tr>
<td>1990</td>
<td>0.60</td>
<td>84</td>
<td>51</td>
<td>35</td>
</tr>
<tr>
<td>1991</td>
<td>0.60</td>
<td>83</td>
<td>50</td>
<td>35</td>
</tr>
<tr>
<td>1992</td>
<td>0.60</td>
<td>83</td>
<td>50</td>
<td>34</td>
</tr>
<tr>
<td>1993</td>
<td>0.60</td>
<td>84</td>
<td>51</td>
<td>36</td>
</tr>
<tr>
<td>1994</td>
<td>0.60</td>
<td>83</td>
<td>50</td>
<td>35</td>
</tr>
</tbody>
</table>

Note: Incidence is the proportion of individuals living below the poverty line; intensity is the gap between the level of poverty and the poverty line, calculated as the weighted sum of individual spending deviations below the poverty line; severity is the degree of inequality among those living below the poverty line.

Box 7.2
Gabon’s Poverty Reduction Strategy

In moving to a growth model that benefits the poor, the programme of reforms aims at:
• Diversifying the economy into sectors with a high demand for unskilled labor.
• Developing the nonoil private sector and increasing labor productivity through better social services.
• Disengaging the state from economic and commercial activity.
• Redirecting public spending towards the poor.
• Laying the groundwork for better governance, through resource management and institutional reforms, including reforming the public service, strengthening the role of nongovernmental organizations, and coordinating social initiatives.

Gabon’s Poverty Reduction Strategy has six primary objectives:
• Reducing unemployment. Encouraging the private sector to create new employment opportunities through the New Labour Code; promoting an entrepreneurial spirit for small and medium-size enterprises; facilitating access to the micro-business loans of the Assistance and Guarantees Fund and the Economic Growth and Development Fund; providing more effective basic social services for the poor; improving education for the poor by reducing the cost of instruction, limiting the number of school repeaters, launching literary campaigns, and bringing back dropouts; and sustaining improvements in the quality of instruction by promoting technical and vocational education, expanding the school system, and decentralizing administration and budget management.
• Enhancing the incomes of small rural producers. Providing adequate transport facilities and credit to small farmers and diversifying income generating opportunities for regional development.
• Improving basic health. Preventing intestinal diseases, malaria, and infectious and parasitic illnesses; providing access to potable water; launching information, education, and communication campaigns to promote use of hygienic latrines and protection against mosquitoes; ensuring the availability of low-cost medications; setting priorities for public spending on health; decentralizing health sector management by providing a health map; and revising laws, regulations, and procedures.
• Rehabilitating the urban environment. Improving sectoral policies and living conditions for the poor in major urban centers; promoting road and sanitation projects; developing procedures for managing public works and contracting; introducing appropriate regulatory and fiscal instruments; and reforming land tenure (urban property rights).
• Redirecting safety nets and social integration policies. Promoting labor-intensive public works projects to absorb the growing numbers of jobless people; supporting the unemployed to ease their re-entry to the labor market as wage-earners or self-employed entrepreneurs; reinforcing the social component of the privatization programme; training unskilled workers and the unemployed; and improving social safety nets.

(continued on next page)
Box 7.2 (continued)

**Gabon’s Poverty Reduction Strategy**

- **Establishing a reliable statistical system.** Ensuring a sound statistical system by conducting surveys essential for proper economic and social management; providing regular data on economic performance and social conditions; creating a body responsible for collecting and processing basic statistical data, aggregate and sectoral, national, and provincial; and complementing the nationwide survey with a Demographic and Health Survey.

**Source:** World Bank 1997; Economic Commission for Africa, from official sources.

---

**Education—stronger indicators, but weak outcomes**

Gabon had a literacy rate of 71% in 2000, with rates lower for women than for men, and a combined gross school enrolment rate of 86% for primary, secondary, and tertiary levels—higher than the Sub-Saharan average of 61.5% for literacy and 42% for enrolment.

Despite these good education indicators, the educational system still suffers from great inefficiency and poor results at all levels. Of a total primary enrolment of 249,000 in the academic year 2000/01, 92% repeated the same grade at least once. Only 8% of students (20,500) ages 6 to 11 years old are of the appropriate age for their course level. And with oil revenues declining, education expenditures have fallen in recent years. Spending per pupil fell by half from $651 in 1984 to $337 in 1994 and to $250 in 1996, but Gabon still spends more per pupil than the $53 average for most other French-speaking African countries.

Technical and vocational training are underdeveloped, and schools continue to turn out people whose skills do not match the needs of the economy. Public institutions pay little attention to the agricultural or informal sector, both growing but with no apprenticeship system. The result is a paradox: graduates cannot find jobs, while employers clamor for more skilled workers.

**Health—high spending, misdirected**

Life expectancy in Gabon was 52.7 in 2000, up from 35.2 years in 1960, while the gross mortality rate fell from 30 per 1,000 in 1960 to 16 per 1,000 in 1995. Moreover, there was a major reduction in child mortality, which fell from 287 per 1,000 to 90 between 1960 and 2000. Total health spending is 3.1% of GDP, with per capita spending of $121, more than twice the Sub-Saharan average. Gabon has an average of one doctor for every 2,196 inhabitants and one nurse for every 1,369 inhabitants, heavily concentrated in urban centers.

In Libreville, women testing HIV-positive increased from 1% in 1988 to 4% in 1995. In 1996–97, 17% of patients with sexually transmitted infections in major cities tested...
HIV-positive, and 6% of military personnel did in 1997. According to the Joint UN Programme on HIV/AIDS and the World Health Organization (UNAIDS and WHO 2000), there were 23,000 adults and children with HIV/AIDS in 1999, with an adult prevalence rate of 4.2%. There have been an estimated 2,000 AIDS deaths, and about 8,600 children have lost their mother or both parents to HIV/AIDS at age 14 or younger since the beginning of the epidemic.

Poor returns to health care spending are due to policies that give priority to tertiary health care rather than primary health care—added to poor planning and ineffective supervision and management (World Bank 1997). Medical facilities are concentrated in the capital city, and the system operates inefficiently, suffering from a lack of personnel, use of obsolete equipment, and shortages of drugs. The cost of medical care has increased substantially, with private care more than doubling since the 1994 devaluation.

The government has shifted its strategy to primary health care. It is establishing health regions for coordinating, supervising, and controlling health department activities. It is preparing a health map as a basic instrument for planning human and material resource allocation and decentralizing management of health facilities. It is standardizing equipment and supplies, encouraging the use of generic drugs, and diversifying health service financing, including direct financial contributions from users.

**Gender mainstreaming—some biases remain, despite legal equality**

The law provides for equality between men and women, with women officially free to enter any profession and subject to the same terms and conditions under the Labor Code in both the government and private sectors. The law also provides for maternity leave for women.

The female labor force participation rate was relatively high, at 80% in 1999, compared with a Sub-Saharan average of 70%. Common with other countries, women have a higher life expectancy than men—54 compared with 51.5 in 1999. And the combined gross enrolment ratio is higher for women at primary, secondary, and tertiary levels. But these statistics conceal biases against women.

Although the constitution confers full rights on women, certain provisions of the civil code contradict it. Values and traditional beliefs are based on customary laws, often unwritten and often restricting the application of measures to empower and advance women. So women are more vulnerable to socioeconomic risks. The HIV prevalence rate for women is twice that of men—4.7% compared with 2.3% in 1999. Women in high-level decisionmaking positions constituted only 7% of the total in 1994, declining to 4% in 1998 (World Bank 2002).
Medium-term prospects and policy challenges

The prospects for growth in the medium term depend on developments in the oil sector, diversification of the economy, and the macroeconomic policy stance of government. All indications point to a decline in oil production, with estimates showing a 50% reduction in the next five years.

Future growth in the economy will therefore have to come from the nonoil sector and its many unexploited opportunities. Diversification to agriculture and fishing, forestry, mining, and other industries will be the driver for growth, employment, and poverty reduction. These sectors have a high growth potential and a high demand coefficient for unskilled labor.

Diversification must be supported by the appropriate macroeconomic environment, underpinned by a credible fiscal policy stance, as well as structural and institutional reforms. Given the weak financial position of the government and the need for higher expenditures in priority sectors, the availability of domestic and external financing will be important determinants of future growth. Resuming arrangements with the IMF and the World Bank will be critical.

The economic programme that the government started to implement after 1994 identified the key elements of reform. These remain valid today. But there has been a clear divergence between policy announcements and implementation. This must change. The challenge is for the government to take the lead in implementing the required policy and institutional reforms:

- Take a prudent fiscal stance to strengthen nonoil revenues and increase expenditure in priority sectors, particularly human resources and physical infrastructure.
- Clear the debt arrears and avoid the accumulation of new debt.
- Pursue the privatization programme vigorously to permit the private sector to undertake activities that it can do more efficiently.
- Concentrate government resources on areas necessary to support growth and the private sector.

It will also be important to implement the regulatory and institutional reforms started in the mid-1990s—to strengthen the incentive structure for private sector development by reducing the cost of doing business and enhancing competitiveness. This should be accompanied by efforts to further liberalize the economy and increase the efficiency of resource allocation, thereby enhancing productivity. Given the small size of the economy, it will be important for the government to support regional integration initiatives.

These programmes will not succeed without sound and efficient economic management for high and sustained growth. This will require eliminating corruption and enhancing...
accountability and transparency in economic management, including privatization, revenue collection, and financial management and control. The government will need a credible system for eliminating and preventing corruption and ensuring efficient public financial management.

Note

1. The Hirschmann diversification index ranges from 0 to 1 with higher values reflecting increased concentration in sectors or products.

References


Mauritius—Moving Up the Value Chain

The Mauritian economy grew at 4% in 2002, down from 5.8% in 2001 and the annual average of 5.75% for the last 20 years. In January 2002 Cyclone Dina hit the sugar sector especially hard, causing a 16.4% contraction for the year. Excluding sugar, the economy grew at 5%, still below the 5.4% in 2001. Several other factors contributed to the less than stellar performance in 2002: the slow recovery of the U.S. and European economies, the lag effects of September 11, and the political instability in Madagascar.

Faced with a slow recovery of global markets and declining interest rates in major financial markets, the Bank of Mauritius eased monetary policy in 2001/02. The Lombard rate, used by the central bank to signal its policy stance, was lowered gradually from 12% in August 2001 to 10.5% in February 2003. Other indicative interest rates adjusted accordingly. For the first time since 1997/98 the money supply grew in 2000/01 and again in 2001/02 with the growth of net foreign assets (8.9%) and domestic credit (7.4%).

The current account improved, with an estimated surplus of $187 million in 2001/02, up from $133 million in 2000/01, largely from a surge in tourism earnings. Despite the slow growth of tourist arrivals, at 1.3% in 2001/02, average tourist spending increased, with higher hotel rates. Capital and financial accounts worsened in 2001/02, mainly because of unusually high inflows of foreign direct investment in 2000/01, thanks to the $277 million participation of France Telecom in Mauritius Telecom.

Inflation, initially targeted at 5%–5.5% in 2001/02, was revised to 6% in the wake of Cyclone Dina. But it reached 6.3%, compared with 4.4% in 2000/01. Apart from the cyclone, the rise in 2002 is attributable to the value added tax hike and expansionary budgetary measures.

Mauritius has a long record of fiscal discipline, with the fiscal deficit averaging about 4% of GDP a year from 1985/86 to 1999/2000. But in 2000/01 the deficit jumped to about 6.7% of GDP, and it is expected to remain at 6–6.5% in 2001/02 and 2002/03. The higher deficits are the result of a massive government investment program to prepare the Mauritian workforce and infrastructure for economic diversification.

Traditionally, the strength of the Mauritian economy has rested on three pillars: sugar, export processing zones (EPZs), and tourism, the sectors behind the “Mauritian miracle” (box 8.1). In the short to medium term these sectors will continue to grow, but
In 1961 James Meade, the 1977 recipient of the Nobel Prize in economics, made a dire prognosis on Mauritius’s development prospects. According to Meade, the country’s heavy economic dependence on one crop (sugar), vulnerability to terms of trade shocks, rapid population growth, and potential for ethnic tensions were all against the country. In addition, the country had a tropical climate and was farther from world markets than most African countries. These initial conditions did not favour high growth. Meade predicted that the outlook for peaceful development was poor. History proved him famously wrong.

Was it openness to foreign direct investment and trade that brought about Mauritius’ success? Local investors were heavily involved in the export processing zone (EPZ). In 1984 only 12% of employment in the EPZ was accounted for by wholly foreign-owned firms. Mauritian nationals owned about 50% of the total equity of EPZ firms. And contrary to popular belief, Mauritius had a highly restrictive trade regime—with exports relatively open but imports closed.

What, then, led to the Mauritian miracle? Mauritius ensured that the export sector was not adversely affected by the restrictive trade regime. Policymakers used several instruments to segregate the export sector from the import sector:

- Duty-free access was provided to all imported inputs, ensuring that the export sector was competitive in world markets.
- Tax incentives were provided to firms operating in the EPZ.
- The labour market for the export sector was effectively segmented from the rest of the economy. Employers in the EPZ had great flexibility in discharging workers and paying overtime. A large proportion of workers in the EPZ were women, whose minimum wages were lower than those of the rest of the labour force. In the 1980s wages in the EPZ were 36–40% lower than in the rest of the economy.

Sound macroeconomic policies also helped the EPZs. Between 1973 and 2000 annual inflation averaged 7.8%, fiscal deficits were sustainable, and the exchange rate maintained the country’s export competitiveness. The rule of law prevailed, and property rights were respected. The Mauritian success story unfolded, with the economy growing 5-6% a year for the past 20 years and unemployment reduced to 1.5% by 1990. A poor country with per capita income of just $260 (in nominal terms) at the beginning of the 1960s turned itself into a middle income country with a per capita income of about $3,800 today.

Two other factors also facilitated the export-led growth. First, Mauritius enjoyed preferential access to U.S. and EU markets (for sugar and textiles and clothing). Second, ethnic diversity helped attract investment from the Far East and ensured participatory politics that in turn established a stable political environment.

Can other countries in Africa emulate Mauritius’s success? It may not be easy. Preferential trade margins for African countries are eroding in an increasingly globalized world. Nevertheless, preconditions that ensured the success of selective trade policies—good macroeconomic environment and political stability—are necessary ingredients for any economic success story.

Mauritius is reengineering itself to move up the value chain and build a knowledge economy based on financial services and information and communication technologies. Measures are also being taken to modernize the sugar and EPZ sectors through higher productivity, better technology, and greater capitalization.

The efforts in the sugar and EPZ sectors and the emphasis on expanding financial and information technology sectors increase the demand for skilled labour. Yet the educational composition of the labour force shows that Mauritius is not equipped to meet the requirements of a knowledge-based economy. Upgrading skills remains a major challenge to fulfill the requirements of the new economy. In response, the government is undertaking deeper reforms to build skills, upgrade infrastructure, and foster an enabling environment for investment in new areas. To complement these reforms, the government has undertaken massive capital spending, to reach an exceptional 5% of GDP in 2003.

Some donors believe that higher deficits will threaten fiscal sustainability. The evidence so far is to the contrary. Despite the substantial increase in capital expenditure, total government expenditure remains close to the international fiscal standards of 25% of GDP. The deficits have been financed mainly through domestic, noninflationary sources. Moreover, the size and the composition of public debt show that the ratio of total public sector debt to GDP (including state enterprise debts) was around 62% in June 2002, with 69% of the debt from domestic sources. Central government debt service remains manageable, at 6% of GDP and 15% of exports.

So far the deficit has not affected the credibility of government or the confidence of the private sector. Mauritian long-term government bonds denominated in foreign currency have a Moody’s credit rating of Baa2, similar to ratings for Malaysia and Republic of Korea. Long-term bonds denominated in local currency get an A2 rating, the same as Greece and Poland. The government expects capital expenditures to decline over time, with the budget deficit reaching the target of 3% by 2005/06. If this target is reached, fiscal sustainability may not be a big concern.

But the diversification efforts of government may create problems by increasing the high unemployment rate, currently around 9%. Indeed, diversification may create a period of jobless growth, as more emphasis is placed on knowledge-intensive financial services and information technology, demanding high skills and creating fewer jobs. Most unemployed people have a low level of education, and the jobs created in the new economy may not help them. Adding to the problem, the modernization programs in
The sugar and EPZ sectors are making them more capital-intensive—demanding less labour and higher skills. Unskilled workers would likely lose jobs as a result of modernization.

The government thus has to extend its safety nets to address the needs of the newly unemployed. Evidence so far shows that the government is handling these pressures well, particularly in the retrenchment program in the sugar sector.

The success of the Mauritian development story has partly to do with the way development strategies are formulated. Strategies are not reactionary measures to deal with economic crises, such as balance of payment or fiscal deteriorations. Instead, they are well thought out to address the needs of the economy and to move it to a higher growth trajectory. The new diversification strategies to move up the value chain fall into this category. So once again, Mauritius is moving in the right direction.

Recent economic developments

Real GDP grew an estimated 4% in 2002, lower than the 5.8% achieved in 2001 (table 8.1 and figure 8.1) and the average annual growth rate of 5.75% experienced over the past 20 years. The main factor contributing to lower growth was the impact of Cyclone Dina on the sugar sector, which contracted more than 16% in 2002 (figure 8.2).

Excluding the sugar sector, the economy grew an estimated 5% in 2002, down from 5.4% in 2001. Several other international and domestic factors contributed to the slowdown. The main external factors were the slow recovery of the U.S. and European economies, the effects of September 11, and political instability in Madagascar. The impact was particularly strong in the EPZ and tourism industries. On the domestic front the general slowdown of the economy also affected the service sectors, including the financial sector, further contributing to weak growth. The negative impacts of these external and internal factors were somewhat mitigated by the substantial growth in the construction sector, up from 1.5% in 2001 to 8.5% in 2002 (see figure 8.2). That growth was led by public sector investment in schools, information and communication technology, and other infrastructure activities.

Consumption, savings, and investment—strong, but slowing

Consumption picked up slightly in nominal terms in 2002, but remained unchanged in real terms. Nominal consumption grew 9.5% in 2002, up from 8.1% in 2001. Real consumption grew 3.1% in 2002, as it had in 2001.

The share of final consumption in GDP at market prices remained high, at about 75%. According to a private Consumer Confidence Survey conducted in July 2002, more than half the surveyed households reported that their financial situation had improved.
Table 8.1
Real GDP growth, 1998–2002 (%)

<table>
<thead>
<tr>
<th>Item</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002a</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture and fishing</td>
<td>−1.5</td>
<td>−25.8</td>
<td>33.3</td>
<td>8.9</td>
<td>−9.6</td>
</tr>
<tr>
<td>Sugar cane</td>
<td>2.5</td>
<td>−43.9</td>
<td>64.5</td>
<td>13.4</td>
<td>−16.4</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>6.2</td>
<td>2.0</td>
<td>7.9</td>
<td>4.6</td>
<td>2.2</td>
</tr>
<tr>
<td>Export processing zone products</td>
<td>6.9</td>
<td>6.0</td>
<td>6.0</td>
<td>4.4</td>
<td>2.0</td>
</tr>
<tr>
<td>Electricity, gas, and water</td>
<td>11.7</td>
<td>8.6</td>
<td>23.2</td>
<td>11.2</td>
<td>6.3</td>
</tr>
<tr>
<td>Construction</td>
<td>6.0</td>
<td>8.5</td>
<td>7.5</td>
<td>1.5</td>
<td>8.5</td>
</tr>
<tr>
<td>Wholesale and retail trade</td>
<td>4.5</td>
<td>5.1</td>
<td>3.2</td>
<td>3.2</td>
<td>3.3</td>
</tr>
<tr>
<td>Restaurants and hotels</td>
<td>6.0</td>
<td>4.0</td>
<td>13.5</td>
<td>1.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Financial intermediation</td>
<td>8.3</td>
<td>10.3</td>
<td>14.6</td>
<td>9.6</td>
<td>8.3</td>
</tr>
<tr>
<td>Banking, including offshore</td>
<td>9.2</td>
<td>12.2</td>
<td>18.5</td>
<td>11.4</td>
<td>9.2</td>
</tr>
<tr>
<td>Public administration and defense</td>
<td>3.6</td>
<td>3.6</td>
<td>4.5</td>
<td>3.7</td>
<td>4.5</td>
</tr>
<tr>
<td>Education</td>
<td>6.0</td>
<td>6.4</td>
<td>8.8</td>
<td>4.1</td>
<td>5.6</td>
</tr>
<tr>
<td>Health and social work</td>
<td>6.0</td>
<td>7.8</td>
<td>6.1</td>
<td>5.7</td>
<td>5.2</td>
</tr>
<tr>
<td>Overall GDP</td>
<td>5.8</td>
<td>2.3</td>
<td>9.3</td>
<td>5.8</td>
<td>4.0</td>
</tr>
<tr>
<td>Overall GDP, excluding sugar</td>
<td>5.9</td>
<td>5.9</td>
<td>7.3</td>
<td>5.4</td>
<td>5.0</td>
</tr>
</tbody>
</table>

a. Estimated.

Source: Economic Commission for Africa, from official sources.

Figure 8.1
GDP growth slowed by sugar sector
Real GDP growth, with and without sugar, 1998–2002 (%)

a. Estimated.

Source: Economic Commission for Africa, from official sources.
or remained stable during 2001 (Analysis 2002). About 13% of respondents reported
an improvement in their financial situation, while 39% reported no change.

The gross national savings rate is estimated at more than 27% of GDP in 2002 and the
gross domestic investment rate (gross domestic fixed capital formation) at about 21%
(figure 8.3). In real terms investment grew 1.8% in 2002 (table 8.2). Once irregular
items, such as the purchase of aircraft and ships involving substantial depreciation, are
excluded, investment grew 5.6% in 2002, against a decline of 2.0% in 2001.

The share of private investment in total investment has declined since 2000, reaching
a low of 66% in 2002. Its share in GDP has fallen as well. Excluding the purchase of
aircraft and ships, private investment contracted 4% in 2001 and experienced a further
fall of 3.1% in 2002. Contraction was greatest in residential construction-related invest-
ments, reflecting the general economic slowdown of recent years. In contrast, public
investment growth, fueled by new infrastructure projects, has been increasing, reach-
ing a peak of 27% in 2002.

Agriculture—sugar losing its preferential access
Agriculture accounts for about 8% of GDP, with sugar accounting for 50% of the sec-
tor. Agriculture, which grew 8.9% in 2001, contracted 9.6% in 2002 as a result of
Cyclone Dina, which devastated the sugar industry in February 2002, and excessive
rainfall during the year (see figure 8.2).

Figure 8.2
Sugar sector plummets, construction picks up in 2002
Growth in selected sectors, 1998–2002 (%)
Sugar is the third-largest export earner, accounting for about 14% of export earnings. Mauritius has profited significantly from preferential access to European markets for the past 50 years. Through the Sugar Protocol and Special Preferential Sugar Agreement the country received guaranteed prices that at some 100–200% above world market prices and guaranteed market share through quotas. Between 1975 and 2000 the cumulative benefit to Mauritius from quasi transfers from European consumers amounted to about $3.5 billion (IMF 2002a), or 6.1% of GDP.

**Figure 8.3**

_Savings and investment remain steady_

_Savings and investment rates, 2000–02 (%)_

![Graph showing savings and investment rates from 2000 to 2002.]

 SOURCE: Economic Commission for Africa, from official sources.

**Table 8.2**

_Public and private investment, 1998–2002 (%)_

<table>
<thead>
<tr>
<th>Item</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002a</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share in total gross domestic fixed capital formation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private sector</td>
<td>74.0</td>
<td>76.0</td>
<td>73.2</td>
<td>71.6</td>
<td>66.3</td>
</tr>
<tr>
<td>Public sector</td>
<td>26.0</td>
<td>24.0</td>
<td>26.8</td>
<td>28.4</td>
<td>33.7</td>
</tr>
<tr>
<td>Real growth in total gross domestic fixed capital formation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private sector</td>
<td>–6.7</td>
<td>22.1</td>
<td>–8.2</td>
<td>3.3</td>
<td>1.8</td>
</tr>
<tr>
<td>Public sector</td>
<td>7.5</td>
<td>10.8</td>
<td>1.0</td>
<td>–2.0</td>
<td>5.6</td>
</tr>
<tr>
<td>Real growth in total gross domestic fixed capital formation, excluding aircraft and ships</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private sector</td>
<td>9.2</td>
<td>10.1</td>
<td>0.6</td>
<td>–4.0</td>
<td>–3.1</td>
</tr>
<tr>
<td>Public sector</td>
<td>2.8</td>
<td>12.8</td>
<td>2.3</td>
<td>3.7</td>
<td>27.4</td>
</tr>
</tbody>
</table>

a. Estimated.

_Summary: Economic Commission for Africa, from official sources._
These privileges are now threatened. The EU’s Everything But Arms initiative grants duty-free, quota-free access to most exports from the 48 least developed countries, thus eroding the preferential access granted to a few countries. Although certain products, including sugar, are granted transitional status, that will be phased out by 2006–09. The Special Preferential Sugar Agreement quota for Mauritius has already been reduced drastically, and it will be gradually eliminated by 2007.

Furthermore, with progress on reform of the EU’s Common Agricultural Policy, Mauritius may lose its guaranteed pricing arrangement. With the price of sugar thus likely to fall, Mauritian sugar production is threatened. The situation may be exacerbated if lower cost producers, such as Brazil and Thailand, gain access to the European market.

To meet this challenge, Mauritius has to improve its competitiveness in the world market. The sugar industry has to slash average production costs, estimated to be 25% higher than the world average (IMF 2002a), modernize milling operations, deepen capital intensity, and find niche markets for special products.

The government, through the Sugar Sector Strategic Plan, has begun modernizing the sector by upgrading technology. It has also adopted some revenue enhancing measures, particularly the marketing and export of special sugars, which have a higher market value. Sales of special sugar to EU markets have grown to some 60,000 tonnes a year. Mauritius is well established in these markets as a supplier of a wide variety of specialty sugars, such as EEC Grade 2 refined sugar, Demerara sugar, golden granulated, golden caster, fine caster and golden bakery sugars, light and dark Muscovado, molasses sugar, and special raw sugar.

Steps have also been taken to retrench older workers through a voluntary retirement scheme. By the end of the first year of the scheme, at the end of March 2002, about 7,500 workers, or about a quarter of the industry work force, had retired under the scheme.

**Manufacturing and export processing zones—is the engine of growth slowing?**

The manufacturing sector, at 30% of GDP, grew 2.2% in 2002, down from 4.6% in 2001. The slower growth was caused largely by the slowdown in the EPZ sector and several other manufacturing activities, such as food processing, beverages, cosmetics, fertilizers, footwear, furniture, paint, and sugar milling. EPZ products, which account for about half the manufacturing sector, grew just 2% in 2002, down from an average 6% a year for the past two decades.

Since 2001 the EPZ sector has suffered several external blows. The main factors have been the slow recovery of the U.S. and EU markets, the main destinations for EPZ exports, and political instability in Madagascar. Higher labour costs (see section on labor market developments) have also hurt the sector. Several enterprises are shutting...
down, increasing unemployment. By the end of the third quarter of 2002 the number of EPZ enterprises had fallen to 506, down from 522 in 2001, and the number of garment manufacturers, the largest subsector, from 240 in 2001 to 229. Almost 3,700 EPZ jobs were lost during this period.

Prospects for garment manufacturing may be weakening, as preferential access to major markets is eroding. The benefits of the Multifibre Arrangement will be phased out by the end of 2004, leaving Mauritius exposed to tough international competition. One of the emerging competitors is Eastern Europe, which benefits from substantially lower transport costs to Western Europe. Other competitors are African countries under the U.S. African Growth and Opportunity Act, and the Southeast Asian manufacturers, particularly China, with their high-volume output and low labour costs. Mauritius, already suffering from high labour costs, will have to compete with countries with cheaper labour.

On the positive side, Mauritian exports will have preferential access to the U.S. market under U.S. African Growth and Opportunity Act II. New export opportunities are being created, such as duty-free access for Mauritian knit-to-shape wool sweaters to the United States. Other African competitors enjoy the same or even more favorable preferential treatment, however. The least developed Sub-Saharan African countries have better access, as they are not restricted by the rules-of-origin requirement stipulating that yarns or fabric must originate in the United States or Sub-Saharan Africa, a rule in effect until 2004.

Expanding value added in EPZ products by upgrading technology and diversifying the product range is crucial for keeping the sector competitive in international markets. Recognizing the threat of losing preferential access, the government is planning to restructure, diversify, and modernize the EPZ sector. The strategy will focus on upgrading technology, developing clusters and linkages, diversifying products and markets, developing skills and human resources, re-engineering business processes, encouraging small and medium-size enterprises to become exporters, and attracting foreign direct investment. India and Italy have proposed investing $100 million in spinning mills. Efforts will be made to develop wider networks, including countries such as Mozambique, Lesotho, and Senegal, for investment projects to develop industrial zones and bonded warehouses and make arrangements between Port Louis and the ports of these countries. An Equity Fund will provide additional financial resources for investing in technology upgrading and restructuring EPZ enterprises (box 8.2).

Tourism—reaching full capacity?

Tourism, the fastest-growing sector, has established itself as the third pillar of the Mauritian economy, after EPZ production and sugar. Contributing about 6% of GDP, it is the second largest foreign exchange earner, with about 16% of exports. Tourism growth fell sharply in 2001 to 1%, from 13.6% in 2000—in line with tourist arrivals, up only 0.6% in 2001, compared with 13.6% in 2000. The main contributory factors
were the world recession and the delay and cancellations of travel projects following the September 11 attacks on the United States. Tourism was expected to recover in 2002, with growth of about 3% in real terms.

The main indicators—expenditures per tourist, room occupancy rates, and employment creation—have improved in the last few years. Average nominal expenditure per tourist (in rupees) is estimated to have risen by 30% between 2000 and 2002, partly because Mauritius is upgrading itself as a high-end tourist destination. Hotel standards and capacities will continue to improve, with major renovations of 6 hotels and the construction of 10 integrated resorts, 11 hotels, and 5 recreational projects.

The sector will continue to register robust growth with the development of regional tourism, the promotion of twinning packages with other countries in the region, and the expansion of air-link networks, such as the recent one concluded with Emirates Airlines. But as a small island, it may not be long before Mauritius reaches its geographic, environmental, and social limits in accommodating the expansion of tourism. A 1998 study on carrying capacity calculates a cultural impact limit of 750,000 tourists and an environmental limit not much beyond current arrivals of 680,000 (KPMG 1998). Clearly aware of the problem, the government’s national

Box 8.2
Venture capital funds—supporting economic diversification

In a singular example of government’s determination to improve the investment climate and stimulate employment, the government and the Development Bank of Mauritius are setting up a 1 billion rupee Equity Fund, to subscribe to the equity capital of new ventures in cotton spinning, information technology, biotechnology, and other strategic areas. The fund will also take an equity position in existing enterprises, including those in the textile and clothing sector that have credible business plans for expansion or restructuring. Professional staff with expertise in screening, financing, and overseeing equity investment will be hired to manage the fund.

Equity participation in private enterprises, of limited duration, is only a catalyst. The fund will eventually withdraw to make room for other shareholders. The government expects private enterprises and institutions—including banks, insurance companies, and pension funds—to follow suit and set up similar equity funds to more than match the billion rupees. Some 2 billion rupees or more could thus be available for equity investment.

Another fund, the Mauritius Venture Capital Fund, the first dedicated venture capital company in the country, will provide equity or quasi-equity finance to new and expanding businesses as well as successful operations that suffer from weak financial structures. As a professional minority shareholder, it will inject cash and provide management support in the expectation of adequate dividends and capital appreciation to compensate for the risk of the investment. It has a medium-to long-term investment horizon, normally holding each investment for four to seven years.

Source: Economic Commission for Africa from official sources.
tourism policy emphasizes low-impact, high-spending tourism. The authorities are also looking to reduce the overreliance on one originating market (Europe) and one product (beach resort tourism).

Financial intermediation and information technology—new pillars of growth

*Financial services—a slight deceleration in growth.* Bank and nonbank financial activities, the stock exchange, free port activities, and offshore businesses are now the fourth pillar of the economy. With average annual growth of more than 10% over the past five years, the contribution to GDP reached 14% in 2002, up from 10% in 2001, supported mainly by the banking sector. However, in 2002 a slight deceleration in the growth rate is expected at 8.3%, while the free-port subsector is expected to grow 10%, as in 2001.

Since the mid-1980s financial activities in Mauritius have gradually shifted away from the dominance of banks and insurance companies. Nonbank financial institutions now mobilize savings, stimulate investment, and provide financial support to other productive economic sectors. But the increased disclosure requirements imposed on listed companies—coupled with poor share price performances—reduced activity on the local stock exchange in 2002 (box 8.3).

Employment opportunities in the financial sector, particularly for highly skilled labour, have increased steadily. Total employment stood at some 7,000 in 2000. Accelerated

**Box 8.3 Mauritius Stock Exchange**

The Mauritius Stock Exchange has made remarkable progress since its launch in 1989. The number of listed companies stood at 44 (including debentures) in August 2002. Activities at the stock exchange showed a slight improvement over the past year. Market capitalization increased to 35.1 billion rupees at the end of August 2002, from 34.4 billion rupees in the corresponding period in 2001, though in dollar terms market capitalization declined from $1.18 billion to $1.15 billion. The Semdex rose to 375.2 points in August 2002 from 365.7 in the same period in 2001, although this was down from 390.1 in 2000 and 435.6 in 1999. The Sem7 slipped to 81.7 in August 2002 from 83.1 in August 2001.

Some shortcomings need to be addressed. The degree of market concentration is relatively high, reflecting the domination of Mauritian business by a few large companies. High volatility, low liquidity, and inadequate transparency are preventing the stock market from doing more. To address inefficiencies the regulatory framework is being strengthened to meet international standards of efficiency and transparency and thus consolidate the drive towards internationalization. The gradual widening and deepening of the market with new instruments will support the building of an efficient stock market.

*Source: Mauritius Ministry of Economic Development, Financial Services, and Corporate Affairs 2002.*
reforms in the financial sector in recent years are intended to improve the efficiency and transparency of its operations and build investor confidence. The government has proposed an array of measures in the 2002/03 budget to consolidate the sector. The Financial Services Development Act of 2001 created the Financial Services Commission to regulate the nonbank financial sector and harmonize regulation of offshore and onshore sectors. This act is being further strengthened to enhance the institutional credibility and independence of the Financial Services Commission.

**Information technology—another Bangalore?** The government is investing heavily to develop the information and communications technology sector and create another growth pole. The government has secured a concessional loan of $100 million from the government of India to build a cyber city, much like the export processing zones set up in the 1970s and 1980s, with further funding likely from international sources as the project gains momentum. The new equity fund should facilitate foreign direct investment and startup investments (see box 8.2). The project is expected to create about 5,000 jobs initially.

The objective is to emulate the success of India’s Bangalore and emerge as a regional hub for information and communication technology products. Taking advantage of the bilingual workforce and excellent telecommunication network, Mauritius will be a gateway for the Indian information technology industry into francophone Africa and beyond. In early stages, operations will involve simple technology such as telemarketing and other back-office services (preparing payrolls).

A crucial part of the government strategy is to attract highly skilled labour and investment into the sector. In addition to upgrading skills by investing in education, labour laws are being reformed to attract foreign professionals. And several incentives along the lines introduced in the EPZ are provided to attract investment, both local and international. The government is also investing in physical infrastructure, including an underwater fibre optic cable that connects with East Asia and South Africa.

**Labour market developments—high unemployment a real concern**

Unemployment, increasing from 5.8% in 1996 to 9.2% in 2001, remains a major problem. Higher among females, most of the recent unemployment is explained by the closure of textile mills and the growing capital intensity of investments (figure 8.4).

Unemployment is partly structural, with a big mismatch in job requirements and job aspirations. Despite high unemployment, there are close to 17,000 foreign guest workers, mainly employed in the EPZ, compared with the unemployed labour pool of 48,000 in 2001 (IMF 2002b). Mauritians generally consider EPZ jobs as having less job security and lower wages than those elsewhere in the economy. Moreover, Mauritians who work in the EPZs are considered by employers to have lower productivity than foreign
workers. Both factors increase the demand for foreign labour, and about 30% of the workers in textile and clothing manufacturing are imported.

Another concern is a rise in wages that seems independent of labour productivity, contributing to higher unemployment (table 8.3). From 1990 to 2001 average compensation per worker increased 9.8% a year, but labour productivity increased only 4.2%. In 2001, the latest year with data, average compensation increased 7.1% and labour productivity only 5.0%. The fact that unit labour costs in dollars have been declining shows that the country depends on currency depreciation to stay competitive.

Realizing that the old pillars of the economy may not sustain growth and employment in the long run, the government is diversifying the production base towards higher value-added activities. The modernization efforts in the EPZ and sugar sectors, and the emphasis on expanding the financial and information technology sectors, are demanding more high-skill labour. The jobs in these industries are for trained graduates and diploma holders. Can the Mauritian labour market supply enough skills?

No, according to an educational breakdown of the labour force, which shows that Mauritius is not equipped to match the requirements of a knowledge-based economy. The average Mauritian worker has completed 7 years of education, compared with 10 years in Singapore and 9 in China and the Republic of Korea (World Bank 2002). About a third of students, most from poor families, fail to complete primary education and drop out at 12 to 13 years old, with no vocational schools to upgrade their skills. And the length and quality of education at all levels of schooling are much lower than

**Figure 8.4**

*Unemployment creaping up*

*Gender breakdown of unemployment, 1993–2001 (%)*

*Source: Economic Commission for Africa, from official sources.*
in East Asian countries (IMF 2002a). So, upgrading skills remains a major challenge in the new economy.

Unemployment is most prevalent among young people (24 years old or younger) who did not complete primary education (figure 8.5). And one in five unemployed did not complete secondary education (World Bank 2002). So creating new jobs in the knowledge economy may not help most of the unqualified.

**Table 8.3**

*Growth in labour productivity, 1990–2001 (%)*

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Economywide</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Labour productivity</td>
<td>4.2</td>
<td>8.2</td>
<td>5.0</td>
</tr>
<tr>
<td>Average compensation</td>
<td>9.8</td>
<td>8.0</td>
<td>7.1</td>
</tr>
<tr>
<td>Unit labour cost, rupees</td>
<td>5.4</td>
<td>–0.2</td>
<td>1.9</td>
</tr>
<tr>
<td>Unit labour cost, U.S. dollars</td>
<td>–0.8</td>
<td>–4.4</td>
<td>–7.9</td>
</tr>
<tr>
<td>Manufacturing</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Labour productivity</td>
<td>4.7</td>
<td>9.6</td>
<td>4.8</td>
</tr>
<tr>
<td>Average compensation</td>
<td>9.7</td>
<td>9.5</td>
<td>5.6</td>
</tr>
<tr>
<td>Unit labour cost, rupees</td>
<td>4.7</td>
<td>–0.1</td>
<td>0.8</td>
</tr>
<tr>
<td>Unit labour cost, U.S. dollars</td>
<td>–1.4</td>
<td>–4.3</td>
<td>–9.0</td>
</tr>
</tbody>
</table>

*Source: Economic Commission for Africa, from official sources.*

**Figure 8.5**

*Unemployed young Mauritians, with little schooling*

*Unemployment in Mauritius by education, age, and location, 2000 (%)*
Because such jobless growth may not be economically and socially viable, the government has to ensure that growth does not widen economic and social gaps. Deeper reforms in education are crucial for building skills for the future workforce in moving to a knowledge economy. To complement these reforms, the government has undertaken massive capital spending to build schools and introduce information technologies. Upgrading the education system may require sustained spending for 5–8 years (World Bank 2002).

**Macroeconomic stabilization policies and impacts**

After years of strong fiscal discipline, Mauritius’ deficit rose in 2000/01 and has remained at about 6.5% of GDP, largely to finance higher capital costs for education and training. So far, the increase has not affected private sector confidence. The government is working to strengthen the tax base and improve efficiency in spending. The Bank of Mauritius eased monetary policy slightly in 2001/02, to stimulate economic activity, though narrowing the inflation differential with trading partners is the main medium-term goal of monetary policy. A new Monetary Policy Committee is being established to coordinate monetary and fiscal policy.

**Fiscal policy—rising deficit**

Mauritius has had strong fiscal discipline. The overall fiscal deficit averaged about 4% a year from 1985 to 1999. Since 2000/01 the deficit has jumped to about 6–6.5% of GDP and has remained there (figure 8.6). The main cause is the increased capital...

---

**Figure 8.6
Budget deficit remains higher**

_Budget deficit, 1997/98–2002/03 (% of GDP)_

![Graph showing budget deficit from 1997/98 to 2002/03](graph.png)

*a. Estimated.*

_Source: Economic Commission for Africa, from official sources._
spending to upgrade the education system and skills in the labour force, and other infrastructure projects in an environment where tax revenues have been falling relative to GDP. As a result, the deficit for 2001/02 was projected at 6.5% of GDP, but the realized deficit was around 6 percent, mainly due to a lack of capacity to undertake all the planned capital projects. In 2002/03 the deficit is expected to again be 6% of GDP.

The increase in the value-added tax from 10% to 12% in July 2001 improved the buoyancy of tax revenue to 15.3% of GDP in 2001/02, but that ratio is still lower than before 2000/01 and much lower than the high of 18% of GDP in 1999/2000. The government is reducing several tax exemptions and introducing measures to increase the tax base.

Recurrent expenditures were held to around 20% of GDP in both the 2001/02 and 2002/03 budgets (figure 8.7). The slight increase in 2002/03 is explained by higher debt servicing, with interest on public debt estimated to increase from 3.3% of GDP in 2001/02 to 4.3% in 2002/03. Wages and salaries grew at 8% in 2002/03, much lower than the 10–15% in earlier years. Expenditures on goods and services rose 9%, down from 13–15% in previous years. And current transfers and subsidies stayed level.

Capital expenditure in 2002/03, at 43% more than in 2001/02, is expected to reach a record-breaking 5% of GDP, reflecting the emphasis on creating economic and social capital. Capital expenditure on education is mainly for buildings and other infrastructure. Further capital expenditures are allocated for the Ebene Cyber City and several sewerage projects.

**Figure 8.7**

*Capital spending up to 5% of GDP in 2002/03*

*Capital and recurrent expenditure, 1997/98–2002/03 (% of GDP)*

The fiscal deficit is not putting undue pressure on inflation and interest rates.
Will diversifying the economy threaten fiscal sustainability? Despite the substantial increase in capital expenditures, government expenditure remains close to the internationally accepted fiscal threshold of 25% of GDP. The government has been pushing forward with the economic diversification strategy without adding substantially to budget deficits. The deficit for 2002/03 is projected to be around 6.0%. The government expects capital expenditures to decline to around 3% by 2005/06. If so, fiscal sustainability may not be a major concern.

The fiscal deficit is not putting undue pressure on inflation and interest rates. Financing has been primarily through domestic, mainly noninflationary sources. So, inflation for 2001/02 was a comfortable 6.3%, up from 4.4% in 2000/01 (mainly due to the hike in the value-added tax in 2001 and Cyclone Dina). Interest rates have been declining throughout 2001/02 and 2002/03.

Fiscal sustainability also depends on the size and the composition of public debt. Public sector debt (including state enterprise debts), steadily declining since 1998, remains manageable, at around 62% of GDP as of the end of June 2002 (table 8.4). Of the total, external debt constitutes 31%. The share of internal debt in total central government debt increased from 76% to close to 90% during 1998–2002, so the external share has fallen over time. Central government debt service remains manageable at 6% of GDP and 15% of exports (table 8.5). These debt and debt servicing ratios are much lower than the debt sustainability indicators compiled by the IMF and the World Bank (to define highly indebted poor countries).

Some potential downside risks:

- Building the skilled labour force and necessary infrastructure for a knowledge economy may require a total of 5–8 years of higher spending (World Bank 2002), with 2–5 years left. It remains to be seen whether the government could restrain spending by 2005/06 as targeted.

Table 8.4
Public sector debt, 1997/98–2001/02 (US$ millions)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Central government</td>
<td>1,892.0</td>
<td>2,028.3</td>
<td>2,164.4</td>
<td>1,977.9</td>
<td>2,003.6</td>
</tr>
<tr>
<td>As % of GDP</td>
<td>49.9</td>
<td>49.6</td>
<td>50.5</td>
<td>47.3</td>
<td>48.1</td>
</tr>
<tr>
<td>Internal debt</td>
<td>1,443.7</td>
<td>1,629.2</td>
<td>1,787.7</td>
<td>1,740.8</td>
<td>1,777.4</td>
</tr>
<tr>
<td>Externet debt</td>
<td>448.4</td>
<td>399.1</td>
<td>376.7</td>
<td>237.1</td>
<td>226.2</td>
</tr>
<tr>
<td>External debt of state enterprises</td>
<td>625.4</td>
<td>672.0</td>
<td>593.8</td>
<td>616.2</td>
<td>584.3</td>
</tr>
<tr>
<td>Total public sector debt</td>
<td>2,517.4</td>
<td>2,700.3</td>
<td>2,758.2</td>
<td>2,594.1</td>
<td>2,587.9</td>
</tr>
<tr>
<td>Total as % of GDP</td>
<td>66.3</td>
<td>66.0</td>
<td>64.3</td>
<td>62.1</td>
<td>62.2</td>
</tr>
</tbody>
</table>

Source: Economic Commission for Africa, from official sources.
• Because a high proportion of the internal debt is of short maturity, there are rollover risks in refinancing at higher interest rates. Currently, however, the attractive yields and high security of short-term treasury bills seem attractive.
• The considerable external debt of state enterprises, rising in recent years, may be a problem. Government guaranteed debt of state enterprises is difficult to monitor but fully secured in case of default.

So far the deficit has not affected the credibility of the government or the confidence of the private sector. Moody’s rating for Mauritian long bonds denominated in foreign currency is Baa2, similar to that of the Republic of Korea and Malaysia. Long bonds in local currency get an A2 rating, the same as Poland and Greece. The World Bank classifies Mauritius as a moderately indebted middle income country (World Bank 2002). If the government reduces the deficit by 2005/06, debt sustainability may not be an issue.

Room for greater efficiency. The government is working to restructure public spending, improve the predictability of resource flows, and strengthen expenditure controls and budgetary processes under a medium-term expenditure framework (box 8.4). These measures should reduce waste and restrain current expenditures. There are also plans to restructure state enterprises to restore them as viable units.

Corporate and income tax collection amounts to about 2.5% of GDP, among the lowest in the world. These taxes capture only a small proportion of firms and individuals, and there are many exemptions and extensions of zero rates for value-added and excise taxes. If the government does not take steps to improve revenues, it may jeopardize capital outlays in outer years and put pressure on the fiscal deficit.

Monetary and financial sector—loosening monetary policy
With the slow recovery of global markets and declining interest rates in major financial markets, the Bank of Mauritius undertook a slight easing of monetary policy in

Table 8.5
Central government debt servicing, 1999/2000–2001/02 (US$ millions)

<table>
<thead>
<tr>
<th>Item</th>
<th>1999/2000</th>
<th>2000/01*</th>
<th>2001/02</th>
</tr>
</thead>
<tbody>
<tr>
<td>External debt service</td>
<td>55.0</td>
<td>166.4</td>
<td>32.2</td>
</tr>
<tr>
<td>% of GDP</td>
<td>3.5</td>
<td>10.7</td>
<td>2.0</td>
</tr>
<tr>
<td>Internal debt service</td>
<td>181.0</td>
<td>224.5</td>
<td>210.3</td>
</tr>
<tr>
<td>% of GDP</td>
<td>4.4</td>
<td>5.2</td>
<td>5.0</td>
</tr>
<tr>
<td>Total central government debt servicing</td>
<td>236.0</td>
<td>390.9</td>
<td>242.5</td>
</tr>
<tr>
<td>% of GDP</td>
<td>5.8</td>
<td>9.1</td>
<td>5.8</td>
</tr>
<tr>
<td>% of current revenue</td>
<td>26.3</td>
<td>42.7</td>
<td>27.0</td>
</tr>
<tr>
<td>% of exports</td>
<td>14.8</td>
<td>25.1</td>
<td>14.8</td>
</tr>
</tbody>
</table>

a. The sharp increase in 2000/01 is due to the repayment of a floating rate note for $107.5 million.
Source: Economic Commission for Africa, from official sources.
2001/02, to reinvigorate economic activity. The bank lowered the Lombard rate from 12% to 11.75% in August 2001 and in steps to 10.50% in February 2003. Other rates changed accordingly (figure 8.8).

M2 rose 13% in June 2001/02, higher than the 9.9% for the previous year (figure 8.9), with positive contributions from the growth of net foreign assets (8.9%) and domestic credit (7.4%). The continuing rise in the net foreign assets of the banking system reflects good export performance.

**Banks still cautious with the private sector.** Domestic credit grew 7.9% in 2001/02, up from 6.6% in 2000/01 (see figure 8.9). Unlike the growth in the previous year, when the rise was all credit to the private sector, this rise resulted from increases in net credit to both the government and the private sector. With a slowdown in economic activity, banks are more cautious with private sector credit. In addition, attractive yields and the high security offered on treasury bills have been more appealing to domestic banks. Nevertheless, the private sector still accounts for about 80% of domestic credit from the banking sector.

The banks’ cautiousness increased the average liquid asset ratio of commercial banks from 17.0% in 2000/01 to 21.8% in 2001/02, evident in the decline in the loans to deposits ratio (table 8.6). The deposits to GDP ratio increased to 76% in 2001/02 from 73% in 2000/01, but these funds were not used to create credit, as the loans to GDP ratio in 2001/02 remained unchanged from the previous year, at 61%.

**Box 8.4**

**Reducing waste with a medium-term expenditure framework**

The government of Mauritius intends to review public expenditure management along the lines of a medium-term fiscal adjustment program, based on revenue consolidation and expenditure restructuring and management. A major element of this program will be a medium-term expenditure framework, to ensure the macroeconomic sustainability of overall public sector expenditure and improve the effectiveness and efficiency of public spending. Public bodies will have to establish priorities and performance targets in line with the overall country strategy.

The medium-term expenditure framework, to be implemented as a pilot in five high-spending ministries in 2002/03, will enhance accountability and service delivery and help in monitoring and evaluating public spending.

A public expenditure review will assess the level and composition of public expenditures to ensure macroeconomic stability and consistency with development objectives. The review will also examine the institutional mechanisms for allocating and monitoring expenditures to ensure efficiency of resource use, focusing on relevance to development objectives, costs and incidence, institutional issues in the management of public expenditures, and the role of the private sector. All this will require careful planning and strong coordination between the ministry of finance and line ministries.

Source: Economic Commission for Africa, from official sources.
Value-added tax and Cyclone Dina cause slight bump in inflation. Narrowing the inflation differential with trading partners is the main objective of monetary policy in the medium term. Inflation targets were initially set at 5−5.5% for 2001/02, around the average for the last five years, but then raised to 6.3%, in the wake of Cyclone Dina (figure 8.10). Actual inflation in 2001/02 was 6.3%, attributable mainly to Cyclone Dina, the value-

Figure 8.8
Interest rates down slightly
Indicative interest rates, July 2001–June 2002 (annual %)

Source: Economic Commission for Africa, from official sources.

Figure 8.9
Money supply up 13%
Growth of monetary indicators, 1997/98–2001/02 (%)

Source: Economic Commission for Africa, from official sources.
added tax hike, and other budgetary measures in 2001/02. These factors, plus the slight depreciation of the rupee, pushed up the price of alcoholic drinks, cigarettes, gasoline, and bus travel. Prices also rose for cooking gas, medical care, fresh vegetables, wastewater tariffs, motor vehicle insurance rates, private tuition fees, and school textbooks.

Monetary and fiscal authorities sometimes have divergent objectives. The new Monetary Policy Committee will coordinate policy between the central bank and the government, to avoid policy inconsistencies and economic distortions. It will also monitor exchange rates, maintaining international competitiveness while reducing the inflationary impact of exchange rate policies. Recent exchange rate movements have already improved productivity and competitiveness indicators for the economy.

**Financial sector is emerging strongly.** To position Mauritius as an international center for financial intermediation, a new Financial Services Development Act will strengthen

### Table 8.6
Banking sector indicators, 1997/98–2001/02 (%)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans to deposits ratio</td>
<td>76.5</td>
<td>81.7</td>
<td>83.7</td>
<td>84.5</td>
<td>81.0</td>
</tr>
<tr>
<td>Financial depth</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>M2 to GDP at market prices</td>
<td>76.1</td>
<td>77.3</td>
<td>78.4</td>
<td>75.8</td>
<td>80.2</td>
</tr>
<tr>
<td>Financial intermediation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposits to GDP at market prices</td>
<td>71.6</td>
<td>73.0</td>
<td>74.4</td>
<td>73.0</td>
<td>75.7</td>
</tr>
<tr>
<td>Loans to GDP at market prices</td>
<td>54.8</td>
<td>59.6</td>
<td>62.3</td>
<td>61.7</td>
<td>61.4</td>
</tr>
</tbody>
</table>

Source: Economic Commission for Africa, from official sources.

### Figure 8.10
Inflation around 5% for the last five years

**Inflation rate, 1989/90–2001/02 (%)**

Source: Economic Commission for Africa, from official sources.
and consolidate the regulation and supervision of the nonbank financial sector. For this, the distinction between offshore and onshore has been eliminated.

With technical assistance from the World Bank, the central bank continues to strengthen banking supervision. It is clarifying the legal framework, increasing on-site inspections, introducing off-time monitoring, and providing special training to staff. There are also plans to establish a credit bureau to assess the exposure of borrowers.

To improve its offshore banking status and remove impediments to entry by foreign financial institutions, Mauritius has taken several measures in the last few years. It removed entry restrictions on foreign banks and financial institutions. In June 2000 the National Assembly passed the Economic Crime and Anti-Money Laundering Act, establishing a system to investigate suspicious transactions and economic offenses. Mauritius also made an advance commitment to the OECD to eliminate harmful tax practices. Other laws were also passed in 2002 to ensure that the financial sector is not used for financing terrorism.

With greater surveillance of the banking sector, the central bank revoked the license of the Delphis Bank—the fifth largest bank with 4.5% of the total assets of the banking sector—in March 2002 after nonperforming loans to overseas banks and closely related domestic parties had wiped out its asset base. Total nonperforming loans are declining, from 9% of advances in June 1999 to 7.7% in June 2001 (IMF 2002a). This reflects the risk management strategies of some banks to improve the quality of their assets.

Even so, there is more room for improvement, given that banks in small open economies tend to have large credit exposures relative to their capital base. According to Moody’s Investors Service Report on Banking System Outlook, Mauritius ranked 47 of 80 countries in average bank financial strength (Vincent 2002). Other indicators of banking development are not high—Mauritius ranked 46 in country ceilings for long-term bank deposits and 43 in average long-term bank deposits.

**Developments in the external sector**

Dominated by EPZ manufactured apparel products, Mauritian exports are overwhelmingly directed to European and U.S. markets. EPZ exports made up 65% of the total in 1998/99, and 76% in 2000/01, slipping to 71% in 2001/02 (figure 8.11), mainly because of unfavourable international developments. Sugar exports declined from 23% in 1998/99 to 14% in 2000/01 but improved slightly to 18% in 2001/02.

Food items have maintained their 14–15% share of imports. Intermediate goods made up a little more than 40% of total imports in 2001/02, and capital goods about 20%. The share of petroleum products increased significantly, from 6.3% in 1998 to more than 11% in 2000 and 2001 (figure 8.12). South Africa, France, India, and the United Kingdom are the main suppliers of imports, in that order.
Current account improves
Improving significantly over the years, the current account surplus was estimated at $187 million in 2001/02, compared with $133 million in 2000/01, largely from a surge in earnings from tourism (figure 8.13 and table 8.7). Despite the slow growth in tourist arrivals, at 1.3% in 2001/02, average spending per tourist increased, mainly because of higher hotel rates.

Figure 8.11
EPZs still dominate exports
Composition of exports of goods, 1998/99–2001/02 (% of exports)

Source: Economic Commission for Africa, from official sources.

Figure 8.12
Intermediate and capital goods dominate imports
Composition of imports of goods, 1998/99–2001/02 (% of imports)

Source: Economic Commission for Africa, from official sources.
Capital and financial accounts worsened in 2001/02, partly because of the foreign direct investment inflows in 2000/01, boosted by the share participation of France Telecom in Mauritius Telecom ($277 million).

Net international reserves increased $166 million, from $1,228 million in July 2001 to $1,394 million in June 2002. In November 2002 the cushion was $1,387 million, equal to a record 39 weeks of imports.

**Figure 8.13**

*Current account improves*

*Current account balance, 1998/99–2001/02 (US$ millions)*

<table>
<thead>
<tr>
<th>Item</th>
<th>1998/99</th>
<th>1999/00</th>
<th>2000/01</th>
<th>2001/02</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current account</td>
<td>–67.6</td>
<td>–57.7</td>
<td>133.1</td>
<td>187.2</td>
</tr>
<tr>
<td>Merchandise</td>
<td>–378.3</td>
<td>–490.8</td>
<td>–294.1</td>
<td>–314.5</td>
</tr>
<tr>
<td>Services</td>
<td>240.6</td>
<td>358.6</td>
<td>349.7</td>
<td>433.8</td>
</tr>
<tr>
<td>Income</td>
<td>–24.6</td>
<td>–22.9</td>
<td>12.5</td>
<td>–5.0</td>
</tr>
<tr>
<td>Current transfers</td>
<td>94.6</td>
<td>97.4</td>
<td>65.0</td>
<td>72.9</td>
</tr>
<tr>
<td>Capital and financial account</td>
<td>11.5</td>
<td>–108.1</td>
<td>–96.8</td>
<td>–276.0</td>
</tr>
<tr>
<td>Capital account</td>
<td>–0.7</td>
<td>–0.5</td>
<td>–1.5</td>
<td>–1.0</td>
</tr>
<tr>
<td>Financial account</td>
<td>12.2</td>
<td>–107.6</td>
<td>–95.2</td>
<td>–274.9</td>
</tr>
<tr>
<td>Reserve assets</td>
<td>–28.8</td>
<td>–85.1</td>
<td>–194.5</td>
<td>–252.8</td>
</tr>
<tr>
<td>Net errors and omissions</td>
<td>56.1</td>
<td>165.8</td>
<td>–36.4</td>
<td>88.8</td>
</tr>
</tbody>
</table>


*a. Estimated.*

**Source:** Economic Commission for Africa, from official sources.
Exchange rate developments—rupee remains competitive
Since October 2000 the monetary authorities have allowed the rupee to float on international markets, intervening only to smooth short-term volatility. Free of restrictions on international transactions, Mauritius continues to maintain a liberal capital account. The trend in the exchange rate follows economic fundamentals and those of Mauritius’s trading partners, so the rupee does not appear to be significantly misaligned.

Between June 2001 and June 2002 the rupee depreciated on an average daily basis against the euro (8.5%), dollar (8.2%), and pound sterling (7.7%), while it appreciated against the South African rand (19.6%). During the second half of 2002 the real effective exchange rate depreciated slightly, strengthening international competitiveness (figure 8.14).

Moving towards regional and subregional integration
Mauritius belongs to several trading blocks: the Indian Ocean Commission (IOC), Common Market for Eastern and Southern Africa (COMESA), Southern African Development Community (SADC), and Indian Ocean Rim–Association of Regional Cooperation (IOR–ARC). Mauritian trade with Africa is only about 5% of total trade.

COMESA has removed all tariffs on intraregional trade. In SADC liberalization is moving in a phased manner, also covering services. Most tariffs have been reduced by half.

Some recent developments could have severe consequences for SADC and for Mauritius. South Africa has a trade agreement with the European Union to reduce tariffs on both

The current account surplus improved significantly—$187 million in 2001/02—largely from a surge in tourism earnings

Figure 8.14
Real exchange rate ticking upward
Real and nominal exchange rates, June 1995–November 2002 (December 1995=100)

Note: An upward movement indicates depreciation, and a downward movement appreciation.
Source: Economic Commission for Africa, from official sources.
sides in a phased manner. The United States has also shown an interest in a free trade agreement with the South African Customs Union, comprising Angola, Botswana, Lesotho, Namibia, South Africa, and Swaziland. These bilateral agreements would affect Mauritius’s trade in the region and in the European Union and United States.

In the short to medium run there could be adverse impacts on fiscal revenues and domestic industry because of trade diversion and increased competition from foreign producers. Mauritius could lose between 22% and 33% of revenue collections from the taxes on trade with countries in SADC (Imani Consultants 1999). Due to the restructuring of tariffs, the impact on domestic industry is likely to be greater.

**Foreign direct investment—attracting new sources**

Foreign direct investment (FDI) has fallen significantly since the early 1990s, mainly because local and foreign firms based in Mauritius moved to other countries in the region. Mauritius now receives less FDI than the Seychelles, Botswana, and Uganda (figure 8.15). Having exhausted the opportunities in the EPZ sector that brought FDI in the 1980s, Mauritius has to develop other sources and sectors to attract FDI.

Excluding the exceptional flows from the sale of Mauritius Telecom shares, the government reversed the net outflow of $10.7 million in 2000 to record a net inflow of $10.2 million in 2001. FDI inflows are expected to be higher in 2002, with the projects announced in information and communications technology, hotel development, and spinning mills. Of the $55.7 million of investment approved in the textile sector in 2002, $31.4 million will be from overseas.

Measures announced in the 2002/03 budget will boost FDI further by eliminating bureaucratic red-tape and administrative bottlenecks, setting up the Equity Fund and Venture Capital Fund for joint ventures between Mauritian and foreign investors (see box 8.2), amending the Non-Citizens (Property Restriction) Act, and offering investment allowances.

Regional arrangements can also attract inward FDI. Singapore has one of the most impressive programs in Asia to attract transnational corporations to carry out a wide array of activities, ranging from servicing regional customers to undertaking research and development work. Mauritius must aim at developing such a regional hub. In particular, with the progress made in the financial sector and the emerging information technology sector, the country can emerge as a center of excellence in education, training, and research to supply skilled labour. The development of training and research programs can evolve in phases, giving priority to international management, multinational finance, public sector management, technology management, environment and coastal management, and marine resources management.

There are also great opportunities to promote outward FDI, particularly in Africa. The de-localization of the textile industries in Madagascar, which started 10 years back, is
a stepping-stone for expanding the FDI base. In 1999–2001 around $9 million worth of FDI focused on textiles and apparel but also included telecommunication, banking, and sugar.

Ongoing structural reforms

Mauritius is undertaking several structural reforms to create an enabling environment for economic diversification. These include strengthening transparency and corporate governance, improving civil society participation in decisionmaking, and moving forward with privatization of state enterprises. Some reforms are straightforward and undertaken with enthusiasm—while others, such as privatization, are pursued cautiously.

Institutional and governance structures—revitalizing public sector efficiency

The government has undertaken wide-ranging reforms in public sector departments and state enterprises. The objective is to revitalize public sector managerial efficiency by taking advantage of new opportunities set out in Vision 2020, the national long-term perspective study on the role of the government. Public services should incorporate principles and ethics of corporate governance. And the public service ethos should include new values of leadership—quality, productivity, and transparency.

A Committee on Corporate Governance has been appointed with wide representation to ensure efficient functioning of financial and equity markets. It is responsible for
implementing a sound corporate governance regime, disseminating information, and enforcing the code of governance. The government is now working on a code of corporate governance and a shareholders’ charter.

The macroeconomic framework is being strengthened by adopting fundamental principles of good governance—accountability, transparency, responsibility, fair treatment, and management discipline. Mauritius has subscribed to the IMF’s General Data Dissemination System and is preparing to graduate to the more rigorous Special Data Dissemination Standards. The central bank has been given more independence in monetary management and inflation modeling. The major instrument for coordination between monetary, fiscal, and exchange rate policies will be the Monetary Policy Committee, discussed earlier.

The present administration came to power on an anticorruption platform, passing anti-corruption legislation and setting up the Independent Commission against Corruption in August 2002. The legislation sets out procedures for making corruption charges and protecting informers and witnesses. Three advisory committees have been appointed with wide ranging powers to address corruption charges: the Corruption Advisory Committee, the Operations Review Committee, and the Community Relations and Prevention Advisory Committee.

**Civil society—encouraging wider participation**
Mauritius has a free press that airs opposing views on the operations of government. The government has given a new turn to national decisionmaking with the wider participation of civil society through a new National Economic and Social Council, with three commissions, one on economic affairs; one on infrastructure, physical resources, environment, and sustainable development; and one on social affairs and human resources development.

**Privatization—slowly but surely?**
Privatization of state enterprises is complex and politically charged, mainly because of potential layoffs. Because each enterprise may require different mechanisms of privatization, given the objectives and constraints, the government has planned the privatization process on a case-by-case basis. One mechanism is to issue shares in state enterprises to the public, as with the sale of shares in Air Mauritius. The government owns 51% of shares and acts as a guarantor on all loans for the expansion of research and development. Build-own-operate-transfer schemes and leasing with the private sector are other mechanisms.

Although no authenticated data are available on the deficits of state enterprises, it is well-established that the majority do not generate profits, except those that are running on purely commercial lines. The Central Electricity Board, a fully government-owned body, ran deficits of 173 million rupees in 1999 and 375 million rupees in 2000 (Central Electricity Board 2000). The justification for loss-making government enterprises is that they are basically service-oriented.
Some other fully owned government companies were slated for privatization, even though they were not incurring losses. The objective was to improve efficiency and generate higher profits. The benefits of privatization can be substantial, as demonstrated by the case of Mauritius Telecom, privatized in 2000 (box 8.5).

**Developments in the social sector**

Since independence Mauritius has made tremendous progress in reducing poverty. In 1968 most of the population lived below the $1 a day poverty line, and today virtually everyone is above it. Widespread benefits of economic growth have increased the quality of life, which compares well with that in other upper middle income countries. Life expectancy at birth has increased from 63 years in 1970 to 71 today, higher than the 69-year average for upper middle income countries. The illiteracy rate is 15%, close to the 10% for the upper middle income group. Equally impressive gains have been made in other health and education indicators. Mauritius also has a generous welfare system, which is comparable to that in OECD countries. With these gains, Mauritius is set to achieve the Millennium Development Goals with ease (box 8.6).

But all is not well. Rising unemployment among the young and less educated is a major concern. And there are pockets of poverty, on the island of Rodrigues and in the regions of Pamplemousses and Flacq. These are sensitive issues in a multiethnic and multi-religious population. If not addressed promptly, they may threaten the social cohesion that has been the strength behind the Mauritian miracle.

**Poverty pockets still exist**

There is no official poverty line in Mauritius. A recent study by Duncan and Valenti (2001) adopts a relative approach, measuring poverty as the proportion of the adult population whose incomes fall below 50% of the median monthly per capita income. According to their estimate, 9.4% of the adult population was living below the poverty threshold of 2,250 rupees (about $118) a month in 1996/97, the latest household survey year.

The incidence of poverty is highest on the island of Rodrigues, where almost 38% of the adult population lives below the relative poverty line, followed by the regions of Flacq (10.4%) and Pamplemousses (10.3%). Poverty is lower in the urban districts of Port Louis and Plaines Wilhems.

Poor families are large, with children more prone to drop out of school at an early age. The incidence of poverty among single parent households—headed in almost all the cases by women—is four times higher than the national average (World Bank 2002).

The government is taking action. More than $34 million was allocated in the 2001/02 budget for public investments in the island of Rodrigues—including education, health, and housing. The government is also extending microfinancing programs to targeted communities and making housing improvements in poor neighborhoods.
Poverty is tightly concentrated along regional and social groupings, making it easy to target programs for the poor. It is estimated that an additional income of 49 rupees a

**Box 8.5**

**Privatizing Mauritius Telecom**

The Mauritian government opened the telecommunications sector to competition in February 1997, calling for an end to all monopoly and exclusive rights in domestic and international services by 2004. The first step was to progressively divest itself of its equity shares in Mauritius Telecom—81% held by the government and 19% by the State Bank of Mauritius Ltd (SBM Ltd).

In November 2000 Mauritius Telecom introduced France Telecom as a strategic equity partner to strengthen and secure its market hold, pending full-scale liberalization of the market by January 2003, and to extend its global reach. In a competitive bid France Telecom obtained 40% of the shares for $277 million, dropping the government’s share to 40%; the remaining 20% is held by SBM Ltd. This partnership has developed synergies between the technological and global strength of France Telecom and the local and regional experience of Mauritius Telecom.

The benefits are already apparent. Access to telecommunications facilities has improved significantly (see table), and profits have increased. Mauritius Telecom gained two rungs on the ladder of the top 100 Mauritian companies in 2001, ranking 6 with a turnover of $127.2 million. With pre-tax earnings of 20%, it becomes the first Mauritian company ever to cross the $34 million profit threshold. With a proven track record in the domestic market, it is pursuing interests in Burundi, Lesotho, Madagascar, Mozambique, and South Africa. In November 2000 it acquired 70% of the capital of Lesotho Telecommunications Corporation.

**Access to telecommunication facilities, 2000 and 2001**

<table>
<thead>
<tr>
<th>Item</th>
<th>2000</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed lines</td>
<td>281,000</td>
<td>307,000</td>
</tr>
<tr>
<td>Fixed lines per 100 inhabitants</td>
<td>24</td>
<td>26</td>
</tr>
<tr>
<td>Cellular subscribers</td>
<td>180,000</td>
<td>300,000</td>
</tr>
<tr>
<td>Cellular subscribers per 100 inhabitants</td>
<td>15</td>
<td>25</td>
</tr>
<tr>
<td>Internet users</td>
<td>87,000</td>
<td>158,000</td>
</tr>
<tr>
<td>Internet users per 100 inhabitants</td>
<td>7</td>
<td>13</td>
</tr>
<tr>
<td>Personal computers</td>
<td>120,000</td>
<td>130,000</td>
</tr>
<tr>
<td>Personal computers per 100 inhabitants</td>
<td>10</td>
<td>11</td>
</tr>
</tbody>
</table>

**Source:** International Telecommunications Union [http://www.itu.int/ITU-D/ict/statistics/].

There were concerns from management and employees about employment security and future prospects. But workers have not been laid-off. Instead, appropriate human resource systems have been established to provide training and development to redeploy the workforce within the enterprise or elsewhere.

**Source:** Mauritius Telecom Web site [mt.intent.mu].
Investing in education and health

The New Economic Agenda puts education at its center. Addressing unemployment and preparing the population for a knowledge economy is the government’s aim. Even though access to education is high, the system is biased towards the more affluent, with high dropout rates among the children of poor families. And the limited vocational training available is not relevant to today’s labour market needs.

The government is introducing far-reaching reforms to upgrade the education system by:

- Increasing mandatory schooling from 6 to 11 years.
- Improving access to primary and secondary schools.
- Introducing information technology in primary and secondary schools.
- Improving the relevance of curricula and restructuring the examination system.

Another objective of the New Economic Agenda is to improve healthcare. Inadequate remuneration of healthcare workers has caused many medical staff to move to Europe. To meet the challenges arising from the reduced supply of doctors and nurses, the government is working to improve the quality and accessibility of health services.

Box 8.6
Set to achieve the Millennium Development Goals

Mauritius is one of the few countries in Africa that is set to meet all but one of the Millennium Development Goals and their targets by 2015. Today, almost no Mauritian lives below $1 a day or suffers from hunger. Child malnutrition is almost eliminated, and the country is on course to reduce maternal mortality by two-thirds. There is universal access to primary education, with gender equality in schools. One target that the country might not achieve is reducing child mortality by two-thirds: now 17 deaths per 1,000 live births, reducing it to 6 (below the level in the United States) may not be easy.

<table>
<thead>
<tr>
<th>Target</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eliminate child malnutrition</td>
<td>Almost achieved—likely to achieve fully by 2015</td>
</tr>
<tr>
<td>Achieve universal primary education</td>
<td>Achieved</td>
</tr>
<tr>
<td>Achieve gender equality in schools</td>
<td>Achieved</td>
</tr>
<tr>
<td>Reduce child mortality by two-thirds</td>
<td>Unlikely</td>
</tr>
<tr>
<td>Reduce maternal mortality by three quarters</td>
<td>Almost achieved—likely to achieve fully by 2015</td>
</tr>
<tr>
<td>Maintain low HIV/AIDS prevalence</td>
<td>Achieved</td>
</tr>
<tr>
<td>Ensure environmental sustainability</td>
<td>Likely</td>
</tr>
</tbody>
</table>

Source: Economic Commission for Africa, from official sources.
nurses, the government has been importing them from other developing countries, particularly India.

Public expenditures signal government priorities (table 8.8). Recurrent public expenditure on education and health has not changed much in the last four years, but capital expenditures on education have increased to undertake some of the reform measures. Note, however, that stagnating recurrent expenditure on services may hamper effective service delivery. Improving the efficiency of public service provision should be given the same priority as increasing spending. Greater efficiency could lead to savings and ease budgetary pressures.

Medium-term prospects are good

The government maintains a clear development strategy of economic diversification geared towards a knowledge economy, with emphasis on the growth of financial and information technology sectors. Efforts are also under way to modernize the traditional sectors, particularly the export-oriented textile and sugar industries. The budget for 2002/03 outlines job creation, educational reform, and environmental protection as other medium-term priorities.

With the recovery of both domestic and international markets, real GDP is projected to grow around 5.6% in 2003, in line with government expectations in the 2002/03 budget (box 8.7). The favourable domestic conditions are led by the strong recovery of sugar since the devastation caused by Cyclone Dina in 2002. With the recovery of international markets exports may pick up in 2003, and with a gradual depreciation of the

Table 8.8
Budgetary allocations to the social sector, 1998/99–2002/03 (% of GDP)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Recurrent expenditure</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td>3.3</td>
<td>3.2</td>
<td>3.2</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Health</td>
<td>1.9</td>
<td>1.9</td>
<td>2.0</td>
<td>1.9</td>
<td>1.8</td>
</tr>
<tr>
<td>Social services and welfare</td>
<td>4.8</td>
<td>4.8</td>
<td>4.9</td>
<td>4.8</td>
<td>4.6</td>
</tr>
<tr>
<td>Housing and community amenities</td>
<td>0.4</td>
<td>0.5</td>
<td>0.5</td>
<td>0.6</td>
<td>0.4</td>
</tr>
<tr>
<td>Recreation and cultural</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Capital expenditure</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.5</td>
<td>1.2</td>
</tr>
<tr>
<td>Health</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Social services and welfare</td>
<td>0.0</td>
<td>0.0</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Housing and community amenities</td>
<td>0.8</td>
<td>1.0</td>
<td>1.2</td>
<td>1.4</td>
<td>1.4</td>
</tr>
<tr>
<td>Recreation and cultural</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.2</td>
</tr>
</tbody>
</table>

Source: Economic Commission for Africa, from official sources.
rupee against the dollar exports may get a further boost. Import bills may increase if Middle East tensions lead to an increase in oil prices. But with a buoyant services account, including the expected recovery in international tourism, the current account surplus would improve slightly. If the $150 million a year World Bank Public Expenditure Reform Loan is taken into account, the balance of payments would produce a further surplus, improving net international reserves.

The budget deficit is expected to persist at its current 6% in 2002/03 and decline slightly in 2003/04 as major parts of the capital outlay program would be under way by then. Both internal and external debt are likely to rise in 2003, with public debt service rising mainly because of rising interest payments on internal public debt.

An increase in the value-added tax would accompany the broadening of the tax base in the medium term, but that could have implications for inflation, projected to hover around 6% in 2003, higher than the targeted 5%. To achieve 5% inflation, the government has to revert to a tighter monetary policy, which may not be compatible with maintaining the M2 to GDP ratio at its current level, as targeted. In fact, tight monetary policy would have hurt debt servicing and investment, which could aggravate unemployment by slowing the growth rate.

Various institutional innovations, such as the Board of Investment, Equity Fund, and Venture Capital Fund, will attract domestic and foreign investment. With clear interest from foreign investors in the EPZ and cyber city projects, the targeted investment of 24–25% of GDP during 2003–06 may be achievable.

Despite the objective of the government to improve job creation, the measures to tackle unemployment may not be adequate to bring about a reversal in the next year. With Mauritius passing through a stage of jobless growth, unemployment is likely to cross 10% in 2002/03. More emphasis is being placed on growth in financial services and

Box 8.7
A medium-term macroeconomic framework

The 2002/03 budget is in line with the trajectory traced out by the New Economic Agenda, which outlined a five-year program for job creation, educational reform, and environmental protection, to modernize economic management and improve competitiveness.

This comprehensive macroeconomic approach is expected to deliver in the medium term a 5.5% average growth rate and to reduce inflation to 4.5% in 2005/06 by maintaining money supply at its present 81% of GDP. Domestic investment is expected to pick up, reaching 24.5% of GDP in 2005/06. Achieving these targets is based on implementation of the reforms spelled out in the New Economic Agenda for health, education, pensions, social aid, and economic management.

information technology, which are knowledge-intensive, creating fewer jobs. And modernizing the sugar and EPZ sectors is making these sectors more capital intensive—demanding less labour and higher skills.

In the medium term the government may have to extend its safety net to address the needs of the newly unemployed. Evidence so far shows, particularly for the retrenchment program in the sugar sector, that the government is handling these pressures well.

Notes

1. These unemployment data are calculated as a residual and include people who are not actively seeking employment.

2. M2 includes currency in circulation and private sector deposits, excluding foreign currency deposits.

References
