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SURVEY OF ECONOMIC AND SOCIAL CONDITIONS IN AFRICA, 1975

(PART I)

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SURVEY OF ECONOMIC AND SOCIAL CONDITIONS IN AFRICA, 1975 Part I

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Prefatory note

This 1975 Survey of Economic and Social Conditions in Africa is published in two parts. Part I consists of two sections. The first covers the international economic situation, the search for a new international economic order and economic developments and policies in the ECA region in 1974 and 1975. The second section contains a study of inflation in African countries. Part II covers current economic developments and policies in the individual countries of the ECA region, mainly emphasizing the years 1974 and 1975.

In Part I, Section I, the first subsection provides an assessment of economic growth in 1974 and 1975 in the OECD countries (the major world market economies) and their prospects for 1976. Exports from ECA member States in 1975 were adversely affected by the deep recession in the industrialized countries which began in 1974. This subsection also examines the special situation of the non-oil producing developing countries.

The second subsection is devoted to the search for a new international economic order, and assesses the measures taken at the sixth and seventh special sessions of the United Nations General Assembly.

The two subsections are essentially introductory to the last subsection which reviews economic development and policies in the ECA region as a whole in the years 1974 and 1975 and the prospects for 1976.

SECTION I

THE INTERNATIONAL ECONOMIC SITUATION, THE SEARCH FOR A NEW INTERNATIONAL ECONOMIC ORDER AND ECONOMIC DEVELOPMENTS AND POLICIES IN THE ECA REGION DURING THE PERIOD 1974-1975

- I. The international economic situation
- II. The search for a new international economic order
- III. Current economic developments and policies in the ECA region

Explanatory notes

Symbols of the United Nations documents are composed of capital letters combined with figures. Mention of such a symbol indicates a reference to a United Nations document. United Nations documents symbols which are preceded by the designation E/CN.14/... indicate that the documents are issued under the auspices of the Economic Commission for Africa.

The following symbols have been used in this Survey:

... not available, -- nil or negligible.
A billion is one thousand million.

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This preliminary draft of the *Survey of Economic and Social Conditions in Africa, 1975*, has been prepared on the responsibility of the ECA secretariat. It is subject to further editing and revisions, including the presentation of the latest available data, prior to its issue in final printed form.

I. THE INTERNATIONAL ECONOMIC SITUATION 1/

In the previous issue of the Survey the ECA secretariat outlined the problems confronting African and other developing countries arising from persistent world inflation over the past few years, increases in the prices of petroleum and petroleum products in the last quarter of 1973, a slowdown in economic activity in OECD countries at the beginning of 1974, and the deterioration in the terms of trade of developing countries following the collapse of the commodity boom in the second part of 1974. The difficulties arising from these multiple economic problems, namely balance-of-payments deterioration, disruption of development programmes and reduced economic activity generally, have not abated in 1975; if anything, they have worsened.

World inflation and the unfavourable current account balance of payments of a number of developed countries led to a series of currency crises in the years 1971 to 1973. The fixed exchange rate (Bretton Woods) system collapsed in August 1971. This was followed by frequent parity changes, including two devaluations of the United States dollar. The currencies of a number of countries have been floated. Throughout this period, the United Nations index of prices of manufactured goods exports rose continually, by 8.1 per cent in 1972, 16.4 per cent in 1973, and 19.2 per cent in 1974. 2/ In the aftermath of large Soviet purchases of United States wheat in 1972, prices of cereal exports rose by 82.9 per cent in 1973 and 40.9 per cent in 1974. The rising cost of manufactured goods, which account for about 68 per cent of developing countries' imports, accompanied by the rising cost of cereals at a time of widespread drought in many developing countries, put an additional strain on their balance of payments.

Between September 1973 and January 1974, the posted price of crude petroleum increased almost four-fold. The direct effect was to increase the current account surplus of the oil-producing countries by some $US 65 or 70 billion, of which about $US 55-58 billion was with OECD countries and about $US 5.4 billion was with the non-oil-producing developing countries, including about $US 1.0 billion for non-oil-producing developing countries in Africa. 3/

1/ Major sources:

(a) OECD Economic Outlook July 1975.
(b) World Bank, Annual Report 1975.
(c) IMF, Annual Report 1975.

2/ Monthly Bulletin of Statistics, Vol. XXIX, No. 9 (September 1975), special table B.

3/ Cf. Survey of Economic and Social Conditions in Africa, 1974, Part I (E/CN.14/632/Part I) p. ix.

At the beginning of 1974, the OECD countries experienced a marked slowdown in economic activity after two years of exceptionally high growth. For the seven major OECD countries, real output declined by 0.6 per cent in 1974 compared with increases of 5.8 per cent in 1972 and 6.5 per cent in 1973. This dramatic reversal in the level of economic activity seriously affected the relationship between exports and imports of the non-oil-producing developing countries, resulting in a trade deficit of $US 14 billion in 1974. 4/

The effect of the slowdown in world economic activity on the prices of commodity exports from developing countries was delayed, as orders are usually placed well in advance of expected delivery. These countries' non-oil terms of trade actually improved substantially in the first part of 1974, but then declined as commodity prices weakened while the prices of manufactured goods imports continued their climb upwards. Overall, the non-oil-producing developing countries' balance of payments improved by some $US 3 or 4 billion during 1974, but all the gains occurred during the first part of the year, and the outlook at the end of the year was bleak.

The immediate effect of these upheavals in the world economy in 1974 for the non-oil-producing developing countries was on their balance of payments, but the longer-term effects were on the implementation of development plans, and on the burden of external debt. As a group, developing countries pursued policies of adjustment, involving fiscal and monetary policies and restrictions on non-essential imports. The middle-income and higher-income countries were in a somewhat better position to borrow funds on international money markets to finance their worsening balance-of-payments deficits. They were able to achieve rates of growth of GDP averaging about 6 or 7 per cent in 1974. The low-income countries (those with per capita GDP of less than $US 200 in 1972), including the 18 least developed countries in Africa, were hardest hit; their growth rates probably fell from an annual average of 4 to 5 per cent from 1970 to 1973 to around 2 per cent in 1974.

The total volume of debt of developing countries rose by 16 per cent a year from 1970 to 1972, and by 19 per cent in 1973. But the average debt service ratio (total debt service payments as a percentage of exports of goods and services and non-factor payments), which had been steady at 9.6 per cent in 1967-1969, advanced to 10.1 per cent in 1970-1972, and fell temporarily to 9.4 per cent in 1973 5/ because of the export boom experienced in that year. As a result of the deterioration of the terms of trade of the non-oil-producing countries between 1973 and 1975 and substantial borrowing, there is little doubt that both the total volume of debt and the average debt service ratio of such countries increased significantly between 1973 and 1975.

4/ International Financial Statistics, Vol. XXVIII, No. 12 (December 1975).
5/ IMF Survey, Vol. 4, No. 20 (28 October 1975).

The situation in OECD countries

An immediate and sharp upturn in economic activity in the industrial countries would help alleviate the economic problems facing the developing countries. However, one year ago OECD predicted that such an upturn would begin in mid-1975, with an over-all growth rate of 3 to 3.5 per cent in OECD countries for 1975. In fact, this upturn has so far failed to materialize, and there are still doubts about when worthwhile recovery will begin. The recession in 1974 and 1975 has been the deepest since the Second World War. In the first quarter of 1975, industrial production was below its previous peak by some 20 per cent in Japan, 10-15 per cent in the United States, the Federal Republic of Germany, France and Italy, and 5 per cent in the United Kingdom.

There were definite signs of recovery in the United States and in the Federal Republic of Germany in the third quarter of 1975. Among other European countries, the outlook for the United Kingdom and Italy is especailly doubtful; these countries will join the recovery only belatedly when it does occur.

There are at least four reasons for the slowness in the upswing. First, there are still large inventories in most countries, and it will be some time before these are worked off and the accelerative effects of inventory build-ups begin to be felt. Secondly, consumer demand is still weak in spite of fiscal stimuli in a number of countries. For example, the Federal Republic of Germany instituted expansionary fiscal reform and a reflationary programme (equivalent to $1\frac{1}{2}$ per cent of GNP) at the end of 1974, while the tax reduction package in the United States was intended to add some 2 per cent to the disposable income of households in 1975. A policy shift favouring hard-hit sectors such as construction was instituted in Japan, and selective measures in France were designed to pump $US 7 billion into the economy. Consumer demand, however, is a function of consumer attitudes as well as disposable income, and it is unfortunate that the inflation and unemployment pictures are so blurred that much of the increase in disposable income has been going into precautionary savings.

Thirdly, as the slack residential construction market testifies, monetary policy, although easing, has been too cautious to have much effect yet on final demand. As interest rates rise or fall, there is a natural tendency to hold off major investment in the hope that the rise will be of a temporary nature or that the fall will continue.

Fourthly, because of considerable unused industrial capacity in most countries, business fixed investment has been slack. Nor are the immediate prospects for this sector very bright, given the behaviour of other final demand components. In spite of measures to encourage investment in many countries, there remains little hope for an expansion of demand from this sector until at least mid-1976.

Recent OECD forecasts are that GNP in the United States and Japan may grow by $5\frac{3}{4}$ per cent and $4\frac{1}{4}$ per cent respectively between 1975 and 1976, with an increase of some 3 to $3\frac{1}{2}$ per cent for France and the Federal Republic of Germany. But the GNP of the other OECD member countries in Europe will rise by less than 2 per cent, with especially low growth rates in the United Kingdom and Italy, basically because of balance-of-payments difficulties and continuing high rates of inflation. Overall, the GNP of the major OECD countries could increase by 4 per cent in 1976 compared with a decline of 2 per cent in 1975.

Total unemployment in the OECD area (seasonally adjusted) was about 15 million in May 1975, or more than double the level at the peak of the previous business cycle. The slow rate of recovery may be consistent with some further increases in unemployment to start with, and little if any reduction in the numbers out of work over the period to May 1976. A major influence on employment has been the desire of most countries to resist expansionary monetary and fiscal policies in order to contain inflationary pressures.

The recession has contributed to some moderation in the rate of inflation in OECD countries, which reached a peak of 15 per cent in the last quarter of 1974. It has now fallen to an annual rate of about 10 per cent, although there is wide variation among individual countries. Wage pressures have been alleviated somewhat due to the recession, but they can be expected to revive vigorously even with a moderate recovery. In a number of countries, sharp increases in nominal wages in the first half of 1975 still have to work their way through the system. In view of all these factors, the inflation rate for the OECD area as a whole, which had been expected to level off at around 8 per cent by the end of 1975, was still over 9 per cent in October.

In general, prospects for 1976 are not good. Previous forecasts have been over-optimistic. The combined real GNP of the seven major OECD countries was expected to increase marginally in the second half of 1974 and continue stagnating in the first half of 1975; in fact, output is now estimated to have fallen by over 1 per cent (at annual rates) in the second half of 1974 and by about 5 per cent in the first half of 1975. The OECD economy entered 1975 with activity on a more steeply declining trend than expected. The extent and geographical spread of the decline are unlike anything recorded in the post-war period. The margin of unutilized resources including industrial capacity and manpower is not expected to decline until mid-1976. All this augurs ill for African and other developing countries.

The effect on world trade

The continuing recession and concurrent weakness of import demand in the developed market economies has had a widespread dampening effect on world trade in 1975. The volume of world trade is actually expected to fall for the first time in 30 years, having risen by 13 per cent in 1973 and 5 per cent in 1974.

The volume of OECD trade (about 70 per cent of world trade) fell by about 10 per cent at annual rates in the first half of 1975 compared to the second half of 1974.

The only segment of world trade still expanding vigorously in the first half of 1975 was the flow of imports into the major oil-exporting countries in response to their continuing high level of investment activity. The flow of imports into the non-oil-producing developing countries was sustained through to the end of 1974, but has fallen in volume terms in 1975 because of lower export earnings.

The terms of trade in 1975 have been characterized by moderately falling prices of petroleum for African producers up to the end of September, a slight hardening of commodity prices in July after a steady decline during the first six months, and continuing but easing upward movements in the prices of manufactured goods. Consequently, the terms of trade of OECD countries improved in 1975, having declined by 2 per cent in 1973 and 11½ per cent in 1974. The oil-exporting countries experienced terms-of-trade losses in the first half of 1975, but these represented only a fraction of their gains in 1973 and 1974. The non-oil-producing developing countries have experienced losses which have completely reversed their gains in 1973 and the first half of 1974.

The uneven character of both volume changes and terms-of-trade shifts has been reflected in altered patterns of current account balances in 1975. The most surprising development has been a current account surplus of some $US 10 billion (at annual rates) for the seven major OECD countries during the first quarter of 1975, compared with a deficit of some $US 20 billion in the second half of 1974. Import demand declined much faster than expected, and the oil-exporting countries have absorbed more of their surpluses than was thought possible. About half of this shift occurred in relation to OPEC countries, one quarter with the smaller OECD countries, and the remainder with the non-oil-producing developing countries.

For the OECD countries as a whole, the current account deficit declined to about $US 5 billion (at annual rates) in the first half of 1975, but there were large disparities between countries. On the assumption of a moderate recovery in the second half of 1975, this deficit was expected to widen again to about $US 15 billion (including official transfers), compared to $US 34 billion in 1974.

The OPEC surplus was expected to be reduced by some $US 20 billion, to $US 47 billion in 1975, but the final result for the year is likely to be much lower. By any standards, the non-oil-producing developing countries have been hardest hit by the current recession and inflation. After a deterioration of some $US 12 or 13 billion in 1974, their current account deficit (including official transfers) was expected to widen by another $US 5 billion to $US 22 or 23 billion.

Table A-1. World current account (in billions of United States dollars)

A = Trade balance; B = Current balance, excluding official transfers; C = Current balance, including official transfers.

	1973	1974	1975 a/		1973	1974	1975 a/
O E C D :				**Non-oil-producing developing countries:**			
A -	7½	-26½	-3	A -	-3½	-16½	-22
B -	10	-24½	-4	B -	-11	-25½	-32
C -	2½	-34	-15	C -	-5	-17½	-22½
Oil-exporting countries :				**Other countries b/:**			
A -	19	82	60	-	-6	-12	-14
B -	3	69	49	B -	-4	-11	-13
C -	3½	67	47	C -	-4	-10½	-12½

Source: OECD Economic Outlook 17 (Organization for Economic Co-operation and Development, Paris, July 1975), table 24.

a/ Estimates. b/ "Sino-Soviet area", South Africa, Israel, Cyprus, Malta and Yugoslavia.

The accuracy of the estimates for 1975 in table A-1 will depend on the extent of the forecast recovery in OECD countries in the second half of 1975, on how much import demand revives, and on the extent to which non-oil-producing developing countries can finance their current account deficits. On the assumption of a weaker recovery, IMF has forecast a current account deficit (excluding official transfers) of $US 35 billion for the non-oil-producing developing countries in 1975, compared with an OECD forecast of $US 32 billion. What is clear is that the non-oil-producing developing countries are currently facing serious balance-of-payments problems.

As a group, the non-oil-producing developing countries had no acute financing problems in 1974 because they started the year with relatively high reserves and because the effects of the recession in the developed market economy countries did not have an immediate impact. However, the sheer size of the expected deficits in 1975 and 1976 does raise the question of how they can be financed. At best, many developing countries will have to contemplate some considerable reduction in their net reserves and some scaling down of development programmes. Countries whose reserves are low in relation to their needs have had to face up to substantial import cuts, with an emphasis on non-essential and luxury items.

The size of the deficit also suggests that the much heralded world economic recovery might be further away than some Governments believe. As several

speakers at the thirthieth joint Annual Meeting of Governors of the International Monetary Fund and the World Bank Group pointed out, the plight of the non-oil-producing developing countries is a threat to recovery in the industrial countries. "If developing countries are not assisted by demand expansion in the industrial countries and by increased aid allocations, their attempts to restore their balance of payments would merely further depress world trade." 6/

The special situation of the non-oil-producing developing countries

Although the current economic situation on the non-oil-producing developing countries has had an immediate primary impact on their balance of payments and terms of trade, the long-term effects are more likely to be felt in the implementation of development plans, resulting in lower levels of fixed investment and imports and lower or negative rates of real growth. Because of a levelling-off or decline in their export earnings and increases in import prices, larger and larger current account deficits have been necessary in order to maintain imports commensurate with previous rates of growth.

The speed and size of the turn-around in their balance of payments has created unusual problems of domestic financial management for the non-oil-producing developing countries. In 1973 and early 1974, many countries with adequate foreign exchange reserves deployed a variety of monetary and fiscal instruments to contain inflationary pressures. These included upward floating or revaluation of their currencies, liberalization of import restrictions and subsidies on consumer goods. In 1975, faced with dwindling foreign exchange reserves and declining Government revenues, most Governments have resorted to direct controls on non-essential imports and substantial deficit financing to mitigate the worst effects of the world recession. However, these policies, by creating new liquidity at a time when real resources available to the economy have been small, have on the whole added to inflationary pressures.

Growth prospects for the non-oil-producing developing countries, particularly those in Africa, have worsened. Per capita real incomes probably rose little and may have declined in 1975 in the low-income countries, in spite of an improvement in agricultural production following the return of normal rains in most drought-affected countries. They are not expected to rise significantly for the remainder of this decade without special assistance. Real growth in some middle-income and higher-income non-oil-producing developing countries was positive over the same period, due in large part to their ability to borrow substantial amounts from foreign commercial sources or their success in gaining access to special aid funds.

The major economic events in the last few years have highlighted the growing disparities among developing countries. Before 1974, some had been

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6/ R. J. Tizard, Minister of Finance of New Zealand, quoted in IMF Survey, Vol. 4, No. 17 (15 September 1975), pp. 274-275.

drawn into the expanding markets of the industrial countries, received large inflows of capital and experienced high rates of growth. These countries benefited most from the 1972-1974 boom. But half of the third world, the least developed among them, were bypassed. No countries have been unaffected by the resultant inflation and subsequent recession: the middle-income and higher-income countries now need to re-orient their economic structures in line with higher import prices, while the least developed countries - those which are disaster-prone and on the margin of subsistence - have very special problems. They are characterized by unfavourable export structures which severely limit the possible adjustments they can make to deficits in their balance of payments, and are largely reliant on external financing on concessional terms for their development. Any shortages of essential imports would threaten not only their development but also the very low standard of living of the people.

II. THE SEARCH FOR A NEW INTERNATIONAL ECONOMIC ORDER

The major economic events of the past two years have brought in their wake the most thorough reappraisal of international economic and financial relationships since the Second World War.

Although discussions on the restructuring of the international economic order have been taking place at least since the collapse of the Bretton Woods system in August 1971, they did not begin in earnest until the last quarter of 1973. The increase in the price of petroleum, dramatically illustrating the inequities in the old order and shifting the balance of economic power, marked the true beginning. Since that time, reform has been discussed in many world forums including the United Nations General Assembly, FAO, UNIDO, UNCTAD, IMF and the World Bank Group.

The first concern of the international community was the financial plight of the developing countries, especially the poorest among them. This concern resulted in the establishment, inter alia, of the United Nations Emergency Operation to channel resources to the most seriously affected countries and the IMF oil facility to help those experiencing severe balance-of-payments problems. The second concern has been the re-evaluation of the flow of long-term development assistance to developing countries. There is growing recognition that flows of assistance in the past have been inadequate for meaningful development except in a few countries, that the distribution of aid has failed to correspond to real needs, and that the terms and conditions of aid have been too hard. The third concern has been the whole tenor of relations between the developed and developing countries, and the urgent need for the developing countries to receive fair treatment in international trade. The climax so far in this respect has been the seventh special session of the United Nations General Assembly held from 1 to 16 September 1975. With the conclusion of this session, it is now possible to detect the outlines of an emerging consensus.

Emergency assistance 1/

While recognizing that long-term measures are required to promote the capacity of those countries most seriously affected by current economic conditions to produce and earn more, international community has had as one of its pressing tasks in 1974 and 1975 that of providing emergency relief.

1/ Major sources:

(a) "United Nations Emergency Operation: Report of the Secretary-General" (A/10201).

(b) IMF Survey, Vol. 3, No.12 (17 June 1974), Vol.3, No. 17 (2 September 1974), Vol. 4, No. 7 (14 April 1975) and Vol.4, No.12 (23 June 1975).

In resolution 3202(S-VI), adopted on 1 May 1974, the General Assembly requested the Secretary-General to establish a United Nations Emergency Operation to provide relief to the most seriously affected countries. The gravity of the situation was underlined by the initial identification on 2 August 1974 of 32 such countries, 21 of which are in Africa. In December 1974 and May 1975 10 more countries were added, bringing the total to 42 countries, including 27 in Africa.

The countries were selected by an interagency technical group composed of representatives of the World Bank, IMF, FAO, UNCTAD, and UNDP using the following criteria: those countries whose projected balance-of-payments deficit for 1974 and 1975 was at least 5 per cent of their projected imports in each year, and whose GNP per capita was less than $US 400 in 1971.

The preliminary estimate of the aggregate financing gap for the original 25 most seriously affected countries was $US 2.2 billion in 1974. Amidst worsening terms of trade and the prolonged recession in OECD countries, this was revised to $US 2.7 billion. The situation worsened in 1975. Revised estimates show a financing gap of $US 3.6 billion for the original 25 countries and $US 4.4 billion for all 42 most seriously affected countries.

The Emergency Operation was concerned basically with co-ordinated mobilization of special assistance from all potential sources. Since its inception, total commitments of emergency assistance have amounted to approximately $US 5 billion; by the end of June 1975, actual disbursements totalled about half this amount. Assistance has taken the form of outright grants, loans on concessional terms, debt relief, cash, general programme aid, and supplies of essential commodities including food, fertilizers and fuel. Major contributors (on a commitment basis) include the OPEC countries, with about $US 3.5 billion both bilaterally and multilaterally, the United States with about $US 925 million, and EEC with $US 625 million. Actual contributions to the Secretary-General's Special Account to finance essential imports amounted to about $US 270 million by June 1975.

The United Nations Emergency Operation has met only part of the requirements of the most seriously affected countries. Additional assistance has also been provided under the IMF oil facility both in 1974 and 1975. The oil facility was set up on 13 June 1975 specifically to help IMF member countries cope with the impact on their balance of payments of increases in the cost of petroleum and petroleum products. The facility was opened for drawings on 22 August 1974, following the announcement of financial arrangements with seven lenders. Total drawings in 1974 amounted to SDR 2.5 billion, of which SDR 650 million went to the most seriously affected countries.

In response to the continuing need for emergency balance-of-payments assistance arising from higher oil prices, IMF decided on 4 April 1975 to extend its oil facility for a second year. On 10 June it announced financial

arrangements with eleven lenders, thus clearing the way for drawings. On 7 August, it decided to open a Subsidy Account to help the most seriously affected countries meet the cost of using the facility by reducing interest charges. As of 15 October, total drawings under the facility by 19 member countries amounted to SDR 1 560 million.

Although interest charges on outstanding drawings under the oil facility are about 7¾ per cent, which is by no means concessional, the facility has filled a definite need by providing quick assistance for relieving balance-of-payments problems. One of the major drawbacks of the United Nations Emergency Operation has been the lag of varying duration between commitments and actual disbursements by most Governments and institutions other than IMF.

Long-term development assistance 8/

The organization of emergency assistance during 1974 and 1975 has temporarily overshadowed the greater long-term needs for development aid. It has not, however, suspended discussions concerning the real volume of long-term aid, its distribution, and its terms of transfer.

Between 1963 and 1973, official development assistance (ODA) from the countries members of the Development Assistance Committee (DAC) of OECD to developing countries and multilateral agencies increased from $US 5 772 million to $US 9 408 million. 9/ However, when adjusted for inflation and currency realignments, this reflects a decline of 7 per cent in real terms over the period, most of which occurred in 1973. As a percentage of the GNP of the DAC countries, it represents a fall from 0.51 per cent in 1963 to 0.30 per cent in 1973.

Total net flows of resources from the DAC countries, including private and other official flows, increased from $US 8 572 million in 1963 to $US 24 429 million in 1973, an increase of 69 per cent in real terms. Total flows in relation to the GNP of the donor countries have remained stationary

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8/ Major sources:

(a) Development Co-operation: 1974 Review (Paris, Organization for Economic Co-operation and Development 1974).
(b) "Foreign aid and development needs" (E/AC.54/L.80).
(c) Robert S.McNamara, Address to the Board of Governors 1 Sept.1975 International Bank for Reconstruction and Development.

9/ Total net transfers to developing countries on the external public debt account rose from $US 6 831 million to $US 12 738 million between 1967 and 1973. (See Annual Report 1975: Washington, International Bank for Reconstruction and Development, 1975, table 8).

over the period, fluctuating between 0.71 per cent in 1966 and 0.81 per cent in 1971. These figures do not include Euro-dollar lending from or through the DAC countries, which is estimated at $US 10 billion in 1973. Hence total financial flows to the third world in 1973 were of the order of $US 34 billion, or well over 1 per cent of DAC members' GNP. The achievement of this target has limited implications for developing countries, since an important part of these resources is provided on non-concessional terms. It is for that reason that recent discussions have concentrated on the ODA target of 0.7 per cent of GNP, which is still a long way from being achieved.

Table B - 1. Net flow of resources from DAC countries to developing countries and multilateral agencies, 1963-1973 (in millions of United States dollars)

	1963	1967	1971	1972	1973
Net official development assistance - -	5 772.4	6 511.6	7 776.0	8 671.5	9 408.0
- In constant 1970 dollars a/ -	6 847.4	7 067.5	7 253.7	7 361.2	6 280.4
- In proportion to GNP	0.51%	0.42%	0.35%	0.34%	0.30%
Net other official flows -	243.2	518.5	1 277.9	1 581.5	2 587.0
Net flow of private capital	2 556.7	4 381.1	8 983.4b/	9 654.7b/	12 433.8b/
Total net flows -	8 572.3	11 451.4	18 037.2b/	19 907.8b/	24 429.0b/
- In constant 1970 dollars a/ -	10 168.8	12 597.8	16 936.3	17 176.6	17 179.3
- In proportion to GNP	0.76%	0.73%	0.81%	0.78%	0.79%

Source: Development Co-operation: 1974 Review (Organization for Economic Co-operation and Development, 1974, Paris), Statistical annex, tables 1-11.

a/ Includes the effect of parity changes. b/ Including grants by private voluntary agencies.

Comparable data on financial flows from the centrally planned economies are not available. However, bilateral aid commitments of these countries are estimated to have increased from $US 1.3 billion in 1970 to $US 2.4 billion in 1973. Disbursements have been smaller than corresponding commitments in the past.

The net flow of financial resources from all OPEC countries to other developing countries is estimated to have increased, at current prices, from $US 650 million in 1970 to $US 1.35 billion in 1973 and $US 4.75 billion in

1974. The corresponding net flow of official development assistance is estimated at $US 380 million in 1970, $US 530 million in 1973 and $US 2.54 billion in 1974, the latter representing 1.8 per cent of GNP in 1974.

One encouraging sign in the aid picture has been the improvement of the terms of ODA from DAC countries. By 1973, 13 of the 17 DAC members had terms above the DAC target of an 84 per cent grant element; average terms for all DAC aid reached the 87 per cent target in that year. However, since the proportion of ODA in total net flows declined considerably between 1963 and 1973, the terms of over-all flows have hardened and the debt service burden of developing countries has increased accordingly.

Table B - 2. Distribution of gross disbursements of ODA from developed market economies and multilateral institutions to developing countries

Recipient group of countries a/ in GDP per capita	Number of countries	Population in 1971	Disbursements (1971)		
			Bilateral	Multilateral	Total
	No.	Per cent	Percentage of total		
1. Less than $US 100	23	45.6	22.6	35.2	24.2
2. $US 100-199 - -	27	23.4	26.6	29.2	26.9
3. $US 200-399 - -	35	13.8	34.0	23.7	32.8
4. $US 400-799 - -	22	13.4	6.1	8.0	6.3
5. $US 800 or more -	23	3.7	10.7	3.9	9.9
All developing countries and areas	130	100.0	100.0	100.0	100.0

Source: "Foreign Aid and Development Needs" UN Economic and Social Council document E/AC.54/L.80 , tables 1 and 2.

a/ Countries and territories are grouped according to GDP per capita in 1971.

The distribution of development assistance remains highly uneven in relation to needs. Bilateral aid from the developed market economies tends to go to the middle-income and higher-income developing countries rather than to the low-income group, mostly situated in Africa. Although multilateral aid shows a more rational distribution in relation to needs, table B-2 shows that the 23 countries with a per capita income of less than $US 100 in 1971, with 45.6 per cent of the population of the third world, received only 24.2 per cent of total ODA. In contrast, the 27 countries with a per capita income of $US 100-199 received 26.9 per cent of total ODA, and the 35 countries with a per capita income of $US 200-399 32.8 per cent - both higher than their share of the total population of developing countries. The large poor countries

simply do not receive as much aid in proportion to their needs as the smaller richer countries.

The current economic situation has added a transitory component to the foreign capital requirements of developing countries in addition to the more traditional external capital supplement to domestic savings. Taking into account changed economic circumstances, the World Bank has estimated the potential per capita growth rates of non-oil-producing developing countries for the remainder of the 1970s on the basis of steady flows of development assistance in real terms, and the total additional requirements that would be needed to reach the targets of the Second Development Decade. These are shown in table B-3.

Table B - 3. Annual GDP growth rates, per capita, in oil-importing developing countries and related capital flows in billions of dollars

	Annual average 1969-1973	1974	1975	Average projected 1976-1980 Case I a/	Case II b/
Growth rates (in percentages)					
Low-income countries c/ -	0.5	-0.5	-0.7	1.2	3.2
Middle-income countries c/-	4.5	3.9	-1.2	2.8	3.8
Capital flows (in millions of United States dollars)					
Net official capital -	7.9	15.0	19.8	24.0	35.2
Private capital - -	7.5	19.4	22.9	25.4	26.5
Total	15.4	34.4	42.7	49.4	61.7
Official development assistance as a percentage of donor GNP					
OECD - - - -	0.34	0.33	0.32	0.29	0.48d/
OPEC - - - -	0.00	1.41	2.57	1.56	1.56

Source: Robert S. McNamara, Address to the Board of Governors (Washington, International Bank for Reconstruction and Development, 1975), pp. 5 and 6.

a/ Case I data assume substantial growth in capital flows in nominal terms between 1975 and 1980, but no increase in real terms. They assume also that the industrialized countries will make a relatively rapid recovery from the current recession.

b/ Case II data represent an estimate of what the additional capital requirements would be to raise income growth for the oil-importing developing countries to the Second Development Decade targets, at least for the remaining years of the Decade.

c/ The population of the low-income developing countries totals 1 billion, and of the middle-income developing countries 725 million. The statistics do not include nations which are not members of the World Bank.

d/ For official development assistance to average 0.4 per cent of GNP from 1976-1980 would require a 1980 level of at least 0.70 per cent.

On the basis of unchanged capital inflows in real terms (Case I, table B-3) the GDP of low-income countries is projected to grow at 1.2 per cent a year per capita for the remainder of the 1970s while the GDP of middle-income countries is expected to grow at 2.8 per cent. In order for both sets of countries to reach their per capita income target for the Second Development Decade (Case II in table B-3), net official capital flows would have to increase from an expected $US 24.0 billion to $US 32.5 billion a year between 1976 and 1980. The major increase will have to come in the form of concessional aid, as developing countries cannot borrow sufficient sums from private capital markets because of the limits to their credit-worthiness.

In an attempt to increase the flow of resources to middle-level and lower-level countries on more concessional terms, the Development Committee of the World Bank and IMF, meeting on 12 and 13 June 1975, unanimously agreed to set up a "Third window" in the Bank, starting on 1 July 1975. This is the fruit of almost two years of discussions. Although the facility is specifically designed to assist middle-level countries with per capita incomes between $US 200 and $US 375 on terms intermediate between those of the Bank and those of IDA, the poorest countries will also feel benefit in terms of greater IDA flows available specifically to them. In practice, the "third window" represents a 4 per cent interest subsidy on loans from the World Bank to such countries. So far, nine industrial and oil-exporting countries have committed funds sufficient to subsidize $500 million worth of "third window" loans. 10/

10/ IMF Survey, Vol. 4, No. 12 (23 June 1975) and Vol. 4, No. 15 (11 August 1975).

The sixth and seventh special sessions of the United Nations General Assembly 11/

A special session of the General Assembly on economic problems was first proposed at the fourth Conference of Heads of State and Government of Non-aligned Countries, held in Algiers in September 1973. The United Nations General Assembly endorsed the proposal later that year and scheduled the session for 1975. Shortly afterwards, however, in early 1974, the Assembly decided at short notice to hold a session devoted to raw materials and development. This sixth special session met in April and May 1974 and produced the now famous Declaration and Programme of Action on the Establishment of a New International Economic Order.

The world economic order to date has been based on an international division of labour in which 70 per cent of the world is relegated to the position of suppliers of raw materials in exchange for finished products, thus participating little in the high value-added activities of processing and manufacture. The international monetary system has been tailored to the needs of the developed countries, allowing inflationary trends to affect not only their domestic economies but also the terms of trade whereby raw materials and primary products are traded for manufactured goods. These terms of trade have continued to deteriorate despite occasional improvements, such as those which occurred at the beginning of the 1950s or more recently in 1973 and the first half of 1974. There has been little price support in the world market for primary commodities, in marked contrast to systems operating in the domestic markets of the developed countries in favour of their own farmers. In short, the old economic order has been marked by the perpetuation of inequalities in economic relations, foreign domination, exploitation and lack of effective solutions both at the domestic and international level to the basic problems of developing countries.

The General Assembly, at its sixth special session, declared that the new international economic order should be based, inter alia, on full

11/ Major sources: (a) General Assembly resolutions 3201(S-VI) and 3202(S-VI), "Declaration and Programme of Action on the Establishment of a New International Economic Order;" (b) General Assembly resolution 3362(S-VII) on development and international economic co-operation; (c) "Position paper of the Group of 77"[A/10003/Add.1 (Part I), annex I]; (d) "Development and international economic co-operation: position paper of the European Economic Community and its member States" (A/AC.176/2); and (e) "Development and international economic co-operation: Informal working paper submitted by the United States of America for negotiating purposes" (Ad hoc Committee of the Seventh Special Session, agenda item 7, working paper No. 10 and Corr. 1).

permanent sovereignty of every State over its natural resources and their exploitation, including the right to nationalization or transfer of ownership to its nationals; a just and equitable relationship between the prices of raw materials and primary products exported by developing countries and the prices of manufactures, capital goods and equipment imported by them; preferential and non-reciprocal treatment for developing countries, wherever feasible, in all fields of international economic co-operation; access for developing countries to the achievements of modern science and technology; and strengthened economic, trade, financial and technical co-operation among developing countries, including the establishment of producers' associations to improve their bargaining power vis-à-vis the developed countries.

Events in the past year and a half have shown that the Declaration and Programme of Action are likely to prove one of the most important bases for future economic relations among countries. The process started at the sixth special session has continued in such international forums as the Conference of Developing Countries on Raw Materials, held in Dakar from 4 to 8 February 1975, the Second Ministerial Meeting of the Group of 77, held in Algiers from 15 to 18 February 1975, the Second General Conference of the United Nations Industrial Development Organization, held in Lima from 12 to 26 March 1975, and the Conference of Ministers for Foreign Affairs of Non-aligned Countries, also held in Lima from 25 to 30 August 1975. The seventh special session of the General Assembly, by focusing on a limited number of issues on which agreement was near, marked a step forward in these consultations.

In all, the seventh special session dealt with seven topics in the field of development and international economic co-operation -- international trade, the transfer of resources and international monetary reforms, science and technology, industrialization, food and agriculture, co-operation among developing countries, and the reform of the structure of the United Nations system -- but it concentrated most of its efforts on the first two topics. Industrialization had already been discussed extensively at the Second General Conference of UNIDO, and food and agriculture at the World Food Conference held in Rome in November 1974.

It will take more than one special session to convert proposals into the kind of effective action which will change the old economic order and the outlook for developing countries in the new order. Yet the seventh special session represented a conceptual breakthrough. The debate was raised to a high level. There was a unity of purpose among the three major groupings -- the Group of 77, EEC, and the United States -- which was missing from, for example, the sixth special session. Further concrete discussions were to continue in the consumer-producer forum starting in Paris in December 1975, in IMF, in the World Bank Group, and at the fourth session of UNCTAD, to be held in Nairobi in May 1976.

If the final resolution adopted at the seventh special session did not represent a new international economic order, it did represent an expression of political will to create one. It brings together the industrialized nations and the third world in an unprecedented way. There was something concrete for everyone. For the United Nations, two organizations -- UNCTAD and UNIDO -- came away considerably strenthened as recognized forums for further serious discussions. For Africa, the resolution contained many references to the special problems of the least developed, land-locked and island developing countries and the special needs of the most seriously affected countries, of which the majority are in Africa. The third world remains a group of developing nations, but there is growing recognition of the different needs of different countries at different stages of development.

Discussions on international trade negotiations

The special sessions gave renewed impetus to discussions in the field of international trade. On the subject of the multilateral trade negotiations within GATT, the Tokyo Declaration of 14 September 1973 listed a number of objectives and procedures intended to favour developing countries, but its initial implementation had begun to raise doubts as to whether the negotiations would in the end bring about much improvement in trading conditions for developing countries. Most developed countries have now enacted a generalized system of preferences towards developing countries, but these have been restricted in application by conditions concerning product coverage, the level of ceilings, the degree of preference and the size of preferential tariff quotas. UNCTAD has proposed an integrated approach to commodities including international buffer stocks, initially for 18 and more recently for 10 key commodities, but has not yet been able to secure high-level agreement necessary for the implementation of its programme.

There have been some positive developments in the past year. Perhaps the most significant has been the Lome Convention between EEC and 46 African, Caribbean and Pacific (ACP) countries which grants duty-free access to EEC for a wide range of industrial products originating in the ACP countries, sets up a modest compensatory financing scheme to stabilize export earnings, and provides for expanded technical and financial aid for industrial development. Associations of countries producing primary products are fast becoming an accepted part of the new world order, and there have been discussions and arrangements affecting a substantial number of commodities.

Against this background, the General Assembly debated three major issues: the regulation of raw material and commodity markets with a view to combating the adverse effects of economic disorders transmitted from developed countries; expansion and diversification of developing countries' exports; and access to developed countries' markets for developing countries' exports. It was generally accepted that developing countries needed to be insultated from the

adverse effects of economic disorders such as inflation and recession transmitted from developed countries. Disagreement arose over how this could be accomplished. The final text was a compromise. There was a commitment "to preserve the purchasing power of developing countries," but there was no outright commitment to indexation or to buffer stocks. Rather, the developed countries agreed to study those proposals sympathetically and urgently. The implicit moral commitment was sufficiently strong to prompt one major industrial country to express reservations, disassociating itself from what it clearly regarded as the beginning of the road to a non-market economy.

All parties agreed that the ultimate defence against dramatic changes in the purchasing power of the developing countries was the expansion and diversification of their exports, more domestic processing of their raw materials, and greater involvement in the transport, marketing, and distribution of their primary commodities. Developed countries made a commitment to assist the developing countries through efforts "towards expanding and diversifying their trade, improving and diversifying their productive capacity, improving their productivity and increasing their export earnings."

All parties agreed that developing countries should have greater access to the markets of developed countries. Developed countries made a commitment to reduce or remove tariff and non-tariff barriers affecting products of export interest to developing countries, to extend the Generalized System of Preferences beyond 1980, to seek differential and more favourable treatment for developing countries in the multilateral trade negotiations within GATT, and to abide by the principle of standstill as regards imports from developing countries.

Discussions on transfer of real resources for financing the development of developing countries and international monetary reforms

There were many developments in this field in the past year prior to the special session. The establishment of the oil facility in IMF and the "third window" in the World Bank have already been referred to. Ministers of OECD countries meeting in Paris on 9 April 1975 agreed to set up a financial support fund of SDR 20 billion to serve as a safety net for member countries with payments difficulties and assist its members to avoid unilateral measures that would restrict international trade or artificially stimulate exports.[12] On 29 May, the ministers reaffirmed their commitment of 1974 to avoid recourse to new restrictions on trade so as not to disrupt further the exports of developing countries.[13]

12/ IMF Survey, Vol. 4, No.7 (14 April 1975).

13/ Idem., No.11 (9 June 1975).

The thirtieth joint Annual Meeting of the Governors of IMF and the World Bank Group, held from 1 to 5 September 1975, produced an important step forward in efforts to reform the international monetary system.[14] The Governors agreed to reduce the role of gold as a central reserve asset in the international monetary system. All references to gold would henceforth be removed from the Fund's Articles of Agreement, so that countries would no longer be required to use gold in any transactions with the Fund. The official price of gold would be abolished. A sixth of IMF's gold (25 million ounces) would be returned to member countries; another sixth would be sold on the free market for the benefit of developing countries. Expected profits from the sale could be about SDR 2 billion. No decision has yet been made on the remaining 100 million ounces.

The Governors also agreed to increase the resources of the Fund by about 32.5 per cent to SDR 30 billion, with oil-exporting countries doubling their voting strenth from 5 to 10 per cent.

The major remaining issue still to be solved in the Fund's evolutionary approach to international monetary reform is the exchange rate system. Some progress here should be made at the next meeting of the Interim Committee in January 1976. There is now almost unanimous agreement both inside and outside the Fund that SDRs should become the basic unit of account in the international monetary system.

Against this background of events, the General Assembly debated four major issues: development assistance targets, the long-term flow of development finance, special assistance to the poorest countries, and the debt burden of developing countries.

The Group of 77 pressed for a specific commitment by developed countries to transfer official development assistance (ODA) equal to 0.7 per cent of their gross national product net of all reverse flows by 1978. This target had been set in the International Development Strategy in 1971. Developing countries received a limited commitment to the 0.7 per cent target by 1980, but not all developed countries accepted the target.

To increase the flow of long-term development assistance, the General Assembly discussed automatic transfers such as the SDR link, greater access for developing countries to capital markets in the developed countries, and expanded roles for multilateral institutions and regional development banks. Agreement that the link between SDRs and development assistance "should form part of the consideration by the International Monetary Fund of the creation of new special drawing rights as and when they are created"was a compromise which enabled the special session to end when it did. All parties supported the idea of a trust fund within IMF, financed partly through gold sales and partly through voluntary contributions, to provide balance-of-payments assistance and export earnings stabilization at subsidized rates. To increase

14/ Idem., No. 17 (15 September 1975).

developing countries' access to the capital markets of the developed countries, the General Assembly welcomed the United States proposal for the establishment of an international investment trust to increase the flow of private resources to developing countries. However, EEC felt that where possible existing institutions should be expanded rather than new institutions created. The General Assembly agreed that the capital of the World Bank Group should be enlarged. The United States also felt that the roles of regional development banks such as the African Development Bank, the Inter-American Development Bank and the Asian Development Bank should be expanded.

With respect to the poorest countries, the General Assembly agreed that special attention should be given to improved terms and conditions for the transfer of resources, including a large grant element, to the least developed, land-locked and island developing countries, and that special measures should be undertaken to assist those countries most seriously affected by current economic disorders.

In spite of an initiative by Sweden, the burden of debt on developing countries received less attention than it should have. The idea of a debt moratorium for the least developed and/or most heavily burdened encountered heavy opposition. The Group of 77 did gain acceptance of the need for a conference of major donor, creditor and debtor countries to devise ways and means of mitigating the burden, but it is unlikely that such a conference will be held until well into 1976.

Discussions on science and technology

All countries recognized the need to improve the transfer of technology to and the development of indigenous technology in developing countries. However, the developed countries stated that they were faced by several restrictive factors in the world market for technology. Most technology in developed countries is in private hands, and is currently transferred through the medium of transnational corporations. International conventions on patents and trade marks are ill-suited to the smooth flow of technology to developing countries.

To enhance the flow of technology, developed countries agreed first of all to contribute to the establishment of an industrial technological information bank, as well as regional and sectoral banks where desirable. Secondly, they agreed to give developing countries "the freest and fullest possible access to technologies whose transfer is not subject to private decision." Thirdly, they agreed to co-operate in evolving an international code of conduct for the transfer of technology and in revising international conventions on patents and trade marks to meet the special needs of the developing countries. The Group of 77 pressed for a code of conduct which would make transfers mandatory, but met serious opposition from the developed countries.

The development of indigenous technology is just as important if not more important than the transfer of technology from developed countries. To this end, developed countries agreed to expand their assistance for direct support to developing countries' science and technology programmes. They also agreed that a United Nations Conference on Science and Technology for Development should be held in 1978 or 1979 with the main objective of strengthening the technological capacity of developing countries to enable them to apply science and technology to their own development.

Discussions on industrialization

Since the Second General Conference of UNIDO had been held in March 1975, the General Assembly spent relatively little time on industrialization except to urge wider acceptance of the decisions taken in Lima and to review what action had been taken so far. The Assembly endorsed the Lima Declaration and Plan of Action on Industrial Development and Co-operation, and requested all Governments to take effective action to implement their undertakings under the Plan of Action. In particular, it endorsed the Lima recommendations that UNIDO should be converted into a specialized agency and that a system of consultations should be established at all levels within UNIDO in order to facilitate the achievement of the goals set forth in the Declaration.

The Group of 77 pressed for a commitment from developed countries to relocate labour-intensive industries in the third world. The developed countries undertook to pursue "policies, including labour market policies, which would encourage the redeployment of their industries which are less competitive internationally to developing countries." However, a major industrial country expressed the reservation that "redeployment of industries should be a matter of the evolution of economies rather than a question of international policy or negotiation."

The developed countries agreed to encourage their own enterprises as far as possible to participate in investment projects in developing countries within the framework of development plans and programmes.

Food and agriculture

The World Food Conference was held in Rome in November 1974 in response to the deteriorating food situation in many developing countries to discuss ways and means of increasing world food production, ensuring a much higher degree of food security, and expanding trade in food products. On the recommendation of the World Food Conference, the United Nations General Assembly, meeting in ordinary session, established the World Food Council in December 1974 to co-ordinate follow-up policies concerning food production, nutrition, food aid, food security, food trade and related matters by all agencies of the

United Nations system. At the regional level, the Council of Ministers of the Organization of African Unity, meeting in Addis Ababa in February 1975, set up an Ad Hoc Working Group to study a proposal for the establishment of an African Ministerial Committee on Food to work in co-operation with the World Food Council and to formulate guidelines for its work. The Working Group has submitted its recommendations to the Administrative Secretary-General of OAU. A meeting of African Ministers of Agriculture will probably be held by February 1976 for the formal establishment of the Committee, which will be charged with monitoring the programmes of member Governments to promote the efficient mobilization of African agricultural resources.

The General Assembly, at its seventh special session, reaffirmed its full support for the resolutions and goals decided upon by the World Food Conference, and for the follow-up action that had already been taken. It was agreed that the solution to world food problems lay primarily in increased food production in the developing countries. To that end, the General Assembly adopted a wide-ranging programme including greater investment by both developed and developing countries in integrated rural schemes in developing countries, improved distribution systems to reduce post-harvest losses and to supply inputs such as fertilizers at reasonable prices, the establishment of an International Fund for Agricultural Development with initial resources of SDR 1 billion, and support for the expansion of national and international agricultural research centres.

Notwithstanding the emphasis on greater production, the General Assembly also recognized the need for expanded food aid on a soft-term basis, especially to the most seriously affected nations. It recognized the need to "build up and maintain world food grain reserves, to be held nationally or regionally and strategically located in developed and developing, importing and exporting countries, large enough to cover foreseeable major production shortfalls." Significantly, the United States promised to double food aid in 1976 and to participate in an international system of nationally held grain reserves.

One negative aspect was, however, the major reservation expressed by the developed countries concerning greater access to their markets for the food and agricultural products of export interest to the developing countries.

Discussions on co-operation among developing countries

It was recognized that this topic was of concern mainly to the developing countries themselves. However, the developed countries were asked to provide funds when requested to strengthen and enlarge co-operation among developing countries at the subregional, regional and interregional levels. The Secretary-General, together with the relevant organizations of the United Nations System, was requested to prepare studies on regional co-operation, including trade liberalization and the transfer of technology between developing countries.

It was agreed that the regional activities of UNCTAD, UNIDO and UNDP should be strengthened.

Discussion on restructuring of the economic and social sectors of the United Nations system

The General Assembly considered inter alia a report by a Group of Experts on the Structure of the United Nations System, entitled A New United Nations Structure for Global Economic Co-operation.[15] In the absence of concrete consensus on this issue, and any determined efforts by major parties, the General Assembly decided to establish an Ad Hoc Committee of the whole to prepare detailed action proposals and report to the Assembly at its thirty-first session in 1976. The United States suggested that 1976 should be dedicated to review and reform of the entire United Nations development system.

It is clear from the descriptive analysis above that progress is being maintained towards the goals adopted in the resolutions of the sixth and seventh special sessions of the General Assembly. However, in view of the economic realities facing ECA member States in 1975, the solutions adopted during the year, including increased aid flows and new commodity arrangements for one or two products, can be looked upon only as temporary palliatives. Whether the move towards more aid funds, some of them of a specialized nature, will bring the total flow of external resources up to the level required by the developing countries of Africa over the next few years is problematical. Thus while some solutions to the current and anticipated financial plight of African countries are in sight, the long-term problems of basic food insecurity, indexation and compensatory financing for shortfalls in export earnings to ensure a positive external trade balance in the face of higher import prices are far from being resolved. Economic growth in developing Africa (other than the oil producing countries) in real terms may have been virtually nil in 1975. Unless there is a fairly rapid restoration of worthwhile growth in the world's industrialized countries, accompanied by more remunerative prices for the major exports from the region, a serious deterioration in the growth prospects for the ECA region non-oil-producing countries as a whole seems unavoidable. It is regrettable indeed that the poorer countries of the world continue to be so adversely affected by the lack of economic foresight and poor management in the industrialized countries.

The move towards a fairer international trade system must be speeded up, and the countries in the region must help themselves as much as possible and reduce their economic dependence on the countries of the developed world by building up their own resources as rapidly as possible. Regional co-operation must be a major economic tool to bring about a relatively rapid transformation, with primary emphasis on developments at the subregional level.

15/ Doc. E/AC.62/9 (United Nations publication, Sales No. E.75.II.A.7).

III. CURRENT ECONOMIC DEVELOPMENTS AND POLICIES IN THE ECA REGION

Commodities and external trade

African developing countries depend a great deal on foreign trade, and the performance in this sector has a very important impact on developments in the domestic sector. Hence it is necessary to begin this review of current economic developments and policies with some discussion of commodities and external trade, in order to throw some light on economic prospects and performance. This is followed by a section on developments in gross domestic product, expenditure on GDP and some information on the individual sectors of the economy. Development aid and fiscal and monetary policies complete the discussion.

The fluctuations in prices on the world commodity markets continued in 1974 and 1975, with peak levels being reached in the second quarter of 1974. In the second half of 1975 the index numbers of commodity prices on the London market place were more than 10 per cent below the level of a year earlier, and those on the New York market showed falls of 20 per cent or more.

The published data on commodities are more uptodate for wholesale prices than for export prices, but the former are in general an approximation to the latter. Table C-1 provides information on wholesale price indexes for the 20 most important commodities in the export trade of developing African countries. All commodities, with the exception of wood and citrus fruit, recorded increases between 1973 and 1974, but in 1975 there have been falls, some of them substantial, for all commodities with the exception of phosphates, tea, iron ore and possibly citrus fruit in the first nine months of the year.

The biggest fall has been in the price of copper: the average price for January-September 1975 was 39 per cent below that for the year 1974. This very sharp reduction has hit the export earnings of Zaire and Zambia severely. Both countries have attempted to reduce production with the object of maintaining or increasing average selling prices, in line with the policy of CIPEC (the Intergovernmental Council of Copper exporting Countries), but this policy was only marginally successful in 1975 itself. Production cutbacks and transport difficulties through Angola probably reduced the quantity of copper exported from Zambia and Zaire by more than 10 per cent in 1975.

Crude petroleum is the most important single commodity in the export trade of ECA member States, and here both the prices realized from exports in 1975 and the volume sold were below those of 1974. Total export realizations in 1975 are forecast at around $US 18 billion, significantly less than the $US 22.2 billion of 1974 but more than twice as high as in 1973.

Prices for both phosphate rock and iron ore were higher in the first part of 1975, although there is some evidence that the prices of phosphate rock weakened in the second half of the year. Export realizations from iron ore should be higher in 1975, but lower for phosphate rock, because of a substantial reduction in the quantity sold.

The volume of agricultural commodities exported in 1975 reflected greater production, but prices were lower because of the impact of recession on market demand in the developed economies. All major commodities except tea (and coffee in the second half of the year) realized lower average prices in 1975. The value of total exports was higher for coffee, cocoa, tea and groundnut products, but lower for cotton, sugar and rubber.

The reduction in the total export realisation of the 20 major commodities was substantial in 1975, with a possible total of $US 26.8 billion compared with $US 31.9 billion in 1974. The breakdown of export earnings from 1973 to 1975 is given in table C-1.

The table may also be used to estimate over-all unit price export index numbers. The result is as follows:

Export price index numbers (1970 = 100)

	1973	1974	1975
20 major commodities - -	164	394	350
Above less crude petroleum -	149	207	170

Terms of trade

There are no index numbers available for 1974 and 1975 obtained directly from the external trade statistics of African countries, but the above export price indexes have been obtained from the wholesale prices or export prices of 20 major export commodities. For import prices it is possible to obtain some approximation of the average unit price by making use of the export price indices of Africa's main suppliers.

In 1972 the commodity composition of imports into developing Africa was as follows:

	Per cent
Manufactured goods - -	77.0
Foodstuffs, drink and tobacco	13.1
Fuels - - - -	4.4
Raw materials - - -	4.1
Other - - - -	1.4

Table C-1. Prices and export earnings from 20 commodities, ECA member States, 1973-1975

Commodity	Index of wholesale prices[a] (1970 = 100) 1973	1974	1975 to date	Export earnings (millions of US dollars) 1973[b]	1974[b]	1975[c]
Crude petroleum	185.2	653.8	620.0 (to Aug.)	8 460	22 200	18 000
Copper - -	123.0	145.1	88.7 (to Sept.)	1 730	2 270	1 200
Cotton - -	175.8	230.4	205.7 (to July)	1 000	1 220	1 100
Coffee - -	120.8	132.3	127.0 (to Aug.)	980	1 100	1 300
Cocoa - -	180.0	283.6	209.0 (to Sept.)	800	1 200	1 400
Iron ore -	114.2	161.5	...	358	430	580
Wood - -	202.6	198.0	...	545	450	430
Sugar - -	156.3	416.5	364.4 (to Sept.)	180	420	360
Diamonds -	...	...	...	240	215	210
Phosphates -	125.1	493.0	550.0 (to June)	300	1 370	1 200
Citrus fruit -	141.0	126.0	...	145	100	120
Groundnuts and groundnut oil -	157.8	305.0	221.0 (to July)	240	230	300
Tea - -	97.0	127.9	129.5 (to Sept.)	95	106	110
Manganese ore -	115	132	...	65	80	70
Rubber - -	170.4	183.5	150.6 (to Sept.)	110	150	120
Zinc - -	187.8	286.7	246.6 (to Sept.)	65	100	80
Sisal - -	327.3	655.9	476.3 (to July)	58	145	110
Tin - -	131.1	222.9	192.4 (to Sept.)	40	63	70
Lead - -	141.4	194.6	145.4 (to Sept.)	40	63	50
Total				15 450	31 910	26 810

Sources: IMF, International Financial Statistics, Vol.XXVIII, No. 11 (November 1975) for most prices. Country publications for other prices. ECA estimates of export earnings based on International Financial Statistics, Vol. XXVIII, No. 11 and country sources.

a/ Wholesale prices are an approximation to export prices. b/ Provisional estimates only. c/ Very approximate figures.

For each of these groups there are published index numbers up to the second quarter of 1975. Applying these index numbers as in table C-2 provides some assessment of the over-all increase in import prices from 1973 to 1975.

Table C-2. Imports price index numbers of developing Africa 1973-1975

Commodity group	Percentage share in imports into developing Africa	Price index (1970 = 100) 1973	1974	1975(1st half)
Manufactured goods - -	77.0	133	162	190
Foodstuffs - - -	13.1	188	231	225
Fuels - - -	4.4	174	512	539
Raw materials - -	4.1	180	228	227
Other - - -	1.4	122	153	121
Total	100.0	144	189	208

Source: Export price index numbers of developed market economies as published in the Monthly Bulletin of Statistics, Vol. XXIX, No.9 (September 1975).

There will probably be some further increase in manufactured goods and fuel prices in the second half of 1975, but little change in the prices of other groups of commodities. Allowing for these increases in manufactured goods and fuel prices would produce the following index numbers for import prices.

Import price index numbers (1970 = 100)

	1973	1974	1975
Into developing Africa	144	189	214

It is possible that this method of estimation understates the actual increase in import prices in Africa in 1974, as transport costs also rose substantially and other published information 16/ suggests a rise in the unit price of imports of 41.9 per cent in 1974 for all less developed areas of the world. Applying this percentage would raise the 1974 figure to 204, and allowing for the price increases already observed and likely the 1975 index would be 231.

16/ IMF, International Financial Statistics, Vol. XXVIII, No. 11 (November 1975).

Thus the trend in the terms of trade from 1973 to 1975 may be estimated as follows:

Terms of trade of ECA Member States (1970 = 100)

Unit price exports	1973	1974	1975
All countries - -	164	394	350
Non-oil producers - -	149	207	170
Unit price imports - -	144	204	231
Terms of trade			
All countries - -	114	193	152
Non-oil producers - -	103	101	74

After 1974, when there was only a small change in the terms of trade of the non-oil-producing countries taken as a group, there was an adverse movement of 27 per cent in 1975. This particularly sharp deterioration would have reduced the gross domestic product of the countries concerned by about 5 per cent and probably eliminated any growth at constant prices in 1975.

Some groups of non-oil-producing countries also saw their terms of trade deteriorate in 1974. This is particularly the case for countries whose main exports are made up of coffee, timber, citrus fruit, tea, manganese ore and rubber. For copper - and cotton-producing countries the increase in export prices in 1974 was substantial, but below the over-all increase in the price of imports.

In contrast the export prices of crude petroleum, phosphates and sugar rose much faster than the average price of imports in 1974 and brought substantial benefits to countries producing these items.

Among the least developed of the developing countries in Africa - identified as Benin, Botswana, Burundi, Central African Republic, Chad, Ethiopia, the Gambia, Guinea, Lesotho, Malawi, Mali, Niger, Rwanda, Somalia, Sudan, Uganda, the United Republic of Tanzania and Upper Volta - none is a producer of crude petroleum or phosphate, and only Malawi and Ethiopia export small quantities of sugar.

The exports of these countries include cotton, coffee and groundnuts, and while the prices of all these products rose in 1974, the price rises except for groundnuts and groundnut oil were below the average increase in import prices. The 1974 export volume of groundnuts and groundnut oil was also depressed because of the impact of drought in the growing areas. This factor was in part responsible for a sharp rise in prices, but very few countries could benefit because they had little to sell.

In 1975 the prices of cotton and groundnuts and groundnut oil have fallen, though coffee prices may have been higher than in 1974 as a result of the Brazilian crop losses from frost damage. However, as in 1974 the least developed countries are likely to suffer a further deterioration in their terms of trade in 1975, with a continuing rise in import prices but over-all a fall in export prices.

Total exports and imports

Although statistics are incomplete, some attempt has been made to estimate the total value of imports and exports in the years 1973 and 1974. For ECA member States these estimates are presented below in table C-3 together with very approximate estimates of the possible position in 1975.

Table C-3. Estimated imports and exports of ECA member States 1973 to 1975 (in millions of United States dollars)

	1973	1974	1975 a/
Oil-producing countries			
Exports	10 110	24 473	20 000
Imports	6 732	11 132	16 500
Surplus(+) or deficit(-)	+3 378	+13 341	+3 500
Non-oil producers			
Exports	9 933	13 055	12 000
Imports	9 731	15 217	18 000
Surplus(+) or deficit(-)	+ 203	-2 162	-6 000
All countries			
Exports	20 043	37 528	32 000
Imports	16 463	26 349	34 500
Surplus(+) or deficit(-)	+3 580	+11 179	-2 500

Source: IMF, International Financial Statistics, Vol. XXVIII, No. 11 (November 1975). ECA estimates for 1975.

a/ Very rough estimates only.

While the estimates for 1975 are naturally subject to a wide margin of error, the very large deficit of the non-oil-producing countries of $US 6.0 billion will be substantially higher than the surplus of $US 3.5 billion of the oil producers. Thus for the first time this decade the external trade of ECA member States as a whole will show a substantial deficit. This is in sharp contrast to the overall surplus of $US 11.2 billion earned in 1974.

The non-oil-producing countries have been able to run their very substantial deficit on merchandise account in 1975 because of the high level of aid flows and financial assistance from the rest of the world, including the oil-producing countries outside Africa. Some of this money was channelled through the International Monetary Fund's oil facility.

Balance of payments

In the years prior to 1973, based on detailed information for a substantial number of countries in the ECA region, there were generally some modest inflows of public transfers and public and private capital. These inflows helped finance deficit balances on the current account and, more directly, to pay the foreign exchange costs of capital projects. In 1974 the same trend was observed based on global estimates prepared by IMF and shown in table C-4 below.

Table C-4. Summary of balance of payments of non-oil-producing countries of developing Africa, 1972-1974 (in billions of United States dollars)

	Current account			Capital account b/	Over-all
	Trade	Other a/	Total	Total	Total
1972	0.1	-1.6	-1.5	1.7	0.2
1973	0.9	-1.9	-1.1	1.5	0.4
1974	0.5	-2.4	-1.9	2.1	0.1

Source: IMF, Annual Report 1975

Note. The coverage in the table is of non-members as well as members of ECA.

a/ Services and private transfers.

b/ A residual, it covers capital and public transfers.

The increase in reserves reflected in the over-all total column was fairly small in the three years shown, and was only $US 0.1 billion in 1974.

The oil exporters enjoyed a large increase in international reserves in 1974, of the order of $US 7.2 billion. This may be compared with the surplus on external trade of $US 13.3 billion. Net service payments were substantial, probably of the order of $US 3 billion, thus producing a current account surplus of some $US 10 billion. The $US 3 billion dollar difference between the current account surplus and the increase in international reserves was probably allocated for aid payments to other countries, to repay principal on outstanding loans, to pay for assets taken over from oil companies and to pay for imported items not covered in the external trade estimates.

Information so far available for 1975 shows that international reserves of both oil and non oil-exporting countries had fallen below the level at which they stood at the end of 1974. In August 1975 these international reserves stood at $US 12.2 billion, a reduction of $US 2.0 billion compared with the $US 14.2 billion of December 1974. The fall in the reserves of the oil producers was much more significant than for the non-oil producers.

The decline in the reserves of the oil producers was $US 1.8 billion from December 1974 to August 1975, and while the second half of the year should have been better with the increased price of petroleum of $US 1 a barrel on 1 October, it is possible that some further erosion of these reserves will occur by the end of the year.

For the non-oil producers the position is less clear. The fall of only $US 170 million in their reserves from December 1974 to August 1975 is due to large financial and aid inflows. Whether such inflows continued at a high level throughout the remainder of 1975 is still unknown, if they did not there will have been a substantial reduction in external reserves from the already inadequate levels at the end of 1974.

Gross domestic product

On the world scene the World Bank has prepared estimates of GDP growth rates of area groupings of developing countries for the period 1971-1974. A comparison of the growth rates of developing Africa and all developing countries is presented in table C-5 below.

Table C-5. Selected economic indicators for developing countries— all countries and developing Africa, 1971-1974

	1971	1972	1973	1974[a]
	(in percentages)			
All developing countries				
Total GDP growth rate	5.8	5.6	7.5	6.1
Agricultural production	2.0	0.4	2.7	5.5
Manufacturing production	8.0	9.7	11.3	...
Share in GNP				
Gross investment	20.5	20.8	21.1	...
Gross national saving	18.1	19.1	20.8	...
Developing Africa				
Total GDP growth rate	4.6	5.5	4.0	5.9
Agricultural production	3.0	0.6	-2.9	7.4
Manufacturing production	8.6	5.4	6.9	...

Table C-5. Selected economic indicators for developing countries—all countries and developing Africa, 1971-1974 (cont'd.)

	1971	1972	1973	1974[a]
Developing Africa (cont'd.)	(in percentages)			
Share in GNP				
Gross investment - - -	21.0	19.9	21.0	...
Gross national saving - - -	15.9	16.7	20.8	...

Source: World Bank Annual Report 1975 table 1.

a/ Preliminary figures.

Information on individual African countries is given in part II of this Survey with available data provided from national sources. In this section, a short review of the over-all situation of the countries of the ECA region will be attempted, based to a certain extent on estimates prepared by ECA.

For African developing countries as a whole, the growth rate of GDP at constant prices (unadjusted for terms of trade effects) was 6.3 per cent in 1974, which is not vastly different from the World Bank estimates (5.9 per cent) for developing Africa. However, the GDP growth rates of two different groups of countries, the oil producers and the non-oil producers, were very different in 1974, with an over-all increase of 6.9 per cent at constant factor cost for the six oil-producing countries compared with 5.8 per cent for the non-oil producers. When account is taken of the changes in the terms of trade, the growth rate of the oil producers rises to 34.3 per cent, while that of the non-oil producers is reduced to 5.2 per cent. For the ECA region the average growth rate of GDP when adjusted for the terms of trade rises to about 17.4 per cent.

There were substantial increases in GDP at current prices, as is shown in table C-6 below, because of the impact of inflation on individual economies and greater export realizations due to higher prices. Judging by the implicit GDP deflator, it seems that prices in the ECA region as a whole rose in 1974 by about 16.8 per cent, which is indeed substantial and is even higher than the peak 15 per cent rate of inflation in OECD countries during the last quarter of 1974.

Table C-6. Gross domestic product at factor cost of ECA member States, 1973 and 1974 (in millions of United States dollars)

	1973	1974	Growth rate (per cent)
At current prices			
Six oil producers - - -	30 268	50 164	65.7
All other countries - - -	44 958	53 036	18.0
All countries - - - -	75 226	103 200	37.2
At constant prices unadjusted a/			
Six oil producers - - -	30 268	32 369	6.9
All other countries - - -	44 958	47 569	5.8
All countries - - - -	75 226	79 938	6.3
Adjusted b/			
Six oil producers - - -	30 268	40 653	34.3
All other countries - - -	44 958	47 293	5.2
All countries - - - -	75 226	87 946	17.4

Source: National sources. ECA estimates.

a/ Basically a volume index.

b/ Adjusted for changes in the terms of trade.

The agricultural season in 1974 was much more favourable than in 1973, and the recovery of production led to an increase in output of the order of 5.3 17/ per cent. The mining sector benefited from increased copper and phosphate rock production, but petroleum output was reduced significantly in the Libyan Arab Republic, which caused a fall in production for the region as a whole.

The construction sector was buoyant, particularly in the oil-producing countries, where large sums were being spent on development projects. Amongst non-oil producers, experience was mixed, but overall the growth rate for the construction sector in all countries in the region will have been particularly marked.

Manufacturing industry continued to advance, although in 1974 itself the agricultural processing industries must have been affected by the poor crop season in certain areas in 1973/74. However, a growth rate near the average of the last few years was probably realized.

17/ FAO estimates.

Higher Government revenues and the high level of imports and exports will have created favourable conditions in the commerce and services sectors, and here the growth rates at constant prices were probably substantial. The transport sector is dependent on general economic activity, and the growth rate for this sector in 1974 was probably near the average for the economy as a whole.

There are very divergent growth rates in 1974 as between the subregions of Africa, ranging from only 2.7 per cent at constant prices (0.5 per cent after adjusting for the terms of trade) for Eastern Africa to 7.9 per cent (23.3 per cent) for North Africa and 6.9 per cent (22.7 per cent) for West Africa. The comparison by subregion is as follows:-

GDP growth rates	Current prices	Constant prices	Adjusted constant prices
		(in percentages)	
North Africa	36.7	7.9	23.3
West Africa	54.8	6.9	22.7
Central Africa	21.8	6.5	6.9
Eastern Africa	19.4	2.7	0.5

It is significant that of the subregions of Africa, Eastern Africa, which had the lowest growth rates in 1974, has as yet no producer of crude petroleum amongst the countries making up its area. This is in contrast to the other subregions, which each have one or more crude petroleum producers.

In 1975 the position for the region as a whole is much less favourable, and with much lower export earnings and reduced production in the mining sector it will be difficult to achieve a reasonable growth rate for the region as a whole.

Imports into the countries of the region rose sharply in value in 1975, reflecting to some extent higher disposable incomes, while the volume of capital equipment imported is thought to have risen fairly substantially pointing to a larger level of fixed capital formation. The higher level of capital expenditure reflected by these imports will help economies to maintain growth of GDP at constant prices in 1976 and 1977, depending on the gestation period, but, as indicated earlier, much of the over-all growth recorded in the non-oil-producing countries in 1975 and 1976 will have been wiped out by the significant worsening of the terms of trade.

Expenditure

In 1974 there was a sharp increase in the level of expenditure on investment at current prices in the ECA region. For oil-producing countries the increase is estimated at 49.4 per cent, which is well above the increases in

construction costs and the prices of capital equipment, while for the non-oil producers the increase of 25.3 per cent probably reflects a volume of output little higher than 1973, with most of the rise due to inflation.

A much higher proportion of the total GDP at market prices in the oil-producing countries went on exports of goods and services in 1974, without a comparable increase in imports. However, imports rose substantially, by 60.4 per cent in value, while exports rose by 133 per cent. For non-oil-producing countries the reverse occurred, with exports of goods and services rising in value by 32.2 per cent and imports by 51.2 per cent.

The distribution of expenditure as between consumption and investment in the ECA region shows that the percentages were 77.2 and 20.8 respectively in 1973 and 70.7 and 21.2 per cent in 1974. Inspite of the large increase in fixed capital formation, the proportion of the GDP which went on net exports rose sharply from 1.0 per cent of GDP in 1973 to 7.2 per cent in 1974. Indeed, the share of domestic saving in GDP for developing Africa as a whole (including the oil-producing countries rose from 21.8 per cent in 1973 to 28.4 per cent in 1974, indicating a marginal rate of savings of 0.476.

Table C-7. Expenditure by ECA member States 1973 and 1974 (in millions of United States dollars at current prices)

	Expenditure 1973	Percentage of GDP at current market prices	Expenditure 1974	Percentage of GDP at current market prices	Expenditure increase (per cent)	
Six oil-producing countries						
GDP at current market prices - - -	32 500	100.0	52 800	100.0	62.5	
Private consumption -	17 300	53.2	21 600	40.9	24.8	
Public consumption -	4 800	14.8	6 600	12.5	37.5	
Gross domestic capital formation - -	8 800	27.1	12 800	24.2	45.5	49.4
Change in stocks - -	300	1.0	800	1.5	...	
Domestic savings - -	10 100	31.2	23 800	46.5	235.6	
Exports of goods and services - - -	10 900	33.5	26 400	50.0	142.2	
Less imports of goods and services - -	9 600	29.5	15 400	29.2	60.4	

Table C-7. Expenditure by ECA member States 1973 and 1974 (cont'd.)
(in millions of United States dollars at current prices)

	Expenditure 1973	Percentage of GDP at current market prices	Expenditure 1974	Percentage of GDP at current market prices	Expenditure increase (per cent)	
All other countries						
GDP at current market prices - - -	49 500	100.0	58 200	100.0	17.6	
Private consumption -	32 600	65.9	39 600	68.0	21.5	
Public consumption -	8 600	17.4	10 700	18.4	24.4	
Gross domestic capital formation - - -	8 200	16.6	10 600	18.2	29.3	25.3
Change in stocks - -	500	1.0	300	0.5	...	
Domestic savings - -	8 300	15.8	7 900	13.1	-4.8	
Exports of goods and services - - -	12 100	24.4	15 900	27.3	32.2	
Less imports of goods and services - - -	12 500	25.3	18 900	32.5	51.2	
All countries						
GDP at current market prices - - - -	82 000	100.0	111 000	100.0	35.4	
Private consumption -	49 900	60.9	61 200	55.1	22.6	
Public consumption -	13 400	16.3	17 300	15.6	29.1	
Gross domestic capital formation - - -	17 000	20.7	23 400	21.1	37.6	37.6
Change in stocks - -	800	1.0	1 100	1.0	...	
Domestic savings - -	18 700	21.8	32 500	28.4	173.8	
Exports of goods and services - - -	23 000	28.0	42 300	38.1	83.9	
Less Imports of goods and services - -	22 100	27.0	34 300	30.9	55.2	

Sources: ECA estimates based to some extent on national sources. Figures converted to United States dollars at current exchange rates.

However, most of the substantial boom in domestic savings took place in the six oil-producing countries, where the average share of saving increased from 31.2 per cent of GDP at current market prices in 1973 to 46.5 per cent in 1974, a marginal rate of savings of 0.675. If the six oil-producing countries are excluded, the picture is entirely reversed. The average share of

savings fell significantly from 15.8 per cent of GDP in 1973 to 13.1 per cent in 1974, indicating a negative marginal rate of savings of 0.05. Indeed, during 1974 there was a significant increase in consumption, both private and public, in this group of countries. While private consumption expenditure rose from 65.9 per cent in 1973 to 68 per cent in 1974, public consumption also increased from 17.4 to 18.4 per cent. And with gross fixed capital formation rising from 16.7 per cent in 1973 to 18.3 per cent in 1974, it is obvious that the big increase in fixed capital formation and part of the consumption was financed from abroad, making it necessary to draw on foreign exchange reserves. The import surplus, in fact, rose from 0.9 per cent of GDP to 5.2 per cent in 1974.

It is indeed disturbing to note that the share of domestic savings in GDP fell sharply in 1974, to 13.1 per cent. At the capital-output ratio of over three to one which has been noticed in the region in recent years, this can hardly sustain a growth rate of GDP in real terms of more than 4 per cent This emphasizes the need for more measures to increase domestic savings if African developing countries are to become more self-reliant.

For 1975 the estimated figures for imports and exports given earlier would point to a much higher expenditure on imported goods and services, probably raising the 1974 total from $US 34.3 billion to about $US 42 billion, while earnings from exports of goods and services are expected to decline from $US 42.3 billion to $US 36 billion. This would leave an import surplus of $US 6 billion in 1975 which was available to add to the increased GDP at current market prices to sustain growth of the economy of the region.

The indications for 1975 are for a further substantial increase in investment expenditure at current prices, but much smaller increases in public and private consumption expenditure. In the region as a whole the level of domestic saving as a proportion of GDP must have fallen significantly from the record level of 1974.

Agriculture

The agricultural sector in developing Africa recovered during 1974 from the setback due to drought in 1973. However, growth was not sufficient to bring the average for 1971-1974 to anywhere near the 4 per cent growth rate laid down in the International Development Strategy. The annual average was only just over 1 per cent in this period. The abnormal weather conditions and patterns of 1973 resulted in a decline in agricultural output during 1973 of 2.1 per cent but with more normal weather the 1974 figures show an increase of 5.3 per cent over 1973. The prospects for 1975 are for a reasonable harvest, but production will be only a little better than in 1974 due to poor weather conditions in several important North African countries and the difficulties

resulting from falls in seed production and livestock levels brought about by the 1973 drought. It is estimated that it will take several years to restore normal livestock production patterns.

The recovery of production in 1974 was due largely to the end of the drought in the Sudano-Sahelian zone. Rains were good in this zone in 1974, and production approached normal. However, in view of the disruption in living conditions and the concomitant decline in economic activities caused by the drought years, plantings were less than normal, while insect infestations in some regions caused output to fall. In addition, the drought in Ethiopia and Somalia took on serious proportions. Hundreds of thousands of head of livestock were lost in both countries, and crop production declined by 20-30 per cent.

Brief review of agricultural performance

The weather conditions in 1975 were generally better than the 1972-1974 average. However, as mentioned above, there were some areas with below-average rainfall. Normal rains returned to Ethiopia and to some of the areas affected by drought in Somalia, but rainfall was poor in southern Morocco and in Algeria, which reduced crop production significantly. Insect infestation has continued in some of the Sahelian countries, particularly the Upper Volta and the Niger. However, over-all grain production in 1975 should be similar to 1974, while total food output should increase by 1 to 2 per cent in the region as a whole.

Because of the poor agricultural season imports of maize and small grains doubled in 1973/74. Wheat output in 1974 was less than the 1973 level and as much as 20 per cent lower than the 1971-1972 average. As a result, imports increased by 36 per cent in 1974 over those for the 1971-1972 period. Among the grains, only rice production achieved a record level in 1974. Annual rice imports have remained at about the same level since 1971. Available information indicates that the output of roots and tubers increased considerably in 1974. In some countries there has been a noticeable shift away from the production and cultivation of cereal grains and back to roots and tubers, possibly as an insurance against the effect of bad weather conditions on the former.

Meat production has been adversely affected by the drought, the impact of which was most pronounced in the livestock-producing regions. Despite the decline in livestock production, however, exports of meat in 1974 were slightly higher than in 1973. There was a modest increase in fish production in 1974, with considerable increases in Senegal and Zaire, but sharp declines in Angola and Morocco resulted in a fall in production of fish meal and oil in those countries.

Some major problems in African agricultural production

(i) Weather patterns

Droughts, floods and unusual climatic conditions in Africa, as in the rest of the world, are in large measure occasional and not periodic phenomena. There is no general agreement among meteorologists as to their causes, but the consensus is that they are essentially dependent on general air flows and thus not subject to predictive analysis. In Africa these climatic variations are capable of adversely affecting agricultural production in most regions of the continent, but in recent years they have been felt particularly north of the Sahara and in the Sudano-Sahelian zone which stretches north and south of the tropical forest zone and covers about a quarter of the agricultural land of the region. Clearly one cannot change the weather patterns. One must therefore change agricultural practices and the use and storage of water and crops so as to minimize their adverse effects. This means that more dams must be built for irrigation and optimum use made of underground water sources. Agricultural production in Africa has not yet developed sufficient resilience to ensure quick recovery from adverse weather conditions, nor are there built-in safeguards and safety margins to protect crops.

(ii) Agricultural technology

The level of agricultural production technology in many African countries is insufficient to permit the production of surpluses and adaptation to weather and price changes. Common patterns of land ownership or control favour production by individual farming families or small groups. This may result in a lack of co-ordination in growing procedures, and failure of crop rotation which would ensure replenishment of the soil. Most small farmers are forced into a production pattern whereby they supply the needs of their families and produce a little extra for sale on the market. The pattern of land use makes it difficult to adopt modern technological methods of farming, while in the past marketing conditions have left the farmer at the mercy of the large buyer. This latter situation is dying out as more and more countries have been able to build up Government marketing organizations for the more important crops sold by farmers. However, there is still room for more extensive use of marketing co-operatives as well as more combinations of producers to use shared technical inputs.

FAO has recently embarked on a project for the establishment of emergency food reserves and storage facilities in a number of African countries. Already recommendations have been made for emergency food reserves in Ethiopia and Botswana, and studies for a few other countries are nearing completion. However, a long-term policy must be developed to upgrade the production technology of the mass of small farmers who are responsible for nearly all the output of food crops. They must be taught to keep stocks of seed on a continuous basis in order more readily to increase production when weather conditions permit.

The food shortage that resulted from the 1972-1974 drought was overcome largely through food aid. About 1.5 million tons of grain in addition to milk and fish were provided for the seven west African Sahelian countries, Ethiopia, Somalia and Burundi. The objective of achieving self-sufficiency in food production presents probably the greatest challenge for development in Africa.

The solutions to Africa's agricultural production and productivity problems are neither certain nor simple, but in light of the drive for self-sufficiency as spelled out in the Declaration and Programme of Action on the Establishment of a New International Economic Order, certain suggestions were made which if carried out would probably result in significant improvements. In the period 1970-1974 agriculture in Africa suffered from a period of climatic disaster which made development difficult. Total food production increased at a rate of 1.2 per cent a year, while per capita food production decreased at an annual rate of 1.4 per cent. 18/

The suggested solutions are well known. Firstly, improvement of credit extension, marketing services, building up of infrastructural facilities such as dams, boreholes, feeder roads and storage facilities and the supply of vital inputs such as fertilizers. Secondly, reform of the institutional structure and organization of African agriculture, including particularly the systems of land tenure, to bring about a more appropriate factor mix in the agricultural sector of African economies. Thirdly, greater co-operation among African countries and with international agencies and independent research institutes particularly in the areas of agricultural research, training of agricultural personnel and marketing.

These are not solutions which can be instituted quickly, nor are they free from the creation of additional problems. For example, changing the pattern of land tenure so as to move toward larger land holdings and the adoption of modern capital-intensive agricultural techniques and a more appropriate factor mix will certainly raise labour productivity and probably absolute production, as has been the case in many developed countries where labour is relatively scarce and commands a high real wage. In the poorer countries, however, with large elements of unemployment and underemployment in the agricultural sector throughout large portions of the year, changing the land tenure system as suggested above could result in displacing millions of agricultural workers unless nutritional standards can be revolutionized so that the extra production is largely consumed within the domestic economy. The problems of agricultural employment are acute for countries whose primary source of employment is agriculture and where the marginal product of workers currently employed in this sector tends to approach zero.

18/ FAO estimates.

A proposed solution for some African countries is to adopt, where feasible, labour-intensive methods of cultivation which for certain crops can raise output per unit of land considerably, and even raise labour productivity at the national level. It has been demonstrated in several countries that output per acre for certain crops in intensively farmed small holdings is greater than on larger holdings. On the other hand, very small holdings tend to be insufficient to provide a reasonable level of income for farm families. Care must also be taken to avoid the creation of large family farms which deny employment to landless labour.

Most agricultural unemployment arises in the off-season periods of the production cycle. To alleviate this problem much more attention needs to be paid to better water utilization, intensification and diversification of production and the introduction of new crops and multiple cropping techniques. Agricultural production in developing African nations has grown only slowly in recent years, and while the basic requirements for a reasonable standard of living as well as the present level of imports suggests that there is a large potential without taking account of export possibilities, the basic problem is how to improve both income levels and production practices in tandem. So far many African countries have been unable to find a solution based on their own limited financial resources.

Industrial sector

Manufacturing

In the period 1970 to 1974 Africa did not meet the target growth rates of 6 per cent and 8 per cent respectively for GDP and manufacturing output set in the International Development Strategy for the Second Development Decade. It is estimated that manufacturing production grew by about 7 per cent a year, 19/ and its failure to reach the target growth rate of 8 per cent was due mainly to the drought-affected agricultural sector. For 1974 itself firm estimates are not available, but the growth rate was probably lower than the 7 per cent average.

In the 1960s the growth rate of manufacturing output was 8.7 per cent a year. The decline to below 7 per cent a year so far this decade is a result of the poor performance of agricultural processing industries due to reduced supplies of raw materials, but has also been influenced by changes in ownership and management of enterprises following nationalization and indigenization measures and a reduced level of demand growth for manufactured products because of reduced incomes in the rural sector.

The performance of manufacturing industry has varied between countries and between subregions of Africa. In 1974 itself the largest GDP growth rates were in the six oil-producing countries, and the expenditure of much larger sums on development together with larger allocations for recurrent Government services and income redistribution measures gave a sharp boost to manufacturing output. The position of manufacturing industry in the non-oil-producing countries was generally satisfactory, except for the influence of the poor 1973/74 agricultural season in Sahel zone countries.

Manufacturing industry in the region is largely consumer-oriented, or geared to supplying the construction sector or to processing local materials before export. Thus the demand from domestic consumption, for construction and from the outside world in general decides the level of activity in this sector.

Initial estimates for 1975 suggest that investment expenditure in the region rose substantially at current prices, but that the growth of consumption expenditure was perhaps more restrained than in 1974. There was an import surplus of goods and services of about $US 6 billion, with earnings from exports reduced from $US 42.3 billion in 1974 to about $US 36 billion in 1975. Thus there is likely to have been growth in the volume of output of industries supplying the construction sector, but probably little increase in industries

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19/ Based on figures for 1971 to 1973 given in World Bank Annual Report 1975, table 1.

supplying consumer goods. For industries geared to the export market the recession in the world economy must have had a dampening impact on growth. Over-all the increase in the output of the manufacturing sector in 1975 in the region was probably at the lowest level so far this decade.

Prospects for development of manufacturing industry

The relatively low rate of growth of the manufacturing sector in developing Africa so far this decade, compared with the fairly rapid increases in production in other regions of the world at similar stages of development, is a very real disappointment. Africa has abundant natural resources, many unemployed or underemployed persons and generally very low living standards. By harnessing the resources available it should be possible to achieve high growth rates for manufacturing industry. Unfortunately this is the theoretical aspect: the reality shows that without abundant capital and the availability of trained and experienced managers, executives and technicians, manufacturing development may continue at a relatively slow rate.

The increased financial resources of the oil producers enable them to cut through the problems which previously oppressed them and had delayed their industrial development, in particular the inadequate infrastructure. New manufacturing enterprises can be constructed fairly rapidly, making use of turn-key contract procedures, while the training of executive and technical personnel takes place in similar manufacturing plants in the industrialized countries as the new enterprise is being developed.

On this basis countries like Algeria, the Libyan Arab Republic, Nigeria and Tunisia are building their manufacturing sectors fairly rapidly, but this is not the case with the poorer countries of Africa whose resources are limited and whose total population can create only a very small demand for consumer goods.

It would certainly help the development of the manufacturing sector in many African developing countries if there were better prices and a more stable demand pattern for their exportable commodities and wider regional co-operation among themselves. The growth of the rural sector, creating better living standards for the majority of the population that is still occupied in this sector, would also help provide a more adequate demand pattern for the products of manufacturing enterprises. Similarly, a higher level of investment would provide increased demand for the products of those plants which produce construction industry materials.

As has already been stated, the effective institution of a new international economic order will have a particular impact on the development of manufacturing industry in the region. In the meantime growth in this

sector will probably be slow, especially in the non-oil-producing countries, unless there can be a substantial and sustained increase in the inflow of external resources to these countries.

Co-operation among countries in various subregions to develop enterprises supplying a grouping of countries would provide a basis for more rapid industrial development, but the evidence to date suggests that though countries pay lip-service to the concept of multinational establishments there are too many national aspirations standing in the way of actual achievements. A new approach to this subject could help speed up the growth of manufacturing industry in the region.

Mining

Africa's mineral resources have been developed basically to supply materials for the industries of the developed world. Copper, crude petroleum, phosphate rock, iron ore, diamonds, manganese ore, zinc, tin and lead are the major mineral exports from the region, and there is also limited production of limestone and natural gas mainly for domestic uses.

In 1974 and 1975 the performance of the mining sector in terms of total output was influenced markedly by the petroleum, copper and phosphate sectors. Output of crude petroleum in the region fell in 1974 because the steep fall in production in the Libyan Arab Republic for conservation purposes was not fully offset by the increased output from Nigeria. Production from the six most important exporting countries fell by 4.7 per cent in 1974, and a further and larger fall occurred in 1975 because of reduced world demand.

Copper output from Zaire and Zambia, the two most important African producers, rose by 2.7 per cent in 1974 to 1 201 000 tons, but production in 1975 was reduced in line with the policy of CIPEC in an attempt to maintain prices, which had fallen to nearly half the level of 1974 in the first 9 months of the year. The output cuts probably reduced the amount of copper won by 10 to 15 per cent in 1975.

Phosphate rock production was increased significantly in 1974, with Morocco, the major producer, showing the largest increase, from 18.4 to 20.5 million tons. The year 1974 also saw a four-fold increase in the export price of phosphate rock. However, market demand fell sharply in 1975 as European farmers reacted to the very large price rises, and as a result production in the region has fallen back to the level of 1973, with Morocco itself mining 18.2 million tons.

Value added in the mining sector rose exceptionally in 1974 because of the three-fold or four-fold increases in the prices of crude petroleum and phosphate rock and higher copper prices. However, in 1975 prices and output of these three major commodities have fallen, and this will lead to a significant reduction in value added from the industry.

New mineral resources are still being found in the continent, with some emphasis in recent years on those areas which had been only poorly prospected in the past. Crude petroleum will be produced by more countries in the region in the future (Zaire joined the list of producing countries in 1975) but the position for other minerals is less clear. There is strong interest in uranium to build up potential supply sources for the nuclear power stations being developed in the industrial countries, and there are large new copper developments under way in Zaire and Zambia. Many potential iron ore and bauxite projects are being examined, but these often require expensive infrastructure developments, so progress will be dependent on the extent of world recovery and the growth of new markets.

The much higher costs of development and exploitation of the newer (non-oil) mineral projects in the face of poor market demand have brought a temporary halt to a number of potential schemes, while the losses made on such projects as Botswana's copper-nickel venture and Mauritania's copper mine are causing the large companies to rethink their strategies, particularly as many existing mines are capable of expansion once market conditions improve. The future rate of the development of mining in the region will be heavily influenced by the rate of growth of the world economy in the years ahead.

Construction industry

As already indicated, there have been much higher allocations for development in the oil-producing countries than in the other countries of the region. This means that the construction industry in the oil-producing countries is much more buoyant than elsewhere. However, available data suggest that in the region as a whole gross domestic capital formation rose by 38 per cent at current prices between 1973 and 1974, which probably reflects a fairly substantial increase in real terms. While the incidence of this increase would have been felt mainly in the oil-producing countries, there is some evidence of a significant rise in the non-oil producers also.

For 1975 countries have tried to keep up the momentum of development with help from much larger inflows of foreign resources, but those countries most in balance-of-payments difficulties have probably been forced to cut their development allocations and thus reduce activity in their construction industries. Because of the high level of the development effort in the oil-producing countries and Egypt's attempts to restore its economy, there should have been a significant increase over-all in construction industry output in the region as a whole in 1975.

Economic infrastructure

The economic infrastructure, as distinct from the social infrastructure, includes transport and communications, commerce, banking and finance, electricity and water and similar services. No country can develop its resources properly without an adequate economic infrastructure, and services like transport, electricity and water have to be developed in advance of potential demand.

There is continuing evidence of bottle-necks in transport services in the region, particularly where these services also offer transit facilities to land-locked countries nearer the centre of the continent. In fast-developing Nigeria and the Libyan Arab Republic many recent reports have referred to very large numbers of ships awaiting unloading at ports because of orders for imports placed in excess of the existing capacity of the ports concerned. Amongst the land-locked countries, Zambia has made constant efforts over the past year to try to ensure that its essential imports and exports can be carried to and from the country. The outbreak of civil war in Angola meant that the railway system from Lobito was no longer available for Zambia and Zaire; Zambia in particular has since had acute transport problems.

These are particular examples, but many potential mineral development projects are being held up because they also involve costly transport developments. In a large continent such as Africa, with existing railway and road links built largely to connect mineral or commercial agricultural areas to ports, there is still a need for many more and more modern transport links within countries and serving adjoining countries. The pace of development is slow and there is not much evidence of capacity on railways and at harbours being built much ahead of demand. Transport bottle-necks seem destined to be a feature of the development of the region for some time to come.

As for electricity supplies, it often happens that as soon as a new major hydro-electric development is launched, considerable interest is generated in potential industrial projects such as aluminium smelting or the production of ferro-alloys or glass making which are intensive users of cheap electricity. Similarly, other industrial enterprises which need substantial electricity supplies may be held up because existing generating capacity is limited. There are still many potential hydro-electric projects on dam sites in the region, and forward planning has generally been able to keep capacity ahead of demand. However, any quickening of the pace of development in the region would imply a faster growth rate in electricity production, while if the region became a major base for industries dependent on cheap and massive supplies of electricity a number of large-scale projects would be required.

In 1974 and 1975 large-scale hydro-electric projects were under way in a number of countries: the Inga scheme in Zaire, Cabora Bassa in Mozambique, Kidatu in the United Republic of Tanzania and Tana River in Kenya. In North African countries there was more emphasis on thermal generating stations fed with fuel oil or natural gas.

Social conditions in Africa

One major problem connected with the analysis of social conditions in developing countries in Africa is the continuing shortage of up-to-date statistics. A further difficulty is that, while social changes may be adopted as policy measures, the actual movement in the direction required may not be easily measurable except after a period of several years. Finally, social conditions vary greatly from country to country and as a result any generalization for the region as a whole would probably be arbitrary and misleading. The following analysis is limited to the observable trends in social conditions.

The impact of price and wage changes on living standards

In 1974 the economy of the region probably grew more than the target growth rate of 6 per cent, but the impact on individual countries was very uneven. The oil producers had record increases in their GDP, while for the remainder the average growth rate adjusted for the terms of trade was just over 5 per cent. However, in East African countries the real growth rate was only 0.5 per cent, and it is evident from the available data that the poorer countries of Africa were particularly affected by the world economy's move into deep recession as the year progressed.

The economic problems faced in many poorer countries included a deteriorating balance-of-payments, high levels of inflation and a fall in living standards. Within countries attempts were made by Government decree to limit the impact of any fall in living standards to the more affluent members of the community. Thus duties on luxury items and non-essentials have been increased, the import of many such products has been sharply reduced and wage rises have been granted on a basis which gives reasonable compensation for price increases to lower wage earners but which mean cuts in living standards for the higher paid. Direct tax rates have also been raised. One indirect result has been that personal savings have been reduced as attempts have been made by individuals to maintain living standards by making use of past savings. Similarly, it seems that in many countries public sector savings fell because of the heavy subsidies granted to mitigate increases in the cost of living.

In the rural sector the returns to the peasant producer are related to his production. A better agricultural season in the region as a whole in 1974 led to greater commercial production selling at better prices, but there were a number of countries in Eastern Africa where the season was poor and the population suffered in consequence. The evidence available to date is too limited to make any assessment of a possible narrowing of the gap between urban and rural living standards in the region, but policy measures operate in this direction, particularly in the oil-producing countries.

Consumption

Estimates of agricultural production in 1974 indicate that for many countries the rate of growth of food output exceeded the rate of population growth, but the year itself was one of recovery from poor performance in 1973, so one result was that imports of cereals into the region were reduced in 1974 from the very high level of 1973. Consumption of food products probably increased a little on a per capita basis, but again the large number of countries in Africa would make such a generalization inappropriate to all.

In view of the sharp rise in prices, a number of countries decided to subsidize imports of sugar and grain in particular, to reduce the impact on consumer prices. These subsidies, in conjunction with rising wages, helped to moderate the influence of inflationary pressures in urban areas.

A particular example of a policy measure which will obviously have a wider impact in African countries in the future is the decision of the Algerian Government to reduce income differentials in favour of the lower paid and eliminate malnutrition. Such a policy will have the effect of increasing consumption and could, if widely adopted in Africa, offer a market for and encourage production of a substantial number of mass consumer goods, including agricultural items.

Employment

The few employment statistics that exist are often only available for the monetized section of the economy, and even here the agricultural sector is only poorly covered because of the difficulty in obtaining regular returns from small employers. Domestic service, while still a substantial source of employment, can be measured only on an indicative basis.

On the basis of available data it seems likely that wage employment grew in almost all countries of the region in 1974, but there were wide divergences in the percentage increases. Mauritius recorded a growth rate of 18.5 per cent and Togo one of 14.4 per cent, but Malawi achieved only 3.6 per cent and Zambia 1.6 per cent. There is strong evidence of continuing widespread unemployment, with economic growth rates in general completely inadequate to permit wage employment to absorb more than a small proportion of the new entrants to the labour force. Exceptions to this generalization are the more wealthy, and particularly the oil-exporting countries. In the Libyan Arab Republic, for example, more than 100 000 foreign workers are currently employed, and Algeria is hoping to attract more of its nationals back from employment abroad.

Some of the poorer countries in the region resorted to austerity budgets in 1974, and this led to a slow-down in the rate of employment creation in the public sector of the economy. The creation of job opportunities in the modern sector as a whole is a function of the level of both current and anticipated fixed capital formation and economic development and the services dependent on and necessary for this. However, the rate of growth of industry is still low

and has worsened this decade compared with the 1960s. Thus for the immediate future most of the labour force will continue to rely on activities in the rural (traditional) sector, and the main thrust in most countries must be concentrated on the reorganization and improvement of traditional agriculture. In 1974 a number of countries including Mauritius, Zambia and the Central African Republic gave a new direction to their economic strategies by emphasizing production for export together with production aimed at self-sufficiency in basic foodstuffs.

Unemployment and underemployment

This aspect of the social scene can be measured only indirectly. Very few African countries count the unemployed, as do the developed countries of the world, and underemployment is measurable only as a result of fairly intensive investigations of a socio-economic nature into living conditions in rural areas.

Studies reveal that in most African countries wage employment creation is insufficient to absorb new entrants to the labour force, let alone start to make inroads into the existing levels of unemployment.

For the underemployed in the rural areas, an agricultural revolution is required to bring about any substantial improvement in the number of days worked per year. This can only come about by the adoption of appropriate land reform measures, including a better factor mix, coupled with multiple cropping where possible based on better water utilization and storage and more modern inputs.

In 1974 attempts by certain countries to enforce policies to restrain migration to the urban areas led to some return of migrants to the rural sector. Such returning migrants would have added to the rural under-employment problem unless they had easy access to their own plots and were able to produce their own food. In Sahelian countries the mass evacuation of the rural areas up to 1973-1974 was reversed as the authorities made efforts to resettle the rural population following the onset of the better rains in 1974.

Education

The number of African countries which are near the stage of universal primary education is growing, but there are also some in which the enrolment ratio is still extremely low. As primary enrolment has increased, leading to larger numbers of primary school leavers, so secondary education facilities have grown and later those in higher education. The function of an educational system is to eradicate illiteracy, to give a basic grounding in learning geared to the requirements of the particular economy and to provide entrants to the labour force at various levels with the educational background required for them to make an easy transition to worth-while employment.

One basic problem at present is connected with the level of education and the requirements for entry to the limited number of jobs available. Increasing numbers of students leave the schools each year without completing their prescribed course of study. Those who do complete the primary course find that there is no work available. The same tendency is increasingly obvious at the secondary level, while university graduates who have taken arts courses are also finding difficulties in obtaining employment.

This education/employment problem is occurring at the same time as developing countries are finding that there is a lack of skilled and trained indigenous personnel to fill posts for managers, executives and technicians. As a result urgent efforts are being made to reorganize educational systems to concentrate more on the development of scientific and technical skills.

In 1974 important steps were taken at the primary level in a number of countries. The Libyan Arab Republic achieved its target of universal enrolment, Algeria is planning to extend the years of compulsory education from seven to nine years (including the first years at secondary school), and Kenya introduced free primary education leading to a very large increase in enrolments.

The participation of girls in the educational system is being progressively increased and there is even one country, Lesotho, which has more girls than boys at school because the boys are required to look after herds of livestock owing to the absence of the older males in employment outside the country.

Some countries are making radical changes in educational curricula in order to improve the quality of education. Teachers are being retrained or better trained before taking up their posts, and the importance of education in all countries is reflected in the expenditure on this subject in the Government recurrent budget. Everywhere it is one of the most important expenditure headings.

The awareness that most school leavers will be engaged in activities in the rural area is leading to some emphasis on agriculture as a subject at the primary level, and there are also courses being introduced for building and other artisan activities.

Migration

Movements across national boundaries have been connected with the prospect of obtaining employment or with the exodus of refugees from some disturbing circumstance. In recent years there has been a fairly substantial curtailment of jobs on offer to migrants in favour of resolving unemployment of nationals in some receiving countries. In others a fairly substantial growth rate has meant that job opportunities for migrants have increased or at least have been maintained. Within

Africa, attracting countries for migrant labour include the Ivory Coast in West Africa and the Libyan Arab Republic in North Africa, and in the south a number of countries continue to send workers to South Africa.

A number of North African countries have traditionally looked to Europe to absorb some of their surplus labour, but in 1974 the onset of recession stopped new recruitment in Europe and led to some return movement of workers who had lost their employment.

Health

In 1974 attempts to provide increasing health facilities in rural areas gained some momentum, with an increase in the number of clinics or other health posts and the movement of staff to such areas. Training facilities are being improved, and the attempts to replace expatriate doctors with local personnel means that larger numbers of Africans are now being trained as doctors both inside and outside the region.

However, in general, ratios of doctors and hospital beds to population show little sign of improvement, except in countries like the Libyan Arab Republic which have considerable funds available for Government recurrent services or have traditionally had high doctor/population and hospital bed/population ratios. Egypt, Tunisia, Algeria and Mauritius are examples of these latter countries.

Housing

In many African countries the housing problem in urban areas is made worse by continual migration from the rural areas. As already mentioned, some countries are trying to reverse this migration and success will make the housing problem a little easier. Any improvement in facilities in rural areas will help reduce the attractions of the urban areas, and here Algeria's policy of developing 1 000 modern villages with large numbers of new housing units, health and educational facilities and electricity and piped water can be considered a model for the rest of the region.

However, housing in urban areas must still be regarded as highly unsatisfactory in most African countries, and only substantial expenditure on subsidized housing for low-income groups and the development of site and service schemes can help redress the situation. As a corollary, the higher-income groups must be made to pay a full economic rent for any leased accommodation or to build their own houses without subsidies so as to release maximum funds for cheaper housing schemes.

Aid to developing Africa

Volume of aid

Table C-8. External resource flows and service payments on external public debt in developing Africa, 1967-1973
(in millions of United States dollars)

Year	Disbursements: Loans	Disbursements: Grants, etc.[a]	Disbursements: Total	Debt service: Amortization	Debt service: Interest	Debt service: Total	Net transfers[b]
1967	1 072.2	812.8	1 885.0	398.0	169.6	567.6	1 317.3
1968	1 061.3	842.6	1 903.9	457.9	191.6	649.4	1 254.4
1969	1 114.1	1 005.1	2 119.2	553.1	225.4	778.5	1 340.7
1970	1 705.5	1 001.3	2 706.8	639.9	261.2	901.1	1 805.7
1971	1 879.3	1 102.4	2 981.8	699.1	299.2	998.3	1 983.5
1972	2 222.2	1 441.7	3 663.9	941.1	345.9	1 287.0	2 376.9
1973	4 448.2	1 455.1	5 903.3	1 477.9	524.5	2 002.3	3 901.0
Growth rate (per cent per annum)	27	10	21	25	21	23	20

Source: World Bank Annual Report 1975, table 8.

Note. Items may not add to totals because of rounding.

a/ Grants include grant-like contributions by DAC countries and grants by multilateral agencies as compiled by OECD, as well as disbursements by the Inter-American Development Bank on loans repayable in the recipients' currencies.

b/ Disbursements on loans grants and grant-like loans, minus amortization and interest on loans.

Table C-8 shows that the volume of net transfers rose from $US 1,317 million in 1967 to $US 3,901 million in 1973, with an annual growth rate of 20 per cent a year. In real terms the rate of increase would have been much less, as inflation has eroded the value of money substantially over the period concerned. Although data are not yet available for 1974 and 1975 continuous expansion throughout the period in current money terms is thought to have occurred.

While total net transfers grew substantially between 1967 and 1973 the increase in grants and grant-like disbursements did not match net transfers, and a rate of increase of 10 per cent a year can probably be compared with a world level of inflation of 5 to 7 per cent a year.

The total debt service of developing countries in Africa was 34 per cent of total aid disbursements in 1973, having grown from 30 per cent in 1967. This rate of increase cannot be allowed to continue and it is to be hoped that a higher proportion of grants and soft loans in future years will help keep down the percentage of aid that is lost in debt service payments.

Loan terms

Another important element in the total aid picture is the terms of loans. These are illustrated in table C-9 below, which shows that there was a moderate extension in the maturity of loans and some increase in the grace periods. These were offset partially by equally moderate increases in interest rates and reductions in grant elements as a percentage of loan commitments. As a result of rapid deterioration in international economic conditions commencing in the second half of 1974, it is possible that effective interest rates have continued to rise and that grants and grant elements of loan commitments will continue to fall. Both of these factors will tend to increase the ratio of debt service to loans and to reduce effective net transfers.

The ability to repay loans

In the long run, net income from exports of goods and services is the only source from which loans can be repaid. In the short run, certain temporary expedients such as using proceeds of new loans and grants, and negotiating longer grace periods and extended maturities, are also available.

Table C-9. Average terms of loan commitments and grant element of loans and grants to developing Africa, 1967-1973

Year	Loan commitments				Grant and grant element of loans b/	Amount of loans used for terms calculation c/
	Average maturity (years)	Grace period (years)	Interest	Grant element a/		
			per cent	per cent	per cent	
1967	18.3	4.2	3.4	43	65	1 157.4
1968	20.7	4.7	3.5	45	65	1 237.1
1969	21.6	5.7	3.7	45	68	1 282.7
1970	24.0	6.0	3.7	47	63	2 202.0
1971	20.1	5.4	4.0	42	64	1 691.1
1972	21.5	5.8	3.8	45	64	2 388.8
1973	22.6	5.8	4.5	40	55	3 919.4

Source: World Bank Annual Report 1975, table 9.

a/ The grant element is the face value of loan commitments less the discounted present value of the flow of repayments of principal and interest, using the customary rate of 10 per cent and expressed as a percentage of face value.

b/ Data for grants are taken from OECD (DAC) and Inter-American Development Bank sources. Included are grant-like flows (loans repayable in local currencies), bilateral grants, and United Nations agency grants. Figures for grants are on a disbursed basis, while figures for loans are on a commitment basis.

c/ This column shows the amount of loans for which repayment terms are known.

Using the short-term techniques, however, only postpones the inevitable burden briefly and possibly increases its seriousness. Even though part of the external public debt of developing African countries has arisen through concessional or semi-concessional means, the service payments take up or will take up a substantial share of the value of exports of goods and services. Table C-10 gives us some insight into the problem.

Table C-10. Service payments on external public debt as a percentage of exports of goods and non-factor services 1970-1973

	1970	1971	1972	1973
Developing Africa - -	6.2	6.5	7.2	7.8
Oil exporters - - -	9.0	9.1	9.2	8.6
Least developed countries -	4.8	5.4	5.6	5.2

Source: World Bank Annual Report 1975, table 6.

Service payments on external public debt for all developing countries in Africa rose from 6.2 per cent to 7.8 per cent of exports of goods and services from 1970 to 1973, but with the very large increase in export earnings in 1974 the percentage must have fallen in that year. However, for the least developed countries the percentage of 5.2 per cent in 1973 is likely to have been unchanged in 1974. The least developed countries received higher grant elements and longer grace and maturity periods in loans made to them. However, for 1975 the lower export earnings of the least developed will have increased their debt burden in relation to exports.

From 1970 to 1973 debt repayment schedules (both interest and amortization) of developing African countries, being on a contractual basis, remained relatively constant, while exports increased, apart from a fall in 1971. However, there was a substantial increase in total borrowing during the period, as is shown by table C-8. Loans increased at the rate of $US 914 million per year and debt service payments by $US 367 million a year. In 1973, total debt service payments had reached $US 2,002 million, while total exports of goods and services were in the region of $US 23,000 million. In 1974 exports of goods and services had reached $US 42,300 million from ECA member States, but there was a fall to about $US 35,000 million in 1975. Thus while there was an improvement in 1974 in the ratio of debt service payments to exports in developing Africa to a level below 7 per cent, in 1975 the ratio was probably nearer 9 per cent.

In 1973 there were seven developing countries in Africa in which the ratio of service payments on external public debt to exports of goods and non-factor services was more than 10 per cent. These countries were Algeria (11.3 per cent), the Congo (10.7 per cent), Egypt (34.6 per cent), the Sudan (11.1 per cent), Swaziland (10.5 per cent), Tunisia (13.8 per cent) and Zambia (28.0 per cent). The position of Egypt and Zambia was particularly serious but for Algeria, the Congo and Tunisia the position must have eased materially in 1974 with vastly increased export earnings.

These debt service ratios are misleading to the extent that they relate only to external public debt. Much private capital has also been received by African countries, and the payment of dividends or interest on such capital together with repayments of capital will have increased the actual burden very substantially.

External public debt

Table C-11 below shows the external public debt outstanding for Africa by source of debt, and also gives a rough estimate of the type of money markets which have been used by various groups of countries. As one would expect, relatively higher income countries have had greater access to private capital sources. Up to 1973 they relied on official bilateral and multilateral loans for about 49 per cent of their external public debt, while the remainder (almost 50 per cent) came from private sources such as banks (28 per cent) or through suppliers' credits. The least developed countries, on the other hand, had obtained their loans to the extent of 91 per cent from official bilateral and multilateral sources. This is both advantageous and disadvantageous for the poorer countries. On the one hand, the large degree of support from official sources enables them to borrow on more favourable terms and thus reduces the debt service burden. On the other hand, their limited access to private capital markets restricts the amount of borrowing they can make and invest without much restriction, and may thus inhibit development plans.

Future estimates on the debt service problem

The World Bank has prepared estimates for 1974 to 1980 concerning debt service on the external public debt outstanding at December 1973 by type of creditor, and these data are presented in table C-12. However, they are not particularly useful for economic analysis as they do not include any forecast of new borrowing and the cost of servicing such loans.

Table C-11. External public debt outstanding of developing African countries at 31 December 1973 (in millions of United States dollars)

	Total	Bilateral official	Multi-lateral	Suppliers' credits	Banks and other
All countries - -	21 775	10 604	4 007	2 788	4 376
Oil exporters - -	7 905	2 940	932	1 711	2 322
All other countries -	13 870	7 664	3 075	1 077	2 054
Least developed - -	(3 607)	(2 322)	(969)	(70)	(245)
Percentages					
All countries - -	100.0	48.7	18.4	12.8	20.1
Oil exporters - -	100.0	37.2	11.8	21.6	29.4
All other countries -	100.0	55.3	22.2	7.7	14.8
Least developed - -	100.0	64.4	26.9	1.9	6.8

Source: World Bank Annual Report 1975, table 5.

Table C-12. Projected debt service on external public debt outstanding at 31 December 1973 (millions of United States dollars)

Type of creditor	Debt outstanding 1973	Debt service projected by year[a] 1974	1975	1976	1977	1978	1979	1980
Developing African countries								
Bilateral official -	10 604	747	782	809	806	788	754	712
Multilateral - -	4 007	157	179	202	222	236	244	245
Private - - -								
Suppliers credits -	2 788	542	556	520	467	370	293	228
Banks - - -	3 650	391	463	543	615	591	561	509
Other - - -	726	165	127	105	95	103	60	54
Total - - -	21 775	2 002	2 107	2 179	2 204	2 088	1 912	1 748

Source: World Bank Annual Report 1975, table 7.

a/ Excludes new borrowing.

The past history of debt service as a percentage of exports indicates that the better the financial credit-worthiness of the borrower, the higher the percentage of loans obtained from private sources (suppliers and banks) as compared to public sources (official bilateral and multilateral). However, as countries find means of faster development, so their credit-worthiness tends to increase, particularly if, as is likely, the faster rate of development is dependent on increased exports. Against this background it can be expected that while the terms for borrowing in such countries will tend to harden, the actual burden of debt should show a reduction as a proportion of export earnings.

The experience of recent years suggests that debt rescheduling seems to be urgently needed for a number of countries which find that they have been unduly optimistic in their development projections and that the realities of export markets do not match expectations. This sort of problem could be mitigated if developing countries were able to measure the future course of prices of their major export commodities against a background of more realistic commodity arrangements, with prices better related to costs of production and high enough to enable the country concerned to earn remunerative returns on the investment which has been made.

Fiscal and monetary developments

It is gratifying to note that as indicated by the size of capital expenditure relative to the total budgetary outlay, African Governments in general have been using the budget increasingly to foster their development objectives. In the period 1974-1975, several African Governments failed to achieve their original budgetary plans. The shortfall was caused mainly by economic difficulties arising from exogenous factors which were mostly unforeseen or outside the control of the Governments concerned. As the import bills and the cost of running the Government administration machinery mounted, and more funds were appropriated to subsidize essential goods for mass consumption, major changes in the original budget became necessary.

While some developing African countries have scaled down their budgetary expenditure, in relation to estimates, others have found themselves in a position to increase it. This is particularly the case where prices of commodity exports have increased faster than import prices. In such countries, the budget has not been subject to the resource constraint of a weak balance of payments; and the rise in fiscal revenue from both tax and non-tax sources has allowed them to finance a large proportion of their own capital development without much external aid.

Ideally, an analysis of country budgets in the African region should be based on actual amounts spent and appropriated over an equal time period so that comparision would be more meaningful. This is not, however, possible, largely due to the lack of adequate statistical information and the different budgeting practices in use in Africa. Whereas provisional estimates for most of the independent countries in the region are readily available, the actual figures are either not published or become available only very late. In such circumstance, the limitations of an analysis based on provisional budget estimates must be recognized. The differences in the functional classification of budgetary expenditure and in the months which the fiscal year covers also have to be taken into account.

Budgets and budgetary policy

Irespective of economic fortunes, all African Governments increased their budgetary outlays in 1974. However, the rates of increase were most uneven. Nigeria had the highest rate of increase, with a growth rate of over 85 per cent in total budgetary expenditure whereas Mali and Niger had the lowest with growth rates of less than 5 per cent. It seems that initially the high rates of imported inflation in 1974 alone were enough to make increases in budgetary outlays unavoidable.

Budgetary policy in Africa is basically determined by the capacity of each country to tax, save, spend and invest. This capacity depends on a complex

of factors, among which are the receipts accruing to a country from its main commodity exports; the policy strategy including in particular the pricing policies adopted as regards the public sector; the amount of foreign aid which a country can expect to obtain; the measures taken to increase efficiency in tax management and increase tax revenue; and the extent of inflationary pressures. Although at any given time all these factors could be present simultaneously in a single country, some of them had a more dominant influence on budgetary expenditure than others. For instance, the rise in Government expenditure in the United Republic of Cameroon in 1974 was largely due to higher wages and salaries paid to civil servants and the higher cost for fuel imports; in Mauritius it was due to the increase in food subsidization and the higher cost of operating the social welfare system; and in Zaire it resulted from the policy emphasis of increasing State ownership of economic resources. The example of Zaire is typical in Africa, where indigenization of economic activity is widespread. This policy has invariably led to increases in State expenditure to cope with the management of a larger public sector. On the other hand, it has also led to larger revenue.

Generally speaking, where there have been large gains from main commodity exports, the additional resources accruing to the State treasury in the form of fiscal receipts have been quite substantial. This is particularly true in the case of countries exporting crude petroleum and some other strategic raw materials. Several major African agricultural exports also fetched high prices on the world commodity markets.

Table C-13 shows that total estimated expenditure increased by over 30 per cent in Algeria, Morocco, Nigeria, the Congo, Gabon, Botswana, Madagascar, Somalia, Swaziland and the United Republic of Tanzania; between 20 and 30 per cent in Egypt, the Libyan Arab Republic, Tunisia, the Gambia, Ghana, Mauritania, Senegal, Togo, Zaire, Malawi, Mauritius and Zambia; between 10 and 20 per cent in the Sudan, Benin, Guinea, the Ivory Coast, Liberia the United Republic of Cameroon, the Central African Republic, Lesotho, Kenya, Mozambique and Uganda; and less than 10 per cent in Mali, the Niger, the Upper Volta, Burundi, Chad and Ethiopia.

With the exception of the Libyan Arab Republic and Tunisia, all the main African exporters of crude petroleum increased their budgetary provisions by over 30 per cent. In the Congo, petroleum revenues rose at an unprecedented rate, and the Government made substantial changes in its budgetary allocations of 1974. The 79.7 per cent increase in total expenditure over the year was based on the revised estimates. Morocco and Botswana too benefited from high prices for their exports, and budgetary allocations rose 41.6 per cent and 34.0 per cent respectively in 1974. The Government budgets benefited mainly from greater efficiency in tax management in the United Republic of Tanzania; higher export prices for sugar in Swaziland and Mauritius; changes in the budgetary system in Madagascar; and increased State participation in economic activities following nationalization in Somalia.

Table C-13. Growth rates of Government expenditure during the fiscal year ending 31 December 1974

	Percentage change over previous year		
	Total expenditure	Recurrent expenditure	Capital expenditure
NORTH AFRICA			
Algeria	33.5	19.3	55.1
Egypt	28.5	30.1	20.2
Libyan Arab Republic a/	20.0	-16.7	60.2
Morocco	41.6	38.2	49.3
Sudan b/	15.9	10.3	48.1
Tunisia	29.3	18.9	49.2
WEST AFRICA			
Benin b/	10.4	10.4	...
Gambia b/	21.5	8.7	59.4
Ghana	29.8	33.0	22.7
Guinea	18.6	...	...
Guinea-Bissau	...	20.6	...
Ivory Coast	13.6	18.0	19.8
Liberia	13.4	22.0	-40.8
Mali	3.2	5.5	-47.1
Mauritania	25.5	34.8	-20.4
Niger c/	0.3	-4.3	38.8
Nigeria d/	88.3	45.7	147.9
Senegal b/	23.7	17.0	55.0
Sierra Leone b/	...	28.0	...
Togo	20.9	17.6	45.1
Upper Volta	6.5	6.7	4.1
CENTRAL AFRICA			
Burundi	9.8	7.0	52.6
Cameroon b/	12.8	11.3	20.3
Central African Republic	12.4	6.2	56.8
Chad	8.6	8.6	...
Congo	79.7	60.9	300.0
Gabon	31.9	16.7	52.7
Rwanda	...	27.1	...
Zaire	22.5	18.9	34.6
EAST AFRICA			
Botswana d/	34.0	58.2	12.0
Ethiopia e/	3.6	4.1	1.9
Kenya b/	19.1	9.2	42.8
Lesotho d/	18.1	11.1	39.3
Madagascar	47.8	16.8	9.9
Malawi d/	27.6	13.6	44.5
Mauritius b/	24.7	19.4	36.3
Mozambique	16.7	11.2	46.9
Somalia	36.6	22.6	103.8
Swaziland d/	43.6	44.5	41.9
Tanzania b/	32.0	37.6	22.8
Uganda b/	18.6	25.8	-1.8
Zambia	26.3	22.2	39.0

Source: ECA secretariat (based on national data).

a/ Annual average between April 1972 and December 1975.

b/c/d/e/ Fiscal year ending 30 June 1975, 30 September 1974, 31 March 1975, 7 July 1975 respectively.

In the six countries with budgetary growth rates of less than 10 per cent, economic difficulties were the main reason for the stagnation. Mali, the Niger, the Upper Volta, Chad and Ethiopia were still affected by severe drought conditions when their budgets were being prepared. In Burundi, the stagnation in the public sector arose mainly from slow economic growth, due largely to unfavourable terms of trade and bad climatic conditions.

In Africa there is a strong correlative relationship between economic performance and budgetary policies and few developing African countries are in a position to maintain a consistent rate of budgetary growth when economic conditions have changed significantly. An assurance of stable and remunerative prices for African agricultural and mineral commodity exports, adequate energy supplies at reasonable prices and stability in the international monetary system are therefore all essential elements for the development of sound budgetary strategies in Africa.

Functional analysis of recurrent and capital expenditures

The available information on recurrent expenditure is not detailed enough to show the vote for each service. Table C-14 indicates that in many countries, social services took a fairly large proportion of the total recurrent outlay in 1974: Algeria and Mauritius allocated over 40 per cent to social services; Sierra Leone, Ethiopia, Kenya, Lesotho and Malawi between 30 and 40 per cent; Egypt, Morocco, Tunisia, the Gambia, Mauritania, Togo, Burundi, Zaire, Swaziland, the United Republic of Tanzania and Uganda between 20 and 30 per cent, and the Sudan, Nigeria, Botswana and Somalia between 10 and 20 per cent.

The provisions under education and health have generally been increased, but in several countries the rates of increase have been relatively low compared with other expenditure items. A notable exception was the Sudan, where both types of expenditure were reduced by 18.9 per cent and 45.9 per cent respectively in the fiscal year 1973/74. In the meantime expenditure on defence has increased in several African countries. However, this type of expenditure was still relatively small: only in a few countries did it amount to over 20 per cent of recurrent expenditure.

In line with their respective development policies, many African countries have recently started a re-orientation of their capital budgets, channelling more resources into the economic rather than the social sector. This change in development approach has gradually led to an increase in recurrent expenditure on the administration and economic services. Table C-14 shows that there was no country which allocated less than 29 per cent of the capital budget for economic development, and in only seven was the allocation below 50 per cent. In contrast, there were only five countries which allocated more than a quarter of their capital budgets for the development of social services, and none more than a third.

Table C-14. Functional distribution and growth rates of recurrent and capital expenditure during the fiscal year ending 31 December 1974

	Percentage of total recurrent or capital expenditure						Percentage change over previous year	
	Recurrent expenditure				Capital expenditure		Capital expenditure	
	All social services	Education	Health	Defence	Economic services	Social services	Economic services	Social services
NORTH AFRICA								
Algeria	43.2	25.8	7.4	11.4	41.2	28.2	32.3	43.4
Egypt	26.2	6.7	4.3	...	83.1	10.6	38.6	-27.2
Libyan Arab Republic	...	8.4	2.7	...	57.8	30.1	...	30.6
Morocco	25.0	18.6	4.9	12.2	54.7	10.2	60.2	-24.5
Sudan[a]	11.8	7.2	2.4	20.8	43.2	8.2	2.2	-41.9
Tunisia	28.7	36.0	10.0	5.3	71.5	11.2	78.6	41.7
WEST AFRICA								
Benin[e]	...	21.5	10.4	...	...	...	...	...
The Gambia[a]	32.3	12.5	8.9	...	85.0	15.0	86.2	-11.9
Ghana[a]	...	...	...	...	35.0	16.0	...	...
Guinea-Bissau	...	9.6	10.6	0.5	68.7	31.0	...	...
Ivory Coast	...	...	...	...	68.2	...	10.4	...
Liberia	...	19.4	15.0	...	42.6	4.3	-57.0	-80.8
Mauritania	28.3	11.4	7.3	12.2	81.8	...	-21.8	...
Nigeria[b]	12.0	5.9	2.0	21.3	45.0	24.8	169.7	287.8
Sierra Leone[a]	31.2	19.4	7.6	4.2	...	...	...	...
Togo	28.1	14.9	7.7	10.9	67.6	22.3	-11.8[c]	-15.3[c]

Table C-14. Functional distribution and growth rates of recurrent and capital expenditures during the fiscal year ending 31 December 1974 (continued)

	Percentage of total recurrent or capital expenditure						Percentage change over previous year	
	Recurrent expenditure				Capital expenditure		Capital expenditure	
	All social services	Education	Health	Defence	Economic services	Social services	Economic services	Social services
CENTRAL AFRICA								
Burundi	26.0	20.0	5.5	...	...	...	...	...
Cameroon a/	...	17.5	14.0	...	...	...	...	...
Congo	...	...	...	...	72.1	18.5	65.7	29.5
Gabon	...	18.8	6.8	9.4	73.1	...	68.5	...
Zaire	26.2	22.7	2.3	14.7	51.8	8.5	116.8	334.7
EAST AFRICA								
Botswana b/	15.0	7.7	6.6	...	...	...	...	...
Ethiopia d/	32.4	19.9	6.1	15.2	78.1	20.9	-0.5	11.0
Kenya a/	39.6	28.5	7.4	...	62.9	17.0	36.2	74.7
Lesotho b/	32.1	19.4	7.6	...	59.4	31.2	6.6	10.4
Madagascar	...	22.2	11.3	...	75.7	10.8	17.3 c/	235.0 c/
Malawi b/	34.8	18.9	5.8	...	64.1	12.0	62.1	66.2
Mauritius a/	46.1	13.5	8.6	...	76.1	9.3	26.0	272.3
Somalia	17.5	8.6	6.6	25.4	67.7	4.4	71.3	-49.5
Swaziland b/	29.8	20.3	7.1	3.8	43.5	30.6	98.3	22.8
Tanzania a/	25.2	13.4	7.2	9.7	...	...	...	...
Uganda a/	26.0	16.2	6.0	13.4	29.0	11.7	-9.2	43.5
Zambia	...	10.5	7.0	...	60.6	13.4	...	..

Source: ECA secretariat (based on national data).

a/ Fiscal year ending 30 June 1975.

b/ Fiscal year ending 31 March 1975.

c/ Average annual growth rate between 1972 and 1974.

d/ Fiscal year ending 7 July 1975.

e/ Formerly Dahomey.

The growth rates of capital expenditure are also shown in table C-14. five countries, namely Liberia, Mauritania, Togo, Ethiopia and Uganda, reduced the vote for economic development in 1974; and another four, the Sudan, the Ivory Coast, Lesotho and Madagascar, increased it by less than 20 per cent. The annual growth rates in the other countries were between 20 per cent and 169.7 per cent. As regards capital expenditure on social services, the sums allocated were reduced in Egypt, Morocco, the Sudan, the Gambia, Liberia, Togo and Somalia; and the annual growth rates in other countries ranged from 10.4 per cent in Lesotho to 334.7 per cent in Zaire.

Sources of public revenue

In the meantime, recurrent revenue was expected to increase in all ECA member States except for Mali and Malawi. The annual growth rates ranged between 2.3 per cent in Benin and 121.7 per cent in Nigeria. During 1974 and 1975, additional fiscal receipts were found from quite diverse sources including larger levies on commodity exports, increased royalties from foreign companies, strengthening of tax collecting machinery, increased tax rates and higher dividends from companies with State shareholdings.

Tax receipts remained the main source of revenue. Direct and indirect taxes accounted for over four fifths of the total fiscal receipts in all African countries except Algeria, the Gambia, Nigeria, the Congo, Gabon, Botswana and the United Republic of Tanzania. Of these seven countries, only in Algeria did direct and indirect taxes account for less than three fifths of total fiscal receipts. Also, given the narrow income base in Africa in general, direct taxes produced less than indirect taxes except in Nigeria. The ratio of direct to indirect taxes was less than a third, except in Morocco, Liberia, the Niger, Chad, Gabon, Kenya and Malawi.

In spite of the increases in receipts, recurrent revenue was expected to fall short of budgeted recurrent expenditure in six countries: Benin, Egypt, Ghana, Mali, Mauritius and Rwanda. This probably implies that additional receipts were expected from unspecified sources in the course of the fiscal year.

In varying degrees, most African countries have relied on external financing. External grants for recurrent budgetary support have virtually ceased, but external financing of capital development has been increasing. The amount of financing which many African countries have received from abroad is difficult to assess since figures are not published. However, according to the information available, external public borrowing has increased in most countries recently. The annual growth rates in 1974 varied between 97.2 per cent in Mauritius and 0.9 per cent in Ghana. In the meantime, internal borrowing from both the bank and the non-bank sector has also increased. In 1974, domestic borrowing was reduced in Mauritius, Somalia, the Gambia and Zambia but increased in all other countries.

Money and prices

As mentioned earlier, most African Governments have borrowed on the domestic market to help finance their budgetary requirements. The full effect of such borrowing on African economies cannot be fully ascertained, but it has definitely created additional liquidity. Domestic borrowing can originate either from the bank or the non-bank sector. Because of the lack of data, borrowing from the non-bank sector is not considered here.

In 1974, as table C-15 shows, the net claims of the banking system on Governments (i.e. Government borrowing from the bank sector) increase in 18 African countries at growth rates varying between 403.0 per cent in Mauritius and 2.6 per cent in Burundi. On other hand, they were reduced in Nigeria, Zambia, Senegal, Ethiopia and Algeria by 325.3 per cent, 60.0 per cent, 53.0 per cent, 42.4 per cent and 26.1 per cent respectively.

Although a majority of African Governments are net borrowers from the banking system, some of them are net depositors. In 1974, there were 10 countries whose Governments were holding net deposits in the banking system. These were the Libyan Arab Republic, Benin, the Ivory Coast, Mauritania, the Niger, Togo, the Upper Volta, the United Republic of Cameroon, Gabon and Somalia. Seven of them belong to either the west African or the central African central banks,[20] which normally require members to leave a cash balance on deposit. The Libyan Arab Republic was the only country where the net Government deposits decreased in 1974 (by 19.7 per cent); in the other 9 countries, they increased by between 6.1 per cent in Somalia and 155.3 per cent in Mauritania.

Any change in net claims on Government or Government deposits affects money supply, which is the sum of demand deposits plus currency outside the banking system. The other main forces which affect money supply are net foreign assets and claims on the private sector. In 1974, net foreign assets fell in Ghana, the Niger, Sierra Leone, Burundi, Rwanda, Zaire, Kenya, Madagascar, Somalia and the United Republic of Tanzania(the rates are shown in table C-15). In Egypt, the Sudan, Mali, Senegal and the Central African Republic, net foreign assets continued to be negative; in other words, these countries held net foreign liabilities. There was a 40.0 per cent increase in net liabilities in Egypt; 34.6 per cent in the Sudan; 33.4 per cent in Mali; and 36.2 per cent in Senegal; and only the Central African Republic reduced its net foreign liabilities, by 43.9 per cent. In the remaining African countries listed economic conditions were sufficiently favourable to enable them to increase their net foreign assets. In Mauritania, Nigeria and the Congo, they rose particularly fast, at growth rates of 348 per cent, 748 per cent and 958 per cent respectively.

20/ The Central Bank of the West African States and the Bank of the Central African States.

Table C - 15. Monetary survey 1974: Changes in money stock and money supply

	Percentage change over previous year			
		Domestic credit		
	Net foreign assets	Net claims on Government	Net claims on private sector	Money
NORTH AFRICA				
Algeria	14.6	-26.1	37.4	23.8
Egypt	40.0a/	20.9	42.9	24.7
Libyan Arab Republic	89.0	-19.7b/	84.4	46.6
Morocco	36.6	34.2	24.5	26.6
Sudan	34.6a/	28.7	24.6	30.3
Tunisia	24.1	20.2	30.8	25.1
WEST AFRICA				
Benin	68.9	109.4b/	28.2	27.6
The Gambia	78.9	50.4	14.9	43.1
Ghana	-90.1	47.0	43.5	30.7
Ivory Coast	107.9	51.0b/	39.0	38.0
Mali	33.4a/	8.0	57.7	47.1
Mauritania	348.5	155.3b/	11.2	64.0
Niger	-10.7	110.2b/	68.3	29.4
Nigeria	748.3	-325.3	32.9	111.2
Senegal	36.2a/	-53.0	41.2	53.4
Sierra Leone	-15.5	52.4	40.9	14.7
Togo	239.2	34.0b/	21.9	116.9
Upper Volta	4.3	48.0b/	68.0	21.2
CENTRAL AFRICA				
Burundi	-37.6	2.6	88.8	20.6
Cameroon	50.4	146.2b/	29.8	29.3
Central African Republic	-43.9a/	10.7	-3.5	28.7
Chad	...	...	19.6	55.5
Congo	958.1	15.8	9.4	36.1
Gabon	174.1	69.6b/	46.8	68.3
Rwanda	-17.2	25.5	128.4	18.4
Zaire	-37.7	73.3	76.6	37.3
EAST AFRICA				
Ethiopia	45.0	-42.4	16.0	19.1
Kenya	-37.8	92.4	21.3	4.5
Madagascar	-8.5	321.4	17.1	17.6
Malawi	23.3	62.1	54.9	33.3
Mauritius	93.8	403.0	10.8	67.9
Somalia	-26.0	6.1b/	47.0	23.9
Tanzania	-42.5	158.6	18.5	28.8
Uganda	...	...	29.4	...
Zambia	8.2	-60.0	90.2	9.3

Source: International Financial Statistics, Vol. XXVII, No. 11 (November 1975); and ECA secretariat (based on national data).

a/ Net foreign assets are negative. A(plus) (minus) sign refers to an increase (decrease) in net foreign liabilities. b/ Net claims on Government are negative, i.e. Government deposits is the banking system exceed Government liabilities. A minus (plus) sign refers to an increase (decrease) in net claims on Government.

In the meantime, net claims on the private sector increased in all African countries except the Central African Republic, where they decreased by 3.5 per cent. In countries whose economies achieved the highest growth rates, there was increased demand by the private sector for additional bank credit to finance greater agricultural production, industrial expansion, larger consumption and increased imports and exports. In several of them, such as Somalia, the United Republic of Tanzania and Mauritius, the net claims on the private sector would have increased more substantially had the Government not taken action to restrain the expansion of bank credit.

The supply of money increased in all African countries at substantial annual rates, as shown in table C-15. In one group of countries the main force behind monetary expansion was the increase in net foreign assets; in another group of countries it was the increase in net claims on Government; and in yet another group, it was the increase in net claims on the private sector. It should be noted, however, that the three forces could reinforce or neutralize one another's influence on money supply. Malawi was a typical example, where all three factors combined to produce a 33.3 per cent increase in money supply; in Algeria the expansionary effect of net foreign assets and net claims on the private sector were partly neutralized by the contractionary effect of the net claims on Government to restrain the growth in money supply to 23.8 per cent.

In a number of African countries, the increase in money supply has intensified inflationary pressure. The frequency distribution of table C-16 shows that in 1974 consumer prices increased by over 30 per cent in 3 countries; between 20 and 30 per cent in 5 countries; between 10 and 20 per cent in 16 countries; and below 10 per cent in 11 countries. The average for developing Africa was about 13 per cent.[21] It is difficult to gauge the extent to which increases in money supply were responsible for the rates of inflation in Africa. In the oil-producing countries like Algeria, the Libyan Arab Republic, Tunisia and the Congo, price increases remained relatively small and averaged only 7 per cent

Table C-16. Frequency distribution of increases in consumer prices in developing Africa during 1974

	Percentage change over previous year			
	0-10	10-20	20-30	over 30
Number of countries in each group	11	16	5	3

Source: International Financial Statistics, Vol. XXVIII, No. 10 (October 1975); Monthly Bulletin of Statistics, (September 1975); and ECA secretariat(based on national data).

Note : The figures relate only to countries for which data are available.

21/ Based on data given in International Financial Statistics, Vol.XXVIII, No.12 (December 1975), p. 36.

in spite of monetary expansion. This is due partly to an increased supply of goods from imports. In the non-oil producers, where the supply of foreign exchange is limited to allow larger imports of goods, the average increase in consumer prices was around 18 per cent and in a number of countries the price rises were greater than the rates of monetary expansion. This suggests that besides increases in money supply, there were other important determinants of price trends in Africa. Among them, of course, are the supply of goods from within the economy and from abroad, changes in the velocity of money in circulation and disposable income, both public and private, and finally the propensity to save.

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SECTION II

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SURVEY OF ECONOMIC AND SOCIAL CONDITIONS IN AFRICA, 1975

SECTION II -- INFLATION IN AFRICAN COUNTRIES

CONTENTS

I. INFLATION - DEFINITIONS AND CAUSES

"Inflation" is used in this paper to describe a state in which prices rise persistently at what may be commonly regarded as a high rate. What rate may be regarded as "high" varies with the mores and experience of the country concerned. Even rates of price increase of 3 per cent were described as inflationary in the United States during the 1950s. Nowadays one would tend to regard such low rates as not inflationary, or at least they would be described as creeping inflation as distinct from galloping inflation. The latter clearly describes inflationary rates of 20 per cent or more and may be applied to what the United States refers to as "double digit" inflation.

Inflation does not refer to once-over or once-and-for-all changes in the level of prices. One particular example of such changes which is important in practice and should not be described as inflationary is when there is a change in indirect (outlay) taxes suitably balanced by a change in income or other taxes. An increase in indirect taxes may cause the general level of prices to increase; but there is no reason why such a price change should persist. This emphasizes the fact that the authorities cannot reduce the rate of inflation by reducing the level of outlay taxes even if there is a corresponding increase in income taxes so that the Government revenue remains the same. What will occur is a once-and-for-all shift in the prices of the commodities on which taxes have been reduced. The rate of inflation will be the same as before subject to the once-and-for-all shift in the level of prices. It is however possible to reduce prices continuously for a certain limited

period by annual reductions in the level of outlay taxes and simulate a disinflationary effect or to increase them and give the appearance of inflation; in this paper however such artifices are not considered as either true disinflation or inflation.

There is also some confusion arising from the fact that the words inflation and deflation are often used to denote changes in real output and employment rather than changes in the price level. In this paper the term contractionary will be used to denote effects constraining the growth of real output and a contraction will indicate a slow down of growth or an actual decline in real output and a reduction in employment. Expansion will indicate the opposite.

Thus when real output growth is consistently in decline and the rate of price increase is high and persistent the situation may be described as one of contractionary inflation instead of "slumpflation" or "stagflation". Where prices are falling and output growth is strong the situation would be described as one of expansionary deflation.

The other set of definitions to be used in this paper concern the time dimensions of the inflationary process. The term "impact" describes the consequences which are manifested in a period of weeks or not longer than six months. A "short period" is one of up to about two or three years and a "long period" is of more than three years' duration.

It is known that most of the price effects, for example, of expansion in the money supply occur in the long period, the reduction of interest rates in the impact period, and the effects on real output growth in the short period.

Characteristics

The inflation that struck a large part of the world during the late 1960s and the first half of the 1970s shows some of the characteristics of inflation in other periods of history such as the rise in prices during the Napoleonic Wars. Yet during this period there has been no wide-scale war; conflicts have been only on a local scale. In history, however, long persistent one time inflations have often been associated with war finance and its aftermath. Historically also one time inflations have been caused by gold discoveries or by technological advances in the extraction of gold from ore such as the cyanide process. However, such factors do not occur during the 1960s and 1970s.

A second characteristic of the 1960s-1970s inflation is that it was virtually world-wide. Very few countries were spared the ravages of rapid inflation. This is partly because the importance of international trade has grown since the inflation during World War II, whose effects lasted until 1951. The vast expansion of international trade has meant that countries have been tied closer together. The more rapid growth of international trade relative to domestic trade has given rise to a more powerful multiplier process so that effects originating abroad are transmitted to domestic economies more dramatically than they were in the pre-World War II period.

A third characteristic of the inflation is that it has been associated with conditions of recession in many countries at least in 1974 and 1975. Economists once believed that there was a trade-off between unemployment and inflation, that is to say that one could increase the volume of employment and reduce unemployment and

increase the rate of growth of output by increasing the rate of demand and accepting a rise in the rate of inflation. The so-called Phillips Curve 1/ gave a possible set of combinations of inflation and unemployment which could be chosen by the authorities. The early 1970s however clearly discredited any such trade-off. The countires of the developed world suffered high inflation and extensive unemployment, a state of affairs that is described here as contractionary inflation but which in other studies is called "stagflation", "inflationary recession", and "slumpflation". These conditions were transmitted to the developing world, although the increases in the price of certain primary commodities made the effects most uneven and exacerbated many of the problems of adjustment. The situation, in short, was not due to gold or world-wide wars; it was international in scope; and it was contractionary not expansionary.

One must emphasize however that these conclusions refer only to the world-wide inflation. Individual countries in Africa have suffered inflation due to the depredations of war and civil disorders. For example the very rapid increase in prices in 1969 to 1971 of from 10.0 to 16.1 per cent in Nigeria were associated with the civil war and its aftermath. Often such war or disturbance-induced inflation occurs long after the event which provoked it; thus in Zaire the rapid rate of inflation from 1963 was a consequence of the political changes of late 1960, and it was not until after 1969 that the inflation was brought down. Indeed the case of Zaire is a remarkable one since it demonstrates that a particular country can pursue a policy of reducing its rate of inflation even when the rate of inflation in the rest of the world is accelerating.

Causes of the world-wide inflation

The main - indeed the only - proximate cause of the world-wide inflation was the expansion of the money supply in the major countries of the developed world. From about 1963 the United States which accounts for about 30 per cent of total world product and probably more than 35 per cent of total world money supply, began to expand the money supply from a previous trend figure of about 2 to 4 per cent to over 8 per cent per annum from 1965 to 1973. The real output growth was rather less than 4 per cent per annum. The consumer price index accelerated from an average of 1.2 per cent increase in 1961-1965 to a rate of over 6 per cent in 1969 and finally in 1974 to over 10 per cent.

The expansion in the money supply was the proximate cause of the inflation in the United States. The ultimate cause was the budget deficits of the Federal Government and an unwillingness to finance such deficits by borrowing from the non-financial private sector. In order to meet the deficit, the Government created additional supplies of money. To enquire into the ultimate reasons for resorting to deficit finance by the United States is far beyond the confines of this study, but it is sufficient to observe here that it was associated with (a) the belief, albeit erroneous, that deficit financing would not lead to inflation but would

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1/ The Phillips' Curve as originally expounded by Phillips in 1958 expressed an empirical relationship between the rate of unemployment and the rate of increase in wage rates. Later writers have tended to corrupt this definition into a relationship between the rate of unemployment and the rate of cost inflation, on the implicit assumption that the rate of cost inflation and the rate of increase in wage rates are highly correlated.

generate increased real growth; (b) the need to finance an extension of the domestic "welfare" programme; and (c) the requirements of finance in the Viet-Nam conflict. These points are taken up in an African context later in the study.

The increase in the money supply was certainly not associated with an expansion of the precious metal base of the monetary system of the United States. Although nominally on a gold standard until 1968 when the two-tier system heralded the de jure recognition of the collapse of the gold standard system, the period as a whole saw a contracting fraction of the world monetary gold supplies in the hands of the United States. The whole expansion of the dollar balances was on the basis of a pure fiat currency and was backed by reserves of high powered money in the form of obligations of the Federal Authorities.

The main way in which the inflation in the United States communicated itself to other countries was that most countries were on a fixed parity of exchange with respect to the United States dollar during this period. There are notable exceptions to this general statement especially in Africa; but all such departures from a fixed parity were brought about by what may be termed "crisis conditions". Normally most countries kept to a fixed exchange rate for long periods.

If the rate of exchange between, for example, the Nigerian naira and the United States dollars is fixed or alternatively the rates of exchange between the naira and sterling and sterling and the United States dollars are fixed, then the price of traded goods such as palm oil, rice, cocoa, and rubber cannot differ much when converted at the fixed exchange rate whether expressed in naira at Lagos or in United States dollars in New York. Of course the two prices will not be exactly equivalent; transportation costs, expenses of marketing and tariffs and other non-tariff impediments to trade will in fact ensure that there will be a difference. But such differences would tend to be fixed either in absolute terms or at least relative to the price itself. Thus one would expect that a substantial movement of the United States price would be accompanied, or followed shortly, by a similar substantial increase in the price in Nigerian naira. If this were not so, supposing that the price in the United States rose and the price in Nigerian naira remained constant, then Nigerians would find it profitable to export their goods to the United States, obtain dollars in exchange for them and sell the dollars for the naira in Lagos. Consequently goods would flow out of Lagos and dollars would flow in. Clearly such a process must come to a stop, since Lagos would not want to accumulate massive quantities of dollar balances and even the United States might find it embarassing to have almost unlimited dollars swamping Nigeria.

There is of course a correcting mechanism. The Nigerian exporters who receive dollars for their goods will offer these dollars to the Nigerian Central Bank (or other monetary authority) in exchange for the naira. Thus the Central Bank will be forced to supply more pounds to the private sector. The Nigerian money supply will increase and so the price of goods in terms of the naira will eventually rise. The effect in the United States will be the opposite, at least in principle. But we know that in practice the United States was quite willing to see massive dollar balances pile up in foreign central banks. In the early 1960s most countries of the world were, at the prevailing fixed exchange rates, short of dollars and so were happy to add to their scarce foreign exchange resources. Even in the early 1970s when there was a dollar glut, certain countries were so short of foreign exchange, at the prevailing exchange rates, that they were still anxious to acquire dollars. But at some stage the business of supplying real goods from Nigeria for the purpose of building up dollar reserves must cease.

In the days of the old fashioned gold standard, Nigeria would have insisted on part of the debt being paid in gold and thus the United States banking system would have lost reserves and so be forced to contract the quantity of money in the United States. 2/ It is well known however that the United States is subject to no such discipline. In a certain sense during the 1950s and early 1960s since at prevailing exchange rates dollars were in short supply, they served as paper gold rather like SDEs do today. Countries wished to hold the United States dollar as the main reserve currency and indeed the main intervention currency in the portfolio of central banks. But after the mid-1960s when the American inflation of the money supply so deluged the world with dollars that the main European countries began insisting on gold being used to settle a substantial fraction of the official indebtedness of the United States, the loss of such gold had no effect on domestic monetary policy in the United States. The inflationary surge continued until 1974.

With a regime of fixed exchange rates, therefore, it makes sense to say the inflation was largely imported from the United States. It is true that other countries in the developed Western world assisted marginally in this process. The United Kingdom, for example, inflated and is still inflating at a much more rapid rate than the United States, but of course there have been many sterling devaluations to ensure that the price level of the United Kingdom does not rise much above that of the United States and continental Europe. Had the dollar/sterling exchange rate remained fixed, the rate of inflation in traded goods prices in the United Kingdom could not have deviated in the long run from that of the United States.

The process of exporting inflation from the United States to the European and Japanese economies has been studied in depth by David Meiselman. 3/ He shows that under conditions of fixed exchange rates a large fraction of the inflation in Europe can be explained by the export of the American inflation. These results have been confirmed by the Manchester Workshop model of world inflation. That model finds that about 50 per cent of world inflation is generated by the United States. The inflation that has afflicted Africa has in part been imported from the United States, again because of the prevailence of fixed exchange rates and in part imported from Europe. The proposition that Africa has been the importer of inflation rather than an exporter of inflation is given some credence by the fact that Africa accounts for only a small fraction of the total world output of tradable goods, perhaps less than 3 per cent. Even a united Africa acting as one large economic unit would exert only a very small effect on the world economy. One may therefore confidently dismiss propositions that the inflation was imported into the United States or Europe from

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2/ It is important to emphasize that the so-called automatic gold standard system never worked either as automatically or as flawlessly as some commentators, have supposed. There was frequent sterilization of gold on the part of the countries in surplus and it was quite possible, as indeed to revoke the gold convertibility conditions the United Kingdom did in 1931. To avoid misunderstanding it should not be suggested that such departures from the gold standard rules were reprehensible. In many and perhaps most cases they were not. For example the United Kingdom's departure from gold in 1931 enabled it to emerge quickly from the slump. Each case must be judged on its merits.

3/ Worldwide Inflation A Monetarist View, (Conference at American Enterprise Institute, David Meiselman, May 1974).

Africa or any other developing country. This is an important conclusion because it has been suggested recently that the prime cause of the world inflation has been the rise in commodity prices such as the rise in the price of oil associated with the policies of the highly successful Organization of Petroleum Exporting Countries (OPEC). The increased price of fuel and in particular of oil has been blamed for much of the inflation that, for example, the United Kingdom has experienced. Most countries in Africa, the obvious exception being Nigeria, have also found that their fuel bills have increased dramatically. It is therefore of some interest to examine in more detail the process by which increases in import prices manifest themselves in a dependent economy.

II. INFLATION AND INCREASED OIL PRICES

The price of oil increased sharply over the period 1972-1974. The price (c.i.f.) of a barrel of oil in 1972 was roughly $2.75 for the countries in the region. In 1974 the average price was roughly four times the 1972 value i.e., $10.75. 4/ This immediately increased the import bill of most countries in the region dramatically. The purpose of this section is to calculate the effects of this increase in prices. The calculation must be highly conjectural since it is not yet known what long-term policy will be pursued in order to deal with the imbalances so created. This is discussed in the next section; here it is merely noted that "importing inflation" is one way of adjusting to straightened circumstances and probably the most likely occurrence. But the issue is complex and cannot be over simplified.

In order to calculate the effects of the oil price rises on countries of the region it has been assumed that in the short run (over a period of three years) there is little or no opportunity for substitution of large quantities of indigenous fuel and that there is virtually no opportunity for a dramatic introduction of conservation and fuel saving. Thus the calculations are made on the assumption that the quantity of fuel imports will not be very much affected by the higher price. This assumption may turn out to be incorrect because, although the demand for fuel is price inelastic, there may be more adjustment than has been assumed. The figures may therefore be regarded as on the pessimistic side. Secondly, in order to project what might happen in the future one must predict what will happen to the price of oil over the next three years or so. It is very difficult to be at all precise in any such prediction. However in these calculations it will be assumed for the sake of demonstration only that the price remains at the 1975 value. Many authorities however would regard this assumption as optimistic for the oil-consuming countries.

Table 1 records the costs of oil imports from 1972 to 1978 on the above assumptions. The most striking result is that the oil bill of many African countries will increase about-seven or eight-fold over the period 1972 to 1978, whereas over the years 1972 to 1974-1975 the oil bill increased five-fold. Although these are dramatic increases in themselves, the effects vary considerably according to the particular countries concerned. Another effect to be noted from this table is the fact that, in general, the poorer the country, the less the impact of the rise in the price of oil. Poor countries tend to be less intensive users of fuel as can be seen from table 3 and as is generally shown by the statistics of per capita energy

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4/ There are many problems associated with defining the appropriate price and quality of oil but they do not affect the argument that follows.

Table 1: Gross domestic product at current market prices and estimated costs of oil imports in some African countries, 1972-1978 *

(Millions of United States dollars)

Country	GDP* (1973)	Cost of oil imports 1972	1973	1975	1978
Ethiopia	2,637	10	17	63	80
Ghana	2,772	16	26	85	101
Kenya	2,295	37	59	199	230
Malawi	411	3	4	16	21
Morocco	4,923	45	73	255	320
Sierra Leone	554	7	11	35	39
Sudan	2,599	17	27	87	98
Uganda	1,669	9	12	43	51
United Republic of Tanzania	1,840	14	22	73	90
Zaire	3,214	21	33	111	130
Zambia	2,061	13	20	66	70

Source: GDP figures are estimates prepared by the United Nations Economic Commission for Africa, Statistics Division.

* At current market prices.

Table 2: Costs of oil imports as percentage of base year GDP, 1972-1978 a/**

Country	1972	1973	1975	1978
Ethiopia	0.4	0.6	2.4	3.0
Ghana	0.6	0.9	3.1	3.6
Kenya	1.6	2.6	8.7	10.0
Malawi	0.7	1.0	3.9	5.1
Morocco	0.9	1.5	5.2	6.5
Sierra Leone	1.3	2.0	6.3	7.0
Sudan	0.7	1.0	3.3	3.8
Uganda	0.5	0.7	2.6	3.1
United Republic of Tanzania	0.8	1.2	4.0	5.0
Zaire	0.7	1.0	3.5	4.0
Zambia	0.6	1.0	3.2	3.4

Source: Table 1.

a/ Base year GDP = 1973.

* The cost of oil imports does not include the cost of oil related products.

** Since base year GDP figures are used and not current GDP figures, column 4 will exaggerate the cost under the assumption of rising GDP.

Table 3: Per capita energy consumption in low-, medium- and high-income countries

Income groups	A*
Low-income countries (under $US 225 per capita)	119.2
Medium-income countries ($US 225-1 000 per capita)	1 024.9
High-income countries (over $US 1 000 per capita)	4 215.6

Source: Statistical Yearbook, 1968 (United Nations publication, Sales No. E/F.69.XVII.I).

A* = Per capita energy consumption in kilogrammes coal equivalent.

consumption measured in kilogrammes of coal equivalent. 5/ In table 2 the cost of oil imports has been computed as a percentage of the gross domestic output of the country concerned. As one might expect, the variations are considerable. The cost of oil imports to Kenya, for example, is almost twice as large, as a fraction of GDP, as any other African country. There is a market association between the degree of development and the importance of oil imports, although there are exceptions when there is an indigenous source of alternative fuel such as hydro-electric power or coal.

Some measure of the possible inflationary impact of the rise in the price of oil can be obtained by supposing that (a) the price of exports of the country does not change; (b) the monetary conditions are not affected by the rise in the price of oil; and (c) exports are increased in order to find the foreign funds to pay for the increased cost of oil. With all these assumptions, the increase in the price of oil to Kenya would account for a 7.8 per cent increase in the price level from 1972 to 1975 - that is to say an increase of 1.5 per cent to 2 per cent a year at the final date. Even States such as Ethiopia and Uganda will suffer an inflation rate increase of about one half of one per cent per annum of the period 1972 to 1975.

These rates of inflation are of course the counterpart of the reduction in real resources available for domestic use as a consequence of the increase in the price of oil. The rise in price is needed to ration the smaller quantity of goods among competing uses or, more appropriately, the smaller rate of growth in the quantity of goods available for domestic use. In this regard, it cannot be argued that a once-and-for-all increase in import prices relative to export prices contributes to persistent inflation. The once-and-for-all increase will result in a once-and-for-all adjustment of the price level. It is likely that the adjustment may be spread over a number of years - perhaps as long as five or six years so as to avoid the impact effects of such a change in circumstances. But after the adjustment is made

5/ United Nations Statistical Yearbook, 1968.

there will be no effect on the rate of inflation interpreted as a persistent rise in the level of prices (i.e. the general price level). This point is of particular importance since the price of oil quadrupled from mid-1973 to mid-1974; but since then the pace has slowed down remarkably and it probably reached a plateau in 1975. One would therefore expect that such a once-and-for-all change in price of oil would affect the rate of inflation over the adjustment period to the extent calculated in the table above and would then disappear. Indeed, if the price of oil remains on a plateau and the price of other goods in trade continues to rise, then it would be necessary to elucidate a deflationary effect of the oil-price plateau; but no such effect is likely to appear for some years.

Secondly it must be noted that the calculations have been made on the assumption that export prices are unchanged. This is of course not correct. Nigerian groundnuts, for example, doubled in price between 1972 and 1974. 6/ Ghanaian cocoa enjoyed a price rise almost comparable to that of oil. 7/ On the other hand for many important commodities in the export economies of Africa, such as coffee, the rise has been quite modest. From 1972 to the end of 1974 the price of coffee increased by only about 10 per cent a year which was roughly equal to the rate of inflation of American prices generally. Of course the volatility of many commodity prices makes it difficult to discuss the effects of rises in export prices in modifying the inflationary impact of the rise in the price of oil. But it is generally true that countries such as Ethiopia, Uganda and Ivory Coast, which have relied to some considerable extent on coffee exports to finance their import bill, will have suffered more than those, which have enjoyed a rapid rise in the price of their export goods.

The third consideration taken into account in the assessment of the effects of the rise in the price of oil on inflation rates is that the country does not borrow from overseas in order to finance the large oil imports. It has been supposed that the unfavourable turn in the balance of trade on current account was offset by increased exports (or corresponding reductions in other imports), which is clearly not generally correct. Many countries have financed oil imports by increasing the deficit on current balance and borrowing abroad or from IMF to cover the foreign exchange outflow. As will be analysed in the next section, this should have the effect of eliminating the inflationary effect of increased oil prices, at least as far as the short run is concerned. In the long run, however, the bill must be met either by increased exports or reductions in other imports.

All these aspects of importing inflation through the higher oil price and the appropriate policy to be pursued are analysed further in the next section. At this stage one must stress that the results of table 3 are to be regarded very much as an upper limit of the effects of the oil price rise. Assuming that the effects are spread out over a period of three years, the maximum inflation that can be ascribed to the oil price rise is 1.5 per cent per annum - and this is the case of the worst hit country in the table, Kenya. For other countries the oil-price-rise inflation rate will be normally less than one per cent.

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6/ Price in 1972 in the United States dollars per 100 pounds = 11.52. Price in 1974 in the United States dollars per 100 pounds = 23.40 (approximately).

7/ International Financial Statistics, November 1974, p. 29.

It may therefore be tentatively concluded that the inflation rates in African countries in 1973 to 1975 cannot be ascribed mainly to the rise in the price of oil. Inflation during these years has proceeded at a rate far faster than can be conceivably attributed to the rise in the oil price rise. Nevertheless it is important to analyse in some detail the effects of a rise in the price of imports. This has been a common occurrence in developing countries as many have suffered from deteriorating terms of trade over the 1950s, 1960s and indeed, in certain cases, the 1970s. Thus the rise in the price of oil is a convenient vehicle for analysing policies towards the phenomenon of "imported inflation". In order to simplify the analysis it will be convenient first to examine the impact effects of an increase in the price of oil, before examining the problems of trade and pricing policy under conditions of inflation.

Impact effects

If it is assumed that the increase in the price of oil relative to other commodities (exports) has no effect on the quantity of oil imported or on the quantity of other commodities imported or exported, then the quantities that enter into the balance of payments are fixed. The increase in the balance-of-payments, or more strictly the balance-of-trade deficit will then be occasioned solely by the increase in the price of oil.

Suppose further that the exchange rate is not adjusted but remains the same as before the oil-price rise was effected. Then the balance-of-payments deficit must be covered by capital flows of one form or another. These may take the form of: (a) aid (or the grant-element in official transfers); (b) imports of private capital; (c) imports of non-grant official capital; or (d) depleting the foreign exchange reserves. With the exception of aid in the form of grants, all methods of financing the deficit involve a stream of future obligations, usually specified in foreign exchange, which will have to be met by the developing country. For the time being, however, one may ignore these future commitments and discuss only the impact effect of the accumulated balance-of-trade deficits due to the increase in the price of oil.

On the assumptions set out above and after the deficit has been covered by capital flows of one type or another, there will be no change in the quantity of goods available for domestic consumption as well as investment. Neither the quantity of imports nor the quantity of exports change, nor is there any reason to suppose that the level of real output will be changed. Strictly one may assume that the composition of output is exactly the same as before.

When the supply of goods is unchanged, attention should be turned to the demand side. The simplest case, and perhaps the most realistic, is where the Government borrows money from abroad in order to pay for the increased cost of oil. Thus the increase in the financial deficit on the accounts of the public sector is exactly matched by its overseas borrowing; there is no need for the public sector to increase its domestic borrowings from the banking system (increasing the money supply) or from the non-bank public or its tax revenue. Both the money supply and the public sector's domestic financial deficit will be quite unaffected by the increase in the price of oil and the foreign borrowing. Thus demand remains the same and there will be no change in the general level of prices as a consequence of the increased oil price.

The question is whether there will be any change in the relative price of oil and oil-based products relative to the prices of other goods and services. This will hinge on the subsidy policy of Government. A first extreme case is where the

Government borrows to cover the higher price of oil and subsidizes the price of oil with its borrowings. Then the price of subsidized oil on domestic markets will be the same as before. Relative prices will not change.

A second case, and perhaps a more close approximation to the normal one, is where the authorities allow the price of oil to rise while using the proceeds from their foreign borrowings to reduce taxes generally. The authorities might simply provide for an across-the-board reduction in the rate of a general fixed percentage sales tax. An alternative strategy is to reduce direct taxes, but that is less likely to be feasible in developing countries. Now clearly relative prices will change; the price of oil and oil-based products will rise relative to the prices of other commodities and services. But there is no reason why there should be any inflationary or deflationary effects of the rise in oil prices. The general price level will not be affected. The proceeds of the foreign borrowings are used to subsidize domestic spending as a whole, and these foreign borrowings are exactly equal to the increase in the price of oil multiplied by the quantity of oil imported. The quantity of money is not affected nor is the domestic impact of Government finance. While oil prices are allowed to rise, the deflationary impact of higher import payments is again fully offset by external capital.

The conclusion, therefore, with the unchanged quantities and full borrowing model, is that there will be no additional inflation generated by the increased price of oil. Of the two cases discussed above the second seems preferable. It is better to permit the increase in the relative price of oil and oil-based products to be reflected in domestic markets so that domestic decisions are based on the relative prices of goods on world markets, that is, on the prices confronting the country. Clearly the change in relative prices must affect the product mix; there will be economies in the use of oil, switches to other sources of power, and a reduction of the output of those commodities that are power intensive and an expansion of other goods which are labour intensive.

If economies are possible in the consumption of power in general and oil in particular one must consider the case when, as a consequence of the rise in the price of oil, less is imported. Also, if the country exports goods that have a relatively small power component, the relative cost and price of such goods should fall and, if the exchange rate is fixed, there will be some increase in the quantity of exports, the extent of that increase being determined by the elasticity of demand for the country's exports.

It is clear that the authorities will then have to borrow less than the additional cost of the reduced oil imports in order to cover the increase in the balance-of-payments current deficit. Certainly the borrowing needed will be less than the increase in value of the old oil imports. Thus the quantity of commodities available for the domestic market will decline as oil imports are reduced and exports expanded. This decline in quantity available for domestic uses is a counterpart of smaller foreign borrowings.

But by the same arguments used above, there is no reason why there should be a decline in demand.* The authorities may control the quantity of money so that it is the same as before. With differential tax rates on different commodities, the change in the composition of production and the reduction in home supplies and increases in exports may affect tax receipts; but these can always be offset by suitable changes in rates. There is however a danger that there may be a reduction or an increase in tax revenue, engendered by composition changes, which is not taken

* The potential change in the quantity demanded would be the result of a change in price.

into account by the authorities. Thus there may be some accidental change in demand. Putting this aside, however, it is clear that if the authorities do maintain the same money supply and aggregate demand, there will be some inflationary effects because of the reduction in the amount supplied to the domestic market.

The conclusion therefore is that with quantities responding to relative price changes and with borrowing only to cover the reduced deficit there will be inflationary pressure, assuming however that the exchange rate is fixed. The maximum amount of inflation will be set by the difference in foreign borrowings at full compensation for the oil price rise and the lower borrowing due to substitution and expanded exports. For example if the gross domestic product of a country were 100 and it enjoyed a stable price level before the increase of oil prices which, with unchanged quantities added 10 to its import bill, then if with substitution and expanded exports it only borrowed 5, the domestic oil-induced inflation would not exceed 5 per cent per annum.* With an unchanged money demand this increase in the domestic inflation would produce the reduction in domestic demand needed to expand exports. It will be noted that the authorities could always eliminate that inflationary pressure provided that there is sufficient access to credit on international capital markets. The authorities could simply borrow more and finance larger subsidies for prices on domestic markets. But as argued above this would depress exports and so provide the need for larger foreign borrowings.

The conclusion is therefore that some inflation induced by higher oil prices may be preferable to more extensive borrowing and the corollary is that it may similarly be preferable to allow domestic prices to reflect the relative price of oil in the world. In principle it would be possible to raise tax rates so that the aggregate demand, either influenced through the reduced money supply or through the direct effect of the reduction in the disposable income of the private sector, is diminished to the extent needed to avoid inflation. But such a policy has disadvantages from which that outlined above is free. First, such a reduction in disposable income and money supply would take a long while to work its effects and in the interim there would be the possibility of considerable excess capacity, unemployment and dislocation of agriculture and industry. Secondly it seems that fairly stable demand conditions are best for development; variations in the stock of money or in taxes to take into account of variations in the price of imports are difficult to effect in practice because such changes in world markets take place rapidly and in some cases unpredictably.

It is important to note that in all these various paths of adjustment inflation and foreign borrowing are alternatives. The more one borrows the less the inflation. The greater the inflation the less one borrows. It follows therefore that a country which for some reason cannot or will not borrow, should find that with the same money demand there will be an inflation which will have the effect of cutting down the domestic use of resources sufficiently to provide the exports needed to restore the current balance of payments to equilibrium.

There are other ways by which equilibrium may be restored. The authorities may reduce money demand either by operating on the money supply and/or by reducing Government spending and increasing tax rates. If it is done, for example, through reductions in Government spending and assuming that there will be minimal effects on tax revenues, the reduction of the deficit on Government account will be largely reflected in the reduction in the deficit on the balance of payments. It is always possible nevertheless that the private sector may change its financial surplus or deficit by a considerable amount, but one may discount that eventuality for many countries.

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* This is assuming that the pattern on demand does not change appreciably.

To avoid misunderstandings it must be emphasized that such a method of reaching equilibrium in the balance of payments, while avoiding inflation, may not be found the best. First it should only be thought relevant for a long period of adjustment - some 2 to 3 years - since there are considerable lags in the system. Secondly it is likely that the reduction in Government spending or the increase in taxation will have a considerable impact on the level of real output in the short run. Although the depressing effect of the reduction in real output will be fairly short lived (probably from 18 months to 2 years), it might be thought that the costs of such reductions are too large a price to pay for reducing inflationary pressure even though such modifications in the level of output will not be avoided in the longer run.

Issues of pricing, trade and commodity policy

The recent changes in the international energy market will affect trade and payments through their effects on production and investment decisions. These effects are chiefly long run in nature and are to that extent outside the scope of this section except as regards the possibility of inconsistency between short run policy and long run objectives. The obvious question in this connexion is the pricing of petroleum and its substitutes. The price of petroleum which affects a particular project or country plan is its price relative to the output of the project, or relative to the prices of actual and potential exports. 8/ This relative price of oil, however, is necessarily still surrounded by uncertainty. Prices have nevertheless to be fixed. As was shown in the last section, the authorities may consider holding petroleum prices below the level which would result from landed prices converted at the current rate of exchange or forcing them higher by taxes. Insofar as long run production decisions are affected in some degree by this price (as may happen, for instance, in the agricultural sectors of several ECA countries) it may be decided to set different prices for different uses or according to the destination of the product. But, quite apart from the danger of a leakage of low-priced supplies to other uses, subsidies on particular inputs distort producer choices and are to that extent inefficient: an output subsidy or simply higher guaranteed prices are in principle superior but may be found difficult to implement. Efficiency-of-use considerations also enter into decisions on the pricing of alternative fuel; the increase in the price of oil has raised the cost of all sources of energy. There is no reason to expect the social marginal cost of petroleum to be greater than its landed price and the only reason for raising the price above this level (reasons of revenue apart) would be the expectation that the relative price of petroleum will rise in future. Most Governments have allowed petroleum prices to rise across the board and have in some cases regulated the use of fuels.

Trade policy in a setting of inflation

Domestic decisions on energy pricing had to be taken in practically all countries in an inflationary situation, and the inflationary potential of higher fuel prices could not be ignored. But the alternatives often appear equally difficult. Balance-of-payments pressures during the present period of international adjustment

8/ If it is thus expected that the price of crude will rise relative to the price of petrochemical products, if their output is enlarged by one additional plant, the value added per unit of output will have been reduced and the scheme may cease to be profitable or may only become profitable at a later time, when demand has increased.

may thus lead to the introduction of or the tightening of import quotas. Growing concern over the distribution of income (itself adversely affected by inflation) may be found to be arguing for the auctioneering of quotas in preference to conferring property rights on quota holders selected by other methods. It may then be objected that such a policy would increase the price of imports and so exacerbate the inflation; but such a view is mistaken. The increase in the price of imports must result from the demand for the limited quantity allowed into the country. Regulating the price of such imports at too low a level through means of licensing will merely drive the demand elsewhere, and probably mainly to swell the income and spending power of those who are lucky enough to command the licenses. This will drive up the price of goods demanded by the license holders. This will therefore increase the prices of other goods and services and, above all, will stimulate the business of procuring licenses.

With the allocation of scarce and rationed commodities on the basis of the export performances of firms it might be believd that the inefficiencies of license allocation can be avoided by methods other than price. The right to acquire scarce petroleum at low prices is some sort of export subsidy but it may be thought not to involve the inflationary effects of devaluation. Insofar as this policy is successful it will give rise to fewer goods being released on domestic markets and more for export, so the domestic supply will be reduced and prices must rise to compensate. Apart from this elementary point, the inefficiencies of such quota allocations often give rise to a marked reduction of useful output in addition to the fall resulting from the resources required to administer such controls. It thus appears that systems of quotas - on imports, inputs or outputs - allocated by methods other than sale cannot contain the rate of inflation but merely drive it into different forms.

Several developed countries have recently introduced import surcharges as a method for controlling the balance of payments. The advantage of the technique is that it requires no additional administrative machinery; a simple 10 or 20 per cent on official valuation is all that is required. 9/ Similarly, there would not be any discrimination among different commodities and thus no unintended effect on relative prices which can be regulated separately from balance-of-payments policy. Attempts to moderate domestic inflation by exempting certain classes of goods from such surcharges have on the whole been found counter-productive. 10/

The attraction of the import surcharge method is greatest when it is believed that the balance-of-payments deficit is likely to be short lived. In many respects an import surcharge is a substitute for devaluation, more particularly for a change in the value of a pegged exchange rate which, when unpegged, is moved to a lower

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9/ There may, however, be difficulties about goods that enter tax free since these would require valuations to be attached.

10/ In the case of the United Kingdom, raw materials and food were excluded from the import surcharge. This was done in the belief that, by discriminating in this way, "cost-inflation" would be reduced. The actual effect was however to reduce the relative price of food and material-intensive products, and to drive up the relative prices of other goods, thus encouraging their production and the diversion of resources from producing substitutes for imported food and raw materials. Finally, the fact that the authorities did not receive as much revenue as they would have done from an across-the-board surcharge raised the need for deficit finance which in turn increased the future rate of inflation.

value and maintained there by deploying the reserves of foreign currency. The major alternative is therefore a move towards a floating exchange rate. The petroleum price rise and its repercussions have ramifications of which only a few have been revealed as yet. The required adjustments have to be carried out by a large group of countries struggling with inflationary pressures as well as declining rates of growth and levels of employment. If it was indeed ever possible for a developing country to choose an appropriate equilibrium exchange rate, the present great uncertainties argue rather strongly against the possibility of a rational choice of that kind. The inflationary consequences of a floating exchange rate are certainly no greater and should in the end be less than those of devaluation to a particular rate chosen in unavoidable ignorance of the sequence of different national adjustments in relation to the disturbances in the established pattern of payments.

Export and commodity policy

Exports and the freeing of access to markets must obviously be in the forefront of economic policy for the countries which find themselves vulnerable to the recent changes in the international energy market. The opening and expansion of export markets in the petroleum producing countries and the development of new types of exports to them 11/ may well be a condition for attracting capital to the exporting countries.

A fuller use of the existing General Scheme of Preferences might also be accompanied by increasing publicity to instances and areas where preferences are being frustrated. Developed countries may become increasingly sensitive to "the inconsistency of the rich countries in mounting emergency programmes to assist developing economies whose opportunities for growth are being simultaneously damaged by other rich country policies". 12/ They may be made similarly sensitive to the waste of opportunities for containing inflation which is inherent in the exclusion or restriction of relatively cheap imports of mass consumption goods.

Several of the commodity schemes which are currently being pursued by groups of producers involve major export commodities of the developing ECA region. The progress that has been made in producer agreements and market leader policies are still to be tested when commodity prices cease rising at the rates of 1973-1974. But the need for such agreements is now particularly great for countries that are vulnerable to higher petroleum prices. The commodity shortages and price movements of the recent past as well as the speculative intervention in several commodity markets towards the end of 1973 should have increased consumer interest in commodity market stabilization: the cost of avoidable adjustments to unstable markets and supplies have proved to be high. In a recent important policy document, UNCTAD discusses the possibility of attracting the surplus funds of petroleum producer countries to finance buffer stocks which form a necessary part of many commodity schemes. The security of such investments which would be backed by physical stocks and their relative protection against inflation and exchange rate variations might be best assured by the creation of a central fund catering for a variety of buffer stocks. Schemes to stabilize the relative prices of major commodities might in addition yield profits equal to or greater than the returns on the expected increments of the surpluses of petroleum producers.

11/ Skills and technology might thus be exported through intergovernmental contract rather than by way of the brain drain.

12/ Report from the Select Committee on Overseas Development, op. cit., p. 25.

III. IMPORTING INFLATION THROUGH HIGH AND INFLATING EXPORT PRICES

Although it is usually claimed that inflation is imported through the high or inflating price of imports, the view occasionally expressed that it is the high price of exports (or inflation in the price of exports) that generates inflation. Some authorities tend to dismiss such an effect as nonsense, or at least as a meaningless attribution of blame. But the case deserves analysis in the African context, since the variation of export prices is often very large and constitutes a continuing problem.

Much of the variation which one sees in African export commodities takes the form of very short-term oscillations. For example the price of cocoa, the main export of Ghana, almost doubled from January to May 1974, from £520 a tonne to nearly £1,000 a tonne. In June however the price fell to some £700 a tonne. One would not expect such quick and violent oscillations to be reflected in the rate of inflation of Ghana. The characteristic feature of the persistent price movements that comprise inflation is that they take a long while to get under way and they also appear to take a long time to stop. Such fluctuations as one observes in the price of cocoa over this period would be absorbed in variations in short run profits or, in the case of Ghana, in the surplus of the Cocoa Marketing Board.

Nevertheless it is clear that, if the price of exports rises on a long-term basis, or if it rises suddenly and stays unusually high for a period of say three years, the possibility of inflationary consequences is not easy to dismiss.

It is convenient to begin an analysis of the problem by assuming first of all that the money demand remains the same, either by the monetary authorities' "sterilizing" the increase in export earnings or by some other similar mechanism. The problem of carrying out such sterilizing operations will be examined later.

It is also convenient to analyse what happens when the volume (i.e. the quantity) of imports remains constant, and then later to take up the problem of varying quantities of imports and exports.

With these two critical assumptions and that of a fixed exchange rate the solution in the short run is simple; there will be no inflationary effect in the domestic economy. The money demand for goods and services is the same as it would have been without the rise in export prices and the quantity of goods available for domestic consumption remains again what it would have been without the rise in export price. There is of course an increase in the surplus (or a reduction in the deficit) on the current balance of payments. And there will be a considerable change in the relative prices in domestic markets. The prices of goods which are both sold as exports and consumed domestically will rise, as will the prices of goods which are produced intensively with those factors of production that also are absorbed intensively in export goods. The prices of other domestic goods, however, will fall relatively. On balance, however, there will be no change of the general price index or alternatively the rate of inflation which would have occurred in the absence of the increase in the price of exports. That is to say a country that has enjoyed an increase in the price of its exports, such as Nigeria has been experiencing from October 1973 onwards, needs experience in the short run no change in the rate of inflation of the general price level provided that the money demand is not expanded at a greater rate as a consequence.

However it must be noted that, if the rise in export prices persists, there will be a marked "wealth effect". The counterpart of the balance-of-payments surplus on current account is the accumulation of foreign paper and other assets in the hands of the central bank. These are offset by their liabilities to domestic exporters and other domestic residents who, one supposes, transferred their foreign exchange to the central bank in exchange for domestic assets. In short the central bank has simply changed its portfolio of assets and liabilities. Note also that the assumption that the money supply conditions are not influenced by the larger balance-of-payments current surplus implies that there is an increase in the long-term liabilities of the central bank vis-à-vis domestic residents.

The wealth effect will imply that portfolios of domestic residents will be adjusted and that there will be some increase in permanent income and so in permanent consumption. With regard to portfolio adjustment, normally one would expect that an increase in wealth and permanent income would give rise to a corresponding increase in the residents' demand for money. This means that the authorities (the central bank or currency board) can supply the increased demand for money without it having any effect on spending. This acts as the seignorage of the authorities associated with the increased demand for money. Such an issue of interest-free Government paper automatically puts real resources in the hands of the public sector. In effect the central bank issues bank notes and exchanges commercial bank deposits and acquires the foreign exchange proceeds of the higher export prices. But, except where a currency board system operates, there is not likely to be a matching one-for-one exchange of domestic money for foreign exchange if the authorities just supply sufficient domestic money to meet the additional demand for it at the existing price level or rate of inflation and the new level of wealth and permanent income.

An example will illustrate this general proposition. In Ghana the velocity of circulation for money and quasi-money is approximately three. Thus for any increase in income the authorities will find that the public wish to hold about one third of that income in the form of money. Exports from Ghana comprised approximately 25 per cent of GNP over the years 1967 to 1972. Imagine a situation where the export prices of wood and cocoa mainly increase by 60 per cent whereas import prices increase by only 10 per cent, so that with unchanged quantities of imports and exports, Ghana enjoys an increase in real income of approximately 12 per cent as a result of changes in the terms of trade. If the increase in income is reckoned to be permanent, then the Government will be able to issue more currency and bank deposits corresponding to about one third of the increase in income, that is to say, the Government of Ghana will obtain resources corresponding to some 4 per cent of the income of Ghana and would increase the money supply by about 12 per cent. This is a once-and-for-all effect; there will not be an increase in the money supply in response to this increase in the demand in the next year owing to the fact that the export prices stay high; the money supply adjustment is a stock effect and does not continue.

It will be observed that the increase in the money stock accounts, even in the impact year, for only about one third (or the reciprocal of the velocity of circulation) of the increase in income. What happens to the remaining two thirds of the income depends very much on the principles and practices of the central bank and treasury, and the extent to which there is a market for domestic debt.

In most African countries the market for Government debt is either non-existent or very limited and confined to "captive" institutions, such as banks, non-banking finance companies, semi-official provident funds or social security funds such as

the National Social Security Fund of Kenya or marketing boards and other nationalized industries. In many cases these captive markets for debt approximate to a non-fiscal system of taxation, and analytically it is more sensible to regard it as part and parcel of the tax system. It is likely that over time some countries, with fairly highly developed monetary systems, such as Kenya, will generate competitive markets for public debt with appropriate interest rates and terms. But generally in the first half of the 1970s and perhaps until the end of the decade no such markets are likely to spring up. Thus in the following analysis the Government debt market in the non-bank private sector is ignored.

Clearly the additional foreign exchange funds in the hands of exporters must be exchanged for the only other instrument which the central bank disposes -- money. Thus on a one-to-one exchange basis the money supply will expand by at least as much as the increased export earnings. The money supply may expand more if the new money created by the central bank in order to pay for the foreign exchange is high powered money. This will then serve as a monetary base for the multiple expansion of deposits in the banking system.

But it must be noted that the central bank is not in general powerless to prevent the mushroom growth of deposit liabilities of the banking system. The central bank may (a) change the reserve ratio so that there is no expansion of deposits, or constitute "special deposits"; (b) sell long-dated Government securities to the banking system, either voluntarily by making the interest rates and terms attractive for the banks to hold, or by forced placements. In case (b), the commercial banks will make deposits of "low-powered money" available for the Government which can then use them to buy the foreign exchange excess. The total quantity of money in the hands of the public needs be no different from the amount that it demanded in response to higher permanent income. But this does require considerable flexibility on the part of the central bank and it is true that many central banks are constrained by law and custom in what can be done. For example many central banks in African countries have emerged from the colonial currency board systems and some still follow currency board or currency exchange board practices. In principle this means that the domestic currency is expanded in a way that corresponds exactly to the foreign assets held by the board, or amounts a specified fraction less than these assets. In most United Kingdom colonial currency boards the authorities were required to hold reserves of foreign assets equal to 110 per cent of the domestic money.

Indeed one may conclude that a more or less automatic expansion of the money supply in response to an increase in export prices is one of the main effects which might generate internal inflation of prices.

Both increased wealth and increased money supply will give rise to an increase in the demand for goods and perhaps foreign securities in certain African countries. The question then is to determine how this increased demand will be distributed between imports and domestic goods. And, in the latter case, how it will be divided between a quantity expansion and an increase in the rate of inflation. This will depend upon: (a) the extent of restrictions on trade and particularly imports; (b) the income elasticity of demand for imports and the income elasticity of demand for domestically produced goods; and (c) the extent of unemployment in the domestic economy and the costs of mobilizing them into employment.

In general in most African economies where there are no restrictive and onerous quotas on imports, it appears that the main effect is to increase the quantity of imported goods. This is in part because the income elasticity of demand for imported goods is high since they generally comprise manufactured and some durable consumer goods. If all the increase in permanent income is spent on imports of both capital and consumer goods then there is a simple solution. There is no domestic inflation at all; the increases in demand is matched by an increase in the quantity of imports at existing prices.

The monetary effects of an all-import solution are also easy to trace, as in the case of Ghana. Since Ghanaians hold about one third of their increased real income in the form of real money balances, the increment in domestic money corresponding to the balance-of-payments current surplus will be divided between additions to money stocks and spending on imports. Thus two thirds will be spent on imports. The central bank will receive demands for foreign currency to the extent of this two thirds of the surplus, and so there will be a corresponding absorption of domestic money by the central bank, with the result that demand for money is equal to the supply available. It will be noted that in fact the supply of money adjusts to demand: in a technical sense the supply of money is demand-determined.

The above case is an archetype but very useful since it epitomizes the conditions in some African countries. In general however there is usually a significant effect on domestic prices since part of the increased demand spills over to goods produced domestically. Similarly goods and factors of production whose value has risen in international trade will increase relatively in price on domestic markets and since there is a larger money demand for the outputs this will be manifest in an increase in the general price level.

The next question is whether the increase in the prices of domestically produced goods and whether the increased demand will call forth a larger quantity of domestic goods by increasing employment and activity in the economy. There is some evidence that the increase in trade and the extension of external contacts will result in a faster marketization of the economy, greater specialization of labour, and therefore some increase in the level of material well-being. But the evidence suggests that such processes take time, perhaps as many as two or three years before their effects are fully appreciated. Meanwhile the increased demand is likely to generate some reduction in urban unemployment since service industries are highly income elastic, and perhaps also some reduction in the underemployment in agriculture and truck farming.

Such increases in prices and domestic outputs will increase the demand for money, and this increase in demand will be validated by the money supply adjusting to it as the central bank responds to the demand. The simultaneous reduction in the balance-of-payments current surplus will, initially, be less when there is an absorption of some of the increased demand by the domestic sector. But the increase of domestic prices will have some effect in reducing the volume of exports, and so eventually the balance-of-payments surplus will be eliminated by domestic cost inflation. It will be noted that in African countries quite large movements in domestic prices may be required to eliminate the balance-of-payments surplus. But their effect will first be to reduce the demand for the existing stock of nominal money balances, and second to reduce the supply of money by reducing the surplus.

This completes the argument about the effect of importing inflation through the increased price of exports. It must be emphasized however that all this analysis refers to a permanent increase in the price of exports. If the effect is known or expected to be transitory, then the effects both on consumer spending and investment and on the demand for money will be much muted. There will be a smaller effect both on the balance-of-payments surplus on current account and on the domestic expansionary and inflationary effects. Whether this is better dealt with by a process of using marketing boards or export monopolies is a matter that has received much attention but is not germane to our discussion here. 13/ UNCTAD has been concerned with promoting buffer-stock schemes to reduce the variation in prices and so the export earnings of primary producers. This is a complex matter which is not taken up in this study.

So far no attention has been paid to the time dynamics of the adjustment process under the assumption of flexible exchange rates. This assumption of flexibility is critical since one of the possible paths to equilibrium is that the domestic currency is revalued upwards. This would reduce the domestic price of exported goods, valued in terms of domestic currency, and it would reduce the price of imported goods using the same basis of valuation. In such circumstances the effect would be to increase the quantity of imports and perhaps also to reduce the quantity of exports, thus reducing or even eliminating the balance-of-payments surplus. In principle flexibility of exchange rates would bring quicker and more certain adjustment to the changed price conditions. But a few cautionary words are in order.

There is ample evidence that the change in relative prices of exports and imports takes a long time to work on the adjustment of quantities. The time lags may extend to some five or six years before their full effects are felt. 14/ The initial effects of a currency revaluation may therefore be adverse in the sense that the surplus is increased for a period of a year or two. 15/

The dynamic effects of adjustment generally create considerable problems. For example, the increased consumption and investment effects which we have described here may take many years to work out. In developing countries the institutions do not necessarily exist by which a country can immediately or in the short period expand its spending. This is remarkably the case in many oil-rich nations in the Middle East. It does not forcibly apply however to Nigeria, which has a large programme of development spending.

The actual policies of African States with respect to exchange rates have varied considerably since 1971. Some countries seem to be allowing their exchange rates freely to float more or less independently or within very wide margins of a central rate fixed with respect to the dollar as intervention currency. Perhaps the most important are the Moroccan dirham, the Algerian dinar, the Nigerian naira,

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13/ Polly Hill, Fluctuations in Incomes of Primary Producers, Economic Journal, 1953.

14/ Patrick Minford, Studies in Substitution in International Trade, Weidenfeld and Nicholson, London 1975.

15/ This may have been the effect of the recent revaluations of the Deutschmark, and in the opposite sense the consequences of the devaluation of sterling in 1967.

the Malawian kwacha, and the Tunisian dinar. But there has generally been a preference for stable exchange rates -- probably because of the experience with the administrative convenience of a stable system.

In the much changed world economic environment of the second half of the decade, African countries have much to learn of the problems of managed exchange rates in a fluctuating world. But such reflections are far beyond the scope of this paper. 16/

IV. MONEY SUPPLY AND INFLATION

One of the best attested relationships in economics is that between the quantity of money and the level of prices, or, in its more modern versions, the rate of growth of the money supply and the rate of inflation. In the context of this study, however, it must be emphasized that:

(a) The effect of money on prices is a long-run phenomenon extending from about 18 months to about 45 to 50 months after the initial change in the money supply, but the inflation will then persist as long as the monetary growth continues at its new higher rate; and

(b) Although the effect of money on prices in the long run is well known, there is also an expansionary effect which is transitory and occurs for some six to nine months, eventually disappearing some 12 to 18 months later.

These findings have been established in virtually every economy that has been systematically studied. Unfortunately there is no long series of statistics either of the money supply or of the national income to test these theorems properly in any of the African States which are studied here.

To establish however the assumption that similar effects occur in African countries, one may observe recent statistics. One country for which the statistics are particularly reliable is Kenya. In table 4 the money supply is compared with the consumer price index. There are two periods when the money supply increased very rapidly -- in 1969-1970 and in 1973-1974. We would expect therefore the effects of the 1969-1970 expansion of about 25 per cent to exert pressure on prices from 1971 through to 1973. It will be noted that by 1973 the rate of inflation had increased to some 10 per cent per annum. Had the expansion of money supply persisted at its 1969-1970 rate, the inflation in 1973 would have been in the region of 17 to 20 per cent, but there was a marked slowdown in monetary growth in 1971 (about 7 per cent) and this modified the inflation in 1973.

The expansion in 1973-1974 was near 28 per cent, and unless there is a marked reduction in the rate of growth in 1975 one is fairly certain to see rates of inflation around 18 to 20 per cent by 1976. If, however, the Central Bank and Treasury carry out a deflationary policy by squeezing the money supply these high rates of inflation may be averted.

It will be noted that Kenya has pursued a policy of stable exchange rates over this period. Thus the rate of inflation in Kenya cannot differ very markedly from the rates of inflation of its trading partners that are also on a fixed rate of

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16/ See the report prepared by S.R. Oluwole Dixon-Fyle.

Table 4: Relationship between money supply and consumer price index in Kenya, 1967-1974

Year	Money supply In Ksh	A*	Consumer price indices and growth Indices	B*
1967	1,410	...	97.8	...
1968	1,627	15.3	98.1	0.3
1969	1,939	19.2	97.9	-0.2
1970	2,426	25.2	100.0	2.1
1971	2,598	7.0	103.8	3.8
1972	3,029	16.9	109.9	5.8
1973	3,862	27.4	120.0	9.3
1974	4,036	4.5	141.3	17.4

Source: IMF International Financial Statistics, July 1975.

A* Average rate of growth per cent per annum.

B* Average rate of growth per cent per annum.

exchange. Indeed the rate of inflation in Kenya during the 1970s is probably not very different from those in the United Kingdom, and, with the exception of the Federal Republic of Germany, much of continental Europe. It must also be noted that, from 1963 to 1972, Kenya had one of the lowest inflation rates in Africa. As far as the present information can be analysed it seems that inflation will continue at a high but uncertain rate into 1976.

Ghana is a quite different example of monetary development. Ghana, unlike Kenya, suffered in the 1960s from very rapid changes in the rate of inflation. In 1964 the rate was 12 per cent, in 1965 about 26 per cent, and in 1968 about 10 per cent; yet over the period from 1969 until 1974 the rate of inflation has been relatively low. This was a consequence of the slow rate of monetary growth over the years 1967 to 1971. The rate averaged about 8 per cent over this period. This would be consistent with a low rate of inflation of about 3 per cent or even less.

In 1972, however, there was a very rapid rise in the rate of growth of the money supply (about 45 per cent). One would expect that this flood of money, although not sustained at this rate in 1973, would put great pressure on the price level towards the end of 1973 and in 1974-1975. There are at present (January 1975) signs that the forecast inflationary forces have appeared but their full strength has yet to be gauged.

It will be noted that Ghana has had quite a different experience from Kenya with respect to foreign exchange rates. There have been many changes in exchange rates and varying conditions of convertibility over this period. From parity with sterling from 1958 to 1965, the cedi has been devalued from $US 1.40 in 1967 to 55 cents in 1971 and back again to 78 cents from 1972. Certainly it cannot be claimed

that the need to maintain a fixed parity has determined the economic policy of Ghana, at least as far as the long run results are concerned.

Morocco contrasts strongly with Ghana in its monetary experience. Over the period 1967 to 1969 the money supply expanded at the rate of about 9 or 10 per cent per annum. This rate fell to roughly 2.5 per cent in 1970, but rose again to about 12 or 13 per cent in 1971. In 1972 and 1973 the rate of growth was further increased to about 18 per cent.

From our hypothesis therefore one would expect that Morocco would experience only a gentle rate of inflation of about 4 or 5 per cent per annum until 1975 when one would predict that the inflationary expansion of the money supply in 1972 and 1973 would have a marked effect on the price index in late 1973 and subsequent years. As far as the historical record goes, these predictions are borne out by events. Consumer prices increased at an average rate and from 1970 at an almost constant rate of 4 per cent per annum up to the third quarter of 1973. Then the price level showed every sign of accelerating. Evidence of this appeared in the indexes for the price of home goods which showed an increase of about 25 per cent in 1973. Such price increases have yet to filter through to consumers.

Morocco also provides opportunity for testing the hypothesis of the effect of variation in the money supply on the rate of growth of real output. The sudden restriction of the monetary growth in 1969-1970 would be expected to have a depressing effect on industrial output in 1970-1971 which would be counteracted in subsequent years. It will be seen that this effect did appear in the index of industrial production and in mining production which was more than made good by a phenomenal increase in 1972.

Table 5: Indexes of industrial production and mining in Morocco, 1967-1973

Year	Index of industrial production	Index of mining production
1967	85.7	93.1
1968	88.2	92.8
1969	94.4	92.8
1970	100.0	100.0
1971	103.7	102.7
1972	114.9	119.1
1973	129.2	...

Source: IMF International Financial Statistics, July 1975, pp. 272-273.

Although one should not regard such evidence as a dramatic confirmation of the monetary hypothesis, it is consistent with it. A further corollary of the monetarist hypothesis is that not all variations in output are brought about by monetary variation.

Zaire provides a marked contrast with the countries reviewed so far. Of all the countries reviewed in this study, Zaire has had the highest inflation rate and it has also suffered from a highly variable inflation rate. Over the years 1963 to 1972 Zaire suffered an inflation rate well in excess of 10 per cent with much of the increase concentrated in the years 1964, 1967 and 1968. From 1969 to 1972 the rate of inflation was at last brought under control.

Zaire is interesting, because of the consequences of the impact of the political changes on economic development change. The first effects of these events were an immediate dislocation of much economic and commercial activities and consequently there was a fall in real output. It is difficult to measure this fall since only partial statistics are available and it is not clear what degree of reliance may be placed upon them. But it seems that the fall in output was not very large and affected only certain sectors of the economy. With an unchanged money supply or to be correct with a money supply increasing at the rate at which it would have grown there would have been only a relatively small effect on the price index - probably less than 6 per cent.

However more important was the fact that the disturbances gave rise to a massive increase in Government expenditure on the one hand, and a reduction in the efficacy of the tax collecting system. The rapid increase in the borrowing requirement of the public sector and in particular the vast increase in the financial deficit of the Government was financed by borrowing from the banking system and so rapidly expanding the money supply.

One would expect that this rapid creation of new money would have a marked effect on the rate of inflation in 1963 and 1964. The rate of inflation of retail prices in 1964 reached 37 per cent; however there was much speculative anticipation in price rises and the reaction set in the following year.

In the mid-1960s again the authorities were constrained to resort to deficit financing and created considerable pressure on the price level which finally broke out when there was a substantial devaluation in 1967. What was needed in Zaire in 1967 was a very large increase in prices in order that the non-bank private sector would willingly hold the large amount of money that had been created to finance Government spending during the difficult years of the disturbances. The revaluation also had the effect of reducing the speculative flight of capital from Zaire and so the authorities were able to expend the money supply considerably in 1968 without having any substantial inflationary consequence in 1970 et seq. The stabilization of the growth of the money supply in 1969-1970 and 1971 was associated with a marked introduction of stability into the price level; in 1971 the inflation rate fell to about 5 per cent. But from 1972 the money supply started again to expand rapidly at the rate of about 27 per cent and one would expect that to have a marked effect from 1973 onwards. A high rate of inflation is to be expected in 1974 to 1976 - perhaps of the order of 20 per cent on average.

In Sudan from 1967 to 1971 the money supply was expanded at the rate of about 10 per cent a year on the average. The inflation rate over this period varied considerably but was probably on average less than 4 per cent per annum. However in 1972 the money supply was increased by almost 20 per cent and in 1973 the rate was increased to above 20 per cent.

The first signs of more rapid inflation began to appear in Sudan in 1973. Although consumer prices in 1972 had increased by almost 9 per cent, in part this could be ascribed to "making-up" from the low increase in the year 1971. The increase in prices in 1973 over 1972 was about 15 per cent, and in 1974 the provisional evidence suggests that price inflation may be running near to 20 per cent.

V. CASE HISTORIES

Case 1 - Kenya

It is particularly important to study the context and nature of inflation in Kenya, partly because Kenya is one of the more advanced and wealthy nations in Africa and partly because Kenya's institutions are relatively well developed. Furthermore, Kenya has been a high-growth economy - reaching a general trend rate of growth over the last 10 years of approximately 7 per cent per annum. Yet inflation has become a very serious problem in the 1970s, reaching 20 per cent in consumer prices in 1974, against an average rate of inflation during the period 1965-1970 of merely 1.7 per cent.

As was seen from table 4 above, the proximate cause of the increase in inflation in Kenya was the more rapid expansion in the rate of growth of the money supply, particularly from 1971 onwards. But this is only the proximate cause. Ultimate causes must be sought in why this more rapid growth in the money supply was induced or at least permitted to happen.

Ultimately the money supply is a consequence of the Government's fundamental financing equation, which can be written in various forms - but the one most convenient for a study of inflation is:

Financial deficit of public sector	-	Borrowing from non-bank private sector	+	Borrowing from abroad	+	Borrowing from banks

The borrowing requirements of the public sector have to be financed by one of these three methods (excluding gifts and aid). The borrowing from the banks provides the reserves for the multiple expansion of deposits by the banking system. (It will be noted, however, that the government might borrow to some extent from the banking system with little or no effect on the money supply - if the authorities persuade the banks to hold non-reserve debt against which the banks cannot expand their deposit liabilities. This is in practice of little permanent importance and will be ignored in the following.)

In developing countries, particularly where there is an increasing monetization of the economy, as has been the trend in Kenya, the authorities will find that there is a natural growth in the demand for money because of the extension of money as a means of payment and as a store of value. There is also the increase in demand for money because of the growth of the economy - and, as we have seen, the Kenya economy has grown at the remarkable rate of between 6 and 7 per cent per annum over the long period since 1965. Associated with these increases in the demand for money is the tendency, even with a given level of monetization, under stable price conditions for people to hold a larger fraction of their income in the form of money; this Friedman has called the "luxury" effect of money.

There are insufficient data to form a statistical estimate of the various effects listed above. However, it is clear that the growth factor of 7 per cent per annum and the addition of the other elements suggest that the authorities could expand the money supply by a figure in the region of 10 per cent without any inflationary consequences. It is likely that even a figure as high as 12 or 13 per cent could be absorbed by the economy without any serious inflationary impact.

The evidence from Kenya bears out this prediction. In fact the expansion of the money supply from 1967 to 1972 was of the order of 13 per cent per annum, while the inflation rate of the retail price index was small - about 2 per cent per annum over the whole period. This implies that the government can appropriate "painlessly" about 3 or 4 per cent (given that the velocity of circulation is about 4 or 3) of the increase in the gross national product to finance Government spending.

Borrowing from the non-bank public in Kenya is largely confined to the National Social Security Fund and other captive markets such as the Cereal and Sugar Financing Corporation, the Post Office Savings Bank, some insurance companies and some finance corporations, and various finance companies. Most private companies have found that private debt is more profitable than public debt and the public authorities have been largely confined to the captive markets where corporations or other institutions have statutory obligations.

Borrowing from abroad has been a very important component of Kenya's financing and is still expanding, although it is becoming less important than borrowing from domestic sources, including from the central and commercial banks. Of course, as was argued above, the fact that the financial deficit of the private sector is financed by foreign borrowing merely delays the demand and potentially inflationary effect until such time as interest payments and redemptions have to be met.

Table 6: Financing the Central Government deficit in Kenya, 1964-1965 to 1974-1975

(£K million)

	1964-1965	1965-1966	1966-1967	1967-1968	1968-1969	1969-1970	1970-1971	1971-1972	1972-1973	1973-1974	1974-1975
Deficit	19.0	20.6	18.5	16.6	19.6	21.3	32.4	38.5	51.8	39.5	67.8
Financing											
Foreign loans	10.7	9.4	7.8	7.9	7.1	10.8	10.9	11.5	24.7	14.5	25.3
Foreign grants	9.7	5.1	3.5	1.9	1.0	1.4	0.8	1.8	0.5	3.5	7.3
Domestic long-term loans	1.0	2.0	7.8	8.3	8.1	12.4	6.7	15.6	21.3	18.9	15.0
Domestic short-term loans	-0.2	0.2	-	0.7	5.6	5.1	15.0	1.1	6.8	-2.9	...
Borrowing from banking sector	0.1	3.8	3.2	0.5	5.7	4.9	12.3	7.9	8.4	5.2	...

Source: Economic Survey 1975 (Nairobi, Central Bureau of Statistics, Ministry of Finance and Planning, 1975), p. 54.

Table 6 illustrates the problem of financing central government deficits (mainly on capital account) and how they have been financed since 1965. The main feature that emerges from the data is the increasing reliance on borrowing from the banking system, especially from 1971 onwards. Foreign borrowings were an important source of finance in the early days when the East African Currency Board was still operating (up to 1966), but thereafter they declined in importance until 1972-1973. Even the massive expansion of foreign capital in that year could not finance the budget deficit, which has almost doubled in a year. However, in 1972-1973 half the budget deficit was financed by foreign loans, and in 1974-1975, when the deficit had reached £K 67.8 million or 23 per cent of the total budget, foreign grants were increased substantially along with a record figure of foreign loans of £K 25.3 million.

Whether the experience of Kenya is interpreted in Keynesian or monetarist terms the outcome is the same. In Keynesian terms, the vast expansion of the deficit of the central Government - it multiplied threefold between 1970 and 1973 - was supported only partially by foreign capital imports and by domestic savings. Such excess demand was pitted against a relatively low rate of growth in 1973 and 1974 (perhaps of the order of 3 to 5 per cent) and the inevitable inflation has appeared (see table 6 above). In monetarist terms the history of Kenya changed dramatically in the early 1970s and particularly from 1971-1972 on. In the 1960s the authorities had not essentially departed from the principles of the Currency Board and had not indulged in borrowing from the banking system to any great extent. The resort to such bank borrowing from 1971-1972 onwards led to an unprecedented expansion in the money stock and, in 1973, to the onset of serious inflation.

To summarize briefly the situation in Kenya, the inflation has been generated proximately by the resort to deficit financing of public authority spending. This was associated with the increasing role of the central Government in the economic life of Kenya -- some 35 per cent of capital expenditure is laid out by the Government and about a quarter of the wage bill of the modern sector is paid by the Government. This increased spending was not matched by a similar buoyancy in tax revenues, and although foreign borrowings have recently much increased, the deficit financing has been a marked feature of the years from 1972 onwards. 17/

The government's attempt to create employment through public spending on education, infrastructure such as roads and other construction cannot be evaluated here. Whether it brought benefits which made the increasing unemployment, particularly in urban areas, less onerous and socially harmful than would otherwise have been the case is impossible to say. The price, however, is easy to determine; it was and is inflation.

Case 2 - Ethiopia

Per capita income in 1968 in Ethiopia was about $US 68, and has grown at a rate somewhat below 2 per cent since that date. The reasons for this low income and the relatively slow rate of growth of the economy are beyond the scope of this study. It may merely be noted at this stage that one presumptive reason is the slow growth of export earnings. Unfortunately for Ethiopia, a large proportion (about 40 per

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17/ It is noted that Kenya has a large fraction of GDP or GNP spent by the Government: about 33 per cent compared with an average for other African countries of about 22 to 25 per cent.

cent) of its exports consists of coffee, the price of which has not even kept pace with world inflation. Indeed, coffee prices slumped in the second half of 1974 by about 15 per cent and have fallen further in 1975.

Ethiopia's dependence on export earnings and the volatility of these earnings together with the vagaries of local food grain crop failure, have meant that the economy is subject to rather violent short-term swings. Broadly speaking, Ethiopian economic growth is determined by its export earnings - often, as we have seen, dominated by the price of coffee. Yet there were exceptions - such as in 1971 when the rise in non-coffee earnings (largely but not wholly through price changes) more than offset the fall in the price of coffee; even so the export earnings were more than swallowed up by the increase in the price of imports. Yet the generalization that coffee still dominates the economy is a fair approximation.

In terms of its monetary history, Ethiopia has largely responded to the state of its reserves. There have been marked deviations from this rule, however, during periods when the authorities have used reserves to finance spending. However, the Government has not in general resorted to financing the spending of the public sector by means of loans from the commercial banks or by using the central bank. From 1967 to 1971 the money supply expanded at an average rate of 3.5 per cent per annum. But such an average rate covers a very large range, between rates as low as -4.5 in 1971 to rates as high as 12.5 in 1969. Again it will be observed there is a negative correlation of the rate of growth of the money supply with the size of the balance of payments deficit on current account.

The monetary authorities therefore tended to act as they would under a currency board system or a gold standard. The balance-of-payments effects were transmitted directly to the domestic economy through changes in the money supply, and its associated values on the asset side of the balance sheets of the banks. Nevertheless, the authorities did prevent any runaway inflation developing in Ethiopia - even keeping inflation down in the very difficult drought year of 1974 to some 12 per cent. In view of the substantial external shocks to which the economy was subject and also in view of internal difficulties this represents a remarkable performance by the standards of most countries in the international community.

The paucity of domestic resources in Ethiopia gave rise in the past to criticism of the limitations on the role of the banking system in providing credit. It was argued that greater extension of credit and the expansion of deposit liabilities would ensure the more rapid growth of the economy. Furthermore, it was suggested that the expansion of the money supply at a more rapid rate would enable the public authorities to supplement their meagre tax revenues at low administrative cost, with the only consequence an increase in the rate of inflation. This may be dubbed the "inflationist argument" for economic growth, and until recent years it enjoyed some popularity.

There is little doubt, however, that the Ethiopian Government has been right to forswear such policies. The evidence suggests that the Government will secure command over the maximum volume of real resources if it keeps price levels approximately constant or even allows a slow deflation in the price index. In other words, it is especially important in an economy that is being gradually monetized to encourage the public to hold balances of money and especially quasi-money. This can be achieved in part by ensuring that the real value of money does not decline, as well as by paying rates of interest on quasi-money. Similarly, another argument for inflation is that it enables the Government to expropriate the owners of Government

debt. But this is hardly applicable to Ethiopia, even if it were desirable to carry out such an erratic redistribution of wealth.

In short, the problems facing the economic development of Ethiopia are immense, but they can be only exacerbated, not solved, by inflationary financing of the public sector financial deficit. Indeed, inflationary finance may divert attention from the great problems of restructuring the system of public finances, or introducing more incentives for saving, or revitalizing the banking and financial system -- not to mention the many administrative problems. Inflation would make these problems more difficult, not less. Finally, but probably most importantly, there is the management of the exchange rate. Ethiopia retained a parity with gold when the dollar was devalued in August 1971. In spite of the devaluations of her competitor coffee producers, Ethiopia has not used exchange rate policy to further her exports and so mitigate the balance-of-payments problem. The dangers of floating the exchange rate or of a devaluation are considerable: the balance-of-payments constraint on inflationary finance will be removed and the Government may well be tempted to use inflation as a short-term panacea. The balance-of-payments discipline remains a valuable check even in a country such as Ethiopia which is subject to exogenous shocks.

Probably the most important task for the monetary authorities in Ethiopia is to find some method of sterilizing the inflow of foreign exchange when the balance of payments on current account is favourable, and to supplement domestic money supplies when the balance is unfavourable. The need for some sterilization policy was clearly demonstrated in 1973. The balance of trade suddenly turned dramatically, largely because of the buoyancy of exports other than coffee and stagnant imports, due to the controls and low incomes of the previous period. Foreign assets flooded the system and the increase in foreign assets, $Eth 218 million, was just about matched by an increase in the total money supply of $Eth 227 million over the years 1973 and 1974. The vast increase in the money supply -- about 33 per cent - has already confronted a drought-diminished supply of consumer goods. One would expect that the inflationary pressure of this money expansion to be manifest for many years.

The main impediment to a sterlization stimulation policy for more stable growth in the money supply is that there is no public debt market except in a limited and unsuitable form. It would be too much to expect the development of a fully articulated public debt market in economies like that of Ethiopia, but this should not prevent the development of new financial instruments which could be deployed for this purpose.

One instrument that has great potential in developing countries is the negotiable certificate of deposit - preferably with a maturity of 3 or 4 years. There are many problems in creating a suitable secondary market for such instruments - and it is likely that the banks would have to provide such a market. The details of such a proposal are interesting to develop, but they are far beyond the scope of this survey. The absolute requirement of any non-compulsory sterilizing scheme is that the interest rates should be attractive enough to soak up excess foreign exchange earnings.

In practice, however, the authorities may find it impossible to devise interest rates so variable that they can soak up voluntarily the excess funds. Various other alternatives may be considered. The obvious approach is to increase the reserve requirements of the banking system so that its assets and liabilities to the private sector do not expand too fast. Under circumstances such as the inflation of the

money supply, the banks earn abnormally high profits and this would be one way for the Government to "cream off" some of these profits in the process of sterilization. Another alternative is to use the tax system to raise revenue and reduce the money supply increase. But again in Ethiopia, as in many other African countries, the tax system is not well adjusted to absorb more than a small fraction of the excess earnings. Major changes in administrative arrangements are necessary, but they also take perhaps decades to implement. Finally, there are various marketing schemes which have been used in other parts of Africa, but these too have been the subject of wide discussion, and will not be pursued here. These suggestions were rendered academic with the recent nationalization measures in Ethiopia which resulted in a substantial expansion of the public sector and Government control of the economy.

Case 3 - Nigeria

Traditionally Nigeria has been a country of price stability. In the first half of the 1960s the consumer price index based on prices observed in the cities increased at an average rate of some 2.4 per cent per annum, with the price of food increasing at only about 1.5 per cent per annum. Allowing for improvements in quality which are not appropriately reflected in the index, this experience suggests virtual price stability.

To a very large extent this admirable record of stability is due to the proper financial discipline exercised by the Government and the Central Bank of Nigeria. Nigeria inherited from the colonial administration a currency board system. The guiding principles of banking and finance were to maintain only a small deficit on the federal accounts and not to rely on any substantial extension of credit from the banking system to the Government. Of course, the economy was steadily becoming more monetized over the years, so that part of Government expenditure could be comfortably financed by the seigniorage at more or less existing levels of prices. But credit to the private sector was constrained by the reserve requirements of the banking system.

This era of stability changed drastically during the civil war. First there was considerable dislocation of production and trade. Oddly enough, the price of food in western towns fell as the food-deficient east was cut off from its normal source of supply in the west; but this was a transitory phenomenon only. Prices began rising sharply in 1969, and food prices raced ahead at rates of 19 per cent in 1969, 23 per cent in 1970 when the war was concluded, and in the post-war reconstruction period to near 30 per cent. However, the liberalization of imports from 1970 onwards considerably modified the rise in non-food items of expenditure, so that even during 1972 non-food items increased in price by only about 3.5 per cent. The competition from imports for goods which were produced domestically induced efficiencies in home production and kept the prices keen.

The civil war caused a large deficit in the budget of the federal Government. It was financed to a large extent by borrowing from the banking system. Much of this increase in debt was in the form of treasury bills of 90-day maturity and treasury certificates (one-to two-year) which ensured that the banks had very adequate reserves for the expansion of credit and the growth of the money supply. Net borrowing from the banking system in 1969, for example, was almost three times the value two years earlier and roughly covered the increase in the Government deficit.

Nevertheless, the increase in the rate of growth of the money supply during the war was not as great as one might suppose. The increase in both money and quasi-money together from 1968 to 1969 was about 25 per cent, which compared with a previously normal increase of about 6 per cent, mainly in quasi-money. During the war period the ratio of the money supply (currency, demand and saving deposits) to GNP (nominal) increased from 13.2 per cent to 16.2 per cent.

The large overhang of liquidity in the banking system and in the private non-bank sector was bound to exert a considerable effect on the rate of inflation in 1970 and 1971. It is typical of such periods of war-time deficit finance that the effects are manifest long after the war is over.

But is is significant that Nigeria recovered remarkably quickly from the devastation. First, the inflation in the price index was brought down from 16 per cent in 1971 to 2.8 per cent in 1972, and about 4.3 per cent in 1973. Such a recovery from so high a rate of inflation without extensive distress is unusual if not unique in the annals of economic history. It was greatly aided by the liberalization measures already referred to and the sound economic policy of the federal Government during the recovery period.

One factor, to a large extent outside the Government's control, which greatly helped the recovery was the increase in oil prices which began in 1971 and continued to unprecedented heights in 1973/1974. But the Government's priority on the resumption of on-shore oil production paid off handsomely. The additional revenues from oil not only eliminated the deficit, but in 1971 the federal Government enjoyed a surplus on its accounts of about 6 per cent of GNP. This contrasts for example with the United Kingdom Government's deficit of about 7 per cent of GNP in 1974/1975.

Thus by 1971 the Government was able to reduce its indebtedness to the banking system. But the banks had a large quantity of reserves, due to the expansion of credit to the Government to finance the war, and there was a considerable expansion of credit to the private sector in 1971 and 1972, which provided resources for making good the dislocations and recovery from the war. Credit to the private sector rose from ₦ 472 million at the end of 1970 to ₦ 778 million at the end of 1972, a rate of expansion per annum of about 28 per cent.

The Central Bank attempted to control the extension of credit to the private sector, partly because of the indigenization policy, but partly to contain the general expansion of credit. The growth of credit far exceeded the guidelines of 1970 and 1971. The problem of attempting to control credit when the banks have vast holdings of liquid Government paper is one which most countries have tried to solve,

Table 7: Growth (percentage per annum) in bank credit to the private sector in Nigeria

Period ending	December 1970	December 1971	December 1973
Guideline target	20.0	8.4	--
Actual rate	44.7	42.9	13.0

and most have generally failed. It is therefore not surprising that success did not follow the authorities' efforts. The attempt to control the expansion of credit was given up in 1972, and growth slowed down remarkably to some 15 per cent. The Central Bank has, however, continued to issue directives about the desired composition of credit - emphasizing "productive" and utility uses and reducing the amount of commercial use. The efforts do not appear to have been conspicuously successful, although it is difficult to predict what would have happened in the absence of the guidelines and directives. This experience stresses again the difficulties of controlling the asset side of the banks' balance sheets. (In the United Kingdom this task was seen to be both difficult, invidious and counter-productive; the authorities concentrated on controlling the liabilities side.)

One main explanation of the phenomenal fall in the rate of inflation was the resilient bound-back of Nigeria after the end of the war, even in transitory conditions of exceptionally high inflation. In the two years after the war, output expanded very rapidly, and over the years 1970-1973 GDP at constant prices expanded by 9.4 per cent per annum. Over the same period the money supply grew at 12.3 per cent per annum (quasi-money at nearly 20 per cent per annum). Nevertheless, the overhang of money from the great expansion during the war, combined with the fact that the recovery from the war and the largest expansion of output was completed in 1970 to 1973, meant that inflationary pressures began to assert themselves again in 1974. Price inflation reached about 14 per cent by mid-1974.

Monetary expansion has accelerated since the end of the war from some 4.5 per cent in 1971 to 24.8 per cent in 1974. To some extent the recent expansion in the money stock has been a consequence of a favourable balance of payments on private account (settlement basis). The acquisition of reserves, largely through extensive oil sales at very high prices, has filtered through the monetary system. Nevertheless, if such a high rate of monetary expansion is continued and the real output of the Nigerian economy grows at around 10 per cent per annum, then, even allowing for the increased monetization of the economy over time, the steady-state increase in the money supply consistent with a stable price level should be between 12 per cent and 15 per cent per annum. The 1974 level of price rises was about 12 per cent but apart from GDP growth rate of about 10 per cent in constant prices, the economy also gained in real terms from the massive improvement in the terms of trade. Moreover, the increase of nearly 46 per cent in the money supply in 1974 can only have highly inflationary results in the future when steps are taken to contain its effect.

To a large extent this inflation rate has tended to correspond to the very large surplus on current account of the balance of payments. Partly this arises because inflation in Nigeria over the years 1971 to 1973 was considerably less than that in the world as a whole. The Nigerian currency was revalued against the dollar on the Smithsonian devaluation, but since then the Naira has maintained parity with the dollar and so has depreciated with respect to many European currencies (except sterling). The Nigerian economy was "importing" inflation from the rest of the world in 1973 and probably in 1974. Thus the price index of imports increased 16 per cent in 1972-1973.

One way of avoiding some of the imported inflation would have been to re-value the Naira. It is difficult to discover whether such a policy was ever actively considered by the authorities. One may easily list substantial objections, primarily on the grounds of distributional justice. A revaluation would have considerably harmed the traditional export industries such as rubber, groundnuts, cotton, palm kernels, etc. These products enjoyed a remarkable rise in price in 1973 and, in

the case of rubber, an equally remarkable fall in 1974. However, such a revaluation would reduce the price of imports and prevent the transmission of the worst ravages of the world inflation into Nigeria.

There would nevertheless have been considerable objections to such a policy from the manufacturing industries in Nigeria. They have grown up under an umbrella of protection from imports and a revaluation would make imports more competitive. Thus the import-substitution industries would have joined with the export industries in opposing any revaluation, and this would comprise a very powerful force of interests. Choosing somewhat more domestic inflation was probably thought better than the alternative. There are, however, many problems worth exploring for the Nigerian authorities. The first is the relative efficiency of a revaluation compared with domestic inflation. It may be argued that revaluation would have involved much less distortion of capital markets and the disincentive to saving inherent in inflation. Similarly, it would not have had any effect on the pace of monetization of the subsistence and non-market sector. Secondly, revaluation would have provided yet another stimulus to efficient domestic industry similar to that provided by the liberalization measures from 1970 onwards. Negotiating reductions in tariffs is a difficult one-at-a-time operation, but revaluation would have been an across-the-board fait accompli. Thirdly, it is not clear what the redistributive effects of the two measures would be. In so far as imported food would cost less, the redistribution is likely to be in favour of the poor urban workers. Furthermore, the revaluation would have reduced the windfall profits occasioned by the increases in world prices for many of Nigeria's exports. One may tentatively conclude that the redistributive effects of a revaluation would have borne less onerously on the poor -- and in particular the urban poor -- than the alternative inflation.

The high price of oil is encouraging the search for alternative supplies and the adoption of substitute energy sources. Nigeria would be wise to make contingency plans for the possibility of a fall in the price of oil. Thus it may be argued that attempting to maintain an undervalued Naira will give Nigeria greater flexibility for dealing with a fall in the price of oil by maintaining her alternative exports in a healthy competitive position. It would be unwise to threaten export industries by a revaluation when such exports may be desperately needed in future. However this argument should be seen against the fact that inflation itself will reduce the competitive edge of Nigeria's traditional exports and, as we are arguing, that revaluation is an alternative to such inflation.

It would be quite out of place here to attempt to settle such arguments as these. The intention is merely to raise issues without any attempt at a final or even an adequately considered answer.

Case 4 - Sierra Leone

The average rate of growth of the Sierra Leone economy from the mid-1960s to 1972 was about 4.5 per cent per annum; but the yearly rates varied enormously from actual declines to rates over 10 per cent. The variations reflected the vicissitudes of the main industry in the country -- diamond mining. This industry exerts a marked effect on the balance of payments and so on the foreign asset composition of institutions, including the Central Bank.

Although there are no nationwide comprehensive price indices available for the years in question, the Freetown consumer price index suggests that the increase in the price index over the years 1961 to 1972 was of the order of 3.5 per cent per

annum (the rate of price increases was considerably higher in Freetown than in the rest of the country, largely because of the high demand for the limited quantity of housing available). As one would expect, the rate of price change over this period varied considerably. In general, poor rice harvests led to a considerable rise in the index, while good harvests depressed the price.

According to the official price index the rise in prices was only comparatively modest in 1973 - about 4.6 per cent. There is reason to believe, however, that this considerably underestimates the true rise in prices. It is clear that the rise in food prices was particularly marked - some 13 to 15 per cent - and it therefore seems likely that, given the high component of food in the average budget, and assuming that other prices did not fall dramatically the real price index has actually been rising by perhaps 10 per cent. 18/ The fragmentary evidence available on the situation in 1974/1975 suggests that the inflation rate has increased to perhaps as much as 14 per cent. But this figure must be treated with much caution until further verification is available.

The monetary history of Sierra Leone showed a period of high stability from the early 1960s to 1968: indeed, there was a fall in the ratio of total liquidity (money and quasi-money) to GNP in 1967. The money supply, which increased modestly thereafter and continued to expand at a non-inflationary rate in 1970 and 1971, began to show signs of expanding more rapidly in 1972. But by 1973 the expansion rate of the money stock was very high indeed at 26 per cent and well above the trend of the previous five years; the main component of this was the large increase in the claims on the Government, which accounted for about 60 per cent of the growth in the money stock.

In the final months of 1973, however, there was a dramatic improvement in Government revenues as a result of the boom in the diamond market and a very rapid increase in the price of diamonds. But the fact that the Government did not need to expand its credit through the domestic banks does not mean that the money supply was thereby reduced. The private sector expanded credit by 32 per cent during the year.

One would expect that this more rapid expansion of the money would impose considerable inflationary pressures in 1975 and 1976. But this may be modified by the propensity of the private sector to hold its assets in the form of quasi-money and even currency. This arises because the diamond industry appears to have a distinct taste for holding cash during periods of buoyant demand. But it is likely that such a demand for currency is transient only, and if diamond demand continues to be high - and there is every likelihood that diamonds will continue to be a commodity much in demand in inflationary situations - then eventually the liquid balances will be reflected in domestic expenditure either on home-produced goods or imported goods.19/

18/ The official price indices were based on budgetary surveys carried out in 1961 for low-income-group families. Few imported goods feature in the index, whereas many of the price increases in 1972/1973 were associated with the increased price of imports due partly to the rise in world prices and partly to the devaluation of the Leone, which was pegged to sterling.

19/ Note that the price of diamonds increased 60 per cent in 1972/1973, after having been more or less stable since the early 1960s.

As one might have anticipated, the expansion of the money supply in 1973 was associated with a sharp turn towards an unfavourable balance of payments on current account. The gross capital requirements for the balance of payments are more than three times as large in 1974/1975 as they were during the years 1967/1973.

Table 8: Gross finance requirements for Sierra Leone, 1967/1973 - 1974/1975

	Annual averages 1967/1973	(millions of Leone) 1974/1975
Current account deficit	14	46
Amortization	4	11
Gross finance requirement for the balance of payments	18	57

Source: IMF Balance of Payments Yearbooks (Washington, International Monetary Fund), various issues, and estimates by the author.

Thus it is likely that domestic credit expansion will continue to be high. Of its effects much will depend on the extent to which the deficit is financed by aid which does not require repayment, and the extent to which resort is made to ordinary private capital which will require requiting by exportables. Such financing will give rise to a merely transitory improvement in the rate of inflation, since the movement in the balance-of-payments deficit will have only a once and for all effect, as reported above.

One method of reducing the impact of inflation and still providing the finance for development so much needed for the country is to ensure that savings are retained in the country and suitably mobilized for development. Inflation has made this task doubly difficult because the rates of interest in nominal terms were fixed during the period of stable prices, and are clearly too low compared with either the advantages of acquiring real assets or the rate of return to be obtained by lending abroad. For example, the rate of return on savings deposits and post office savings bank deposits was only 4.0 per cent. Furthermore, the cartel structure of the banking system ensures a very large spread between borrowing and lending rates. Large blocks of lending are placed in Treasury bills and in Government stocks - mainly by the banks, who find it profitable to take deposits at zero (demand) or 4.0 to 5.0 per cent and invest in Government stocks at an effective rate of between 11 and 15 per cent.

There is some possibility that the inflation may continue at a somewhat high rate in Sierra Leone over the period 1975-1977. The urgent problems are to find ways of ameliorating its effects by avoiding the distortions to which it will give rise both in the distribution of incomes and in the discouragement of development and enterprise. We have touched on the problem of savings and interest rates. The other major problem is to ensure that Government revenue is made as inflation-proof as possible. This can be achieved by switching from specific duties in the tariff to ad valorem scales (it will be noted that import duties count for a substantial fraction of Government revenue), and by revising excise taxes onto an ad valorem basis. It is most important that the authorities should not try to hold down the

prices of goods by subsidies - such as the rice subsidy which was recently withdrawn. Although introduced for the most laudable reasons of trying to protect the poor from a reduction in their standard of material well-being, such a policy will be counter-productive. It will discourage the supply (as was found in the case of rice), give rise to greater imports, increase the deficit on the current balance of payments and increase the borrowing requirement of the Treasury. Such borrowings will be generally financed by increasing the borrowing from the banks, so increasing the money supply and exacerbating inflationary pressure.

The great problem for Sierra Leone's financial and fiscal system is how to ensure that the reforms needed to mobilize capital, to increase the elasticity of the revenue and to reduce the amplitude of the effects of foreign trade on domestic money supply and demand are carried through without either inhibiting the growth of real output on the one hand or encouraging the explosion of persistent inflation on the other. These problems require more detailed study than can be accorded to them here.

Case 5 - Zambia

Zambia is a dramatic case of an economy which is considerably susceptible to the fluctuations in price of a single commodity - copper. Yet copper is also the foundation of Zambia's wealth - with a GNP *per capita* in 1971 of $355, Zambia has one of the higher standards of material well-being in the continent.

From 1964 to 1969 GNP in real terms grew at about 17 per cent per annum - but most of this increase was due to the favourable turn in the terms of trade caused in turn largely by the rise in the price of copper. The tide turned dramatically at the end of 1970, and copper prices fell by about 30 per cent in 1971 and 1972; this fall was compounded by a decline in output caused by the flooding of one of the main mines. GNP *per capita* declined by more than 15 per cent over the two years.

From 1973 through to 1974 the upturn in the price of copper dramatically changed the country's finances. From the average value in 1972 to the first quarter of 1974 the price of copper more than doubled, and it continued its rise through to May 1974. The tide has now decisively turned again as the world slides into a depression - and the price of copper has slumped from £1,500 in May 1974 to £480 in January 1975. In March 1975 the London price (£540 per tonne) was well below the values of 1969 and 1970, and only 20 to 25 per cent above the very depressed values of 1971/1972. (Note that since there has been a world inflation and an even greater inflation in terms of sterling, this represents a real price in 1975 which is somewhat less than that in 1971/1972.)

The price of copper reacts back on to the economy in two ways: first, a reduction in the price of copper reduces Government revenues and so increases the borrowing requirement of the public sector; secondly, it reduces the amount of domestic money (Kwachas) in the hands of the public since there are reduced foreign exchange receipts to be exchanged against Kwachas and so there will be a smaller rate of growth of the stock of Kwachas (or, if allowed, the foreign exchange holdings of non-public bodies). Correspondingly, an increase in the price of copper will give rise to a smaller public sector borrowing requirement (or even a surplus of funds to invest) and an increase in the money supply of the non-bank private sector.

These are two conflicting forces. The Government may wish to borrow money from the banking system when there is a reduction in its tax receipts due to a fall in the price of copper - and this will tend to increase the supply of money. On the other hand, the deterioration in the balance of trade will result in residents buying foreign exchange from the Central Bank and surrendering Kwachas in return. The foreign exchange is spent on imports and the volume of Kwachas in the hands of domestic residents is reduced; this therefore results in a reduction in the quantity of money. The question is which of these two forces dominates - we may call them the deficit finance and the balance-f-payments effect respectively.

Quantitatively it is easy to see that the balance of payments effect wins in Zambia. 20/ The turn on the current balance from 1969 to 1971 was from 338 million Kwacha surplus to a deficit of 159 million - a change of approximately 500 million. (This may to some extent have been offset by the differential private capital flows in the two years. The statistics suggest that there was an outflow of 167 million in 1969 and something over 100 million in 1971. These figures are very approximate, but they do suggest that the private capital flow offset cannot have been large.)

From 1969 to 1971 the overall Government deficit changed from a surplus of 33.9 million Kwachas to a deficit of 160.8 million. This is a net turnaround of less than 200 million, and it should be compared with the balance of payments change of about 500 million, i.e. about two and half times as large.

It might have been possible, of course, to finance the overall deficit on the Government accounts by resort to long-term borrowing from the non-bank private sector. But in fact in conditions of stringency, that is, precisely when the Bank of Zambia wishes to raise finance from the non-bank public, it has naturally enough been difficult to place the bonds. The Bank was forced to add 17 million Kwachas of bonds to its own portfolios (together with 6 million of treasury bills) and the remaining deficit was largely financed by running down the Government reserves with the banking system (about 124 million Kwachas). This finance was of course inflationary in the conventional sense.

Yet it is difficult to criticise the Government for adopting such a policy. With a dramatic fall in the price of copper and the absorption of so much of the money stock through the acquisition of the foreign currency balances in order to finance imports, it seems sensible for the Government to step into the financial breach and stop a sharp decline in the money supply. As it was, in 1970 the total money supply (including quasi-money) was 372 million and by 1971 it had declined to 319 million - a drop of about 14 per cent. Should it have declined even more? Clearly the answer must be no. It is also clear that with the usual lags in monetary effects one would expect that the real effects would begin to appear in 1971-1972, while the effect on the rate of inflation would begin to appear only in 1973 and after. Yet in 1973 the recovery of the copper price was remarkable and the average price level in the last two quarters was higher than in any other year by as much as

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20/ Note that this is the opposite of the conventional wisdom in, for example, the United Kingdom. It is argued by the new Cambridge School that the balance-of-payments deficit on current account is a consequence of the financial deficit of the public sector, with the private sector maintaining roughly the same surplus. Clearly in the case of Zambia it is the export price of copper that is the dominant causal factor - and this may be considered to be exogenous.

25 per cent. To meet the inflationary finance of 1971 there was therefore a dramatic improvement of real GNP due to the favourable turn in the terms of trade.

The danger to which a country such as Zambia is peculiarly susceptible is "stepping-stone" inflation. The Government may, as it did in 1971, offset the depressing effects imported from the world markets, by expanding its borrowing from the banking system. But it is equally important during the boom years to sterilize the flow of funds into the country. This can be done by building up reserves during the good years and by thrusting selling of Government bonds and other guaranteed paper. If this is not done, there will be too rapid an expansion of money during these periods when there is a large balance-of-payments surplus, and this is not unlikely to have effects much later when the balance of payments has turned sharply into deficit.

This suggests that one of the important tasks for Zambia is to develop its financial instruments so that they are not merely bought by the captive customers, such as until 1970 the Employees Provident Fund. The three main financial instruments of Government borrowing are (i) the treasury bill with interest rates varying up to about 4.5 per cent; (ii) short-term (5-year) bonds; and (iii) long-term bonds (over 5 years) with interest rates up to 6.5 per cent. (There were the rates in 1973. It is believed that the rates of interest have been raised, but there is as yet no confirmation of this).

The urgency of so doing however is clear from the very rapid rate of increase of the price index. After being more or less stable for four years the wholesale price index jumped almost 20 per cent in 1973. By 1973-1974 the consumer price index was rising at some 17 or 18 per cent per annum. The Kwacha was revalued by about 11 per cent against the dollar in March 1973, and this would be expected to allay some of the so-called "imported inflation".

With inflation rates running at some 20 per cent per annum - which may continue in 1975 - it is clear that nominal interest rates must be raised considerably in order to encourage confidence in saving. In the United Kingdom, where inflation rates of the same order are currently being experienced, interest rates on long debt have hovered around 14 to 18 per cent; and yet it is widely recognized that though nominally high, these rates are still causing negative rates of real return and are giving such institutions as life funds and pension funds considerable problems in meeting their obligations. The United Kingdom has demonstrated that it is possible for a country to run a long time with negative rates of return on assets. But the difficult present state of the United Kingdom economy is also an object lesson in the dangers of so doing.

High interest rates are only one of the inducements to tempt asset holders to buy Government paper, or at another remove bank or institution paper. It is important to fashion the instruments themselves so that they are attractive to the holders. This can be achieved by combining elements of negotiability, confidence and security. As remarked above, one of the most suitable instruments appears to be the negotiable certificate of deposit. Again it must be emphasized that there should be a suitable secondary market and it would probably be advisable to secure the correlative signature of a main international banking house.

These measures will take a long time to put into practice. Meanwhile Zambia faces the most pressing problem of slumping copper prices, burgeoning expenditure on development and welfare and a tax system that over-responds to the oscilliations in the copper price -- so creating grave budgetary and balance-of-payments problems which are manifest now and will continue to be exacerbated by the continuing world slump. The balance-of-payments deficit will cause a decline in the money supply, as in 1971-1972, and, on the other hand, the Government may be forced to resort to deficit finance in order to prevent the severe contractionary effects spreading too wide and too sharply throughout the economy -- although again the main immediate problem will be one of simply finding enough finance to support the spending programme. Thus there may well be serious dangers of continued inflation in the years from 1976 onwards. Much will depend on the extent of aid to Zambia, the state of the international trade cycle, and Government policy during this critical year of 1975.

Case 6 - Zaire

Since 1967 Zaire has experienced a higher rate of inflation than any other country that falls within the range of this survey. To a very large extent this high rate of inflation is accounted for by civil disorders and disruption in production and trade. The birth pangs of a new nation are often fertile ground for inflation. Zambia now seems to have got over many of the problems of painful adjustment and the destruction that it brought.

But Zaire's inflationary pressure and indeed potential is still strong. This arises, as in the case of Zambia, from a dependence on copper, which produces more than 55 per cent of the revenues from exports. (Cobalt and diamonds are also important mineral exports, but they do not approach the importance of copper). The Zaire economy has tended in recent years to follow the vicissitudes of the copper market, and again the basic story is not dissimilar from that of Zambia set out above. The big difference is that Zaire suffered a larger trend of inflationary pressure than did Zambia, and the reason for this is undoubtedly to be found in the need of Zaire to make good the devastation and dislocation caused by civil unrest, the need for a strong army, police force and administration and the requirements for integrating the disparate groups and tribes by means of an extensive and expensive communications system. This, combined with a virtual breakdown of the tax system in the early days of independence and the slow build-up from the devaluation of 1967, has meant that many inflationary pressures were being felt throughout the period.

After a massive inflationary surge from 1967 to 1968, at a rate of more than 50 per cent, the inflation rate settled down to a much more modest rate of increase of 5 to 8 per cent per annum to 1971. But, as in Zambia, the slump of copper prices in 1970-1971 took its toll and the inflation rate increased to about 15 per cent, rising to some 16 per cent in 1973. In spite of the sharp but brief boom in copper prices in 1974 (see above) there is evidence that inflation has accelerated to some 25 to 30 per cent and it may still be continuing.

The spring of the present more rapid rate of inflation was the presumably unexpected collapse of the price of copper. Even so, the Government had prepared to some extent during the high-copper-price years for this eventuality. The stabilization programme of the IMF in 1967 worked effectively in the milieu of booming copper prices. Economic growth was near 10 per cent in 1969 and 1970. Although the Government increased its outlays rapidly, for the purposes enumerated above, revenue more than kept pace. In 1969 budgetary savings were approximately 23 per

cent of revenue. With the balance of payments in comfortable surplus by the middle of 1970 the foreign exchange reserves had risen to about $250 million, or approximately four months retained imports. International confidence in the country was high and much investment flooded in.

The crunch came in 1971 after the drastic fall in copper prices in 1970: total export earnings from copper fell by 20 per cent. Although imports slowed down, they still increased about 19 per cent and there was a massive reduction in reserves. This continued into 1972 in spite of large loans ($55 million) from the Euro-markets (incidentally a sign of the creditworthiness of the country) and drawing-down of SDRs. At the end of February 1972 the reserves had already fallen to $150 million - or approximately two months of imports. This shows the remarkable rapidity with which a country which cannot be accused of being profligate during the boom years suffered all but a collapse of its finances.

The reaction of the Government was prompt and drastic. Total current expenditure for 1972 was cut below (about 7 per cent below) the levels of 1971, and greater central control was introduced to ensure that central directives were met. New tax measures were introduced to curb imports and to increase budget revenue. Import surcharges and other restrictions on imports were enacted to cut back the requirements for foreign exchange. In summary it is difficult to fault the basic strategy of the Government's policy, although it is possible to argue on some of the details; for example, it might have been more efficient to introduce a devaluation rather than to implement the import controls and the regulations over the repatriation arrangements.

Whatever the policy adopted, some increase in the rate of inflation was unavoidable. The reduction in the volume of goods absorbed by the home market combined with the extensive borrowing from the banking system and the consequent expansion of the money supply by more than 23 per cent in 1972 ensured that inflation would continue for some time. The policy did result in an improvement of the reserve position - after slumping to $127 million in the second quarter, reserves rose to $178 million in the fourth quarter of 1972.

The situation was changed dramatically again in 1973 and the early part of 1974 by the boom in the price of copper, which, at the peak, was more than three times the price in 1972. Although there is no direct evidence on the balance-of-payments position, there are adequate grounds for believing that there was a dramatic improvement. Foreign reserves accumulated very rapidly. But so did the money supply as foreign earnings were presented at the banks or accumulated in bank deposits. Towards the end of 1974 bank deposits were almost twice the size of those in 1972 and quasi-money had expanded more than four-fold. This vast expansion is bound to fuel the inflation at higher rates for many months and even years to come.

To add more troubles to the situation, the price of copper fell back to its 1972 level (in real terms) during 1974. Again reserves dwindled away rapidly. By the end of October 1974 reserves were at only about one half of the level in June 1974. The Government seems to have resorted to borrowing from the Bank of Zaire in order to finance its spending; in the first seven months of 1974 the claims on Government in the portfolio of the Bank of Zaire increased by about 100 million Zaires, or about $50 million. The Euro-dollar market was closed except for first-class risks, and unfortunately Zaire, along with many other former borrowers, could not get credit.

The best alternative facing Zaire is perhaps an open and, temporarily at least, a more rapid inflation combined with a currency devaluation in excess of the present Smithsonian slide with the United States dollar. Domestic demand must be reduced quickly. Money national income must rise until it is consistent with the expanded stock of money, so that the excess demand is eliminated. To attempt to repress the inflation by controls and regulations -- such as price controls and allocative rationing -- would cause a great deal of problems to the Zaire economy. Fundamentally the Zaire economy -- in terms of its existing production and its enormous potential -- is sound, as was evident in the years 1968-1969, when much profitable investment was attracted to its economy. Restrictive controls can quickly destroy the viability and efficiency of industries as well as the faith of the international investor.

In the long run the Government must attempt to insulate the economy from the more violent swings of the international markets. This is probably best achieved by massive reserve accumulation during the good years, fashioning financial instruments (referred in the case of Zambia above) and ensuring very large budgetary surpluses in the good years. Only then will there be a reasonable insurance against the switchback of inflation that has caused so much difficulty.

VI. THE CONSEQUENCES OF INFLATION IN AFRICA

The effects of inflation on the standard of material well-being, the rate of growth of that standard, and the social and economic fabric of society depend very much on whether the inflation is short and sharp or whether it is steady and prolonged. It is undoubtedly true that a rate of inflation that oscillates violently between, say zero and 25 per cent is much more upsetting than a steady rate of inflation, year in year out, of, say, 12 per cent. With a steady rate of inflation even as high as 12 per cent the economy can adjust. All bargains and contracts can be indexed to reflect the rate. More important, the tax system tends to be indexed to reflect this inflation. (It is of course notoriously easier to index the expenditure of the public authorities.)

Such a steady state rate of inflation has been characteristic of many developing economies. One example is Brazil which had a roughly 20 per cent rate of inflation for many years. Brazil has suffered a much more intensive rate of inflation since 1972; however.

Steady rates of inflation are however, not the rule in Africa. In part this arises because many countries in Africa are relatively small and in general producers of raw materials such as copper or coffee, which are subject to wild fluctuations in price.

Real incomes, through terms-of-trade effects, fall when the price of the export commodity plummets downwards, and Government revenues tend to be rapidly reduced, thus leaving uncovered a large amount of expenditure which must be financed by borrowing or by expanding the money supply. But in addition the balance-of-payments deficit on private account must be covered by using up foreign exchange reserves (or by some necessarily limited borrowing from abroad). Thus there is a great pressure to pursue restrictionist policies - to reduce the money supply, to cut public spending, to increase tax rates, and to cut down imports. The country then is pitched into a contractionary phase - although it is likely that there continues to be a rapid rate of price inflation for some time before the rate of change of prices eventually begins to decline.

This switch-back process - or, to use an older phrase, "stop-go" process - is characteristic of many of the economies studied. Zambia and Zaire, with their dependence on copper, Ethiopia, with its dependence on coffee, many other countries (such as Ghana) with their dependence on cocoa, or iron ore (Liberia and Guinea) are all subject to this process. 21/ Such variations in markets are largely unforeseen and cannot be predicted with any precision. 22/

We have already discussed the consequences of these external oscillations in price on the accounts of Government and the balance of payments. In this section we discuss how these variations affect different sections of the community and how they distort production and trade. It must be emphasized that there are very few statistics on these effects on different sectors of the community. It is virtually impossible to quantify the effects. (It is indeed difficult to quantify effects even in countries with advanced statistical systems such as the United Kingdom and the United States.) Much of the following is based on evidence that is inherently unquantifiable - but nevertheless it is important to consider all the facts, whether quantified or not.

Subsistence sector

African countries still have a substantial subsistence sector. Broadly speaking the farmer grows his own food for his own consumption. Some food crops may be traded on the market in a barter arrangement, or farmers may grow a small "cash crop" such as rubber or coffee, which is sold so that they can acquire other goods or services.

Inflation has affected the subsistence sectors in various ways. In some cases the inflation was partly generated by a crop failure or successive crop failures (as in Sierra Leone in 1973). But these are transient effects which disappear when the harvest is good. In most cases the persistent inflation cannot be attributed to such causes.

Nevertheless, a characteristic feature of inflation which was well brought out in the Central Bank of Nigeria survey referred to infoot-note was the tendency for food price rises to outstrip by far the general rise in prices. (Similarly there was the characteristic trend of fuel prices due to the successful operation of OPEC.) The price of rice increased dramatically (almost three-fold from 1972 to 1974) and the prices of edible oils multiplied three-fold over the same period. The prices of manufactured goods over this period increased by some 15 to 20 per cent (all values in United States dollar terms).

It is clear, then, that to the extent to which subsistence sectors not merely supplied their own food but also traded a small surplus for manufactured goods, they need not have suffered and were even likely to have benefited from the differential rates of price increase. In most of Africa the staple subsistence crop is rice - usually hill or dry rice - and, although its market price probably has not risen to the same extent as Thai or United States rice, it has undoubtedly increased relative to the price of manufactures.

21/ The Central Bank of Nigeria have carried out an admirable analysis of the process of, and variation in the rates of, inflation in African countries.

22/ For example the Economist was predicting in the latter half of 1973 and in 1974 that raw material prices would come down. In fact they went up.

(It is necessary to emphasize, however, that a relatively more rapid rise in the price of food is not a necessary feature of inflation. The rise between 1971 and 1973/1974 was partly caused by the collapse of the Soviet harvest and number of other crop failures.)

Those households in the agricultural sector that grow cash crops such as coffee and trade those crops for food grains have suffered considerably. The price of coffee has hardly kept up with the price of manufactured goods and has lagged considerably behind the price of food grains. In the long run it may have brought a setback, to some extent, for farming for the market and specialization of crops. On the other hand, those households that produce other cash crops, such as coconut oil, copra and sisal, as well as subsistence food will be induced to expand their cash crop production and cut back on subsistence food since with these commodities the price has risen faster than that of rice.

Thus with the exception of the coffee-cash-croppers and others of a similar kind, the substantially subsistence sector has probably benefited from inflation. But one must be careful in interpreting such results. In many cases the Government has attempted to control the price of rice and other food grains. Governments have tended to offer inducements for rice planting during low rice prices, and have tried to insulate the economy from increases in the price of rice when the world price has risen sharply. For example, in Sierra Leone the Rice Corporation kept domestic prices above world prices until 1973 but when the price boomed in 1973/1974 the Rice Corporation kept the domestic price at first about 80 dollars a ton below the world price, and then in 1974, when the world price went up to 550 dollars a ton, the domestic price was kept down to about 300 dollars a ton. Although the price incentives have been increased, they are considerably less than those that would result from the application of world prices.

Another feature which may also upset the beneficial effects on the subsistence farming sector is that Governments may increase taxation on that sector. The anti-agricultural bias in taxation (and Government spending) has been recorded by others.23/ Even if the taxation is not levied directly on the subsistence sector, the taxation of agriculture through export and production taxes would have a depressing effect on the subsistence sector since the reduction in farming for market would create fewer opportunities for employment as casual labour for harvesting and planting by those who are substantially subsistence farmers.

Market agriculture

The economic effects of inflation on farming for market depends primarily on the crop and its price experience. Some have done very well -- examples are cocoa, groundnut oil, coconut oil, cotton, groundnuts and certain other commodities. Others, notably coffee producers and more recently rubber farmers, have suffered from relative price movements. Again one must not generalize too readily. Taxation and the monopoly position of marketing boards have played a considerable role in modifying the effects of world price changes on the domestic farmers. One particularly interesting example is Nigeria. The price of Nigerian groundnuts in London increased from $11.52 for 100 pounds in 1972 to $32.68 in the first quarter of 1974,

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23/ See, for example, John Levi, "Anti-agricultural bias in west Africa: The case of Sierra Leone", (mimeo) Oxford, 1974.

almost three-fold. The changes in the producer price, however, were from £N 80.43 to 81.60 a ton in 1971 to 1973 and to 94.25 a ton in 1973/1974 - an increase of the order of 15 per cent. Similar comments apply to cocoa, cotton, palm kernels, and so on.

The net result of these arguments is to suggest that the main beneficiary of the favourable revenue effects of the rise in relative prices has been the marketing boards, at one remove, or the Government as the final recipient. The marketing boards, however, have often taken an increase in revenue as an argument for expanding their expenditure and perhaps thereby reducing the efficiency of marketing.

Such marketing board arrangements do, however, prevent the large-scale acquisition of foreign exchange by the exporting farmers and so modify the increase in the domestic money supply. Indeed, the increased profits of a marketing board would enable it to buy Government debt and so place the funds at the disposal of the public authorities. This tends to be a general effect of inflation; the Government profits sometimes at the expense of the private sector.

The next question is the consequences on the factor distribution of income in the agricultural sector. Unfortunately, little is known about this problem. What evidence is available suggests that there is the expected tendency for the farmer himself to take the brunt of the main oscillations in prices. But there is also a response in both the level of employment and ultimately in the wage rate. Generally, with reasonable specialization in a district there are few opportunities for alternative employment and a depression in the market for the produce will soon give rise to a reduction in the demand for labour. This appears, for example, in the case of rubber with a reduction in the marginal trees tapped - it is simply not worth paying the labour costs for tapping. Alternatively, when the price of rubber rises dramatically - as in 1973 - the tree owners would want to tap even the most decrepit trees and would probably indulge in double tapping, all of which require more labour. The adjustment of wage rates, however, is a complex matter since there are so many dimensions, and they cannot be explored in this survey.

In general, one would probably be correct in supposing that inflation - and particularly the form of it in food and the produce of agriculture - has to a large extent benefited the agricultural sectors of African countries. There are, however, dramatic and important exceptions - particularly in coffee, and more recently in rubber.

Whether this has redistributed income to the poor from the rich is more difficult to ascertain. Much farming for profit may be carried out by relatively high-income farmers, as in the case of rubber or palm kernels, and as suggested above the benefits to the agricultural workforce may be modified or considerably delayed.

Urban poor

It is probably the case that the section of the population that is worst hit by inflation are those least able to stand it - the urban poor. Usually they have no subsistence arrangements to fall back on, although there are many exceptions to this generalization. (For example, many of the urban poor belong to a nuclear family and are normally engaged on the farm during the clearing and planting and harvesting season - only migrating to the town during the off season in the hope of picking up at least casual labour and perhaps even a permanent job.)

In the budgets of the landless urban poor food bulks large, and such food has to be bought on the free market. It is understandable that many Governments see it as their duty, and often an expedient policy to preserve social order, to subsidize staple foods, or introduce price control to reduce the effects of deprivation on the urban poor. It seems doubtful that this is the best way of dealing with the problem. Clearly the reasonably well off also profit by such subsidies - including for example the farmers for market who, by producing palm kernels for export, may thereby obtain cheap labour through subsidized food. To relieve urban poverty is, however, a very difficult problem. Furthermore, such relief as is afforded also creates the drift to the towns which is the bane of so many developing countries. Probably the best way is to ensure that the jobs in rural areas are more plentifully available by seeing that there is not an unfair tax placed on agriculture and so on agricultural employment.

It is important to emphasize that, with food prices rising relatively faster than the average rise in prices, the urban poor suffer worse than any other section of the population. And this redistributive effect is one of the main indictments of inflation - and is especially damaging to those who claim that inflation redistributes resources in favour of the low-income classes.

Attempts to regulate the price of food grains below the free market level have not been conspicuously successful. (Such attempts have been made in many countries in the region, and it would be invidious to distinguish them on the judgement of the relative degree of "success", whatever that word may mean in this context.) The main problems are:

(a) Evasion and the difficulty of policing such arrangements. Food grains often come from a wide variety of sources and it is very difficult to ensure that a substantial fraction is sold on the controlled market at prices which are well below the value they would command elsewhere;

(b) "Free-marketeering" (sometimes called black-marketeering). In many cases the amount sold on the "free market" far exceeds the amount sold at controlled prices;

(c) Rationing or queueing for allocations. Again there are great difficulties in administering such a system and ensuring that there are no elements of corruption.

All the evidence suggests that such methods of control are at best ineffective and at worst positively harmful as much in relieving urban poverty as in ensuring that farmers have an incentive to produce and market their produce.

Industry and growth

There was a widespread view that inflation would help industrial development since it would stimulate savings, increase profits at the expense of wages, stimulate investment, expand employment, and so generate growth of the industrial sector, which since it is a high-productivity sector, will cause an increase in the rate of growth of the total economy. 24/ One suspects that this view was associated with the well known observation that economies tend to grow more rapidly in a boom than

24/ For an excellent critical account of the various theories see "Origins and development of inflationary trends in African countries (impact on their growth)", presented at the Seminar of the Association of African Central Banks held in Addis Ababa from 5 to 16 August 1974 by the Research Department of the Central Bank of Nigeria.

in a slump. It was therefore thought that if one could keep going a perpetual boom (a go-go rather than a stop-go economy) one would enjoy a higher rate of growth.

Again, one must distinguish carefully between steady inflation and variable and unanticipated inflation. Countries which have experienced steady inflation - such as Brazil - have indexed most transactions and have adjusted all their institutions to that steady rate. These economies have grown and prospered perhaps only slightly less than those economies - such as the Federal Republic of Germany - which has enjoyed substantial price stability. But even if it is possible to hold a steady rate for some decades (and the experience of Brazil in recent years gives reason to doubt this), such experiences are largely irrelevant to the problems of African economies - especially in the first half of the 1970s. We must be primarily concerned with varying and to some extent unanticipated inflation.

The reasons which have been produced to show that inflation is favourable to investment may be summarized as follows:

(a) Inflation redistributes income in favour of profits;

(b) Inflation thereby increases the "resources available for investment";

(c) The high profits of demand pull raise the expected profitability of investment;

(d) The expectation of further inflation raises the expected return on investment more than the induced rise in interest rates dampens demand - prices are, in any case, not subject to the same controls as interest rates;

(e) Rising prices reduce the real burden of debt, benefiting the entrepreneur at the expense of the rentier;

(f) With inflation and demand pull there is a strong incentive to innovate.

Probably the best answer to this "case" is the experience of many European countries - the United Kingdom and Italy in particular - during the recent inflation. The points may be taken in turn:

(a) Profits as a share of national income dropped continuously to an all time low in the United Kingdom during the inflation, and the redistribution of wealth was largely in favour of certain "key" trade unions and public sector employees and at the expense of industrial profits;

(b) The resources available for investment did not find their way into industrial investment (on the contrary, in the United Kingdom it is likely that there has been net disinvestment in industry) but into finance and property companies; the liquidity crisis in 1974 drastically curtailed new investment;

(c) and (d) Inflation reduced the expected rate of return since entrepreneurs correctly anticipated that the Government would introduce price controls which would ensure that investment only made losses; furthermore the rise in interest rates was both dramatically sudden, very sharp, and most damaging to even otherwise healthy enterprises;

(e) Most industrial investment is not financed on fixed-interest long-term debt; bank credit and rolling credits with re-financing problems were characteristic; in any case there would soon be few prospects of low interest rates on long-term debt as soon as the inflation gets under way;

(f) In the United Kingdom there was evidence of a reluctance to innovate because of the arguments advanced above.

At the end of 1974 it was estimated that British industry was valued at less, in real terms, than it had been in any period after the First World War (i.e. 1919). The depressed capital markets brought investment virtually to a standstill. The rate of growth became negative - perhaps of the order of minus 2 or 3 per cent in annual terms. Tax laws which were fashioned under conditions of stable prices overestimated real profits by not allowing for replacement, both of stocks and fixed equipment, at new prices. It has been estimated that real profits were probably negative during the years 1972-1974, but of course there is much room for disagreement about such a statement.

The experience of most industrial countries during the inflationary surge of the 1970s has been broadly the same, but perhaps not quite so deleterious as in the case of the United Kingdom and Italy. The slowing-down of investment and growth - even moving into decline - is, however, characteristic of all developed economies.

We may confront this finding with the admirable summary of the Central Bank of Nigeria's reveiw of the evidence ... "there is no consistent relationship between rates of inflation and rates of growth of output ..." 25/ The remarkable experience of the developed countries during the 1970s however must surely add a rider: that countries that accelerate their rate of inflation form some 3 per cent to 20 per cent, or from zero to 10 per cent, suffer both a decline in investment and a change of an absolute decrease in the level of output. Unfortunately, the national product figures and price indexes are not yet available for us to test this hypothesis with respect to developing countries during the great inflation of the 1970s, but it seems at least to be a plausible hypothesis on the basis of the fragmentary data at present available.

Inflation and distortions

In developing countries probably the most important distortion of inflationary finance is the degeneration back into the subsistence sector and the "flight from cash". In steady price conditions one of the forms of development is the formation of outside contacts, specialization and farming for market and cash and the encouragement of thrift. With inflation - and particularly when the inflation is suppressed or regulated and "controlled" - one would expect a reassertion of barter as the main form of transaction and, in conditions of very rapid inflation, the complete forsaking of money and the elevation of some goods - the cigarette or the bottle of brandy - into the place of intermediator in transactions. There are many examples of such degeneration of the monetary system - the Federal Republic of Germany in 1947, Indonesia in the late 1960s, and more recently Chile. In Indonesia monetization was delayed many years by rampant inflation.

25/ Ibid., p. 41.

The other main form of distortion is the acquisition of real marketable assets - and particularly foreign currency and other foreign assets - rather than domestic assets, and particularly rather than domestic assets denominated in the form of currency. Again this was particularly prevalent in Chile. The flight from esoudos primarily took the form of transfers of bank balances, delayed payments etc., but also the illegal holding of United States dollar notes and other hard currency instruments. Characteristically this reduces the Government's taxing power through (a) encouraging the evasion of tax through illegal holdings; and (b) reducing the seigniorage in real terms from the issue of currency and the increasing money supply (in nominal terms).

In most cases of inflation the rate of interest is kept below the rate of inflation - at least for a substantial fraction of debt and for lengthy periods of time. Again if there is a more or less open door to the flight of capital much of it will find its way abroad where positive real retrurns or smaller losses may still be available. The incidence of such flights however is important. The savers who have the opportunity to escape in this way are usually the large asset holders; the small saver and asset holder is unlikely to have such opportunities and he will tend to be partly expropriated.

The disincentive to saving occasioned by such negative real rates is characteristic of many developing countries in Africa as well as many countries in Europe, and it has been noted in a number of countries in this study. The authorities are reluctant to raise interest rates of banks and other saving institutions because of the effects on the money required to service new debt, and because of a belief in the need for low interest rates to foster investment. But low interest rates (in particular negative real rates) are unlikely to lead to the sort of stimulus for investment required for growth and profitable employment of limited capital resources. In some cases in Africa low interest rates have given rise to "round-tripping" operations by borrowing cheap money internally and lending profitably externally. Furthermore there is ample evidence that cheap money during a period of inflation encourages speculation in property and extensive building to the detriment of productive activity in the industrial and agricultural sectors.

The greatest distortions, however, normally arise from Government attempts to suppress inflation by regulations and controls. Although such measures merely delay and do not slow the inflation, they do cause great hardship and much misallocation of energy and resources.

Government and the national debt

In most African countries there is no substantial amount of debt held domestically - except by institutions, such as social security funds, financial institutions and banks and other semi-public bodies which are forced or required by "custom" to hold a substantial fraction of their portfolio in the form of Government debt. Inflation does tend to extinguish the debt since its value in real terms falls, often even more rapidly than the rate of inflation (because of anticipations of future higher rates of inflation). It must be observed that it does not extinguish debt held by foreigners since such debt will normally be denominated in another currency such as dollars, German marks, etc.

Devaluing the debt by inflation does involve many problems. It is not simply a case of expropriating the capitalists; on the contrary, it is sometimes a case of expropriating pension funds (as in the case of employees' provident funds).

Similarly, if the banks are subject to the debasement of their public debt holdings, the value will tend to be recouped by increasing the margins between lending and borrowing rates - which will discourage productive investment.

Many countries in Africa would be advised to foster a market for national debt - to encourage thrift and savings and to mobilize resources, and to provide for the cushion so necessary in the case of economies that are much buffeted by external shocks. Inflationary expropriation of the existing holders of public debt is not a good way to start a proper capital market.

Some condluding thoughts on inflation and redistribution

While it is undoubtedly true that inflation redistributes income and wealth, it is not clear whether it reduces or increases differences in the standard of material well-being on the average. Among the poor, it makes the urban poor somewhat worse off while those in the relatively poor subsistence sector are made better off. Among the rich, it will probably increase the income of some large farmers and landowners, who are engaged in producing a crop that has increased relatively in price, but others with financial assets, either domestic or foreign, have suffered.

Governments gain a larger command over real resources by the use of inflationary finance - but this gain is only transitory and will soon be eliminated. Indeed, the Government will eventually find that in conditions of rapid inflation it commands a smaller quantity of resources than it could under more stable conditions.

From all this evidence it is not clear whether there is a tendency to more equal shares or less equal shares; it is clear, however, that the redistribution is quite arbitrary and in no way rewards the deserving and punishes the undeserving, either rich or poor.

VII. CONCLUSIONS

This study of inflation in several African countries has shown one common thread. Inflation generally takes place when there is an increase in the supply of money at a more rapid rate than can be absorbed by the growth in real output and the increased requirement to hold money consistent with the increased monetarization of the economy. In other words, the cause - or one should properly say the proximate cause - of inflation is too large an increase in the supply of money relative to the demand for it.

The reasons for too large a supply of money relative to the supply of goods (and increased monetization) are much more complex and vary from country to country. In some cases there is a marked reduction in real output arising from disorders, civil war, or perhaps some natural catastrophe (such as failure of a harvest) which drastically and suddenly reduce output. Dislocation of markets and indeed ordinary commercial life is characteristic of such events, often resulting in a sharp decline in Government revenues and a sharp increase in the level of public spending. The simultaneous reduction in the demand for money due to the fall of output - probably reinforced by doubts about the value or even survival of a currency - and the great need of Governments to borrow from the banking system to finance financial deficits in the public sector creates great pressures on the price level. If the state of affairs continues then there is virtually certain to be rapid inflation and all the adjustment difficulties it entails.

Such states of civil disturbance, however, have usually been transitory and temporary in character in Africa (as distinct from such conditions in, for example, South-east Asia). The inflation tends to be temporary, provided that the monetary authorities reduce their borrowing from the banking system and restore normally balanced (or nearly balanced) budgets as soon as possible. Nevertheless the build-up of liquidity during the emergency will give rise to a rapid rise in prices which will take place after the emergency is over and when budgets of the public authorities are nearly back to normal. The real inflation takes place after the events which have caused it. Again, however, the temporary nature of such an inflation makes it less of a threat than the persistent inflations that have dominated so many countries in the 1970s. Growth with stable or gently rising prices can soon be regained. Indeed, in the most striking case of recovery, that of Nigeria, the civil war seemed to be only an interruption in the normal growth of the economy. The level of output advanced very rapidly when peace was restored. The price level also increased very rapidly, but the growth in real output soon increased the demand for money to hold (and the wise policy pursued by the federal Government restored stability and confidence in the currency).

The other overriding cause of inflationary and deflationary disturbances in Africa is variations in the price of the main export commodities, and to a much smaller extent the variation in the prices of imports. By changes in the terms of trade, vast changes in the level of real domestic incomes are brought about. And the fact that in many countries Government revenue substantially depends on the price of certain important exports means that when the price and real incomes fall the revenue of the Government falls even more steeply. Thus the Government is driven to seek finance either through foreign borrowing or by borrowing from the banking system, so tending to increase the supply of money and storing up inflationary pressure. (It will be noted that it is often difficult, or at least very expensive, to borrow abroad.) Conversely, when the price of exports is high the exporting firms receive large sums of foreign exchange which they excahnge at the central bank (or at commercial banks) for the domestic currency or deposits. The attempt to spend this money will increase imports and reduce to some extent the financial (current) surplus on the balance of payments - but if the substantial surplus persists there will be a danger of over-expanding the money supply. And unfortunately the price inflation effects of such an expansion will not appear for some time - perhaps only when the high prices have slumped to a trough and the Government is desperately trying to cope with falling real incomes and Government revenues. This "switch-back" effect of inflationary injection is one that is difficult to avoid even if the economy has a well developed market for public debt - and virtually all countries in Africa have only a vestigial or captive debt market. The oscillations induced by export prices might be thought to be the inevitable price for the great advantages of specialization and trade.

There is no ready-made and easy solution to this problem of externally induced inflation on the switch-back process. It has been stressed that it would be most useful to develop debt markets that would enable the authorities to mop up excess liquidity during the glut and to inject it during the slump. But the development of markets for public debt, although highly desirable, takes a long time to generate confidence, skills in dealing, subsidiary institutions, and the complex set of relationships with existing international firms and agencies. In many countries the market for public debt is "captive" in the sense that the rate of interest is too low to attract the public and only public institutions (such as employees' provident funds) or banks and financial institutions buy such debt, because the law requires it. Whether the best answer is to develop "two-tier" debt markets -

one kind of debt to be bought by the general public and another kind to be bought by the captive institutions -- is a matter which cannot be investigated in this study, but it should be on the agenda for further study. Other suggestions, such as controlled marketing arrangements or attempts at international control, also extend well beyond the scope of this study.

It is a commonplace of much economic writing that some inflation in the developing countries of the world was imported from the United States and, to some extent, from Europe. Since the countries of Africa tended to maintain parity with the dollar or perhaps eith the pre-Smithsonian dollar the price level was, in the long run, bound to rise with the rise in the world price level. Taking the period from 1970 to 1974 this would suggest that the overall imported long run inflation rate would have been about 5 per cent per year - accelerating to the 1975 value of perhaps 8 or 10 per cent. But this is the steady trend of inflation and must be distinguished from the switch-back effects discussed above. Furthermore, the importation of the developed countries' inflation rates could be delayed or speeded up by domestic financing decisions which would be cushioned, at least for some time, by the use or accumulation of foreign exchange reserves. In the long run such an importation of inflation could have been avoided only by continuous appreciation of the domestic currency against the dollar. In some countries a certain appreciation did indeed take place, but it tended to be swamped by other factors, and in any case it was never enough to offset the imported inflation. This reluctance to revalue a currency is quite understandable since there are considerable distributional problems involved.

Over the seven or eight years which form the field of view of this study, there is little evidence that African Governments were deliberately using inflation as a means of collecting revenue, whether such money was to be spent on development projects or on current commitments. In this sense there is a marked difference between the more prudent approach of African central banks and treasuries and the inflationary finance pursued by many South American and some Asian countries, and some industrialized countries. In part this considerable financial prudence appears to arise from the inherited principles of the orthodox finance which existed in the various currency board arrangements. Certain countries threw off such constraints early in their period of independence and embarked on an inflationary expansion of public spending. In general such infaltionary financial policies soon run into the difficulty of obtaining sufficient foreign credit to finance the expanded volume of imports, and often also difficulties with repaying the existing interest commitments become acute. Furthermore, inflatinn is counter-productive as a means of raising real resources for the use of the public sector since the increase in the rate of depreciation of the currency induces smaller real holdings and so provides a smaller quantity of real resources for the public secror's disposal. These lessons seem to have been well assimilated.

The social and distributional consequences of inflation in African countries appear to be most serious. In particular, the relatively more rapid rise in the price of food affects the urban poor and exacerbates an already serious problem of urban poverty. Similarly, there is a grave danger that inflation will divert resources from productive uses to the traditional hedges against falling currencies - investment, property and various financial operations. There are no data to enable a judgement to be made of the various redistributional effects, other than that on the urban poor already mentioned. It is likely that among the middle and upper income groups considered as a whole there will be no large variation in the fraction of their total assets denominated in nominal terms, so that there will be no wholesale redistribution of wealth between these groups. But more evidence is required.

It is likely that inflation will continue at the present pace (January 1975) for some months in most African countries -- and the rate is likely to accelerate in certain States. Little can be done to stop it. Controls on prices and wages are apt to make things worse rather than help. Governments would be well advised to raise their sights to the medium-term and long-term solutions to the various problems of imported (switch-back) inflation and the need for control of the banking and monetary systems.

Compared with those in the various developed countries of the world, African monetary and fiscal authorities have done a commendable job in coping with the immense problems in their all too open economies. The inflations in the United States, the United Kingdom and many other European countries are of those countries' own domestic making. In the United Kingdom for example, inflation was generated by a deliberate policy of deficit spending financed by increasing the money supply (from September 1971 onwards). In the United States the inflation began in the late 1960s when deficit spending became fashionable, and was associated with the need to finance the Viet-Nam involvement as well as the expanded domestic welfare programme. Until 1973 none of the developed countries was subject to the massive changes in terms of trade, nor do they have such a high fraction of their income traded internationally as the countries in developing Africa. Furthermore, African countries do not have the great advantage of a sophisticated market in public debt. Yet the authorities in Africa coped reasonably well with the great surges of inflationary pressure that the developed countries unleashed in the late 1960s and early 1970s. Some countries have suffered severely (e.g.,Ethiopia) while others have profited from the expansion in export earnings which has, in some cases, been associated with inflation. On balance, however, the inflation with its recessionary aftermath has done some considerable harm to Africa; and for this the developed countries of the world must be held to be partly responsible.