

FINANCE AND TRADE IN AFRICA
**MACROECONOMIC RESPONSE IN A WORLD ECONOMY
CONTEXT**

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INTRODUCTION

1.1 Introduction and Overview

Notwithstanding the recent optimism about African economies, the performance of these economies since the time of political 'independence' can only be described as dismal. There has been a secular deterioration in their terms of trade (particularly from the mid 1970s); the level of external debt has grown enormously, leading to near insolvency; dependency on foreign aid has grown at an alarming rate (and this has been exacerbated by stagnation in exports); and, finally, levels of investment have been extremely low. Partly as a result of the latter, physical and social infrastructures have deteriorated rapidly. Political instability, frequent wars, and natural disasters have further aggravated this situation. The major question to be asked then is 'why?'

In this book an attempt to address only one part of this question – the impact of the external sector - will be made. Specifically I will focus on understanding the major causes of Africa's external finance and debt problem. It will be argued that Africa's external finance problem is a consequence of the structure of its trade in the world economy (and, in particular, its position as a commodity producer). It will also be argued, that this is compounded by the adverse effect of the macroeconomic policies adopted by 'Northern' (industrialized/ developed) countries. The purpose of this book, therefore, is to underline the existence of an economic structure, primarily built in the colonial era, which continues to shape the external economic conditions of the African continent today. Thus, it will be argued that any analysis of the external finance problem of Africa, as well as proposed policy proposals based on such an analysis, will be incomplete if this fails to take account of such issues. The book addresses these issues using historical information, and employing both partial and general equilibrium analyzes. The following are some of the major findings of the study.

First, with regard to capital flows to Africa, these are found to depend on the relative (to other 'South') position of Africa, in terms of the economic, political and strategic self-interest of donors. Humanitarian considerations are not found to explain aid flows.

Second, with regard to trade, the study shows that there is a clear difference between UNCTAD's world commodity prices and the regional export prices constructed in the context of this study. Hence, previous studies, using the former set of prices, could have biased elasticities. In order to examine determinants of exports of primary commodities, three competing models of export supply are applied to three regions of Africa for four commodity categories. Although the result is mixed, the model based on a real exchange rate is found to be comparatively the best one. This model underscores the importance of both relative prices and capital formation indicators. However, relative prices are found to affect capacity utilization but not capacity creation.

Third, two macroeconomic effects of external finance are examined, namely fiscal response and 'Dutch Disease' effects. With respect to fiscal response, the result of the empirical analysis is mixed. However, the following major points may be stated. Firstly, the impact of capital inflows on taxes varies, depending on the type of capital inflows, nature of taxes and region. In general, bilateral flows are found to have a negative impact on direct taxes. Capital inflows, in general, are

also found to have a strong positive impact on current government expenditure in all regions. Capital inflows to Africa, generally, were disbursed conditional on deficit reduction. However, these inflows have an inherent tendency of aggravating the deficit and, consequently, may result in governments drifting away from sustainable self-financing behaviour. The study also shows that there is evidence of the 'Dutch Disease' effect in all regions. Interestingly, in almost all cases, government spending on the nontraded sector is found to have a statistically significant negative elasticity. Thus, insofar as part of this spending is financed by foreign inflows, the 'Dutch Disease' effect may be observed indirectly. This is entirely plausible since most capital flows to Africa are directed to the public sector.

The last important sets of findings are derived using the global model developed in the book. From simulation of different policies and external shocks, the following major results are obtained. Firstly, the effect of aid on Africa depends on the manner of its financing in the 'North'. Compared to budget financing, deficit financing of aid is found to have an adverse effect on commodity prices and, hence, export revenue. If bond/ deficit financing is deemed the preferred means of financing, there may emerge asymmetric relations in policy choice between the 'South' and the 'North'. Secondly, the exact effects of this policy will vary, depending on the specific dynamics of each commodity. Thus, depending on the composition of exports, different regions may experience different effects, for the same policy shock. Thirdly, unlike some global models, where aid leads to a rise in South's GDP (e.g. MULTIMOD see Jamshidi, 1989: 38), the impact of such aid in Africa is not only found to vary across regions but also to be generally negligible. The latter is the result of both the degree of disaggregation and the inclusion of the macroeconomic effect of aid in the model developed within this book. Thus, although aid might initially result in a rise in the level of imports, and hence output, the macroeconomic ('Dutch Disease' and 'fiscal response') and terms of trade effects of such aid work against this initial positive impact, resulting in no noticeable effect on output. Finally, the study shows that debt cancellation is not a panacea to the African debt problem, since these problems are intricately linked with trade problems. It is also shown that its impact can vary drastically between regions. However, debt cancellation may alleviate the pressure on the fiscal balance of governments, both by reducing the expenditure burden and by providing positive signals to private lenders.

The remainder of this chapter is concerned with providing a solid conceptual background to the various questions and findings noted above. In section 1.2 the external finance problems of Africa are described. The section concludes by highlighting a number of economic implications of the debt problem for Africa. Section 1.3 describes how the debt issue has been examined during the course of a recent policy debate about African economic problems in general. Section 1.4 examines how the structure of African economies may usefully be seen as a legacy of its colonial history. Section 1.5 highlights a number of important methodological issues. Finally, section 1.6 sets out the organization of the remainder of this book.

1.2 Background to African Debt and Macro Policy Debates

1.2.1 Background to African Debt

African economic problems can be seen as a complex of interrelated factors of an internal and external nature. As noted in section 1.1, this study focuses on the latter. The external finance problem, and debt crisis in particular, represents one of the major problems facing African nations, today. As can be seen from Table 1, the total external debt of Africa has risen nearly twenty-five fold from a relatively low level of US \$13.9 billion, in 1971, to over \$300 billion in 1998. The major component of this burden comprises outstanding long-term debt. During the late 1970s, and early 1980s, IMF credits were increasingly used, with 'Structural Adjustment' and

'Enhanced Structural Adjustment' facilities comprising an ever-important component of flows to Africa.

Table 1.1: Major Debt Indicators for Africa (in billions of US dollars, unless otherwise stated)

	1971	1975	1980	1985	1990	1991	1992	1993	1994	1995	1996	1997	1998
Total External Debt Stock (EDT)													
East and Southern Africa (ESA)	4.9	11.4	28.3	55.4	85.2	88.8	91.1	93.4	101.4	106.0	104.0	103.2	107.3
North Africa (NA)	5.1	12.9	51.3	75.0	93.0	90.9	88.7	86.7	94.1	99.6	98.0	92.2	94.4
West and Central Africa (WCA)	3.9	8.2	32.2	51.7	91.7	94.2	90.9	94.7	98.2	103.9	101.7	94.5	98.1
Sub-Saharan Africa	8.8	19.7	60.8	107.1	176.9	183.4	182.7	194.8	221.3	235.4	231.8	223.1	230.1
All Africa	13.9	32.6	112.1	182.1	269.8	274.2	271.4	281.5	315.4	335.0	329.9	315.3	324.5
Long-term External Debt (total, All Africa)	11.9	27.2	84.6	140.1	227.7	231.7	227.2	234.0	253.0	266.9	260.9	249.2	256.3
Multilateral (DOD),													
East and Southern Africa	0.5	1.4	4.0	8.9	18.9	20.7	21.5	23.4	25.9	27.7	28.0	28.0	29.8
North Africa	0.2	0.6	4.1	7.2	12.4	13.8	14.2	15.4	17.0	18.4	18.2	17.2	18.5
West and Central Africa	0.5	1.2	3.6	7.8	19.4	20.9	21.7	22.8	25.3	27.1	26.7	25.6	27.3
Sub-Saharan Africa	1.0	2.6	7.6	16.7	38.2	41.6	43.2	46.1	51.2	54.7	54.7	53.6	57.0
All Africa	1.2	3.2	11.7	23.9	50.6	55.4	57.4	61.4	68.2	73.0	72.9	70.7	75.6
Bilateral													
East and Southern Africa	2.6	5.0	11.1	23.7	36.6	37.3	37.2	36.8	39.2	40.0	39.5	38.2	39.8
North Africa	3.0	6.0	17.5	31.9	36.6	37.8	38.2	38.1	44.4	49.8	50.7	48.0	49.1
West and Central Africa	2.0	3.2	6.9	10.5	33.9	36.7	37.1	37.0	40.4	42.8	41.2	38.7	40.7
Sub-Saharan Africa	4.6	8.3	18.1	34.2	70.5	74.0	74.4	73.8	79.6	82.7	80.7	77.0	80.5
All Africa	7.6	14.3	35.6	66.1	107.2	111.7	112.6	111.9	124.0	132.6	131.4	125.0	129.7
Private creditors (DOD)													
East and Southern Africa	1.1	2.6	5.4	8.6	13.3	13.3	13.0	13.0	12.9	13.5	12.6	12.6	12.3
North Africa	1.2	4.8	21.0	23.8	34.5	30.8	29.0	27.3	26.1	24.5	21.5	18.7	17.6
West and Central Africa	0.7	2.3	10.8	17.6	22.1	20.2	14.5	14.6	13.9	13.4	12.2	10.6	10.6
Sub-Saharan Africa	1.9	4.9	16.3	26.3	35.4	33.9	28.2	33.4	34.6	36.8	35.1	34.7	33.6
All Africa	3.0	9.7	37.3	50.1	69.9	64.7	57.2	60.7	60.8	61.3	56.6	53.4	51.1
Interest and Principal Arrears (Percent of total external debt)													
East and Southern Africa	0.3	3.6	10.3	16.4	21.1	25.2	28.4	32.5	34.0	36.7	35.0	34.2	35.4
North Africa	1.5	0.2	0.9	6.9	6.3	0.9	0.3	0.3	0.3	0.4	0.5	0.5	0.5
West and Central Africa	2.8	3.9	1.6	3.1	9.6	10.3	14.1	19.2	19.5	21.9	23.8	22.7	25.6
Sub-Saharan Africa	1.4	3.7	5.6	10.0	15.2	17.5	21.2	25.0	24.2	26.3	26.2	25.5	27.5
All Africa	1.4	2.3	3.5	8.7	12.1	12.0	14.4	17.4	17.1	18.6	18.6	18.2	19.6

Source: World Bank 'Global Development Finance' (2000).

Table 1.2: Major Debt Indicators for Africa (in Billions of US dollars, unless otherwise stated)

	1971	1975	1980	1985	1990	1991	1992	1993	1994	1995	1996	1997	1998
Net Transfer on Debt													
East and Southern Africa	1.09	2.19	2.48	2.49	2.07	0.80	2.45	0.84	-0.04	0.47	-0.45	1.65	-1.32
North Africa	0.54	4.68	2.25	-0.06	-5.64	-3.39	-5.71	-5.85	-2.80	-3.33	-3.58	-4.86	-5.97
West and Central Africa	0.40	1.12	4.01	-1.89	-0.27	-2.22	-2.02	0.83	-2.80	-0.57	-1.33	0.31	-3.28
Sub-Saharan Africa	1.50	3.31	6.56	0.55	1.78	-1.18	0.74	2.53	5.48	2.01	-2.57	0.15	-6.48
All Africa	2.04	7.99	8.81	0.49	-3.86	-4.57	-4.98	-3.32	2.68	-1.32	-6.15	-4.71	-12.45
Aggregate Net Transfer													
East and Southern Africa	1.08	2.30	4.18	5.37	7.62	7.57	7.55	6.46	5.66	5.76	3.77	5.37	4.13
North Africa	0.46	5.19	2.95	2.60	3.08	0.54	-0.75	-1.80	0.39	-1.54	-0.23	0.29	-2.20
West and Central Africa	0.29	1.14	1.16	-1.28	2.32	1.80	1.49	4.19	5.45	3.05	2.77	2.52	1.95
Sub-Saharan Africa	1.43	3.41	5.11	4.44	9.23	8.97	8.83	10.21	11.75	15.36	8.66	13.33	6.68
All Africa	1.90	8.60	8.06	7.04	12.31	9.51	8.08	8.41	12.14	13.81	8.43	13.61	4.48
Technical co-operation grants (as percentage of total grants)													
East and Southern Africa	61.81	36.39	36.77	32.06	24.31	25.61	26.44	28.94	24.26	29.06	33.98	31.25	24.94
North Africa	38.70	16.33	58.53	39.71	20.31	22.50	31.49	52.21	38.85	51.19	40.04	43.32	33.25
West and Central Africa	51.54	46.90	54.37	36.61	30.04	31.78	35.62	37.18	26.81	32.06	30.01	32.53	28.86
Sub-Saharan Africa	61.36	49.23	42.60	35.52	29.76	31.79	32.91	33.86	28.45	30.70	32.69	31.30	27.82
All Africa	50.03	32.78	50.57	37.61	25.04	27.14	32.20	43.04	33.65	40.94	36.36	37.31	30.53
Debt (EDT)/GNP (%)*													
East and Southern Africa	19.87	23.12	44.32	77.66	99.45	94.71	115.66	116.12	141.51	133.18	114.93	103.40	111.55
North Africa	29.33	31.56	57.07	84.27	71.98	75.11	68.30	67.02	69.68	68.75	61.36	58.15	55.81
West and Central Africa	21.35	27.61	59.61	106.68	121.16	127.89	147.63	167.20	158.63	145.95	146.27	163.02	
Sub-Saharan Africa	14.55	15.52	23.45	56.37	63.01	63.68	62.91	70.99	82.57	77.57	73.82	67.74	72.32
All Africa	21.94	23.54	40.26	70.32	67.50	69.39	65.61	69.00	76.13	73.16	67.59	62.94	64.07
Debt service Ratio (%)*													
East and Southern Africa	8.54	9.63	14.23	21.89	20.87	21.73	18.79	17.55	14.86	21.26	15.26	12.39	15.49
North Africa	21.77	8.52	22.27	30.24	32.96	34.58	37.21	36.49	29.86	24.48	21.15	20.10	22.38
West and Central Africa	5.28	6.88	13.16	22.08	19.29	18.12	15.83	14.52	21.12	18.98	18.39	15.92	17.08
Sub-Saharan Africa	7.20	17.58	12.92	12.46	12.28	9.20	14.57	15.29	14.22	14.72	14.68
All Africa	14.73	23.91	22.94	23.52	24.74	22.84	22.21	19.88	17.69	17.41	18.53

* Simple arithmetic mean (based on countries that have relevant data) Source: Based on World Bank 'Global Development Finance' (2000).

Net transfer = Loan disbursements less amortization and interest payment [as defined in World Debt Tables]

Aggregate net transfer = Aggregate net resource flows (Loan disbursements less amortization) plus official grants (non-technical) and foreign direct investment (FDI) less interest payment and FDI profit [as defined in World Debt Tables]

Changes in the structure of African debt can also be described in terms of creditor patterns. From Table 1, it can be seen that bilateral debt comprises the largest component of Africa's total debt. This is followed by multilateral debt, with private inflows showing a decline. Generally, it may be observed that a larger share of official debt is now disbursed on concessional terms. Finally, it is interesting to note that the debt problem is being aggravated by capitalization of interest and principal arrears, which constitute nearly a quarter of the external debt burden.

Although the share of African debt as a proportion of the total debt of developing countries is low, the relative debt burden born by African nations remains high. As can be seen from Table 2, the debt to GNP and debt service ratios rose from 22 per cent and around 9 per cent, respectively, in 1971, reaching a high of 67 per cent and 23 per cent during the late 1980s. In 1998, the last year for which we have data, these ratios stood at 64 per cent and 18 per cent, respectively.¹ Africa's burden of debt may also be assessed by examining net transfers to the sub-regions. Thus, if we exclude from Table 2, grants and net foreign direct investment inflows, it can be seen that net transfers since 1990 have, in fact, flowed *from* Africa to the developed nations. Further, it is noteworthy that the level of such transfers has increased, from US \$ 3.86 billion in 1985 to nearly US\$ 12.45 billion in 1998. Finally, it is worth pointing out that in the 1990s nearly 35 per cent of grants to Africa, in fact goes to 'technical experts' coming from the North.

In summary, the last three decades have witnessed an unprecedented increase in the level of African debt. This debt is characterized by its predominant long-term character, the growing importance of debt owed to bilateral and multilateral creditors, a trend away from concessionality to nonconcessionality and an increase in the importance of interest and principal arrears (usually capitalized through the Paris and London clubs) as a component of long term debt. Indicators of the debt burden also indicate that African debt is extremely heavy compared to the capacity of the African economies, and, in particular their export sectors. Moreover, most African nations have been subjected to net financial outflows in the period since the mid 1980s. The performance of these economies, coupled with a mounting debt burden, surely indicates that African countries are incapable of simultaneously servicing their debt and attaining a reasonable level of economic growth, let alone addressing issues of poverty alleviation.

The actual size of indebtedness does not usually represent an economic problem in itself, since this debt may usually be mitigated by rescheduling and similar short-term arrangements. However, the size of accumulated debt, relative to capacity level, and subsequent impacts on the economy, do represent a serious problem for African nations. In this respect, three inter-related implications of the debt problem deserve mention. First, servicing of the external debt erodes foreign exchange reserves, which might otherwise be available for purchase of imports. This has led to the 'import compression problem', in which a shortage of foreign exchange adversely affects levels of public and private sector investments. The import compression problem represents one of the major macroeconomic issues facing Africa today. Second, the accumulation of a debt stock results in a 'debt overhang' problem, which tends to undermine the confidence of private investors, both foreign and domestic. A decline in levels of private investment as a share of GDP, from the late 1970s onwards, may partly be attributed to this factor. Finally, servicing of debt is placing an enormous fiscal pressure on many African nations. Such pressure has had an adverse effect on public investment. This finding is reflected in a reduction in the share of public investment in GDP from late 1970s onwards. Naturally, a reduction in levels of public investment will tend to have negative consequences for physical and social infrastructure. To sum up, the debt issue is a crucial element of the overall economic crisis facing Africa. How, then, has this crisis come about? The following sections will briefly summarize some of the general arguments surrounding this issue.

1.2.2 Africa's Economic Crisis – What caused it?

There are three sets of contending explanations for Africa's economic crisis. The first is set out in World Bank (1981) - also known as 'the Berg Report' - and a number of subsequent World Bank publications. An alternative explanation for Africa's economic problems, associated with the United Nations' 'Economic Commission for Africa' (ECA) is outlined in *African Alternative Framework to Structural Adjustment Programs*, AAF-SAP (ECA, 1989a). Finally, there exists a third view, which is less clearly associated with any particular institution and largely held by academics of a Marxist orientation. This latter position is often offered as a critique to the other two explanations. Although the scope of all three sets of explanations is general, encompassing every aspects of the African economic crisis, we focus mainly on how problems in the external sector of the economy are explained. Nevertheless, by referring to this wider debate, we aim to locate the problems and the role of the external sector in a wider context.

The World Bank's *Agenda for action* (1981) argues that Africa's problems relate to underdeveloped human resources, political fragility, problems of restructuring colonial institutions, inheritance of poorly shaped economies, climate, geography and population growth. Set in the context of these problems, disappointing performance of the external sector is, perhaps, a little more understandable. The Bank argues that, in spite of external shocks, associated particularly with a rise in oil prices in the periods 1973-74 and 1978-80 and a decline in world demand for primary commodities, the balance of payments problems experienced by most African nations since the 1970s cannot generally be attributed to a deterioration in terms of trade². With the exception of mineral exporters, it is suggested that terms of trade for most African nations have, in fact, either been favourable or neutral³.

The main cause of the balance of payments problem, according to the Bank, has been a decline in the volume of exports. The decline in terms of trade faced by African nations is attributed to three factors. Firstly, structural changes in the composition of world trade, with trade in commodities growing at a slower rate than that of manufactures, has resulted in a decline in the African share of total world trade. Secondly, drought and civil strife has negatively affected Africa's supply capacity. And thirdly, trade restrictions and agricultural subsidy policies of industrial countries represent a barrier to African trade⁴. The Bank goes on to argue that the failure of Africa's export sector may be explained in terms of three *main* factors. Firstly, government policy has tended to be biased against agricultural and export production. Secondly, increased consumption associated with rapid population growth has placed a burden on resources, which might otherwise have been used by the export sector. And, thirdly, inflexibilities in African economies are seen as representing an obstacle to diversification. The Bank's insistence that policy failure represents the main explanation for Africa's economic crisis, and consequent emphasis on the need for reforms, has continued with the publication of its long-term perspective study (World Bank, 1989). Moreover, as recently as 1994, the Bank continues to argue that orthodox macroeconomic management represents the road to economic recovery in Africa and, hence, that more adjustment, not less, is required (World Bank, 1994). This assertion has been the subject of various criticism, coming from a host of different angles (see *inter alia* Adam (1995), Mosley *et al* (1995), Lall (1995)⁵).

A number of other analysts have arrived at conclusions, in line with those of the Bank. van Arkadie (1986), while sympathetic to the problems posed by external shocks, argues that stagnating or falling output has had an important impact on export earnings. On the latter point the World Bank (1989) argues, rather vigorously, that declining export volumes, rather than declining prices, account for Africa's poor export revenue. Grier and Tullock's (1989) analysis supports this view. Based on their survey of empirical studies into the causes of the African economic crisis, Elbadawi *et al* (1992), also found domestic policies to be important. White

(1996b), citing the case of Zambia, argues that economic decline following Zambia's independence may largely be attributed to economic mismanagement. Using a simple pooled multiple regression equation for thirty-three African countries, Ghura (1993) also found significant support for the Bank/ IMF viewpoint. Easterly and Levine (1996) suggest political instability, low levels of schooling, deterioration in infrastructure, as well as policy failures as representing possible causes of Africa's growth problems. They conclude, however, that policy improvements alone are likely to boost growth substantially. (See also Collier and Gunning (1999) for a similar argument). Although the above survey is not exhaustive, the aforementioned works would tend to lend strong support to the Bank/ Fund's viewpoint. The logical conclusion to be drawn from this survey, therefore, is that the remedy to Africa's economic problems is to implement Structural Adjustment Programs (SAPs).

In contrast, the ECA (1989a) prefers to explain Africa's problems in terms of deficiencies in basic economic and social infrastructure (especially physical capital), research capability, technological know-how and human resource development, compounded by problems of socio-political organization. The ECA sees inflation, balance of payments deficit, a rising debt burden and instability of exports as resulting from a lack of structural transformation, unfavourable physical and socio-political environment, as well as an excessive outward orientation and dependence. The ECA study suggests that weaknesses in Africa's productive base, the predominant subsistence and exchange nature of the economy and its openness (to international trade and finance) have all conspired to perpetuate the external dependence of the continent. Hence, one of the striking features of the African economy is the dominance of the external sector. This has the effect of rendering African countries quite vulnerable to exogenous shocks⁶. Consequently, according to the ECA viewpoint, perceiving African problems in terms of internal and external balance problems and seeking a solution within that framework (most notably, through the implementation of Structural Adjustment Programs) implies not only the wrong diagnosis but also the wrong treatment. The ECA study argues that '...both on theoretical and empirical grounds, the conventional SAPs are inadequate in addressing the real causes of economic, financial and social problems facing African countries that are of a structural nature' (ECA, 1989a: 25).

Based on this alternative diagnosis, and the major objectives of 'the Lagos Plan of Action' (OAU, 1981), the ECA formulated an African alternative framework to the Bank/ Fund's policy recommendations. The ECA framework focuses on three dynamically interrelated aspects, which need to be taken into account. First, *the operative forces* [political, economic, scientific and technological, environmental, cultural and sociological⁷], second *the available resources* [human and natural resources, domestic saving and external financial resources] and third *the needs to be catered for* [i.e. focusing on vital goods and services as opposed to luxuries and semi-luxuries]. The adoption of this general framework would allow the different categories of operative force to influence not only the level and structure of what is produced but also the distribution of wealth. Moreover, these forces may then influence the nature of needs to be catered for and the degree of their satisfaction. At a concrete level this is envisaged as taking a number of policy directions. Firstly, improving production capacity and productivity, mobilization and efficient use of resources, human resource development, strengthening the scientific and technological base and vertical and horizontal diversification. Secondly, improving the level and distribution of income, adopting a pragmatic balance between the public and private sectors, putting in place 'enabling conditions' for sustainable development (particularly economic incentives and political stability), shifting of (non-productive) resources, and improving income distribution among various groups. And, finally, focusing on the required needs, particularly in relation to food self-sufficiency, reducing import dependence, re-alignment of consumption and production patterns and managing of debt and debt servicing.

Just as many have argued in favour of the Bank/ IMF view, so too, many analysts have come out in support of the ECA's position. Thus, various studies have emphasized Africa's extreme dependence on primary commodity exports (See Ngwenya and Bugembe (1987), Fantu (1992), Adedeji (1993)). Siting this discussion in a broader historical context, these studies have highlighted the impact of colonialism in establishing the rules by which Africa might participate in the world economy. According to these rules, African nations produced raw materials and agricultural goods for Europe's industries. Further, it is argued that this pattern of trade has changed very little since the time of political 'independence' (Fantu, 1992: 497-500, Adedeji, 1993: 45). Indeed, Stefanski (1990) argues that, understood in the context of direct continuum with the colonial experience, Africa's economy still depends on external factors to a much greater degree than any other developing region. As a result of this dependence, Africa's economic crisis is seen as being intricately interconnected with external factors such as falling terms of trade, declining demand for African exports and related external shocks (Stefanski, 1990: 68-77, Adedeji, 1993: 45). Collier (1991) also argues that abrupt external shocks (be they negative or positive) have represented important causes of the poor long-term economic performance of Africa⁸. Ali (1984) has touched on another dimension of the problem. He argues that, for most African nations, the mitigation of their problems depends not only on the characteristics of the commodities they export (and specifically their elasticities) but also on the presence or absence of the necessary market staying power. Wheeler (1984) has made an exploratory econometric analysis of the sources of stagnation and suggests that 'environmental' factors (especially terms of trade and international conditions of demand) have had a greater impact on growth than policy variables. Indeed, based on Ghura's (1993) recent econometric analysis, world interest rates represent a further significant variable, which should be added to Wheeler's list of adverse 'environmental' factors.⁹

The negative impact of dependence on exports of primary commodities is reflected in three interdependent phenomena. Firstly, a decline in prices faced by exporters ('terms of trade'). Secondly, instability of export earnings. And, thirdly an absolute decline in levels of demand and supply. Attempts to compensate for a deterioration in the exchange rate facing exporters, by increasing supply, have resulted in a further decline in prices (Fantu, 1992 :502, Stefanski (1990) Stein (1977)). Stein (1977) examined export trends in East Africa (Uganda, Kenya and Tanzania) in order to determine the causes of the divergence of each country's export growth from that of the world. He found that unfavourable commodity composition¹⁰, as opposed to the favourable/unfavourable nature of its market and increased competitiveness went a long way in accounting for this divergence. Because African countries depend on a few commodities, whose prices swing cyclically and may decline over time, these countries face export-earning instability. Naturally, such instability adversely affects their economies. However, Fosu (1991) examining the evidence for sub-Saharan Africa, argues that export instability *per se* is less important than fluctuation in capital formation (capital instability) in affecting economic growth. Yet, as his own work shows, in sub-Saharan Africa, high export instability may render export proceeds a relatively unreliable source for funding for investment projects (Fosu, 1991: 74-75). This usually forces countries to depend on external finance (discussed, at length, in section 1.3).

The third view differs from the other two in its understanding of what crisis means in the African context. For these analysts crisis '...has a connotation of systemic breakdown, but more generally it can refer to a moment or a specific time period in the history of a system at which various developments of a negative character combine to generate a serious threat to its survival' (Lawrence, 1986:2). Sutcliffe (1986), for instance, argues that the African crisis represents the continuation of a complex process of polarization trends. It emanates from Africa's economic dependence. For him, the African crisis is best understood in terms of the combined result of long-term secular effects of imperialism suddenly aggravated by the impact of the world capitalist crisis. Thus, according to these viewpoints, Africa's problems are best understood as resulting

from long-term underdevelopment, following dependency theory¹¹, and short-term vulnerability, following international aspects of crisis theory (Amin 1974a, 1974b, Ake 1981 cited in Ofuately-Kadjoe 1991, Sutcliffe, 1986:19-20; Harris, 1986:93; Onimode, 1988: 13, Moyo et al, 1992: 210). In general, these writers are against the view that there is a 'norm' from which African countries are in a temporary deviation, with associated implications that these countries may return to that norm given a particular adjustment measure (Harris, 1986:84). Harris (1986) and Mamdani (1994) for instance, argue that the IMF and Bank's ultimate objective is not to correct distortions in a free market international system, but to construct such a system (Harris, 1986:88). In so doing, these institutions may undermine any attempt to create an independent, integrated and self-sustained [African] economy (Mamdani, 1994:129).

While there are areas where the first two approaches both converge and diverge, the third explanation for Africa's economic crisis stands firmly in opposition to both. Thus, the core of the disagreement between the bank and ECA views centers on 'the role of the market' mechanism¹² (Oskawe, quoted in Asante, 1991:179). While the Bank believes in the market mechanism as representing the fundamental instrument of resource allocation and income distribution, the ECA questions this viewpoint. Thus, while the bank focuses mainly on financial balances, the ECA considers a much broader transformation as an enabling condition for the former. While the Bank emphasizes the export sector, the ECA strategy advocates selectivity (See also Asante, 1991:180). While the Bank expresses concern about anti-export bias and population policy, the ECA prefers to emphasize the need to ensure total structural transformation and food self-sufficiency. While the Bank places more emphasis on short-term policies than on Africa's long term needs, the ECA Strategy, as defined in the Lagos plan of action, stresses the importance of also addressing issues of long term transformation, alongside these short-term policies.¹³ However, these institutions do agree on some major issues, such as the need for human resource development, improving the efficiency of parastatals, and sound debt management. The ECA analysis is quite comprehensive in addressing the causes of the crisis and in suggesting not only short run solutions but also a framework for long term transformations¹⁴. Thus, the analysis of the external sector of Africa, adopted in this study, will be conducted within this broader context. Within this perspective, it is not difficult to show that the African debt crisis has developed as part of the broader external economic problem of the continent.

The literature on the origins of the African debt crisis lists a number of factors as its cause. The oil price shocks of 1973-74 and 1978-79, the expansion of the Eurodollar, a rise in public expenditure by African governments following increases in commodity prices during the early 1970's, recession in the industrialised nations and subsequent fall in commodity prices, as well as rises in real world interest rate are all mentioned as major factors. Surprisingly, almost all of this literature focuses on the post-independence period, with a greater part of the analysis contained therein relating to the 1970s, 80s and 90s. The main argument set out in this book is that we need to extend this analysis to the pre-independence period if we are adequately to explain the current debt crisis, as well as propose possible solutions for its resolution. From this point of departure, the following section traces the historical formation of an African economic structure incapable of handling the current debt crisis.

1.3 The Historical Origin of Africa's Economic Linkage with the North

Following Amin (1972), African economic history may be classified into: (i) the 'pre-mercantilist period' (from pre-history to the beginning of the seventeenth century); (ii) the 'mercantilist period'¹⁵ (from the seventeenth century to 1800), characterized by the operation of the slave-trade; (iii) the 'third period' (from 1800 to 1880) characterized by attempts to set up a European

dependent African economy; and finally, (iv) the 'period of colonization' in which the dependent African economy became fully established (Amin, 1972:106). This section will not pretend to discuss the details of Amin's periodization. Rather, after briefly reviewing the economic history of the other periods, it will focus mainly on the colonial period, during which time the economic structure African countries inherited at the time of independence became established.

1.3.1 Pre-colonial Trade in Africa

African interactions with the rest of the world, and especially Europe, date back many centuries, before culminating in fully-fledged colonisation in the latter part of the nineteenth century.¹⁶ During the first part of this period, Africa had autonomy in its linkages with the rest of the world¹⁷ (Amin, 1972:107-110). However, during the sixteenth century, African trade centers moved from the savannah hinterland to the coast, in reaction to changes in European trade, which shifted increasingly from the Mediterranean to the Atlantic (Hopkins, 1973:87).

Various studies have documented how pre-colonial Africa was characterized by production of diversified agricultural products (see for instance Rodney, 1972: 257). The internal trade of the continent was distinguished by regional complementarities, with a broad natural resource base. Thus, a dense and integrated network was set in place, dominated by African traders, which included, *inter alia*, trade among herdsmen and crop farmers, supply of exports and distribution of imports. This was dominated by trade in salt, West African 'spices', perfumes, resins and kola nuts, of which the latter was the most important (Amin, 1972:117, Hopkins, 1973: 51-86; Neumark, 1977:128-130, Vansina, 1977: 237-248, Austen, 1987:36). Brooks' account of the economic conditions prevailing in this period provides an impressive insight into African trade at the time (Brooks, 1993). Specifically, one is struck by: (a) the extent of local and long distance trade; (b) the range of goods traded; and, (c) the degree of processing of commodities (for instance in textile manufacturing, dyeing and metal working), particularly in West Africa. According to his account, the major commodities traded among West Africans in pre-colonial times include salt, iron, gold, kola, and malaguetta pepper and cotton textile. Of these, Kola and malaguetta pepper were important, not only in West Africa, but also in the trans-Saharan trade. Indeed, this trade was so extensive that Europeans were able to obtain malaguetta pepper at inflated prices from Maghreb¹⁸ middlemen from at least the fourteenth century onwards (Brooks, 1993: 51-121). Moreover, in this period, Europeans were able to purchase cloth from Morocco, Mauritania, Senegambia, Ivory Coast, Benin, Yorubaland and Loango for resale elsewhere (Rodney, 1972:113; Hopkins 1973: 48). (It is curious to note that, in a geographic and economic sense, North Africa was connected, rather than separated, by the Sahara to other parts of Africa¹⁹.) It is also worth noting that the quality of many of these processed goods was quite comparable with products originating in other parts of the world. For instance the level of manufacturing of textiles in pre-colonial West Africa was so sophisticated that these textiles were not only traded in West, North and Central Africa but also in the European market (See Hopkins, 1973:48 for detail). Moreover, none of the goods brought by Europeans supplied any of the basic or unfulfilled needs of African societies. Indeed, similar commodities and/or substitutes were obtainable through West African commercial networks. Specifically, African artisans of the time manufactured high quality iron, cotton, textiles, beers, wines and liquors (Brooks, 1993:56). Austin argues that this trade, sometimes referred to as the 'Sudanic economy', represents "an ideal African development pattern: continuous and pervasive regional growth with a minimum of dependence upon foreign partners for provision of critical goods and services" (Austen, 1987: 48). However, this autonomy in traditional industries was to be undermined by subsequent events (Konczacki, 1990:24).

The early development pattern of Africa varies between regions. In contrast to West Africa, East and Southern Africa (ESA) were characterized by a well-established economic interaction with the Arabian and Asian countries, long before the arrival of the Europeans. More specifically, this part of Africa supplied a range of products, such as gold, copper, grain, millet, and coconut to the Middle East and Indian Ocean economies. There also existed a dynamic caravan trade and commercial plantations long before the onset of European colonial rule. According to Austen, the towns in this part of Africa degenerated into little more than entrepôts for raw material exports and manufactured imports, rendering them dependent on the external economy (Austen, 1987:67-74). However, as documented by Kjekshus, during the mid-nineteenth century, prior to the onset of the colonial period, the interior of what is now mainland Tanzania carried an estimated four and a half million head of cattle. Indeed, the entire coastal region also supported a rich agricultural and pastoral economy (quoted in Leys, 1996:111). Further, Nzula *et al* (1979)²⁰ argued that the region was characterized by peasant production, which was mainly a natural and closed economy, with a substantial number of people leading a nomadic existence (Nzula *et al*, 1979: 38). The existence of an independent and autonomous economy, dating back to antiquity, is also well-documented in Ethiopian history²¹. Amin also notes that the African societies of the pre-colonial period developed autonomously (Amin, 1972: 107-108). Thus, one may reasonably conclude that, although its economy was not as complex as that of West Africa, nevertheless, that the ESA region had some degree of autonomy in its economic activity, and, hence, was not as dependent on the export of commodities, particularly to Europe.

To sum up, there would appear to be a long history of integrated and autonomous economic activity in most regions of Africa with local and long distance trade playing a linking role. This is not an attempt to paint a 'golden past' for Africa. Rather, it is meant to underline the fact that Africa had a healthy and fairly independent economic system, before colonialism intervened to force a structural interaction with Europe.

1.3.2 The Formation of a Commodity Exporting and External Finance Constrained Economy

The period leading up to the industrial revolution, and the 16th and 17th centuries, in particular, witnessed the beginning of the shaping of the African economy by European demand. A clear example is the pressing demand for gold coin in Europe, and the subsequent search for gold in West and Central Africa (WCA)²². Indeed, demand for labour, required in the American gold search, was instrumental in the formation of the European slave trade (Rodney, 1972:86-87). Thus, the shaping of the African economy by Europe began, even before the onset of the formal colonial period.

With the onset of the industrial revolution in Europe, Africa lost its remaining autonomy and was reduced to being a supplier of slave labour for the plantations of America (Amin, 1972 :107-110). The European slave trade, and the so-called 'triangular trade', both of which are beyond the scope of this book, are widely discussed issues in the economic history of Africa. Any resistance to the slave trade was silenced, not only by the co-opting of local chiefs, but also by sheer force. Such use of force has been documented in what is now Angola, Guinea and various other parts of the continent (Rodney, 1972:90-91. See also Bernstein *et al* (1992) for a brief summary of the triangular trade). Moreover, this era witnessed a widespread expansion of European control. This expansion was undertaken with the dual aims of: a) incorporating new areas under primary crop production, using African land and labour (which were priced below world market prices); and, b) increasing the level of production of existing primary commodities. On the import side,

cheaper and purer iron bars, and implements such as knives and hoes were made available, displacing some of the previous economic activities undertaken by local blacksmiths. This had knock-on effects in terms of a reduction in levels of Iron smelting and even a decline in the mining of iron-ore (Wallerstein, 1976: 34-36; Baran, 1957:141-143²³).

Within the ESA region, cloves grown in Zanzibar and Pemba islands, for export to the Asian and European markets, were the first cash crops successfully produced prior to European colonialism. Mainland estates, dominated initially by Arab and Asian traders, were involved in externally oriented production through sales of copra, sesame seed and oil-yielding materials, for which France was the principal market (Munro, 1976: 55). Following colonization, peasant cash cropping developed in East Africa. However, unlike the WCA region, this was mainly as a consequence of a combination of political injunction and regulation. Such imposition from above was usually resisted, the Maji-Maji uprising, in today's Tanzania, being a case in point. In other instances cash cropping simply failed to take hold, as in the case of a cotton scheme proposed for Nyanza province, Kenya (Munro, 1976: 116). However, in spite of these initial setbacks, eventually the colonial powers were successful in implementing their policy of introducing cash cropping to the region.

As described above, there existed a reasonable degree of trade linkage with Europe in the pre-colonial period. Leaving aside the slave trade, the main feature of this trade was the export of primary commodities by African nations to Europe. Thus, even before the onset of the colonial era, the seeds of Africa's subsequent role (as a supplier of raw materials and foodstuffs for Europe, and a market for European manufactures) as well as its dependence on external finance had already been sown²⁴. Or, to take a slightly different perspective, a move from the production of primary products to processing of these products (by Africans and in Africa) was interrupted. This represents the first pre-designed attempt to articulate African economic activity to the requirements of the outside world. This development was vigorously followed up upon during the colonial period as a consequence of: (i) the so called *imperial self sufficiency in raw materials* scheme; (ii) the impact of the first and second world wars; and, (iii) financing requirements for the creation of public utilities designed to serve (i) and (ii).

i) The Imperial Self Sufficiency Scheme

As noted above, the export structure associated with colonialism did not arise by accident. Rather, it was preceded by various experiments to produce agricultural products demanded by the developing European industries. A French experiment to produce crops similar to those produced in America, the establishments of plantations in Senegal, during the 1820s, British experiments with 'model farms' in Niger, during the 1840s and cotton experiments²⁵ in Senegal, Nigeria and the Gold Coast (Ghana) all represent cases in point (Hopkins, 1973:137). In Germany, Bismarck, initially reluctant to create a colonial empire, was persuaded by German commercial interests that overseas territories could provide raw materials for German industries, as well as markets for their products (Longmire, 1990: 202). This growing demand for raw materials, the search for a market for finished products from Europe, inter-European competition, and a number of other factors conspired to form the basis upon which colonialism was to evolve.²⁶

During the colonial period, one of the main phenomena, which strengthened primary commodity exports from European colonies in Africa, was the so-called '*imperial self sufficiency*' scheme. Thus, British, French and Belgian textile industries sought to obtain cotton from Africa, and invested accordingly. A similar scheme was also developed for tobacco. This was administered both by colonial governments and by some European based companies (Munro 1976: 128-137)

and resulted in an expansion in colonial trade. With the onset of colonialism, the centre of African trade shifted from the hinterland to the coast, and the composition of this trade also changed in response to the demands of the increasing external orientation of the economy (Amin, 1972:117). For example, expansion in the production of palm products and groundnuts in Africa was directly linked with increased demand for inputs required in soap and candle factories, lubricants (particularly for the railways) and European economic growth in general (Hopkins, 1973:129).

At the same time, the processing of such primary products in Africa, except in white settler colonies was actively discouraged. Indeed, this was the case even when factories were owned by Europeans. For example, in Senegal, the proportion of groundnuts, which could be processed, prior to their export to France, was strictly controlled (Fieldhouse, 1986: 48; Fyfe quoted in Wallerstein, 1976:36; Onimode, 1988:177). In Angola the Portuguese prevented the operation of flourmills, with the country exporting wheat to Portugal and importing wheat flour back (Konczacki, 1977:81). According to Austen, the fact that colonial governments, (with the possible exception of the Union of South Africa), saw themselves primarily as representatives of the 'mother' (colonial) country, which was benefiting from the existing pattern of trade, explains why they pursued policies which were directly and indirectly designed to block efforts at local industrialization (Austen, 1987: 133).

In order to achieve these dual objectives, of inducing the colonies to be suppliers of inputs, and markets for manufactured goods, various methods of coercion were employed. Africans were forced, by superior firepower, to abandon small scale manufacturing industries and trade with rival European nations (Dickson, 1977:142). At the same time, large European firms were encouraged to concentrate on growing and trading in agricultural products. This was easily achieved for a variety of reasons. Specifically, African peasants moved into cash cropping: (a) to ensure access to European goods, to which they had become accustomed, in a limited way, in the pre-colonial era; (b) to earn cash, which was required to pay various taxes; and, finally: (c) as a result of force²⁷. In other cases, Africans were simply exterminated to pave the way for settlers²⁸. In other parts of Africa Europeans directly controlled the production of commodities such as cotton, sugarcane and tobacco. (Amin, 1972: 112-113). Indeed, in areas such as British East Africa the law required that farmers grow a minimum acreage of cash crops. However, these peasants were not wholly dependent on cash crop production. Rather, they also produced food for own consumption, this being in the interests of the big firms, since it enabled them to pay only minimal wages, which did not have to cover maintenance of the labourer and his family (Rodney, 1972 :172). Nevertheless, the colonial authorities ensured that the extent of such food production was not large enough to ensure self-sufficiency. For instance, in British Guinea it was a criminal offence to grow rice (at a time when it was imported from India and Burma) because it was feared that rice growing would lead to the diversion of labour from the sugar plantations (Frankel, 1977:236). Thus, in this manner, Africa's economic role, basically as a producer of primary commodities, continued to be shaped to serve Europe's industrial and commercial interests.

ii). The First and Second World Wars (W.W.I and II)

The impact of The First World War on African colonies was devastating. Although trade was disrupted during the period, nevertheless African colonies were forced to supply commodities to finance the war. The end of the war was followed by a surge in major commodity prices and hence high export earnings for the African colonies (Munro, 1976: 119-23). Similarly, The Second World War also resulted in an increased demand for primary commodities, and especially those with military strategic importance such as vegetable oils, metals and industrial diamonds (*Ibid.* 170, Burdette, 1990:84.). This had the effect of reinforcing the commodity producing and

exporting role of the European colonies in Africa. In addition to the direct effects of the war, the post-war reconstruction of Europe, rising levels of European incomes and removal of restrictions on consumer demand and commodity stockpiling, engendered by the outbreak of the Korean war in 1950, resulted in the price of African exports surging to unprecedented heights (Munro, 1976: 177). Thus, when war erupted or was expected to erupt in the colonizing countries, commodity production and exports by African colonies was boosted by non-price mechanisms. Further, the end of the war was usually also followed by a commodity price boom and associated increase in the level of the commodity exported, this time through the operation of the price mechanism. In the process, the specialization of European colonies in Africa as producers and exporters of primary commodities became firmly established.

iii) **Financing Public Utilities and Commodity Exports**

In general, in the pre 1929 international financial order, which was dominated by government bonds (i.e. portfolio investment), Asian and African colonies had little choice in relation to the nature of their involvement in international financial systems. Political considerations were at the heart of regulating access to capital markets (Bacha and Alejandro, 1982: 2-3). Besides, such inflows to Africa were generally negligible (UN, 1949: 26-28). Capital inflows from W.W.II onwards increasingly came in the form of Foreign Direct investment (FDI). There was a moderate flow of such capital from the United States and Britain to Africa. However, such investment that did come (especially that originating in the United States, which was the largest supplier) was concentrated mainly in South Africa, Egypt and Liberia, the latter relating to the introduction of a shipping line by the United States (UN, 1954: 15-16). In almost all cases the investment went into plantations and mineral extraction (UN, 1949: 32-33).

The colonial period also witnessed a flow of loans and grants from European centers to the African colonies. In almost all cases these funds were spent on public infrastructure development such as railways and roads to link ports to export production sites, and, to a lesser extent, on schools and health facilities. This was undertaken with the aim of developing the primary commodity exporting capacity of the colonies (see UN, 1954: 32-33). In some circumstances the colonial powers were also motivated by military-strategic considerations. It is estimated that, from the mid 1940s to 1960 only 15 to 20 per cent of such inflows were allocated for social and production sectors, while the rest went into infrastructural development (Munro, 1976:183). The nature of these financial flows to the colonies also differs before and after W.W.II. In general, it can be said that the pre-W.W.II flows came mainly in loan form, while the post W.W.II flows, and especially those from France, increasingly incorporated a grant element (See also Austen, 1987:197-202 for details). However, the repayment of this debt by colonial administrators created serious difficulties.

These financial difficulties were exacerbated by instability in the world commodity market and the vulnerability of the African colonies to this. Indeed, various analogies may be drawn between the current debt crisis and the situation in this period. For instance, after the great depression (1929-1932), African exports declined by about 42 per cent. The depression also resulted in contraction of credit flowing to the colonies. These events led to a serious incapacity to service debt owed to the 'mother' (colonizing) country. Since colonies were not in a position to default on these debts, there was effectively no way out for them. This had repercussions for every African economy, with widespread Bank failures, retrenchment programs in colonial administrations and liquidation of businesses (See Munro, 1976: 150-53 for details).

Setting in place a vicious cycle, the financial difficulties being experienced by colonial governments forced the colonies to vigorously follow a policy of producing export commodities, at the expense of other alternatives (Munro, 1976: 155, Austen, 1987:127). Peasant cropping, with its attractive minimum cost for colonial governors, was chosen as a convenient vehicle to address this problem. This, the so called the 'peasant path' to financial solvency, became a universal phenomenon throughout the colonies, and especially in the present day WCA. It was attained by forced involvement of ordinary peasants in the primary commodity export sector. Indeed, this coercion was sometimes so harsh that the ordinary peasants were paid not in cash, but in bills of credit to the administration's head tax (Munro, 1976:156). In the British colonies of East Africa a similar emphasis to the 'peasant path' was also followed (*Ibid.* 156-57).

In summary, through the process discussed above, the foundations for the existing economic structure of African countries were laid during the colonial period. This was achieved through two channels. Firstly, by directly contributing to the expansion of an enclave of primary commodity exporting economies. And, secondly, by bringing about a situation of indebtedness, it further accentuated the importance of these activities as sources of foreign exchange required for settling of this debt. Although this general pattern was applied throughout the African colonies, some variations existed across the regions. The following section addresses this issue.

1.3.3 The Three Macro-Regions of Colonial Africa: The Amin-Nzula Category

Although colonialism shaped the production structure in a similar way across Africa, nevertheless one may observe certain variations in this general pattern between different macro regions. Leaving aside North Africa, Nzula *et al* (1979),²⁹ and Amin (1972) divide the continent into three distinct regions, based on their colonial structure. Firstly, *Africa of the labour reserves* (Nzula *et al* 1979) label this 'East and Southern Africa'). Secondly, *Africa of the colonial economy* (Nzula *et al* 1979 label this the region 'British and French West Africa'). And, thirdly, *Africa of the concession-owning companies* (Nzula *et al* 1979 label this 'Belgian Congo and French Equatorial Africa'). The fundamental distinction between these regions is derived from the manner in which the colonial powers settled the 'land question' (Nzula *et al*, 1979: 36).

In West Africa, commodity production did not take a plantation form. Besides, until quite recently the mineral wealth of the region remained largely untapped (Amin, 1972: 115). The amount of African peasant land expropriated was also negligible (Nzula *et al* 1979). However, in spite of this, the control and growth of the commodity sector was governed by European interests, while land remained in the hands of small peasants. The mechanisms for this control were as much political as economic (Amin, 1972: 115). Hopkins lists a number of reasons why plantation-based production never became fully established in West Africa. Firstly, some traders were opposed to plantations for fear that they might compete with the export sector for scarce capital. (Such objections were voiced, for example, by businessmen such as Lever and Verdier). Secondly, a few plantations, which were established, failed because of lack of capital and ignorance about tropical conditions. The third, and perhaps most important, reason why plantations failed to become fully established in West Africa was that small African peasants had already succeeded in forming an export economy by their own efforts. Moreover, establishing plantations would have created conflicts with traditional land rights. Indeed, some crops, such as groundnuts, would not have been suited to plantation agriculture (Hopkins, 1973: 213-214). Finally, it is worth pointing out that it was not necessary to develop formal plantation agriculture, since it was possible to influence the nature of production and control the export supply of

peasants through monopolistic trading practices, customs restrictions, fiscal controls and appropriate credit arrangements (Nzula *et al*, 1979:38).³⁰

In much of today's Central Africa, and part of Southern Africa, concessionaire companies, usually supported by their European state, dominated the entire economic structure through their involvement in mining, fishing, public works and communication, and even taxation (See Seleti, 1990:40). In these regions, the indigenous population were reduced to semi-slavery, and exploited by open and non-economic forms of coercion on the plantations and mines (Nzula *et al*, 1979: 37, Austen, 1987:140-142). The establishment of such concessionaire companies was further facilitated by the indigenous population fleeing and seeking refuge in the more inaccessible parts of the region. Discouraged by this population exodus, the colonial authorities encouraged adventurer companies to 'try to get something out of the region' (Amin, 1972: 117). The activities of these companies were organized in line with demand in the 'mother country'. One example of this was the demand for raw materials required in the European war effort. Thus, the mining companies, in co-operation with colonial officials, designed and determined the nature of their enclave activity to meet the increased demand for copper and other base metals required by the European war industries. (Burdette, 1990:84).

In Southern and Eastern Africa both systems referred to above were intricately interwoven with a number of specific features (Nzula *et al*, 1979: 36). In this region the extraction of mineral and settler agriculture was accompanied by the creation, often by force, of a small, and often insufficient, reserve of labour comprising land owning peasants and the urban unemployed. This was undertaken with the labour demands of mineral extraction and settler agriculture firmly in mind (Amin, 1972: 114, Nzula *et al*, 1979:37). This labour was further supplemented by inter regional migration. Other economic instruments, such as taxation, were also used to create reserve labour for European plantations and mining (Seleti, 1990:34; Konczacki, 1977:82). The reduction of the cost of labour in such regions to mere subsistence levels rendered the exports of the colonies competitive, in comparison to similar goods produced in Europe. Clearly, the formulation of such a structure was 'as much political as economic'³¹ (Amin, 1972:115; Seleti, 1990:47). However, since the focus of this book is on the economic, we do not go further into such political considerations here. Rather, we would simply observe that, during this period, an economic structure was set in place, characterized by the export of primary commodities.

By the end of the colonial period, what had been achieved in all these macro-regions was the creation of a commodity exporting economy and virtual monopoly of African trade (both import and export) by Europe (see Hopkins, 1973: 174). The commodity export-led strategy was vigorously followed during this period. As a result, not only did production for overseas markets expand at a high rate, but also several new items (especially foodstuffs) began to appear on the import list (Hopkins, 1973 :178). In some cases, European business interests were so pervasive that they created a protected market, on which to dump their manufactured goods³². Summarizing the stylized facts in the colonial period, Konczacki described the economic pattern of what is called 'matured' colonialism³³ as having three distinct components. Firstly, both imports (which were mainly manufactured goods), and exports (mainly raw materials), were fixed with the 'mother' country. Secondly, capital investment in the colony was determined by the trading interest of the 'mother' country, and concentrated in exporting enclaves. Finally, a supply of cheap labour was ensured through a variety of mechanisms (legal, monopolistic employment and through other economic instruments.) (Konczacki, 1977:75-76). Indeed, it is worth noting that this pattern has not changed fundamentally, even today. Another important characteristic of this period relates to technological change. For example, if one focuses on cotton production, during the colonial era, Africa '...was concentrating almost entirely on export of raw cotton and the import of manufactured cotton cloth. This remarkable reversal [compared to the pre-colonial period] is tied to technological advance in Europe and to stagnation of technology in Africa

owing to the very trade with Europe" (Rodney, 1972:113). Colonialism further exacerbated this situation. Thus, as Amin notes, when we speak of the exchange of agricultural products against imported manufacture (i.e. the terms of trade), "the concept is much richer: it describes analytically the exchange of agricultural commodities provided by a peripheral society shaped in this [colonial] way against the product of a central capitalist industry (imported or produced on the spot by European enterprises)" (Amin, 1972: 115).

To sum up, it has been shown that African nations were in possession of an integrated and autonomous economic structure prior to their intensive interactions with Europeans during the colonial period. It is hard to speculate what the future of such a structure might have been, in the absence of colonialism. However, it goes without saying that it would not have been what it is now, since clearly the present is the result of specific historical process. More specifically, historical interaction with today's developed countries has shaped the structure of the economic activity of African nations, particularly in the areas of international trade and finance. Indeed, economic domination, accompanied by colonization, has further cemented this structure. Thus, given such historical process it is not surprising to find that almost all African nations had become exporters of a limited range of primary products, and importers of manufactured goods, by the time of independence, in the 1960s.³⁴ This was further accompanied by a demand for external finance, when export earnings were not sufficient to finance the level of public expenditures required for maintaining and expanding the commodity exporting economy. This structure has not changed in any meaningful way in the post-colonial era. Thus, when one examines the financial problems of Africa (which I am arguing relate to its role as a primary commodity exporter) one is, compelled to conclude that these problems are a direct outcome of historical process.

1.4. Some Notes on Methodology

Methodological discussions in economics are usually problematic. Mainstream economists, usually follow the Popperian approach [of theory -hypothesis - critical test/evidence - falsification or corroboration chain] (see Blaug 1992). However, it could be argued that this approach is more relevant for physics than it is for economics. Thus, some of the problems a researcher in developing countries might face while following the Popperian approach include the possibility of excluding rival explanations *ex-hypothesis* as well as the difficulty of obtaining 'evidence' or 'facts'. Moreover, as noted by Feyerabend (1975), a method, which adheres to a binding principle, stands in contradiction to the history of research/science. Indeed, openness in research, and Feyerabend's principle of 'anything goes', may be defended under all circumstance. However, as Dutt (1990) notes, the problem, which Feyerabend does not address, is how a researcher may become versed in all the relevant theories pertaining to a particular problem. Dutt's answer to this question is, 'by specializing in areas or problems' (Dutt, 1990: 6). And, one might add, by explicit recognition of the fact that the researcher is dealing with an aspect of a problem which is presumed to fit the overall structure, not as a jig-saw-puzzle, but as an integral part of it. This implies an obvious trade-off between depth (in the sense of deeply focusing on the particular) and breadth (which entails focussing on the overall picture).

The approach adopted in this study departs from the Popperian one in favour of a realist approach. It is our view that the adoption of such an approach represents a much more fruitful avenue of research in developing countries. This methodological framework is informed by the works of Lipton (1991), Mukhrjee and Wuyts (1991), Wuyts (1992a, 1992b) and Lawson (1989). The overall framework adopted in this study is Lipton's 'inference to the best explanation' (contrastive inference), which looks for residual differences in similar histories of facts and foils as a fruitful method for

determining a likely cause (Lipton, 1991:78). This approach entails testing competing hypotheses in the process of research.

At a practical level, this general approach is narrowed down to a more refined one proposed by Mukherjee and Wuyts (1991) in which *a working hypothesis*, is confronted with the evidence and various rival explanations. Wuyts (1992b) argues ‘the best way to test an idea (wrapped up as a hypothesis) is not merely to confront it with its own evidence, but to compare it with rival explanations. It then becomes easier to detect which explanation has more loose ends or will need to resort to *ad hoc* justifications to cope with criticism’ (Wuyts, 1992b: 4). Once a working hypothesis has been arrived at, the dialogue between data and alternative explanations may best be handled by exploratory data analysis, which comprises graphical display, techniques of diagnostic analysis and transformation of data (Mukherjee and Wuyts, 1991: 1). This does not imply that theory has no role to play. Rather, that theory is important ‘as a guide to pose interesting questions which we shall explore with data’ (Wuyts, 1992a: 2).

The generation of working hypotheses, and the subsequent examination of these, may be pursued along Kaldorian lines (Lawson 1989, Lawson *et al* 1996). In this realist approach to economic analysis, the researcher is free to start from ‘stylized’ facts - broader tendencies ignoring individual details – and to construct a working hypothesis, which fits with these facts. The final stage of the analysis entails subjecting the entities postulated at the modelling or explanatory stage to further scrutiny (Lawson 1989).

Building on this methodological background, the study is divided into three main sections. In the first of these, a theoretical literature study, in line with the research problem, will be undertaken. This will help to shape alternative theoretical explanations, in order that the questions and problems posed might be more clearly defined. In part II (comprising Chapters 4 and 5) the dialogue between the data and alternative explanations will be explored. At this stage in the analysis, the researcher is faced with the practical problem of being open to all conceivable explanations for a particular phenomenon. Thus, economists might differ on their view on a particular economic phenomenon (Dutt, 1990: 6). Based on this line of thinking, the underlying view adopted in this study is that the African economy has its own peculiarity. Moreover, it is suggested that different institutions and agents, both in the North and South have different behavioural rules by which they operate. This, in turn, affects the functioning of the economy. Since such structures are explicitly incorporated into this study, the book may be seen as lying within the structural macroeconomics school (see, for example, Taylor 1983, 1991, FitzGerald and Vos 1989, FitzGerald 1993). Thus, the amalgamation of the view of an economy with the ‘inference to best explanation’ leads one to work under a specific paradigm *a la* Khun. The wider context of ‘inference to best explanation’ is not lost, however, because, as research progresses, the view about the economy, and judgement about theories, follows a dynamic process of learning. Once the empirical exploration is conducted within the framework of this background, the final step is to depict the stylized facts, which emerge from the dialogue between data and theory, using modelling techniques. This is undertaken in part III, which comprises the last two chapters of this study.

1.5. Organization of the Book

As set out above, this book is organized in three main sections. Part I, comprising the current chapter and Chapter 2, explores some background issues and reviews a number of relevant theories. Part II, which comprises Chapters 4 and 5, presents an empirical analysis of the major issues and theories explored in part I. In part III (comprising Chapters 6 and 7) these empirical issues are brought together within a North-South modelling framework. Chapter 7, in particular, is devoted to an

analysis of external shocks and policies, using the model developed in Chapter 6. Finally, Chapter 8 highlights some of the major policy implications arising from this study.

In this introductory chapter, I have argued that Africa's external finance problem is the result of the structure of its trade in the context of the world economy, in general, and its place as a commodity producer in particular. I have also argued that this is compounded by the adverse effects of macroeconomic policies adopted by the Northern (industrialized) nations. The major purpose of this background discussion is to underline the existence of an economic structure, primarily built in the colonial era, which continues to shape the external economic conditions of African nations today. This discussion sets the ground for subsequent chapters, which will examine the questions posed from both a theoretical and empirical perspective.

Chapter 2 is devoted to an in-depth analysis of the key theoretical explanations for the external finance problems of Africa. This analysis is carried across financial instruments which comprise the external finance to Africa (FDI and official and private flows). The theoretical discussion presented in this chapter is used to specify the model developed in the book. The chapter will also attempt to identify theories, which may be used to explain the linkage between Africa's trade and finance problems. Cognizant of the importance of the primary commodity trade in Africa, the chapter attempts to identify theories to explain the functioning of the commodity market, in general, and terms of trade, in particular. The chapter also reviews the literature relating to commodity modelling strategies, with the aim that this might inform the commodity modelling exercise undertaken in this book.

Chapter 3 focuses on theoretical issues relating to African macroeconomics. In this chapter, a cursory look at existing African macro models is undertaken. Major theoretical issues in African macroeconomics, such as import compression, 'the fiscal response' and 'Dutch Disease' effects are discussed. The Chapter also describes the accounting framework, which is used to organize the macro database of the twenty-one sample countries, used in the study.

Chapter 4, which begins the empirical analysis section of the book, focuses on the determinants of foreign exchange supply to Africa. The chapter addresses two broad themes. Firstly, capital flows to Africa are examined. The chapter then moves on to examine other sources of foreign exchange, and, in particular, earnings from commodity exports. An attempt to understand the determinants of African export supply is conducted by locating these exports in the context of the world commodity market.

Chapter 5 examines some macroeconomic ramifications of the foreign exchange earnings discussed in Chapter 4. This is undertaken by extending the discussion presented in Chapter 2 to take account of a number of theoretical and empirical issues. Again, the chapter covers two broad themes. Firstly, the 'fiscal response' to external finance is examined, and an alternative framework for analysing the relevant issues is set out. Secondly, the 'Dutch Disease' effect of such flows is described. The results obtained in this analysis feed into the global model developed in Chapter 6.

Chapter 6 represents a synthesis of the preceding chapters. Specifically, the theoretical discussion and empirical analysis set out in these chapters is formalised in a North-South Economic model. The chapter begins by examining the analytical framework developed by Dutt (1990) with the aim of developing a taxonomy of the major global models currently in use. By critically examining existing models, the framework lays the foundation for the model developed in this book. The main focus of the model, which is based, among others, on Taylor (1981) Darity and FitzGerald (1982) and Vos (1994), is an elaborated modelling of Africa using a Kalecki-Lewis set-up. Most of the model's parameters are econometrically estimated for the three African sub-regions, and for the North. In Chapter 7, this model is applied in the analysis of various policy issues and external shocks. Finally,

Chapter 8 summarizes the major implications arising from the policy and external shock simulation undertaken in Chapter 7.

Notes to Chapter 1

¹ Naturally, these aggregated figures show only an 'average' scenario, for African nations in general. However, there are significant exceptions to the picture painted by these statistics. Specifically, Burundi and Guinea-Bissau, in the WCA region, had a debt service ratio of 40 per cent and 94 per cent, respectively, by 1992, while, Uganda and Madagascar in the ESA region had ratios ranging from 40 to 70 per cent and 50 to 60 per cent, respectively, from the mid 1980s. In relation to debt to GNP, Mozambique recorded a ratio ranging from 300 to 580 per cent from the mid 1980s to early 1990s, while Guinea-Bissau had a debt to GNP ratio of between 130 and 300 per cent from 1980-1990. Finally, the debt to GNP ratio for Congo and Cote d'Ivoire stood at close to 200 per cent during the mid 1980s (Source: World Bank, World Debt Tables, electronic, 1994).

² However, the Bank acknowledges that many African nations were faced with unfavorable terms of trade during the early 1980s.

³ In subsequent publications, notably *Africa's adjustment and growth in the 1980s* published jointly with UNDP, the Bank argues forcefully that Sub-Saharan Africa has been in relatively 'good shape' compared to other parts of the developing world and that policy mistakes have been the *principal* cause of its economic crisis. However, the ECA (1989b) argues that the Bank has based its conclusions on 'pseudo-statistics' and selective reporting. Re-examination of the data by ECA analysts would tend to suggest that the Bank's argument cannot be substantiated (See ECA 1989b and Mosley and Weeks 1993 for a brief summary).

⁴ However, according to the Bank, the effects of the protectionist policies of developed nations may be rendered less significant due to the low capacity of African manufacturing, an inability to produce temperate products as well as the continent's preferential status within the EEC. See also Amjadi *et al* (1996) for a recent argument along these lines, as well as proposals for a possible policy conditionality plan for privatizing African shipping lines.

⁵ See White (1996a) for a review of this debate.

⁶ In contrast, Collier and Gunning (1999) argue that lack of openness represents one of the major causes of poor performance of African economies.

⁷ This basically includes the system of government, public enterprises, the private sector, domestic markets, research and development, forces of nature and climate, ethnicism and society's value system, external commodity markets and finance and transnational corporations.

⁸ Collier (1991) cites the Zambian economy and copper price as a classic example of negative shocks. In Collier's opinion two errors are made. Firstly, the price fall was treated as temporary, and, secondly, foreign exchange shortages were handled by rationing. Notwithstanding an acknowledgment of the effect of negative shocks, he emphasized poor policies in what he called 'controlled' economies as representing a major problem. However, it could be argued that the root cause of these policy problems lies in the structure of the economy of these countries, and in their external trade in particular. Taken in this light, policy problems, per se, may be of only secondary importance.

⁹ However Ghura (1993) is extremely optimistic in stating that judicious macro and trade policies may stimulate growth in Africa, even if external conditions do not improve. This viewpoint is essentially similar to the types of empirical studies undertaken in support of Bank type policies.

¹⁰ This is measured as the divergence in the rate of growth of a country's exports from that of the world as a whole, over the period under study, multiplied by the total exports of the country in question. This is taken from a simple model, which specifies the different factors affecting exports (See Stein, 1977:106).

¹¹ See Leys (1996) and Ofuately-Kodjoe (1991) for critiques of dependency theory, in the African context.

¹² Makandawire (1989 cited in Elbadawi et al 1992) summarizes the two contending views about the cause of African crisis as structuralist and neoclassical. He notes

The structuralist view is one which highlights a number of features and 'stylized facts' that almost every point contradicts the neoclassical view...class based distribution of income rather than marginal productivity based distribution of income; oligopolist rather than the laissez-faire capitalist market; increasing returns or fixed proportion functions rather than 'well-behaved' production functions with decreasing returns and high rates of substitution; non-equivalent or 'unequal exchange' in the world rather than competitive, comparative advantage based world system; low supply elasticities rather than instantaneous response to price incentives (Makandawire (1989) quoted in Elbadawi et al (1992).

¹³ See Stewart (1993) for a discussion of this issue.

¹⁴ See, however, Helleiner (1993) who argues for an emerging consensus on this issue.

¹⁵ See Amin (1974), Chapter Two, on the mercantilist period.

¹⁶ Amin (1972) has termed this the Pre-mercantile period.

¹⁷ Wallerstein characterizes the trade of the period as trade in "luxuries", with such trade being undertaken between external arena and not in an integrated world economy framework. Wallerstein and Amin define luxuries as those goods, the demand for which comes from the part of the profit that is consumed. Suraffa defines luxuries as goods, which are not used in the production of other goods. He, however, took it as trade/ exchange in which 'each can export to the other what is in his system socially defined as worth little in return for the import of what in his system is defined as worth much'. Or, in Alpers' phrase 'trade from which each side believed itself to be profiting' (Wallerstein, 1976:31 and footnote 3).

¹⁸ Maghreb refers to North Africa.

¹⁹ This stands in sharp contrast to the current categorization of North Africa as geographically and economically distinct from Sub-Saharan Africa. For justification of this view see Sommers and Assefa (1992) and various World Bank/IMF classification schemes for Africa.

²⁰ The original work is written in 1933.

²¹ The commonly argued case that, since Ethiopia was not colonized, it represents a 'counter factual' for how other parts of Africa might have developed, in the absence of colonialism is a very weak one. Firstly, a good part of the history of Ethiopia has been a history of wars under the ideology of either religion, region, nationality or a combination of these. This has created a serious crisis in the agricultural sector (See Gebrehiwot, 1917). Secondly, Ethiopia's history has been characterized by two clearly distinct antagonistic classes: the landed aristocracy and the peasantry, with corresponding state structures (see Gebru, 1995). Given the history of conflict, which characterizes Ethiopia's history, the main preoccupation of the landed aristocracy and church has been to maintain its power. Thirdly, colonialism had the effect of disrupting the dynamic caravan trade, which linked the Southwest parts of Ethiopia to the rest of the East African region. And, finally, Ethiopian independence was basically a besieged one. Since it was encircled by hostile and powerful colonial forces, naturally this had an influence on the political and economic structure of the country. More specifically, Ethiopia developed as a militaristic nation, with a dependent economy based on the export of commodities and import of manufactures.

²² First by the Portuguese, and later by the British, Dutch, Germans and Scandinavians.

²³ In describing the impact of underdeveloped nations' interaction with Western Europe Baran noted " [the population of these nations] found themselves in the twilight of feudalism and capitalism enduring the worst features of both worlds. Their exploitation is multiplied, yet its fruits were not to increase their productive wealth; these went abroad or served to support parasitic bourgeoisie at home. They lived in abysmal misery, yet they had no prospect of a better tomorrow. They lost their time-honored means of livelihood, their arts and crafts, yet there was no modern industry to provide new ones in their place. They were thrust into extensive contact with advance of the West, yet remained in a state of the darkest backwardness" (Baran, 1957:144). Perhaps we should not be surprised that Baran's description, written nearly four decades ago remains relevant today.

²⁴ Imports of palm oil by Britain, groundnuts by France, palm kernels (for cattle cake) by Germany (and for the manufacturing of margarine) by the Dutch represented the main items traded during the 19th century, prior to the onset of formal colonialism at the end of that century. (For a description of this, see particularly Chapter 4 of Hopkins (1973).)

²⁵ These were prompted by the so called 'cotton famine' in Europe, following the American civil war.

²⁶ The motives underlying colonialism represent a widely debated topic. For instance, Austen (1987) argues that "within [the] general context of intense multifaceted international competition, the economic rationale for African colonization was to a considerable extent pre-emptive -designed to assure access to potential rather than actual markets and commodities as well as trade routes... to Asia" (Austen, 1987:116).

²⁷ There are many examples of Africans being forced into cash crop production. This occurred in Tanganyika (today's mainland Tanzania), in the Portuguese colonies, in French Equatorial Africa and French Sudan (today's Mali). In Congo Brazzaville the French enforced cotton cultivation by banning traditional agricultural activities. These policies of coercion were resisted to the extent possible. The revolts in Tanganyika and Angola represent cases in point (See Rodney, 1972:172-181, Austen, 1987:140-142).

²⁸ This was the policy followed by Germany in what is now called Namibia. Indeed, the extermination of the Africans was so extensive that, when they discovered diamond, the Germans had to look for migrant labour for mining from other regions (See Longmire, 1990:203-204).

²⁹ The English translation appeared in 1979.

³⁰ See also Amin (1972) for a political and social analysis of how the region's commodity production and exports were controlled.

³¹ Pim places this at the center of his investment analysis and argues that the main investment was in areas with extensive mineral wealth, plantation possibilities and a mass of unskilled labour. This involved heavy expenditure in communications, which required an expansion of the export sector for its finance. The latter, in turn, required a large labour supply, which was secured by direct and indirect compulsion, affecting every aspect of native life (Pim, 1977:229).

³² France was in possession of such a protected market in West Africa. The protectionist policy was the result of pressure from French metallurgical, textile and chemical industries, which had difficulty competing with Britain (Hopkins, 1973:160). Portuguese industrialists had also created such protected markets in Africa, especially for their textile industry (Seleti, 1990:36).

³³ Portuguese colonialism does not qualify as 'matured' in his analysis.

³⁴ In virtually all African countries, one to three commodities account for 50 to 90 per cent of total exports. Indeed, in the period 1982-86, in 13 African countries 1 product, in 8 countries 2 products, in 6 countries 3 products, and finally, in 8 African countries 4 products accounted for over 75 per cent of export earnings (see Adedeji (1993) for details).

Editor's Preface to Alemayehu Geda *Finance and Trade in Africa*

At the start of a new millennium and after almost half a century of independence, the African economy seems trapped in a low-level disequilibrium. This not only condemns millions of people to a life of poverty but also blocks the process by which human and material capital can be accumulated. Many of Africa's economic problems are to be found within her own state and civil society, but it is too easy – and too convenient for the rest of the world – to attribute all economic problems to 'governance'. The fact is that Africa is an integral part of the world economy, open to financial and trade shocks and without the means to protect itself effectively against these shocks.

There are 51 countries in Africa, which accounts for 12 per cent of the world population. Yet, according to IMF estimates, the region generates only 3.3 per cent of world GDP at 1998 purchasing power parity and 1.8 per cent of world exports of goods and services. By comparison, Italy alone accounts for 3.4 per cent of world output and 5.7 per cent of world trade. This apparent marginalization is, of course, asymmetric. Although the world may not 'need' Africa in an economic sense, what happens in the world economy does have profound effects on Africa through commodity prices, interest rates, foreign investment flows, migrant remittances and aid budgets. African policymakers – and indeed ordinary Africans – are well aware of this asymmetry but seem powerless to affect it, or even to reframe the agenda of international debate.

Indeed, the prevailing orthodoxy in Washington and Brussels tends to be that this is an out-of-date socialist view, based on discredited 'dependency' theories, originating in the independence struggle. The importance of the world economy to Africa is not denied, of course, but national governments are enjoined to adjust to 'economic reality' and 'market discipline' in order to stimulate exports and promote foreign investment. The danger that the efforts of individual countries trying to adjust will lead to a 'race to the bottom' in labour standards, environmental safeguards and tax concessions is ignored; as is the 'fallacy of composition' inherent in the small-country assumption, leading to the over-expansion of commodity supplies and declining prices.

The problem is thus one of economic *perception* as well as one of economic *reality*. What has been missing, perhaps, is a modern view of the world economy from an African standpoint. Alemayehu Geda is perhaps uniquely qualified to undertake this task, since, possibly alone among young African economists, he possesses the technical skills to see beyond the platitudes of the ‘North-South’ debate. Thus, he examines external economic relations as a variable, rather than as a given. Hence, domestic economic events become endogenous to the model rather than simply at the behest of policy makers. This shows, on the one hand, how limited the options really are for domestic policymakers (especially if they act individually and only for short periods) and, on the one hand, the crucial importance of changing international arrangements – particularly trade and investment rules rather than aid.

In this book, Alemayehu Geda constructs a rigorous model of the world economy. This is based on earlier work by The Hague based ‘Finance and Development’ research group on global economic accounting and modelling. Some of this work is reported in two previous volumes in this series- Rob Vos’ *Debt and Adjustment in the World Economy* (1994) and Joke Luttick’s *Accounting for the World Economy* (1998). These set the foundations of how the world economy can be modelled, in a tractable fashion that allows the effect of trade and investment flows upon macroeconomic balances in any one developing region to be identified. In this way, the global framework required to analyse the full effect of aid and other capital flows from ‘North’ to ‘South’, as well as the effect of northern macroeconomic policies on the ‘South’ can be set up in such a way as to be compatible with the variables used in the analysis of structural adjustment.

The book opens with an outline of the historical origins of African debt and external finance problems, arguing that the debt problem results from the structure of its trade, in general, and commodity trade in particular. That the twin effects of low income elasticities and low price elasticities in northern markets have led to declining terms of trade and high price volatility is generally agreed. The issue, then, seems to be why Africa has not switched to other export products – manufactures, services or processed raw materials – which offer better growth prospects. However, such a switch requires capital (infrastructure and plant) and skills (or ‘human capital’) which Africa does not currently possess. Debt and aid have both been used in an effort to

overcome this constraint – but to no avail. The book then moves on to examine what existing economic theory has to say about this issue, providing a useful survey of theories of international finance, primary commodity trade models, and macroeconomic frameworks coming from an African perspective. In particular, the incisive analysis of macromodels currently being used in Africa is valuable for the insight it provides into import compression, fiscal response and ‘Dutch disease’ from the point of view of a domestic ‘consumer’ rather than an international ‘producer’ of knowledge. Indeed, in this book, Alemayehu Geda provides the basis for a textbook for advanced African students of economics that would take them beyond the one-country technical and dependency political perspectives.

The empirical part of the book explores the patterns of capital flows to the region and their relationship to foreign exchange earnings from commodities, where the declining terms of trade are not balanced by aid or debt flows in the short run, while in the long run these latter lead to unsustainable liability positions. Fiscal response to these external shocks and the consequences for the real exchange rate are then analysed, closing the circle, so to speak, as we return to the chronic trade deficit. On the basis of these data and the theoretical framework discussed above, Alemayehu Geda builds a simulation model of the region, which is a *tour de force*, not only in technical terms, but also as an alternative interpretation of reality. This empirical work demonstrates what should be the conventional wisdom but unfortunately is usually overlooked: that investment is the key to the problem and its possible solution.

What lessons does this book hold for the economic future of Africa? The author is too modest to put forward strong policy recommendations himself, although his main conclusions do have serious policy implications. Firstly, his view that the debt problem in Africa is essentially a commodity problem is amply confirmed. In part, this implies that the HIPC process led by the UK and the World Bank – which, while limited in scope to bilateral debt, and thus hardly reducing the bulk of the debt which is now multilateral, at least indicates a political commitment to act – will have little lasting effect unless export capacity and prices are raised. Secondly, his findings on the mixed effects of aid on growth - both through the ‘Dutch disease’ effect of overvalued currencies on exports, and through the diversion of public investment away from production – imply that (a) more aid should be channelled towards small

export farmers, so as to promote exports and reduce poverty; and (b) that aid should be accompanied by expansionary policies in order to keep the exchange rate competitive.

Thirdly, his conclusion that Africa is highly vulnerable to changes in world interest rates – due not to capital market effects but rather to their impact on commodity prices resulting from the activities of speculators – implies that action can only be taken at an international level as part of the construction of the new ‘global financial architecture’. Fourthly, his finding that fiscal deficits are largely exogenously determined by aid flows has important implications in terms of the need for donors to co-ordinate their actions in order to ensure macroeconomic sustainability, rather than leaving this task to the IMF.

These various findings imply that trade relations will need to be improved. The question, then, is how? Improved access to northern markets for processed primary commodities, and, in particular, the replacement of the Lome system with improved access to the European market, would be a first and important step. Commodity price stabilisation schemes are currently out of favour, and would require the full co-operation of the major importing transnational corporations in order to work at all. However, this is a problem of price volatility around the trend, as well as the declining trend itself. Reducing this volatility would benefit both importers and exporters and thus should not be impossible to achieve through a properly administered buffer stock system. The market mechanism alone cannot achieve this result, since hedging ranges are so short, so this would have to be a form of public intervention. However, the long-term downward direction of the terms of trade is difficult. It wouldn't matter so much if volume was increasing fast enough to raise the income terms of trade (as is happening with labour-intensive manufactures), but this is not, in fact, the case. The market for tropical commodities is oligopsonistic and riddled with restrictive practices – examples being sugar and cotton in the US, bananas and coffee in Europe as well as minerals. Therefore, a producer's cartel may be the only theoretically viable solution. However, in spite of the recent success of OPEC in driving up oil prices, Africa is unlikely to be able to organize such a cartel, in view of the worldwide competition in those commodities, which it supplies.

In fact, Africa needs to change the mix (or at the very least upgrade the quality) of its primary export products, with the continent unlikely to be able to compete within the foreseeable future. This requires investment, and investment not so much by foreign companies (which is in fact already fairly high as a proportion of the total by international standards) but by domestic investors such as firms, flight capital and households. More than savings, risk is the main problem here, since there is plenty of capital held overseas and also plenty of liquidity within the banking system. However, this cannot be undertaken by each African country in isolation, but rather requires an international agreement on investment rules and stabilisation of commodity prices. In other words, the *orderly* insertion of Africa into the global market.

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