

Ending Africa's Poverty Trap

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EXECUTIVE SUMMARY

This Version: May 10, 2004

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Africa's development crisis is unique. It is the only major developing country region with negative per capita growth during 1980-2000; its health conditions are by far the worst on the planet; its soaring population is exacerbating ecological stresses; and despite the policy-based development lending of structural adjustment, it remains mired in poverty and debt. The standard diagnosis is that Africa is suffering from a governance crisis. However, many parts of Africa are well governed, and yet remain trapped in poverty. Governance is a problem, but Africa's development challenges are much deeper. Poorer countries systematically have poorer governance measures than richer countries, since good governance itself requires real resources. Nevertheless, regression analysis shows that Africa's governance, on average, is no worse than elsewhere after controlling for income levels. Moreover, even after controlling for governance, Sub-Saharan African countries grew more slowly than other developing countries, by around 3 percentage points per year. Africa's crisis requires a deeper explanation than governance alone.

Our explanation is that tropical Africa, even in well-governed parts, is stuck in a poverty trap, too poor to achieve robust, high levels of economic growth (and in many places, simply too poor to grow at all). More policy or governance reform, by itself, is not sufficient to overcome this trap. The paper outlines a theory of Africa's poverty trap, including three interactive factors that could cause it: capital thresholds, saving traps, and demographic traps. The structural conditions and history that have led to the trap include very high transport costs, small market size, low productivity agriculture, very high disease burden, adverse geopolitics and slow diffusion of technology from abroad. Africa's extreme poverty leads to low national saving rates, which in turn lead to low or negative economic growth rates. Low domestic saving is not offset by high inflows of private foreign capital, for example foreign direct investment, since Africa's poor infrastructure and weak human capital discourage private capital inflows. With very low domestic saving and low rates of market-based foreign capital inflows, there is little in Africa's current dynamics that promotes an escape from poverty. Something new is needed.

We argue that what is needed is a "big push" in public investments to produce a rapid "step" increase in Africa's underlying productivity, both rural and urban. Foreign donors would be critical to achieve this step increase. In particular, we argue that well-governed African countries should be offered a substantial increase in official development assistance to enable them to achieve the Millennium Development Goals (MDGs), the internationally agreed targets for poverty reduction by the year 2015. These are a useful intermediate target for breaking Africa's poverty trap, since they address the key sectors in which major productivity improvements are both needed and achievable, and since the rich countries have repeatedly committed themselves to help Africa achieve these goals, with more funding if necessary. However, the rich countries have not yet delivered on that promise.

We identify how a big push in key investments could enable Africa to meet the MDGs, and how that, in turn, would help to extricate Africa from the current development trap. This will require a comprehensive strategy for public investment in

conjunction with improved governance. The paper lays out such an investment strategy focusing on *interventions* – defined broadly as the provision of goods, services and infrastructure – that we have grouped into seven intervention areas: Agricultural Productivity and Rural Infrastructure; Health, Nutrition and Family Planning; Education; Slum Upgrading and Urban Management; Science, Technology and Innovation; Gender Equality; and Cross-National Infrastructure, Trade Integration and Government Cooperation. Since a full discussion of these proposed interventions is far too long to be included in this paper, we describe only two categories of interventions (rural productivity and child health) to illustrate the specific investments that could make enormous changes in productivity at rather low cost.

We then estimate the financial costs required to meet the MDGs, and suggest how those costs could be allocated between domestic resources in Africa (both public and private) and increased official development assistance. To be aligned with the MDGs, the full intervention package must be converted into a country-level investment plan, one that works backward from the outcome targets to identify needed input targets and then identifies infrastructure, human and financial resource requirements to meet the targets. We dub this a “needs assessment” approach to the MDGs. We estimate the costs of the intervention for three countries, Ghana, Tanzania, and Uganda, chosen for their high levels of extreme poverty, insufficient progress towards achieving the MDGs, and good governance relative to their level of income. Although our estimates are biased downward for a number of reasons, the overall results suggest that, in order to reach the MDGs, these countries will require average annual ODA equivalent to at least 20 to 30 percent of GDP through to 2015.

Finally, we propose a new framework for donor-African relations to underpin a big push designed to meet the MDGs. The package of public investments proposed in this paper implies a significant increase in ODA transfers to Africa, perhaps a doubling or more. Donor-recipient mechanisms will be needed to translate large-scale aid flows into effective investments and poverty reduction. Where domestic governance is adequate (e.g. at or above the norm for countries at the given income level), aid processes should be guided by five core principles. First, policies should be aligned with the 2015 time horizon, with that MDG target date serving as the planning horizon for both recipient countries and donors. Second, the public investment program needs to be guided by bottom-up assessments of *needs* rather than *ex ante* budget constraints set by the donor countries. Third, donor assistance needs to be harmonized and coordinated around budget support, particularly in countries where governance structures are not the limiting factor to accelerate progress towards the MDGs (only approximately 27 percent of net bilateral ODA to Sub-Saharan Africa took the form of budget support in 2002). Fourth, donor financing requires new notions of sustainability, including recognition that grant financing is the only way to pay for the investments and leave the recipient countries with viable public finances at the end of the process.

In practical terms, we recommend that African governments implement these guiding principles through a three-stage process. First, each country should convene a planning team comprised of itself and key stakeholders and technical advisors – the

bilateral and multilateral donors, UN specialized agencies, and civil society leaders – to conduct an MDG needs assessment. In the second step, the needs assessment should then feed into a ten-year public investment and human resource strategy. The third step would be to construct the medium-term budget framework (e.g. for three years, as with the PRSP), which would finance the first three years of the 10-year investment strategy. In developing an explicit MDG-based planning framework, increases in ODA inflows will raise a number of structural macroeconomic issues. Countries must maintain their efforts to mobilize domestic revenue and foster domestic savings and investment in order to support long-term economic growth. With significant increases in ODA inflows, issues of Dutch disease will arise and need to be managed carefully. Finally, underlying this discussion of macroeconomic programming is the consideration of what to do if donor funds are not readily forthcoming to meet the needs of the MDG-based PRSs. In that case, of course, the MDGs are unlikely to be met. The IMF, however, should not simply urge a country to live within its means. The Fund should also present the technical case that the country could achieve the MDGs if given additional support, and should urge donor countries to expand the level of available support such that it is sufficient to enable any well-governed African country making the effort to achieve the MDGs. Government-led coordination will be crucial not just for crafting plans but also for implementing them. As their part of the bargain, recipient governments will need to implement a clear and transparent system for monitoring and evaluating the implementation of plans, building in regular milestones and check-points through which plans can be fine-tuned or adjusted as necessary.

In countries where governance is weak, the preceding framework will not apply, mainly because development aid allocated to poorly functioning governments can easily be squandered or even used to reinforce bad practices. The key is to understand the nature of the poor governance, and to take actions that make sense in the context. In some cases what is called poor governance is actually an issue of lack of financial resources to carry out reasonable public functions. In other cases, the problems of governance are deeper. They may involve violent conflict, authoritarian rule, or corrupt and predatory practices by the state. When the problem is violent conflict, the role of aid needs to be focused in the first instance on peace making, peace keeping, and humanitarian assistance. When the problem is entrenched despotic rule of some sort, large-scale aid transfers to the government are ill advised; aid to such governments should be limited, and aid should be substantially allocated through non-governmental organizations and international agencies rather than through the central government.

The paper also discusses a comparison of the aid flows needed to achieve the MDGs (equivalent to 20-30 percent of recipient countries' GDP) with the benefits of increased international trade liberalization. Although trade reform is welcome and important, the paper outlines how it is certainly not sufficient to achieve the MDGs in Africa. This is for two reasons. First, trade gains do not directly provide the targeted public investment strategies needed in health, education, rural development and other social sectors. Second, gains from trade liberalization are commodity-specific and therefore country-specific. Non-foodstuff exporters, such as the cotton producers of West Africa, will enjoy significant benefits from trade liberalization with welfare benefits

estimated at perhaps 2 percent of GDP. Meanwhile, net food importing countries will in many instances be adversely affected by trade liberalization that increases global food prices. In aggregate, the net benefits of trade liberalization for Africa are estimated as being an order of magnitude smaller than the ODA transfers needed for African countries to achieve the MDGs.

In considering the small population size of most African countries and the large number of landlocked countries, the paper reinforces the need for deepening regional integration and investments in cross-country transport, energy and communication infrastructure, as promoted by the New Partnership for Africa's Development (NEPAD). Not only does Sub-Saharan Africa have extremely low per capita densities of rail and road infrastructure, but existing transport systems were largely designed under colonial rule to transport natural resources from the interior to the nearest port. As a result, cross-country transport connections within Africa tend to be extremely poor and are in urgent need of extension to reduce intra-regional transport costs and promote cross-border trade.

In addition, many of Africa's challenges in agriculture, health, environment, or access to energy services require breakthroughs in science and technology. Examples of promising technologies that could help Africa achieve the MDGs include new vaccines or treatments against malaria and HIV/AIDS, improved agricultural varieties and cropping systems for rain-fed and drought-prone agriculture, cost-effective information and communication technologies, and low-cost water treatment and purification technologies. While private markets in developed countries are able to produce development stage and, to a lesser extent, research-stage science, this is not the case in poor countries. Even though these market failures have been understood for some time, the international system has so far not responded adequately. Appropriate solutions could consist of global coordinating mechanisms based on one of the following models: (i) pre-commitment purchase agreements, (ii) ex-post prizes, (iii) public-private partnerships based on contractual terms that ensure free access to intellectual property rights generated through publicly-funded research, and (iv) direct financing of research.

Although we do not calculate the global increase in ODA needed for all countries to meet the MDGs, our conservative bottom-up estimates suggest that the total might perhaps be an additional \$50-75 billion of ODA each year. The bottom line is how small even these "large" numbers really are. In the Monterrey Consensus, and on many occasions both before and since, the rich world has committed to official development assistance of 0.7 percent of donor GNP. With a combined GNP of around \$25 trillion, the donor countries of the OECD have in effect committed to donor flows on the order of \$175 billion, compared with actual flows of around 0.23 percent of GNP, between \$50 billion and \$60 billion per year. Even our high estimate, of an additional \$75 billion per year would put the donor countries at around \$125 billion per year, or 0.5 percent of current GNP, far below the long-standing commitment. With continued growth in the donor world between now and 2015, and with the incremental aid flows only materializing in full at the end of the period, the needs would be below 0.5 percent of donor GNP.

Large-scale aid is not sufficient for ending the poverty trap, nor even warranted, when domestic governance is poor. We are advocating large-scale help only for countries that can help themselves. We do not seek to pick ODA numbers out of the air, but argue for true needs assessments on a country-by-country basis. We believe that the situation in much of Africa is sufficiently desperate and the potential benefits of increased donor-finance investments is sufficiently high, that the world community should start immediately in partnership with well-governed African countries to help them to end their poverty trap once and for all.