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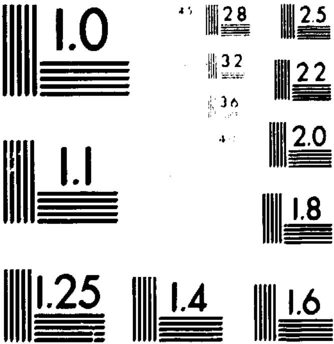


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# INDUSTRIAL DEVELOPMENT OF AFRICA AND EXTERNAL DEBT*

Communication by the African
Development Bank

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## Introduction

1. In the first 25 years following independence, the economic performances of Africa have been particularly modest and have fallen substantially short of those of other developing regions. The growth in per capita GNP averaged 1.3 per cent a year in the period from 1960 to 1970, thus lagging far behind the growth rate of 3.5 per cent for the developing countries as a whole. During the decade from 1970 to 1980, results were even poorer, with an average annual growth of per capita GNP of 0.8 per cent. The economic report on Africa for 1985 by the African Development Bank and the Economic Commission for Africa stresses the persistence of this poor development, stating that, in 1984, per capita production once more declined and was thought to have fallen short of its 1980 level by 10 per cent. On the whole, the growth recorded had been either minimal or negative.

2. It is true that the mediocre performances of agriculture played a big part in this "anti-performance" of African economic development. None the less, this poor development of the African economies must also be attributed to the failure of the industrialization strategies adopted by most of the African countries immediately following their political independence. The results recorded in this sector have hardly ever come up to expectations.

3. At the time of their independence, nearly all the African countries assigned a relatively high priority not only to agriculture but also to industrial development. They expected the following from industry:

(i) A decisive impetus to the overall growth of their economies;

(ii) Rapid job creation, something which would be particularly timely in view of the fact that the freeing up of labour expected from the improvement in productivity hoped for in agriculture and from population pressure are both factors which can generate a potential surplus of rural labour for use in other sectors;

(iii) A catalytic role in the vocational training of labour, making it possible to achieve some mastery of modern technology;

(iv) Initially, substantial savings in foreign exchange and, later on, foreign exchange earnings through export.

4. We shall not attempt to draw up a balance sheet of industrialization, but rather shall set forth the interaction between the external debt and industrialization and sketch the new prospects for a readjustment of industrial development financing. First of all we shall allude to some performances and the medium-term objectives of this sector.

5. The growth in manufacturing industry production declined from 7.1 per cent to 5.5 per cent between the decade of the 1960s and the following decades. This is a mediocre performance which illustrates the formation of the gross domestic product in the African countries. The share of the GDP accounted for by manufacturing industry remained very modest: 7.6 per cent in 1960, 9.5 per cent in 1970 and 9.8 per cent in 1980. In 1980, Africa accounted for 0.8 per cent of the formation of world manufacturing value added. The behaviour of the manufacturing sector has remained disappointing during the first years of the 1980s. Value added in this sector declined in 1984 and remains lower than it was in 1980. This means that the continent is further away than ever from the quantitative target it had fixed, i.e., to account for 9.4 per cent of world manufacturing production by 1990. It should however be mentioned that Algeria, Egypt and Nigeria accounted for around 43 per cent of manufacturing value added in 1980.

6. On the whole, African industry is too dependent on imports and in some cases is structurally inefficient. The industrial sector, which has been looked upon as highly profitable, has not always received the resource allocations it would need to play a dynamic role. Therefore, the linkages of economic development finance should be redefined in order to curtail the perverse effects of incoherent financing.

## Allocation of external resources and its effect on the debt

7. Economic development is essentially a function of the distribution of resources between satisfaction of present needs and future needs, in other words, between consumption and investment. As a result of the low level of domestic savings in most of the African countries, there has been almost chronic recourse to foreign financing. History has indeed shown everywhere that the development process is marked by more rapid growth where there are inputs of foreign capital than where there are only domestic resources. None the less precautions should be taken. The flows giving rise to the debt should go above all to finance projects and programmes which bring in enough convertible currency to ensure servicing of the debt or which promote a savings in foreign exchange exceeding the outflow in respect of debt servicing and the various inputs. This, then, poses the problem of the trade-offs required in the sectoral distribution of resources.

8. The experience of the Ivory Coast would serve as a good example to illustrate the problem of optimum allocation of external resources and its implications for the debt guaranteed by the State. The Ivory Coast follows a liberal, but pragmatic, economic policy. For example, the State did not remain aloof from intervening in the economy when it deemed it necessary to supplement private initiative that was inadequate or not dynamic enough. In the 20 years from 1960 to 1980, its GNP increased by an average of 7 per cent a year. The rapidity of this development was attributable to agriculture, and primarily to coffee, cocoa and wood.

9. Industrial policy initially focused on import substitution and the utilization of agricultural raw materials. The industrial sector is characterized by the following:

(i) A strong presence of public interests (around 55 per cent equity closely associated with foreign private interests, around 35 per cent equity);

(ii) Concentration on several agro-industrial and textile sub-sectors producing 65 per cent of the manufacturing value added;

(iii) A preponderance of large enterprises; 45 enterprises employing 80 per cent of the labour and supplying 78 per cent of industrial exports;

(iv) Small and medium-sized enterprises which are very weak, and very limited relations between industrial enterprises, particularly between large foreign enterprises and small local enterprises.

10. After a strong average annual growth of 11.6 per cent between 1960 and 1970, the growth of manufacturing production gradually slowed down. Its average annual growth rate was 5.8 per cent between 1970 and 1980. From 1981, industrial production declined and remained below its 1980 level. The share of the GDP accounted for by manufacturing industry remains modest. It amounted to 12 per cent in 1983, as compared to 7 per cent in 1960. The industrial sector has not fulfilled the hopes that were placed in it. At the present time, several enterprises are operating at 50 per cent of capacity. The State and the private sector have closed some factories and carried out some redeployments to achieve better utilization of existing investments.

11. The structure and evolution of the external debt demonstrate a high degree of correlation with the behaviour of the production sector. As at 31 December 1984, the guaranteed external debt of the Ivory Coast was assessed at CFAF 3,130 billion, or approximately $US 7.54 billion. Of this amount, 74 per cent is accounted for by direct loans and 26 per cent by guaranteed loans. From 1980, the State contracted approximately $US 1.77 billion in unearmarked loans (or 23.5 per cent of the total external debt) to cope with economic difficulties. These took the form of structural adjustment loans under the International Monetary Fund stand-by arrangements.

12. The sectoral distribution of earmarked resources shows a clear preponderance for transports and collective facilities. These two sectors absorbed 46.9 per cent of resources, as against 15.7 per cent for administrative buildings, housing and tourism. Health and education received 5.6 per cent. As regards the agricultural production, agro-industry and industry sectors, the loans contracted amount to around $US 1.7 billion and account for 29.5 per cent of earmarked loans. Manufacturing industry absorbed $US 700 million directly and through credit lines, thus accounting for 11.6 per cent of earmarked loans. Among industrial projects, sugar complexes absorb $US 465 million, cement complexes $US 133 million and the petroleum refinery $US 288 million. The production sectors were financed to the extent of 60 per cent by means of guaranteed loans.

13. The historical evolution of the external debt of the Ivory Coast shows notable structural changes. Until 1976, the external debt remained modest in relation to exports and the gross national product (GNP). The ratios of debts to exports and debts to GNP were 58.8 per cent and 25.9 per cent, with a guaranteed public debt of $US 2.1 billion and debt servicing of $US 174 million. In 1977, the external debt went up sharply, by 81 per cent, and became $US 3.8 billion, whereas debt servicing was $US 277 million, representing a growth of 59 per cent. In spite of the substantial rise in GNP and exports the debt ratios deteriorated: the ratio of debts to exports rose to 68.5 per cent and the ratio of debts to GNP to 31.4 per cent. It is thus clear that the production system was lagging behind the external debt. A change in resource allocation was necessary to reduce the pressure of the external debt on the economy within a reasonable period. Unfortunately, the country continued to become heavily indebted, the debt amounting to $US 5.7 billion in 1980 and $US 6.3 million in 1982. Debt servicing increased to $US 811.2 million in 1980 and $US 996.7 million in 1982. In 1981 the ratio of debts to exports was 132.5 per cent, whereas the ratio of debts to GNP was 53.1 per cent.

14. The acceleration in indebtedness has been due to excessive anticipation of export earnings over a long period. The Ivory Coast also intensified its private borrowing to finance various investment programmes, without distinction as to economic sector. The private debt increased from 62 per cent to 70 per cent of the external debt between 1976 and 1977 owing to a substantial increase in bank credit. The latter represented 63 per cent and 72 per cent of private debt respectively in 1976 and 1977. Since that date, bank credit has constituted more than 50 per cent of the external debt of the Ivory Coast and its percentage within debt servicing has increased, rising from 37.6 per cent in 1977 to 68.8 per cent in 1980 and 70.4 per cent in 1982.

15. The burden of indebtedness on the production system had become intolerable by 1980, particularly as there was a sharp contraction in export earnings due to the drop in world prices for coffee and cocoa, and also as certain productive projects (sugar, cement, petroleum refining) turned out to have been economically ill-conceived and were financially unprofitable.

16. This brief review permits the following preliminary observations:

(i) Recourse to external financial resources has not led to a consistent and judicious policy of sectoral allocation permitting the productive sectors to generate the foreign exchange earnings necessary to cover debt servicing;

(ii) Selection of projects and programmes has sometimes been insufficiently careful even within the productive sectors. As a result, investment has not always yielded the expected results;

(iii) Financial flows have undergone a notable structural change. Considerable use has been made of hard bank loans because they are easy to mobilize and flexible;

(iv) The rapid increase in the debt servicing burden has become intolerable for the production system, hence the frequent requests for rescheduling of the external debt.

## Rescheduling of the external debt

17. As a result of the incapacity of the production system to generate sufficient external earnings, and the aggravation of macroeconomic imbalances, balance-of-payments pressures are compelling the African countries to seek the rescheduling of their external debts. Rescheduling, or reorganization, of the debt must have a dual nature in order to offer a chance of success. At the financial level, it may consist in both a postponement and an alleviation of repayment terms; at the economic level, it must permit the development, restructuring or revival of the production system.

18. The financial aspect of the operation is generally what is best known. Rescheduling takes place through the Club of Paris, which brings together representatives of creditor Governments in the case of public loans, and the Club of London, which brings together the representatives of creditor commercial banks to deal with commercial loans. The creditors have increasingly linked this operation with a prior economic diagnosis carried out by the International Monetary Fund and the granting of expanded facilities by the latter. The two Clubs approve the principles of the operation, defining its nature, the terms of the rescheduling, interest rates, etc.; they make general recommendations with a view to bilateral negotiations and propose modalities of implementation. Then the country engages in separate negotiations with each Government or creditor bank.

19. From 1975 to 1983, the Clubs of Paris and London negotiated the rescheduling of the external debt of 34 countries, including 15 in Africa. Forty negotiation exercises have been with African countries, out of a total of 84. Zaire has engaged in six negotiation exercises, Togo in five, Senegal, the Sudan and Liberia in four. Togo is the only African country to have obtained two reschedulings with the Club of London. On 31 December 1983, the rescheduled African external debt amounted to $US 11.1 billion compared with a total outstanding debt of $US 96.6 billion - i.e. about 11.5 per cent. The Club of Paris has rescheduled $US 7.8 billion, representing 14 per cent of public debts, whereas the Club of London has negotiated $US 3.2 billion, corresponding to 8 per cent of State-guaranteed private loans.

20. Requests for rescheduling are based on economic and financial arguments showing the existence and persistence of serious payment difficulties. The nature and extent of the operation are determined in the light of an economic and financial programme, from which the expected movement of certain economic and financial indicators can be predicted and the viability of the measures to be taken can be assessed. The rescheduling should thus be based on a programme of adjustment organized around a revival or restructuring of the production system in which

industry and agriculture are closely associated. A reorientation of capital flows and of their optimum allocation for the development of industry and agriculture is necessary; it is however advisable to introduce a consistent policy of incentives capable of stimulating gains in productivity and competitiveness.

21. During negotiations the main problems encountered by countries are generally as follows:

(i) Definition of the debt. This may involve confining the operation to part of the debt contracted before a particular date, but above all it means limiting the number of instalments of repayments of principal and interest on the debt which can benefit from relief measures. The Club of London often has reservations about the rescheduling of interest;

(ii) The terms of the rescheduling are of the greatest importance. They have to be negotiated in relation to the economic and financial prospects, so that the effects of the relief will be in harmony with efforts to revive the production system. But very often they are the main stumbling block in financial negotiations;

(iii) The interest rate and the conditions governing the payment of interest are fixed bilaterally.

22. The constant need to resort to rescheduling of the foreign debt is a reflection of the inadequacy of the economic and financial measures in adjustment programmes. African countries, whose production systems are modest in scale, should follow the example of Mexico and Colombia and request a multi-annual rescheduling of their debts, while at the same time negotiating financial assistance of the most suitable kind for the restructuring of their production systems. It is worth thinking here about such arrangements as participatory credit lines for the promotion of small-scale and medium-sized industry, and co-financing with commercial banks in the industrial sector.

## Small-scale and medium-sized industry: promotion of a class of industrial managers

23. The history of industrialization in the world shows that a country's economic and social development depends on the density and diversity of its industrial network. This network is made up essentially of clusters of small-scale and medium-sized industries. They accordingly constitute the basis of the production system, lending themselves to rapid adaptation. In the African countries' industrial development strategies, however, the roles have been reversed, with the emphasis on big industry, which is very expensive and inadaptable, but carries prestige. The results are well known, but fortunately a number of countries have duly revised their industrial strategies, giving priority to small and medium-sized businesses.

24. We consider that this strategy should be given a new dimension by efforts to promote the creation of a new class of industrial managers. This means encouraging redeployment of some cadres and stimulating the establishment of individual enterprises. From the financial standpoint, one of the bottlenecks encountered in this policy is the low level of private saving by developers. It is therefore necessary to encourage participatory loans on concessionary terms to enable them to amass the necessary equity. The arrangements for introducing such a financial policy will have to be determined in the light of the specific features of each African country.

Co-financing operations with commercial banks

25. Because of the serious general economic recession, the amount of concessionary funds available for Africa's urgent economic development needs has become flagrantly inadequate, and various African countries have been obliged to turn to commercial sources to obtain the additional funds they need.

26. Being ill-informed about African economies and the investment opportunities there, commercial banks have tended to look elsewhere, or to adopt restrictive credit policies with regard to Africa. African countries acting individually have received only a very limited share of commercial banks' loans. Various production projects have thus not been able to come to fruition.

27. Multinational institutions such as ADB could enable African States which are candidates for assistance not just to gain access to capital markets, but also to obtain funds on the best terms possible. In the case of highly viable projects, the presence of a multinational financing agency would be a stimulus for commercial banks, which might not otherwise have been ready to make loans to the countries concerned or would have offered them on less favourable terms.

28. Those are in brief our main observations on this topic, which is of particular importance in view of the need to resolve the dilemma of foreign debt versus the establishment of an efficient production system and take appropriate action as a matter of urgency.