Productivity Growth: The Key to Poverty Reduction in Africa

African Growth and Opportunity Forum

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1.3 billion people, less than $1$ per day
½ world’s population, less than $2$ per day
U.S. average, nearly $100$ day.  Why?
Answer: Productivity Is Low

- **Productivity** = output \( (Y) \) per hour of work \( (L) \) = \( Y/L \)
  - Sometimes called labor productivity
- It’s “the explanation” why some countries are rich and other countries are poor
- Countries with few high productivity jobs are poor
- Creating more high productivity jobs—productivity growth—is the only way to reduce poverty.
But Why Is Productivity So Low In Poor Countries?

• Productivity (Y/L) depends on:
  – capital (K/L) and technology (T)

• If there are no impediments to the spread and use of capital and technology, then countries behind in productivity should be catching-up

• Capital and technology would go to where they are relatively scarce because the returns are so high
GROWTH RATE OF PRODUCTIVITY
OR
GROWTH RATE OF INCOME PER CAPITA

Catch-up line

Poor but growing more rapidly

Rich but growing more slowly
States in the United States: Catch-Up Clearly Seen
ANNUAL GROWTH RATE OF REAL GDP PER CAPITA, 1960-1999

More Advanced Countries: Catch-Up Seen Here Too

PORTUGAL GREECE SPAIN ITALY CANADA
UK FRANCE AUSTRIA BELGIUM NORWAY SWEDEN CANADA
U.S. TURKEY FRANCE NETHERLANDS LUXEMBOURG DENMARK
ANNUAL GROWTH RATE OF REAL GDP PER CAPITA, 1960-1999

All Countries: Not Much Catch-Up Seen Yet

- Korea
- Singapore
- Hong Kong
- Japan
- U.S.
- Bangladesh
- Nigeria

REAL GDP PER CAPITA IN 1960 (1995 $)
Recent Productivity Trends (1990s)

- East Asia: 5.5
- United States: 2.1
- Europe: 1.2
- Latin America: 0.7
- Middle East: -0.1
- Sub-Saharan Africa: -0.5
Why Isn’t There More Catch-Up

- Poor governance
  - weak rule of law, corruption
  - creates disincentives to invest, to start up new firms, to expand existing firms
- Poor education
  - reduces human capital
  - impedes adoption of new technologies
- Restrictions on economic transactions
  - lack of openness to trade, state monopolies, and excessive regulation
  - reduce incentives for innovation and investment needed to boost productivity
The New Foreign Aid Agenda

• **Increase foreign aid**
  
  (1) Funding for Millennium Challenge Account to increase to $5 billion a year by 2006 — a 50% increase over and above existing U.S. development assistance
  
  (2) Contribution to World Bank’s International Development Association (IDA) increase by 18%
  
  (3) Larger fraction of IDA aid in form of outright grants rather than loans

• Let **good performance** determine which countries get aid for economic development

• Insist on **measurable results**
Large Increases in Funding Compared to Historical Averages

ODA held constant in 2001-06 for presentational purposes
Good Policy Performance is Part of the Millennium Challenge Account

- “Ruling justly”
  - lack of corruption, rule of law
- “Investing in people”
  - good education and health policy
- “Encouraging economic freedom”
  - good trade and macro policy
Measurable Results Are Part of IDA-13

• U.S. Contribution to IDA up by 18%
  – Year One: $850 million
  – Year Two: $950 million
  – Year Three: $1,050 million

• Each $100 million increment in year two and three depends on measurable results
  – time to start up a business,
  – measles immunization,
  – primary school completion rates.