

# **Financing Africa's Future Growth and Development: Some Innovations**

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## **1. Introduction**

The main development challenge facing Africa now is how to reduce significantly the extent and depth of poverty in the region while transforming the structure of its economies. Making poverty reduction the focus of current development initiatives is justified by the extent and depth of poverty in the region and also by the fact that such poverty slows down all manner of social and economic progress. By the early 1990s, as many as 51% of the population of Africa lived below a poverty line of \$34 per person per month. Throughout Africa, the current average income of each person has been estimated at 83 cents per day. Despite the significant variations among the different parts of the region, it is obvious that Africa will have to devote a significant chunk of its resources to fighting such humiliating poverty in the coming years if its peoples are to survive the growing demands of a rapidly changing world.

In view of the state of poverty, the financing requirements of African nations are now largely determined on the basis of what it will take to achieve the Millennium Development Goals (MDGs) set for 2015. These goals include cutting in half the proportion of people living in extreme poverty, of those who are hungry, and of those who lack access to safe drinking water. They also include the achievement of universal primary education and gender equality in education; to accomplish a three-fourths decline in maternal mortality and a two-thirds decline in mortality among children under five. They finally include halting and reversing the spread of HIV/AIDS and providing special assistance to AIDS orphans, while improving the lives of 100 million slum dwellers. Thus, in addition to the financing needs of individual poor nations, there is also the need to finance global public goods in achieving those goals.

Since agreeing on the MDGs, there have been a number of attempts to estimate the financing requirements of developing countries as they attempt to achieve faster growth and development. Achieving the MDGs is linked to faster growth

and structural transformation in Africa as it implies that the *per capita* consumption of over half of Africa's population should rise to a minimum of \$1 per day. To achieve that level of consumption, it is reckoned that African and other low-income countries must, on the average, grow at 8% per annum for the period. This high growth rate requires a much faster rate of investment than countries usually experience. UNCTAD (2000) estimated that the investment/GDP ratio would have to rise to a minimum of 25% from about 19%. But it was unlikely that the poor nations could find the necessary resources to finance such investment growth from the traditional sources, i.e., domestic savings (both private and public) and foreign savings (Official Development Assistance and Private Capital Flows). This made it essential to identify immediately sources of additional financing, while boosting the capacity to generate further resources from the traditional sources.

### *Why the Interest in External Finance in Africa?*

It is remarkable that a lot of the attention on meeting the financial requirements of poor African nations have focussed on external finance. It is important to put in perspective at the onset the significance of external resources and the problem of domestic resources. Indeed, quite a bit of the recent development literature attribute Africa's relatively slow growth in the last three decades to slowness in capital accumulation, leading to increasing attention being paid to the apparently low saving rate in the region (World Bank 1994). For the entire region, gross domestic savings averaged only 14% of GDP in the 1980s, compared to 23% for Southeast Asia and 35% in the Newly Industrialised Economies of Korea, China and Singapore. (See Fig. 1). Aside from being generally low, savings rates have shown consistent decline over the last thirty years in most countries, seldom exceeding 15% of GDP. Where rises have been seen, these have been very modest.

Over the years, a number of explanations have been provided for the difficulty in accumulating capital for consistent growth in Africa. These run through the mass of literature on African growth in the 1980s. (See Easterly and Levine 1997; Sachs and Warner 1997; Bloom and Sachs 1998; Collier and Gunning 1999, etc.). What is common to all the various explanations for slow African growth is the fact that slow capital accumulation is associated with limited participation in world trade. This is in turn explained by many different factors, including those of the prevailing macroeconomic policy framework, inward-looking trade policies, institutional development, poor development of market structures, geography, conflicts, etc.

The issue of trade within the context of recent globalisation has gained considerable significance in explaining Africa's growth and development problems, particularly since it became clear that it has been the main springboard for putting East Asia onto that steady growth path. It is a growth path that has seen East Asia increasingly attracting more external financial resources for its

development. Radelet and Sachs (1998) have noted that despite the 1997 crisis in South-east Asian economies, the basic structure for participating in world trade that has evolved in the last three decades remains essentially sound.<sup>1</sup> In Africa, on the other hand, the weak foundation of many economies can be more vividly shown in their modes of international linkages. By the early 1990s, the failure to diversify export structure and attract foreign direct and portfolio investment flows had left the continent virtually ignored by the dynamic forces that swept the international trading and financial systems with the aid of advanced information and telecommunication technology. The absence of active participation in world trade has meant the loss of significant opportunities for many countries to accrue foreign exchange, essential to building up the physical capital required for increased production. There is a genuine fear that Africa will continue to be "marginalised" in the process of global integration and formation of a new international order unless concrete actions are taken to put the region at the centre of world events through trade.

In sum, Africa needs to develop a framework and strategy for closing its resource gap in order to achieve the objective of halving poverty by 2015. While the closure of the resource gap requires effective action to mobilise domestic resources, there are indications that in the short-medium term considerable attention will have to be paid to mobilising external resources. But the mobilisation of external resources will depend largely on how the region positions itself in the global market.

This paper is an attempt to summarise all the issues relating to how African countries can best position themselves to close the resource gap. It refers to the more difficult exercise of enhancing domestic resource mobilization as a "hard option" and the probably less difficult one of attracting external resources as a "soft option".

### ***Outline of Paper***

In section 2 of the paper, I look at the estimates of the financing requirements for achieving the Millennium Development Goals. This is followed with a discussion of the current state of financing for development in the region in section 3, looking at both domestic resources and external resources. In section 4 I consider what the financing will be in the medium term in the absence of a radical change in policies and approach to financing development in the world. Section 5 provides a summary of some recent initiatives to introduce innovation into how development may be financed from both domestic and external sources. In section 6 I turn attention to the hard and soft options that African governments face together with their development partners in financing Africa's future growth and

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<sup>1</sup> It was the form and scale of financial integration into international capital markets that triggered the currency and general economic crisis and exposed the vulnerability and fragility of their financial systems.

development. This section discusses the structural and policy changes that may be embarked upon in order to free up resources for development in Africa. It is based on several strands of relevant research in this area. Section 7 sums up and concludes the paper.

## **2. Financial Requirements for Achieving the MDGs**

After making allowance for domestic savings, UNCTAD (2000) estimated that the annual total capital inflows of \$9.5 billion to sub-Saharan Africa at the time had to be doubled over the next ten years in order to raise the investment/GDP ratio to 25% while the savings/GDP ratio went up to 18% to achieve an annual growth of 6%. This assumed that the proportion of the capital inflows used for real resource transfers would be around 62% with the rest going to finance various financial transactions and reserves.

The UNECA (2000) in turn argued that raising the net capital inflows to \$20 billion would raise the investment ratio to 27%, which was what Malaysia had used earlier to achieve an average annual growth rate of 8% in the 1980s, Africa's desired growth rate. An argument for raising the net capital inflows to \$20 billion instead of UNCTAD's \$18 billion was justified with the devastating effect that the HIV/AIDS menace was having on the cost of development.

Taking all the above considerations into account, the report of the Zedillo Panel (UN 2001) estimated conservatively that an additional US\$50 billion would be required annually to achieve the millennium development goals throughout the developing world. The Panel argued that there was a strong case for international financing of global public goods, and identified the goods that fell in that category as peacekeeping; the prevention of contagious diseases; research into tropical medicines, vaccines, and agricultural crops; the prevention of chlorofluorocarbon emissions; the limitation of carbon emissions; and the preservation of biodiversity. The cost of peacekeeping was estimated at about \$1 billion, while the cost of dealing with the HIV/AIDS epidemic was given as \$7-10 billion a year. This would include the cost of creating a Global Fund for HIV/AIDS and Health, and another \$2 billion a year for the fight against TB and malaria.

While it has been estimated that the cost of developing vaccines can run into billions of dollars, it is also noteworthy that most developed vaccines are of little relevance in the specific case of developing countries since these countries cannot afford them. The work of the Consultative Group on International Agricultural Research (CGIAR) is still considered important in the delivery of global public goods, spending some \$330 million a year on research into crops of relevance to developing countries. It is estimated that the rate of return on its activities is very high, and the primary beneficiaries are poor farmers.

Other areas that are budgeted for in the delivery of global public goods are the control of chlorofluorocarbon emissions. The cross-border cash payments

designed to compensate developing countries for joining the global campaign are estimated at some \$1.2 billion so far. The Zedillo Panel also reported that limiting greenhouse gases would be a more costly venture. Since the bulk of those costs are expected to fall on individual countries, it is important that they are allocated fairly among them. In the area of biodiversity, there are no definite estimates of what it would take to deal with the problems of mounting a serious effort to counter the continuing loss of plant and animal species. But the Panel members reckoned that it would run into billions of dollars each year. These are summarized in Table 1 below. The present expenditure on global public goods of around \$5 billion a year is financed from a wide variety of sources, and it is reasonable to assume that the revenue from these will not keep up with the increasing need for such goods.

**Table 1. Estimates of Additional Annual Costs for Achieving the 2015 Millennium Development Goals**

	<i>Billions of dollars</i>
Halving poverty and hunger	20
Halving population without access to safe drinking water	0
Achieving universal primary education	9
Achieving gender equality in primary education	3
Achieving three-fourths decline in maternal mortality	No estimate
Achieving two-thirds decline in under-five mortality	No estimate
Halting and reversing HIV/AIDS	7-10
Providing special assistance to AIDS orphans	No estimate
Improving lives of 100 million slum dwellers	4
Total cost (approximate)	50

Source: Report of the Zedillo Panel (UN 2001).

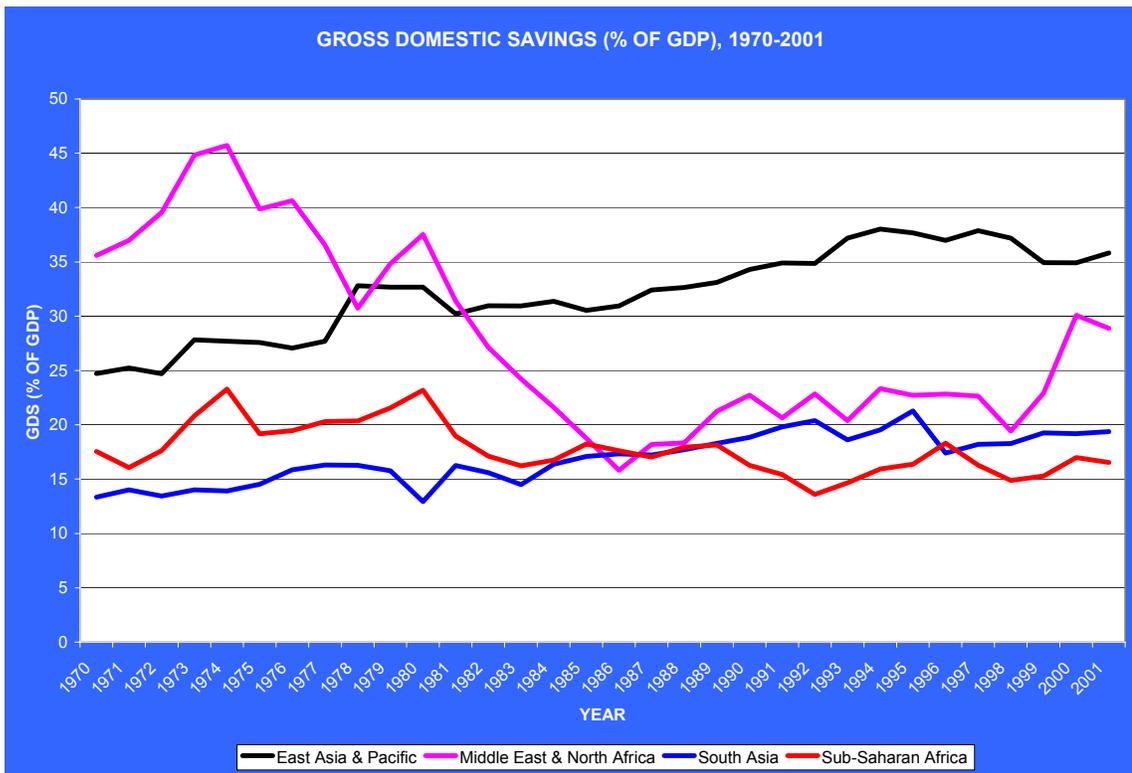
Other estimates by the World Bank in preparation for Monterrey, also suggested that an additional US\$30-70 billion was required to finance the process towards achievement of the Millennium Development Goals throughout the developing world.

If the DAC member countries actually delivered ODA equal to 0.7% of GNP, as agreed, aid would increase by about \$100 billion a year, twice as much as is required to achieve the MDGs. This amount would obviously permit full funding of the Dakar Global Initiative on Education (UN 2001) and of the programme on Macroeconomics and Health to deal with the health crisis in Africa (WHO 2001). Such an increase in ODA would also permit the extra expenditure of some \$7.5 billion a year on the achievement of universal access to reproductive health facilities, while allowing the CGIAR centres to undertake the research necessary to transform the technological landscape. But that means raising aid from the US\$57 billion that is currently available globally, and it would appear to be a huge task for the developed nations in view of the expected political fall-out in

those countries. It is for the fact that major constraints are expected in the campaign to increase ODA flows that efforts to identify alternative sources of financing are constantly being made. Africa is expected to require about 60% of all additional funds raised, an increase from the current 41% share of ODA.

### 3. Current Financing for Development in Africa

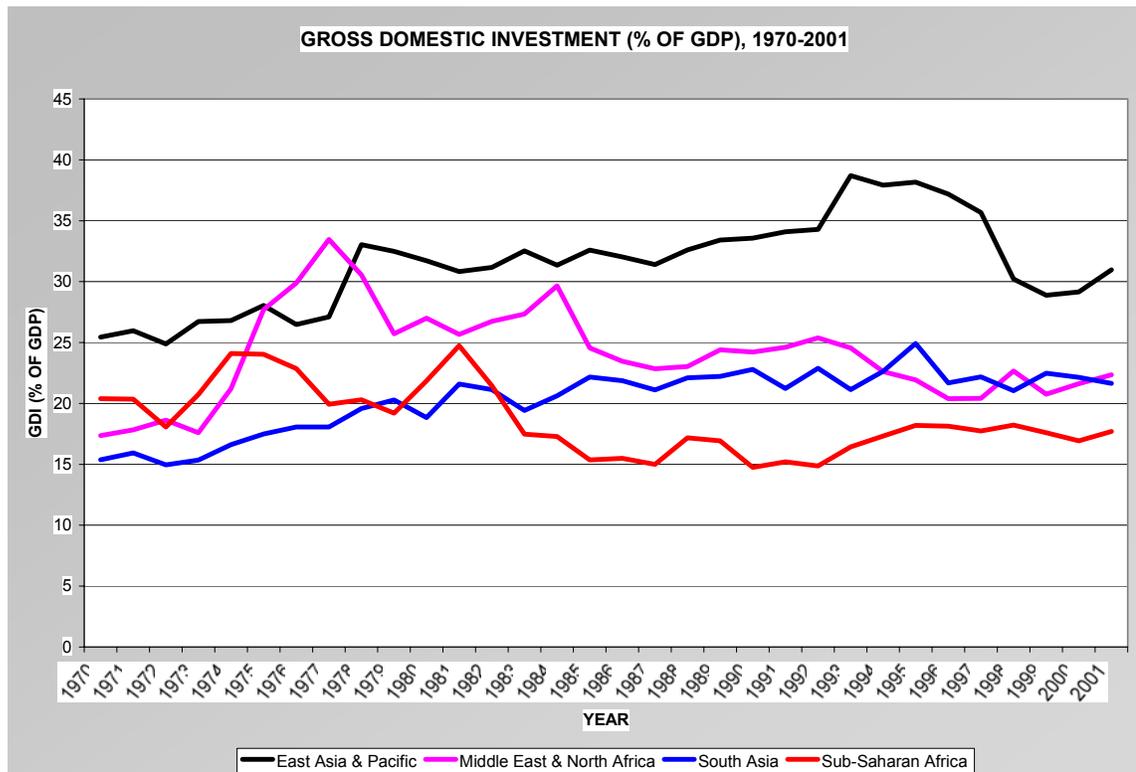
The growing reliance by African countries on external resources to finance their investments is a relatively recent phenomenon. Figure 1 and Figure 2 show that by 1980, Gross Domestic Savings (GDS) was 23% of GDP, while Gross Domestic Investment (GDI) was 22% of GDP leaving hardly any gap to be filled. At the time, foreign direct investment (FDI) formed only 0.7% of the region's GDP. Incidentally, the East Asia and Pacific region was investing as much as 32% of GDP and saving 30% of GDP, creating a somewhat larger gap there for external resources to fill. The gross domestic investment figure for Africa in 1981 has been the highest in the last two decades but it was made up largely of public sector investments. In other words, until the mid-1980s, Africa financed most of its investments from domestic public resources, a fact that obviously limited the magnitude of investments that could be made, and the growth of such investments.



**Figure 1**

The question that is raised by the above observation is whether African countries were unwilling to use external resources to raise the level of investment or such

resources were simply not available. Was it a demand problem or a supply problem? The answer would appear to be a combination of both (Aryeetey and Nissanke 1998). On the demand side, it may be noted that from the latter part of the 1970s through the first half the 1980s, many African countries were struggling with political instability in the wake of oil price shocks that made it difficult for them to develop any coherent macroeconomic management and development programmes. That certainly made it difficult to establish any credible demand for private foreign capital. The evidence on the supply side is provided by the sharp drop in ODA to the region between the 1970s and 1980s. The growth of ODA fell from 25.1% in 1974-80 to 13.2% in 1981-90. Indeed, very little aid was going to many African countries prior to economic reform programmes. (See Fig.7).



**Figure 2**

After the mid-1980s when many countries began to pursue economic reforms, the resource composition changed significantly for the region, as did the structure of demand. By 1990, GDI had fallen to 14.6% of GDP, as the average annual growth was  $-3.8\%$  for 1985-90. For the rest of the 1990s, however, investments grew by an average of  $3.7\%$  annually, reaching  $17\%$  in 1998. The gradual rise in investments as savings continued the slow growth was largely made possible by external resources in many countries.

### ***What is the Problem with Domestic Resource Mobilisation?***

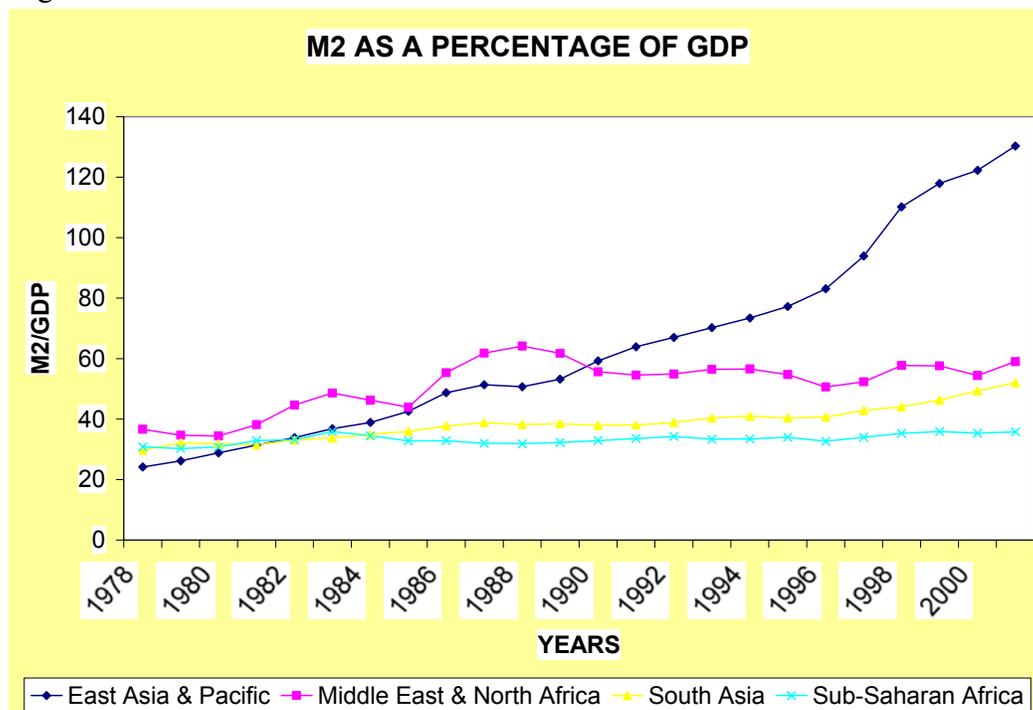
The issue of domestic resources needs to be put in the right perspective: in too many African economies, there are not enough savings being generated to facilitate the required investment. Africa appears to have low and stagnant savings. Some of the best saving rates in Africa may be found in Angola where the domestic saving rate averaged 28% in 1980-96, and Gabon with an average saving rate of 38% for the same period. These are by all accounts unusual in a region where a majority have domestic saving rates of less than 15% of GDP and sometimes have negative savings. Their high saving rates can be attributed to their being relatively small economies with large oil exports. The public sector dominates saving in these two countries.

Despite the economic reforms that many African countries attempted in the last decade, there is little evidence of these having had a major impact on savings and investments in countries (World Bank 1994). Over the reform period, only a couple of serious reformers saw some modest improvements in their savings performance. One of the more comprehensive reformers, Ghana, had a very low average domestic saving rate of about 5% of GDP throughout the 1980s. Ghana's saving rate only rose from 4% to 7% after a decade of reforms. By 1990, only five countries, including Kenya and Zimbabwe, had saving rates above 20%. One of the characteristics of all the data on domestic saving rates is that they declined for most countries in the period 1980-96 and has not seen a revival yet. (See Elbadawi and Mwegu 1998).

An interesting point about the performance of savings in Africa, in contrast with savings performance in the fast growing Asian economies during the reform period, is that changes in saving rates in Africa have been largely driven by changes in public sector savings (World Bank 1994). In Asia, they were usually driven by private savings. Srinivasan (1993) observed about largely East Asian savings that "public sector savings, if anything, do not appear to have increased significantly in the last four decades. .... One has to look for an explanation in the behaviour of the private sector for the measured rise in aggregate savings rates". In contrast private saving in Africa dropped from 11.4% of disposable income in the 1970s to 7.5% in the 1980s. By the mid-1990s it was still less than 9%. Public savings performed even worse, staying at under 3% of disposable income by the mid-1990s after falling from 4.5% in the 1980s. In many of the African countries where savings rates declined, they did so because public savings declined faster. Mwegu (1997) conducted a comparative analysis of average private saving rates in 15 African countries and found evidence that saving rates were unambiguously lower than in other developing countries. The important issue for Africa is why private savings, dominated by household savings, do not rise fast enough to offset the negative trends in public savings.

A low saving rate among households does not necessarily mean African households do not have assets. A major problem is indeed the non-financialisation

of assets reflected in relatively low  $M_2/GDP$  ratios (See Fig. 3). From a number of household surveys carried out in several countries, households show assets that are in excess of 30% of their incomes (Aryeetey and Udry 2000). In the analyses of Ghanaian data, Aryeetey and Udry (2000) find that it is only among the wealthiest 10% of rural households that financial assets begin to move with income changes. What this reveals is that, there is a certain income threshold level that has to be crossed before households can afford to hold the financial assets required for generating most investments. In other words the high level of poverty makes relying on households to provide financial resources unrealistic at this stage.



**Figure 3**

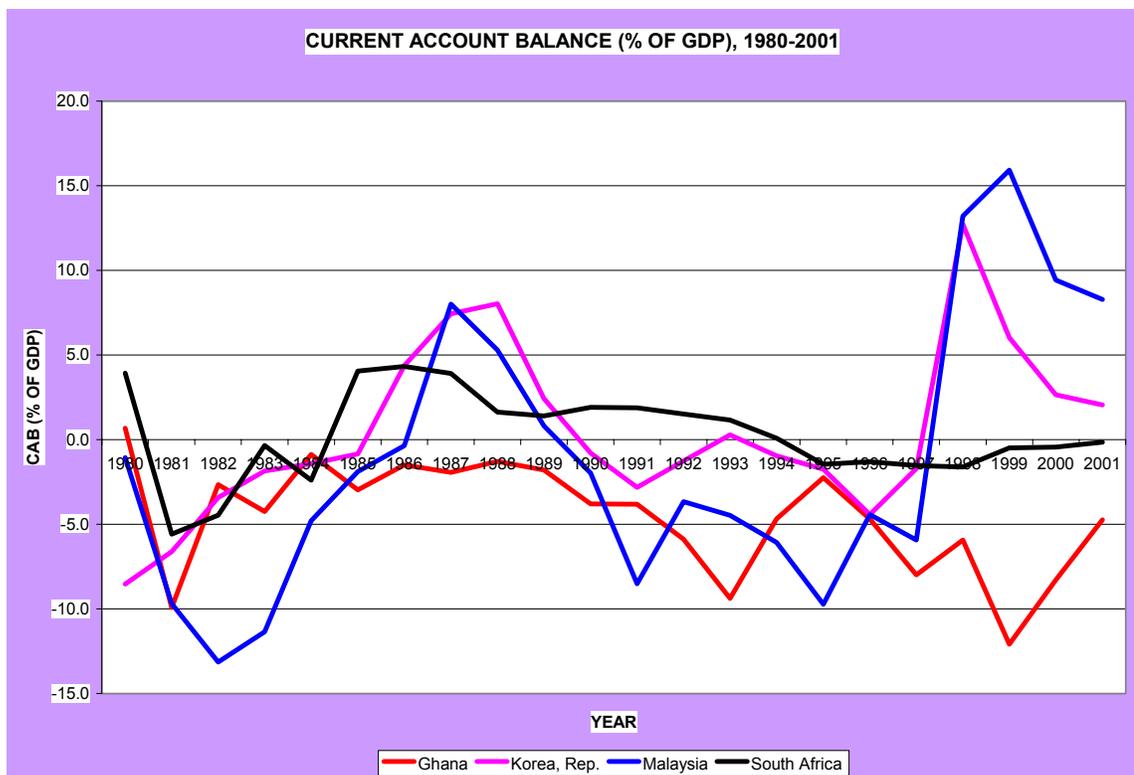
### *Resources from External Trade: Reducing the Current Account Deficit*

For many countries, the largely negative current account balance for most of the last three decades shows relatively little change in the structure and composition of both exports and imports. Most countries are still heavily dependent for export earnings on a very limited number of primary commodities which fail to provide either a stable or growing source of revenues.

With an average current account balance of -3.8% of GDP for the period 1990-2000 for the whole of Africa, the need for external flows has remained significant. While the export of goods and services grew by only 1.9% in 1980-90 and by 4.0% in 1990-2000 for the region, this grew by 8.8% in the earlier period and by 12.8% in the latter period for East Asia and the Pacific. Figures for Africa show a significant drop from the figures for the 1960s when they grew by an average of 6% per annum. A number of the East Asian and Pacific economies managed to

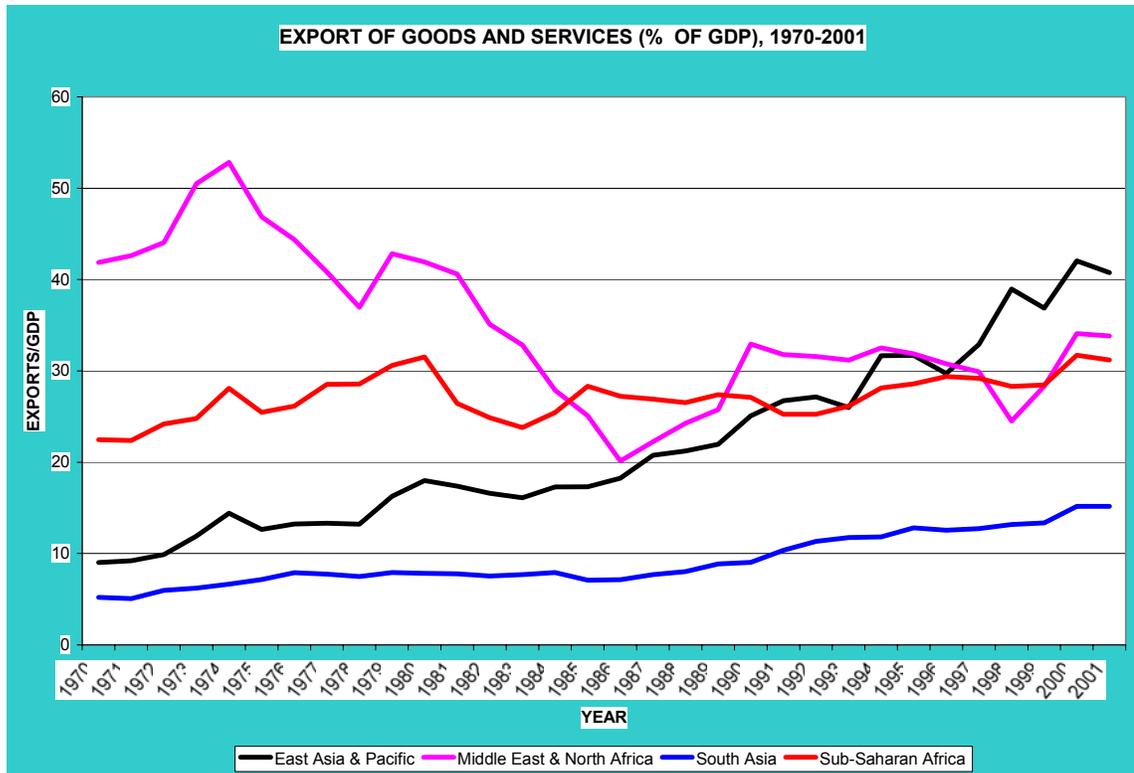
move from being primary export producers in the 1960s and 1970s to become major exporters of manufactured goods. Indonesia, Malaysia and Thailand raised the share of manufactured exports from less than 6% in 1965 to 56%, 80% and 74% respectively in 2001. In contrast, the share of manufactured exports for African countries was only 32%, thanks largely to South Africa<sup>2</sup>.

What is remarkable about the poor external performance of African economies is the fact that aside from being unable to match South-East Asia in the area of manufactured exports, they also lost ground with the export of primary commodities, as Africa's competitiveness in world markets decreased. The export of traditional export commodities such as cocoa, coffee, rubber, spices, tin and tropical vegetable oils declined throughout the 1970s and 1980s. This happened at the same time as Malaysia, Indonesia and Thailand raised their shares in the export markets for the same items. While the export of primary commodities has declined in value for many African countries, they continue to dominate their external trade, accounting for 83% of all exports in 1970 and 76% in 1992. Africa's overall share in world exports fell from 3.7 % in 1970 to 2% in 1998, and has risen only marginally since then.



**Figure 4**

<sup>2</sup> The figure drops to less than 10% if South Africa is excluded.



**Figure 5**

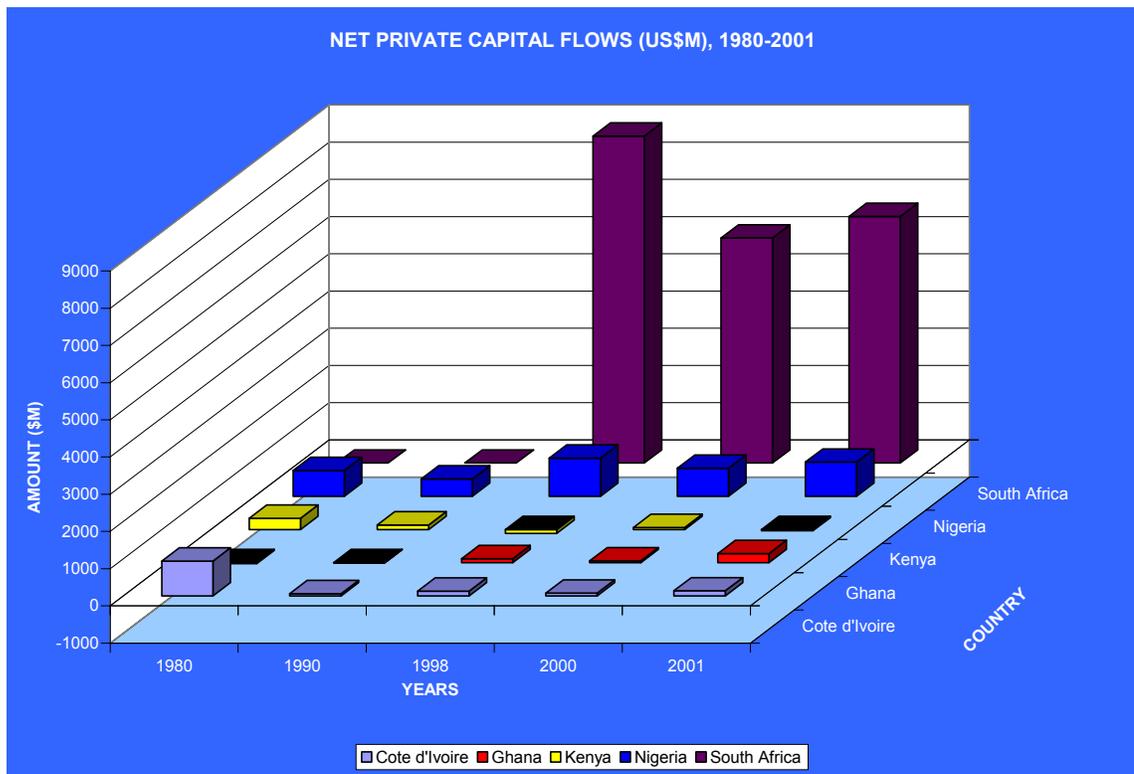
Undoubtedly, one of the critical factors responsible for the unchanging structure of Africa’s trade patterns has been the lack of openness in economic policies pursued over a much longer time span. Countries did not invest in enhancing export performance in the 1960s and 1970s when many countries followed inward-looking import-substitution policies. By not investing in infrastructure to facilitate exports, and by not developing appropriate export-enhancing policies, the competitiveness of the marginal African exports became completely eroded by the early 1980s when many countries began to undertake economic reform programmes. Unfortunately the reform programmes of the 1980s did not address all the problems confronting export diversification. These need to be addressed now.

***Capital Flows***

African countries have not been able to offset the large negative current account balances with significant growth in capital flows. In the 1980s and the early 1990s, Africa's share of foreign direct investment to developing countries was under 1% of the estimated total of around \$200 billion per annum (Collier 1994). This was despite the fact that private capital flows into the developing world grew remarkably in the 1990s.<sup>3</sup> FDI to low income countries rose from \$5,732 million

<sup>3</sup> There is, however, a growing view that private capital flows to Africa are much more significant than some official data from international financial institutions would suggest. FONDAD (1999).

in 1990 to \$53,517 million in 1998, an increase of over 800%. For sub-Saharan Africa, however, FDI only rose by \$834 million to \$4,394 million, i.e. at half the rate of growth to the rest of the low-income world. By 1998, FDI formed only 7% of GDI in sub-Saharan Africa and 1.3% of GDP, compared to 12.4% and 3.9% respectively in East Asia. Trends in North Africa (classified together with the Middle East) were better than for sub-Saharan Africa.



**Figure 6**

a. Foreign Direct Investment

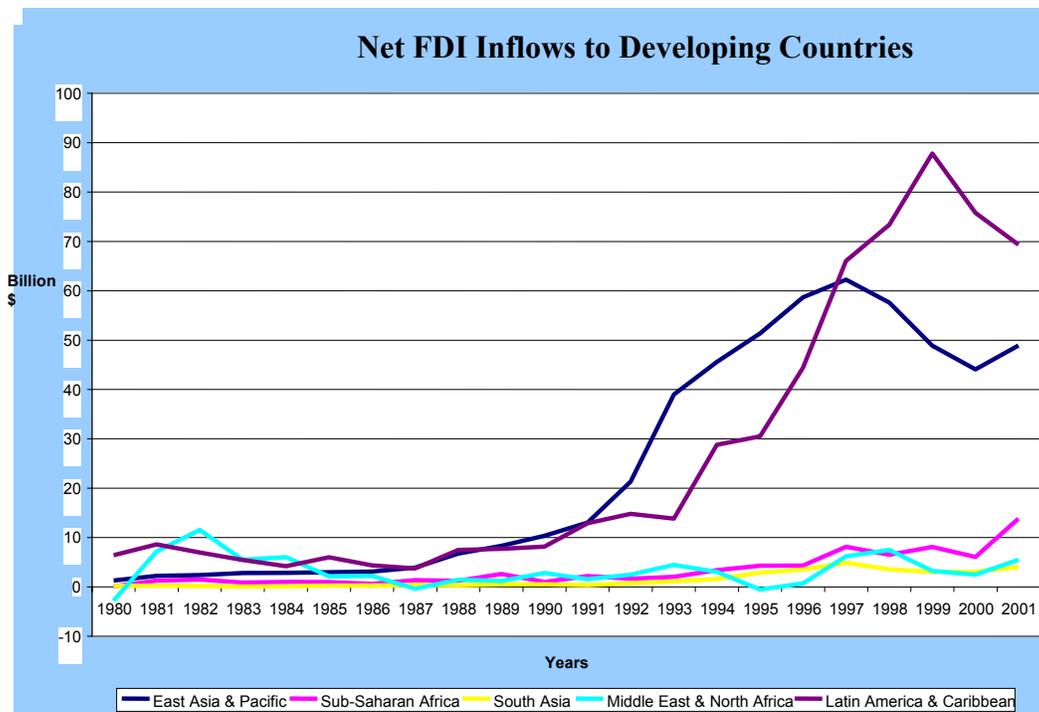
A number of studies have shown that FDI usually flows to countries that are experiencing growth (UNCTAD 2000). It is, however, important to observe that significant and consistent growth does not necessarily lead to equally significant growth in FDI, as the experience of Ghana in the second half of the 1980s and early 1990s quite clearly showed. Despite the fact that Ghana's GDP growth rate was on average 5.5% for the period 1984-91, FDI only moved from 0.4% of GDP to 0.7%.

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FONDAD suggests that FDI flows to Africa more than tripled in the 1990s and that the growth rate was comparable to that in SE Asia and Latin America. They note that "FDI is diversifying its source and recipient countries and sectors, largely due to innovation by non-OECD investors". The under-reporting by countries is attributed to a poor monitoring capacity.

To show that a long period of growth may be essential to induce limited FDI, we note that its growth in Ghana only went up from \$15 million in 1990 to \$56 million in 1998, significant by African standards but far less than in other developing regions. At its peak in 2000, FDI amounted to only \$110 million. A lot more needs to be done to attract FDI than simple growth.

But there were some new and interesting trends in FDI flows shortly before the Asian crises. The sources of new FDI had begun to vary considerably. Whereas for most countries, the sources have traditionally been the previous colonial powers, these seemed to have changed considerably for a number of countries. Thus Malaysia became a new source of FDI to a number of African countries, including South Africa. Australian and Canadian firms also become important sources of FDI in the



**Figure 7**

mining sector, just as South African firms began to move into the brewery and service sectors in many African countries. Nigeria nevertheless remains the largest recipient of FDI, but this is not diversified and is mainly restricted to the extractive sector of the economy. One lesson from the new trend is the fact that countries will have to look at many more countries than they have traditionally dealt with. What remains equally important is the need to diversify the countries of origin as well as the economic sectors in which they operate. Using FDI to access technology remains crucial in the search.

The perception that Africa attracts far less private capital than it deserves has been attributed to its not being “structurally able to assimilate these large flows” (Aron 1996).<sup>4</sup> From the mid-1970s, monetary and fiscal policy continued to be loose, while trade and exchange controls prevented the adjustment of the exchange rate. Unlike the situation in East Asia, the deterioration in the terms of trade coupled with high inflation ensured that the real exchange rates appreciated rapidly, forcing significant macroeconomic instability. With the deterioration in national economic management in most of Africa, aggravated balance of payments problems and fiscal deficits, the continent saw considerable capital flight instead.

#### *Other Private Capital Flows*

Portfolio investment in sub-Saharan Africa in 1998 amounted to \$250 million worth of bonds and \$679 million of equity. This had dropped from almost five times the amount in 1995. By 2001 bonds amounted to \$1938 million and equity - \$960 million. For North Africa (together with the Middle East) equity holdings were only marginally higher than SSA while far more bonds were available. The East Asia and Pacific region attracted \$1,870 million of bonds and \$9,007 million of equity holdings in 1998. Equity holdings rose to \$19,254 million in 2000 in East Asia and the Pacific. Africa’s share of private flows to developing countries has averaged 1.6% in the last decade.

While bonds and equity capital are very much missing in African countries they seemed to diminish further after the East Asian crises. Indeed there are indications that portfolio investments were beginning to rise in Africa up to 1996, with FONDAD (1999) suggesting that they were the fastest growing source of private capital. Africa definitely was affected in no small way by the shrinking that has followed in the emerging capital markets.

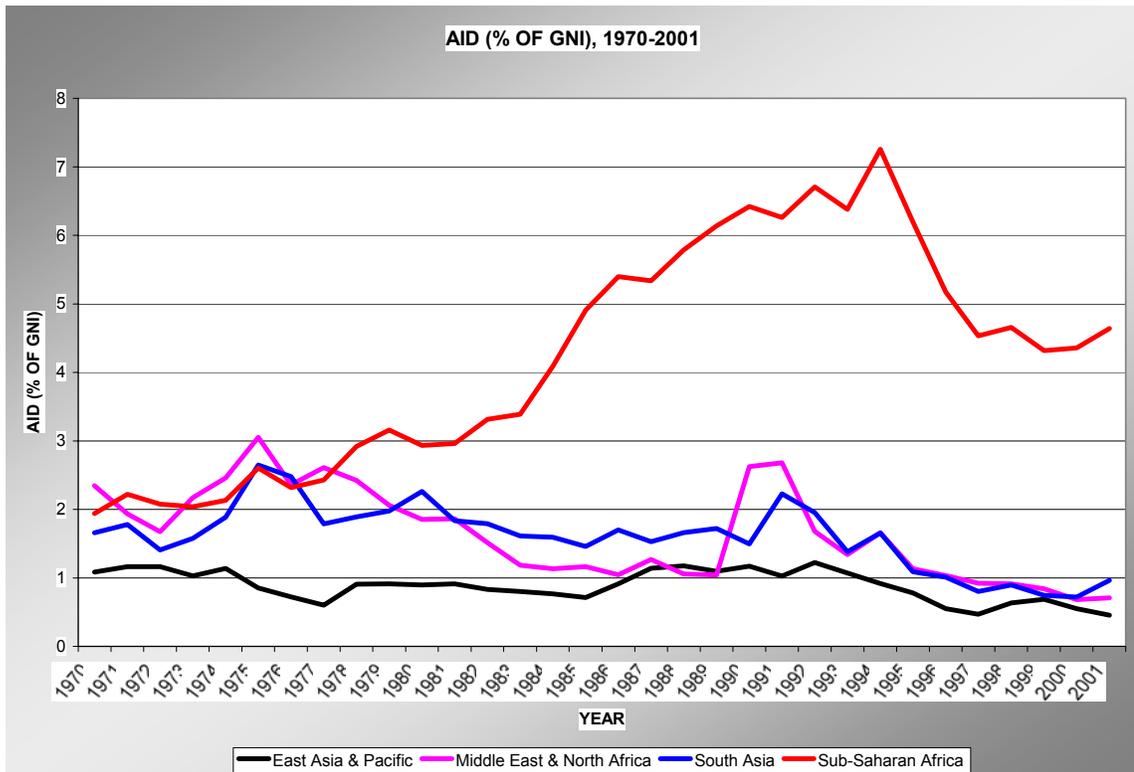
The serious impediments and challenges facing African financial systems can be summed up as follows: fragmentation, illiquidity, informational inefficiency, limited size and capacity, underdevelopment of human capital, inefficient regulatory schemes, excessive risk factors, dearth of risk-sharing and hedging mechanisms, legal and contract enforceability issues. The irony of the developments in global capital markets is that they are occurring at precisely the time that many African countries are attempting to develop their own capital markets. Reforms of the 1980s yielded a positive outcome in terms of growth of the number of stock markets. There are about sixteen stock markets, and they have become a basis for the commensurate introduction of Africa-based funds trading in New York and Europe. The stock markets have emerged as a real potential for integration of Africa into the global economy. However, the markets remain the smallest of any region in terms of capitalisation, except South Africa and are very illiquid (Senbet 1997).

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<sup>4</sup> But Bhinda et.al (1999) believe that this is due mostly to poor information being sent to investors all the time about Africa.

## Official Development Assistance: Historical Trends

Having benefited very little from the growth of private capital flows to the developing world in general in the 1990s, Africa has continuously had to use official development assistance to make up for the shortfall in resource flows. This is in spite of the fact that aid was insignificant up to the mid-1980s. In the 1990s, Africa, on a per capita basis of \$40, was the largest recipient of ODA. In current prices, net ODA for Africa from all donors more than doubled from \$7,395 million in 1980 to \$18,155 million in 1994. That was the peak. By 1997 current net ODA flows amounted to \$14,212 million. There is every indication of decline as net ODA, which amounted to 10.7% of GNP in 1990 fell to 5% of GNP in 1997. Incidentally ODA amounted to less than 1% of GNP for East Asia and Pacific, and only 0.8% for South Asia in 1997. While aid to most of Africa was increasing in the 1980s, it was understandably shrinking in the high-performing SE Asian economies.



**Figure 8**

More than a half of net ODA to Africa came from the DAC donors, while multilateral donors provided a little under a half, with the small remainder coming from non-DAC donors. It is interesting that in the 1990s, Japan emerged as one of the leading bilateral donors to Africa, having taken over that role from the traditional colonial powers in many countries. One of the lessons from the application of Japanese aid in Asian development is that it is possible to use aid as an instrument for jump-starting the growth process, so long as domestic

conditions are made conducive to achieving aid effectiveness. In effect, ODA can and should play a useful role in the financing of African development, but there is a need to define the exact role that such assistance will play and a development of the necessary policy and institutional environment.

### *Recent Trends in ODA and the Millennium Development Goals*

Total ODA was \$57 billion in 2002, with only about 41% going to sub-Saharan Africa. As discussed earlier, it is reckoned that a doubling of it would suffice for annual development needs up to 2015. Currently a half of total ODA comes from the EU and its member states, and a quarter from the United States. The ODA amounts in the last couple of years reflect a marginal increase over the 1990-97 average of \$55 billion. As a proportion of the gross national income of donor countries, ODA fell from 0.33% in the mid-1980s to 0.23% in 2002. Only the Nordic countries, Luxembourg and Netherlands are able to meet the 0.7% target.

But there is in general greater enthusiasm to increase ODA allocations currently. Prior to Monterrey, the EU committed itself to raising its ODA to 0.39% of Gross National Income, from the then figure of 0.33%. Three countries gave firm dates to reach the UN 0.7% target, namely Belgium, Ireland and France. Significantly, the US Government announced that it would increase its core development assistance by \$5 billion annually, through the establishment of a new Millennium Challenge Account. The new Account is distributed to developing countries showing a strong commitment to “good governance, health and education, and sound economic policies”. Observing these changes, the World Bank commented that, “a return by donors to their early-1990s average aid ratio of 0.33 percent of GNP would provide an extra \$20 billion” (2001, page 89). It is estimated that if the average ODA from DAC countries could be raised to 0.5% of GNP, then the \$50 billion additional ODA would be realised. This would then make the search for alternative sources redundant. Atkinson (2004) notes that, “The funding of the MDGs could be achieved solely by increasing ODA. At the same time, it would require a step change from the present, going considerably beyond what has so far been promised. Growth of ODA at 4.9% per year will require 14 years before ODA is doubled, and by then the target date of 2015 will have passed. The widening of the circle of aid donors is going to take time. Time is however of the essence. For this reason alone, it is necessary to consider new sources”.

### *Reversing Capital Flight*

Capital flight refers to large private capital outflows from developing countries. It is a problem inasmuch as the outflows present major macroeconomic problems for those countries. Claessens and Naude (1993) carried out estimates of capital flight for various countries that suggested that capital flight in the preceding decade had been more of a problem for some African countries than it had been for SE Asia. In 1981-91, Nigeria was the seventh largest source of flight capital in the world, with an average annual flow of over \$2800 million. The stock of

capital flight at the end of 1991 for sub-Saharan Africa represented more than 85% of the region's GDP. The situation was worse only in the Middle Eastern and North African region, with the region's capital flight stock equivalent to 118% of 1991 GDP. SE Asia had a capital flight of only 15% of 1991 GDP, which was the least in the developing world. More recent figures by Ajayi (1997) placed the stock of flight capital at \$22 billion, which is more than has been estimated as required to fill the resource gap. Collier and Gunning (1997) reckon that African wealth owners have chosen to locate 37% of their portfolio outside Africa. This share is compared to 29 % for the Middle East, 17% for Latin America, 4% for South Asia, and 3% for East Asia. For individual countries, we note that Gabon, Nigeria and Uganda were included in the top-ten countries for the ratio of capital flight stock to GDP in 1991. Gabon had a stock of capital flight that was almost triple its 1991 GDP. Nigeria and Uganda had the equivalent of about 150% and 140% respectively of their 1991 GDP staying out. Other major sources of capital flight from Africa in the 1990s have been Zambia and Sudan.

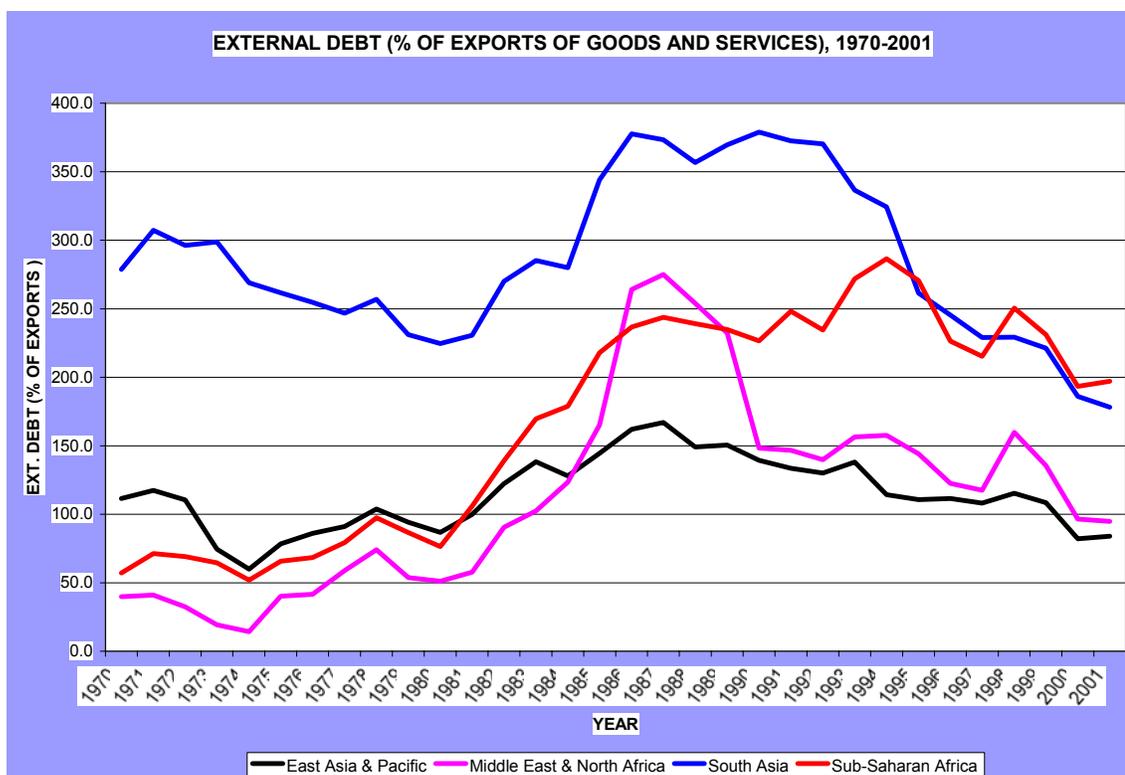
Ajayi (1992) indicated that trade faking was an important vehicle for capital flight in Nigeria. For the period 1970-89, he suggested that "a significant amount of under-invoicing of exports and over-invoicing of imports took place" (p.59). Exports were under-invoiced to the tune of \$8.2 billion while imports were over-invoiced by up to \$5.96 billion. Most of this was related to Nigeria's oil trade. He concluded that domestic macroeconomic policy errors were largely responsible for the capital flight. These included high inflation, exchange rate misalignment, fiscal deficit and the lack of opportunities for profitable investment in the domestic economy. There are indications, however, that criminal transfers arising from political malfeasance and corruption are also a major source capital flight in many countries, and these have to be dealt with differently through the institution of sound governance structures.

Some recent studies have suggested that if there were to be a reversal of capital flight, the private capital stock of most of Africa would go up by as much 64% (Collier et.al. 1999). The issue that this raises is how best to achieve such reversals. There are, obviously policy as well as institutional issues, to be taken care of.

### ***Debt Relief***

High debt stocks and high interest rates have combined with increasingly adverse terms of trade to make debt service unmanageable for Africa since the 1980s. Despite repeated debt rescheduling facilities, the total external debt of Africa rose by 278% from \$60,820 million in 1980 to \$230,132 million in 1998. That of East Asia and the Pacific went up faster by 609% from \$94,080 million to \$667,522 million for the same period. While African debt has been smaller in magnitude and grew far slower in the last decade than that of SE Asia, difficult debt management in Africa was reflected in the higher debt burden. The present value of debt as a proportion of the exports of goods and services exceeded 200% for

most African countries in the 1990s. For Malaysia this was only 33.6% in 1995 and for Thailand 77.6%. Although the debt service ratio (to exports) of 30% did not vary much across the developing regions on the whole in the 1990s, the faster growing economies of SE Asia have been better able to sustain external debt with growing earnings from exports than African economies. Also, while most of African debt (77.5%) has been long-term debt and 74% of it is public, the problem is made grave by the capitalisation of interest and principal arrears. These make almost 25% of the total external debt currently.



**Figure 9**

The sustainability of most of African debt has for long been one of the critical issues on the international development agenda as most countries have had to continuously deal with several intractable external debt issues. The region’s debt is judged to be unsustainable, particularly in relation to the current growth requirements.

Africa has not seen much debt relief over the years despite a lot of rhetoric in this area. The best known of the more recent initiatives is the HIPC initiative launched in 1996.<sup>5</sup> While the original programme was the first comprehensive debt

<sup>5</sup> Phase one of HIPC required a 3-year record of compliance with an IMF programme that leads to a decision point. Acceptance at this stage required countries to show they were beyond debt sustainability by having a debt service ratio of 20-25% of exports and a present value of debt to export ratio of 200-250%. This entitled them to a two-thirds reduction of all external debt stock. In

reduction programme from the donor community for highly indebted countries that satisfied a number of policy criteria, it was received with little enthusiasm in the region in view of the perceived difficult conditions for eligibility. In a revised version that has been agreed with African leaders, the enhanced HIPC initiative is generally regarded as more flexible.<sup>6</sup> The interesting thing about the enhanced initiative is its link to the preparation and implementation of Poverty Reduction Strategy Papers in countries. While it is true that African leaders have endorsed this new initiative and the link to poverty reduction, it also remains true that its operationalization would be problematic for many countries in view of the uncertainty associated with the road to poverty reduction and the medium-to-long term nature of it. It is certainly not clear what standards will be used to measure poverty reduction that will facilitate unconditional relief.

But beyond the issue of operationalization, considerable doubt has been expressed about the ability of the enhanced HIPC initiative to provide a lasting exit from debt problems (USGAO 2000, UNCTAD 2004). This is mainly because there has to be strong and consistent growth in the economies but there is no guarantee that debt relief that provides resources for poverty reduction will automatically lead to sustained growth. There are many other investments that African governments need to make in order to ensure that. That also means that many beneficiary countries will still have to borrow extensively in order to meet other obligations, a process that would likely endanger their debt position. Other concerns relate to the resource-intensity of the PRSP preparation process in countries and how the focus on satisfying this requirement could affect the need to develop longer term growth and development frameworks. In a number of countries there is already tension between country ownership of the PRSP process and donor support for it as the process seems to have created a new consultancy industry in the donor world. We note here that in the UNCTAD (2004) report on Economic Development in Africa, there are a number of reservations mentioned about the efficacy of the enhanced HIPC initiative. These include (1) inappropriate eligibility and debt sustainability indicators that exclude domestic debt (2) the use of overly optimistic growth projections (3) insufficient interim debt relief, (4) problems in the delivery of HIPC debt relief, (5) the limitations of the burden-sharing concept, and (6) inappropriate use of discount rates for the calculation of NPV. There is merit in the UNCTAD argumentation, particularly in respect of the issue of domestic debt and the difficulties with the debt sustainability indicators. The main issue remains, however, how to make debt relief growth-enhancing in order to facilitate the achievement of sustained poverty-reduction.

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Phase 2, another three years of an IMF programme and an acceptance into the category was expected to lead to an 80% reduction in debt stock.

<sup>6</sup> The requirement for the present value of debt to export ratio has been reduced to 150%, while debt relief commences from decision point and the length of the interim period is based on the achievement of specific development actions.

#### **4. Development Finance in the Absence of Change**

There are a number of concerns that need to be expressed about likely trends in the various sources of finance discussed. A number of studies suggest that without any dramatic change in current approaches to the financing of investments and other expenditures in Africa, the current volumes and sources will shrink even further (Geda 2000).

##### ***Domestic Resources***

On domestic financial resources, it may be noted that rising rates of poverty would mean that the growth of financial assets among households will be far slower than it is presently and also than is required. The situation is worsened by the fact that structural and institutional factors also play a major role in keeping households from financialising their assets. There is ample evidence that financial sector reforms of the last decade have not resulted in significant resource mobilisation in most countries. While fragmented market structures provide little incentive to financial sector operators to seek marginal savers and borrowers in view of relatively high transaction costs, it is unlikely that those market structures will change independently of the structures of economies. In a sense, there is a vicious circle that makes it excessively difficult to mobilise domestic resources, particularly from households. In the case of public savings, there are indications from the structure of public accounts in most countries that the nature and weight of the expenditure burden on the African state make it extremely difficult for governments to consistently achieve some savings. This is not likely to change in the absence of steady and significant growth.

##### ***Export Revenues***

In terms of export revenues, while considerable hope can be held out on account of on going attempts to diversify exports through the development of non-traditional items, the medium-term prospects are quite mixed. While the passage of the Africa Growth and Opportunity Act in the US offers considerable opportunity for strengthening the exports of shoes, textiles and leather products, there is also little understanding of the benefits of the Act among business communities; and indeed there are few structures in the region for drawing the attention of business people to it.

Other problems with the development of exports remain what may be seen as the protectionist stance of many African economies, despite the considerable liberalisation of trade and exchange rate regimes in the last 10-15 years (O'Brien 2000). Indeed trade regimes vary extensively across Africa and the degree of openness is lower than in other regions. Thus, "at present, despite considerable reductions in trade barriers over the past decade, most African countries impose

fairly high barriers through tariffs and export taxes or through managed exchange rate arrangements" (Oyejide et al. 1997, p.16). Tariff levels in Africa are some of the highest in world trade. Even though there has been significant rationalisation of tariffs and in the number of tariff categories, nominal average tariffs have not declined much in Africa, averaging 40% in the 1990s, which is not much different from what they were in the 1980s.

But while African countries may consider the lowering of tariffs in order to fall in line with WTO regulations, it is important to point out that, it will not necessarily lead to a rapid expansion in exports. The need to develop suitable production structures for facilitating exports development suggests that financing development from this angle should be seen as a medium-term engagement rather than an immediate one.

### ***Official Development Assistance***

Can Africa expect increased official development assistance in the short-term? Despite the very strong case made by UNCTAD (2000) for a doubling of aid to Africa in the short-medium term in order to generate the growth that will attract private capital flows, there is still scepticism about the willingness and capacity of the donor institutions to respond positively to that gesture immediately. On the side of willingness, frequent references to *aid fatigue* and *aid dependency syndrome* in the popular press as well as in academic documents, are used as indicators of a perceived growing unwillingness to raise aid volumes significantly in the short-medium term (Cho 2000). This is tied to the growing perception among taxpayers in the western world that their governments commit enough already to African countries and the results from these endeavours are not significant (World Bank 1999). With respect to the capacity to provide additional funds, it may be noted that the US General Accounting Office (1999) raised doubts about the capacity of both bilateral and multilateral agencies to provide debt relief if they were to continue with their already agreed programmes of assistance. They show that three of the four largest multilateral creditors face financing gaps while the bilateral donors face additional budget costs that have to be funded. The suggestion that the USGAO makes is that the capacity of aid institutions to provide additional assistance is limited but requires review. This is not likely to take place immediately without sustained pressure from the entire region and its partners.<sup>7</sup>

### ***Private Capital Flows***

What are the prospects for FDI and other private capital flows in the short-medium term? The question that needs to be asked alternatively is whether African countries can position themselves to attract private capital. The UNCTAD (2000) argument that private capital will be attracted if there is significant and

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<sup>7</sup> This is in spite of the proposed International Finance Facility and the Millennium Challenge Account.

consistent growth in economies obviously requires careful scrutiny. While growth may attract private capital, there are obviously many other structural and institutional requirements that need to be fulfilled. A number of studies have suggested that “Africa is too risky” (Senbet 1997). What is the nature of the risk faced by private investors? At a more fundamental level, high macro-economic instability leads to high volatility in the financial markets. The existing evidence suggests that country risk, by implication, macro-economic risk, is the predominant source of variation in stock returns across countries (versus industry-specific shocks). However, macroeconomic or fundamental risk is not the only risk faced by African economies. Other categories of risk include political risk as investors are concerned about risk associated with the probability of adverse changes in government policies; foreign exchange risk as local currencies face unhedged currency exchange volatility; and the risk of Afro-pessimism or Afro-contagion arising out of the images of war, famine, massive corruption, failed projects, poor governance, etc. (Aryeetey and Senbet 1999). Unfortunately, perception becomes reality in an environment characterised by grossly imperfect information. Without an elimination of the high-risk perception it will be difficult to attract private capital.

### ***Capital Flight***

Are there any prospects for reversing capital flight? Incidentally the conditions that will lead to attracting private foreign capital are the same ones that will lead to a reversal of capital flight. The evidence from other regions, such as Latin America and East Asia, suggests that globalisation of local markets leads to large reversals of flight capital. Given that Africa stands within the top tier of regions in terms of flight capital stock per GDP, there is a potential for significant reversal of flight capital, if the region becomes sufficiently integrated into the global economy, of course mindful of the broader implications of such globalisation.

### ***Debt Relief***

Discussions of debt relief often present room for optimism. This is largely because debt relief for Africa has managed to find its way onto the agenda of most major international meetings to discuss global development, including those of the G-8 countries. For the UN Millennium General Assembly, the issue of debt relief for impoverished nations has been one of the issues strongest on the minds of leaders. The focus on debt relief in different forms, including debt cancellation, has received considerable attention largely as a result of the pressures from a consortium of NGOs, governments and several humanitarian international agencies. But inasmuch as debt relief manages to get on the agenda of meetings, the resulting initiatives, if any, are often perceived to be inadequate in addressing the problems, in view of the magnitude and scope of the debt problems (USGAO 2000). Thus, unless debt relief is structured in such a way as to reduce significantly the amount of borrowing that beneficiary countries have to endure

and also promote growth, it is unlikely that significant financing of African development can come out of current initiatives.

## **5. New Initiatives to Enhance Development Finance**

In making proposals for tackling the financing gap, the Zedillo Panel (2001) had a very comprehensive ‘plan’ for raising the necessary funds and also managing economies in order to make sustainable the fund-raising efforts. Indeed they made provision for action in the following key areas:

- Policies in developing countries
  - Governance
  - Macroeconomic policy
  - Fiscal policy and social spending
  - Financial system
  - Pension reform
  
- Private capital flows
  - Actions by developing countries
  - Actions by industrial countries
  - Actions by international community
  
- Trade
  - “Development Round” of negotiations
  - Measures for least developed countries
  
- International Development Cooperation
  - Estimates of need
  - Further debt relief for highly indebted poor countries
  - Making aid more effective
  - A campaign for the International Development Goals
  
- Systemic issues
  - Global Council and Globalisation Summit
  - Support for multilateralism
  - Faster reform of international financial architecture
  - Reinforcement of the World Trade Organization
  - Institutional response to environmental and labour issues
  - Innovative sources of finance
  - The role of an international tax organization
  - Migration policies

The Zedillo Panel suggested that, “many of the issues at the heart of development financing have to do with global economic governance. Economic and social policies are subjects not only of national but also of global governance. The dramatic

events of the first half of the twentieth century taught nation states that global interdependence without global rules and institutions is in nobody's long-term interest." They fully endorsed the need for a global rules-based framework, which is noted to have led to the building of the existing multilateral system. They suggested further that, "despite its shortcomings this system has made powerful contributions to the unprecedented progress and stability that much of humankind has enjoyed since the end of the Second World War." In effect the world should seek solutions to the current financing problems from the same multilateral system including.

### ***New Trends in Domestic Resource Mobilization: The Promise of Microfinance***

The biggest revolution in mobilizing domestic resources in the last decade has been in the area of microfinance. Microfinance activities are definitely better known in Asia and Latin America than they are in Africa. The Webster and Fidler (1995) study of micro-finance institutions in eight West African nations, showed countries with a good number of microfinance programmes, (including Mali, Guinea, Burkina Faso, The Gambia and Guinea Bissau), and others with very few, including Sao Tome, Chad, Mauritania and Sierra Leone. In Kenya, where K-REP, probably the best known microfinance arrangement in Africa is located, over three hundred microfinance institutions (MFIs) have been registered.

A number of evaluations of microfinance projects suggest that their practice has been less successful in Africa than in other developing economies, (Christen, Rhyne and Vogel 1994). Microfinance programmes, derived from innovative schemes generally, are more likely to be born out of donor projects<sup>8</sup>, and are not necessarily community-based. It may be observed that many African microfinance arrangements have benefited from best-practices developed in other developing regions, as they have indeed drawn ideas from more successful projects elsewhere, including the following: 1) the issuing of short-term loans; 2) starting with small initial loans; 3) concentration on small working capital to firms with proven track record; 4) specialized services without targeting; 5) simplified services; 6) localized services; 7) shortened turn-around time for loan applications; 8) motivation of repayment through group solidarity or joint liability; 9) savings mobilization from the poor; and 10) charging of full-cost interest rates.

But the biggest change outside of Africa, which is yet to gain root in the region has been the involvement of more formalized financial structures, like banks, in the delivery of microfinance services. Indeed the last decade has seen a relatively rapid expansion in the involvement of formal financial institutions in poor countries in the provision of savings services to marginal customers. Financial systems are being re-organized to make them more efficient as formal institutions pursue marginal clients. A number of them continually search for possibilities to extend services to the poor without affecting costs adversely. Some also reckon that costs

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<sup>8</sup> Eighty-two percent of 62 microenterprise development programmes studied by Webster and Fidler (1995) have a micro-credit component. As much as 52% offer exclusively micro-finance.

will inevitably rise and seek to design structures and organizations that will cover them. This expansion comes from the increasing acceptance of the fact that the aggregate volume of deposits from such customers in many countries is not insignificant (Nissanke and Aryeetey 1994).

A major approach to mobilizing deposits from small depositors by formal financial institutions involves the decentralization of those services that allows most direct decision making to be done away from the centre of the institution. Such decentralization may involve the *delegation* of decision making authority to lower levels of the organization, including greater authority at the branch level, the *deconcentration* of the organizations with the creation of semi-autonomous units within the institution or the *devolution* of authority to organizations that are basically outside of the institution. It would appear that the approaches of delegation and deconcentration are more widespread than the devolution of authority to external agents.

There are obvious advantages and disadvantages in whichever methods that formal financial institutions may choose for the decentralization of their financial services in the pursuit of the marginal depositor. There are many bank chief executives that would be worried out about the kinds of incentives that branch managers may have to offer in order to attract more deposits from the poor, particularly if these are tied to lending programmes. Associated with the difficult management of incentives is the low calibre of personnel usually found in branches that are closest to poor and marginal customers. Similarly, giving greater authority to a semi-autonomous unit within the institution may introduce a problem of reduced accountability, and the cost of dealing with this may not be insignificant. Obviously if banks in Africa are going to get involved in microfinance they will have to consider how best costs may be kept down without affecting the expansion of services to marginal clients.

### ***New Initiatives in Mobilizing External Resources***

Since the Monterrey Conference, there have been several initiatives to put into action the ideals of that conference. Aside from the actions on debt relief, the most significant have been the several proposals discussed thoroughly in the Atkinson (2004) book. The work, which is a re-visit to several well-known proposals from a number of people and institutions, notes that, while the effectiveness of international organisations has been called into question, and the role and functioning of the United Nations is debated, the same international organisations are generally viewed as the key to the free movement of goods, services and capital. This is what the adoption of ambitious development targets in the form of the Millennium Development Goals is seen to represent. This idea matches with the consensus reached by the Zedillo Panel that multilateral action is required to deal with the financing problem that developing countries face. In this latter project, it is widely recognised that there is need to develop new and innovative sources of funding, both public and private, to be dedicated to social

development and global poverty eradication. These ideas are reflected by Atkinson (2004) as follows:

“The tension between these two forces pervades discussion of resources for world development. On the one hand, there is talk of “donor fatigue”. Official Development Assistance (ODA) stagnated for many years until the recent upturn. The amendment to the IMF’s Articles approved by the Board of Governors in 1997 allowing a special allocation of Special Drawing Rights (SDRs) remains unratified in 2003. Proposals for any form of global taxation meet immediate opposition from the US Congress. On the other hand, there is widespread appreciation of the need for new flows to allow the Millennium Development Goals to be achieved. There are interesting proposals for new sources of revenue such as a global lottery or the International Finance Facility. Individuals continue to support development charities. US billionaires are personally funding development and world health activities” (Atkinson 2004).

The new innovative sources that Atkinson (2004) and his team consider are presented as follows:

<i>Source</i>	<i>Description</i>
Currency Transactions Tax (“Tobin tax”)	Tax on short-term capital and currency flows at a uniform rate payable by all banks and foreign exchange dealers, collected on a national or a market basis, covering a range of transactions to be defined (spot, forward, future, swaps and other derivatives). See Haq, Kaul and Grunberg 1996, Spahn 1996, Mendez, 1997, Patomäki and Denys 2002)
Global environmental taxes	Tax on commercial use of hydrocarbon fuels according to their carbon content; tax on international air passenger mileage and freight transport. See Pearce 1991, Poterba 1991 and Cooper 1998.
Global lottery or Global Premium Bond	Global lottery operated through national state-operated and state-licensed lotteries, with proceeds shared between national participants and an independent foundation established in conjunction with UN. See Ahde, Pentikäinen and Seppänen 2002. Global premium bond, parallel to national bonds with lottery prizes..
Creation of new Special Drawing Rights (SDRs)	New round of creation of SDRs as approved in 1997 but not yet ratified, with donor countries making their share available for development

	purposes. See Soros 2002.
Increased private donations for development	Measures to encourage private funding of development through UN agencies. Global funds. Corporate sponsorship. Internet.
International Finance Facility (IFF)	Long-term, but conditional, funding guaranteed to the poorest countries by the donor countries. Long-term pledges of a flow of annual payments to the IFF would leverage additional money from the international capital markets. See HM Treasury and Department for International Development. 2003.
Increased remittances from emigrants	Logistics (reducing cost of remittances), financial institutions (encouraging repatriation) and citizenship rather than residence basis for taxation. See Bhagwati and Hamada 1982, Mirrlees 1982, Bhagwati and Wilson 1989, and Solimano 2001.

Source: Atkinson (2004)

On the *currency transactions tax or Tobin tax*, it is observed that James Tobin first put the idea forward as a way of curbing financial volatility and not as a means to raise revenue for development. This second potential outcome is generally seen as a by-product (Nissanke 2003). While some have suggested a tax of 0.25 percent on each currency transaction, it is reckoned in the Atkinson report that a tax of 0.02 percent could easily raise US\$28 billion in a year. While this tax is expected to generate a double dividend through a reduction in foreign exchange speculation as well as revenue generation, there is still a lot of debate about it. The debate revolves around the technical feasibility of it, largely in view of the fast development of financial markets. It is not clear how the various financial markets of the world will be affected, particularly if the introduction is not universal.

The main argument for *global environmental taxes* is also the expected “double dividend” as a result of both generating revenue and helping reduce environmental damage. The argument has been made at the national level for corrective taxes on environmental external diseconomies coming from the damage done to the environment. It is estimated that a tax on the consumption of hydrocarbon fuels that harm the environment will have a positive allocational effect as consumers switch spending away from polluting goods towards those causing less or no environmental damage. In view of the desirable nature of such a switch, the world obtains both the revenue and the environmental gain. “A global tax on carbon use at a rate equivalent to 4.8 cents per US gallon (approximately €0.01) levied only on high-income countries could indeed raise US\$50 billion a year” (Atkinson 2004).

On the *global lottery*, (see Addison and Chowdhury 2003), it is observed that the use of these to raise funds for public sector projects is now commonplace. It is estimated that about US\$120 billion is realized yearly from world sales of gaming products. Under the leadership of President Martti Ahtisaari of Finland, a proposal has been made by the Crisis Management Initiative for national lotteries to run national versions of a global lottery game. It is proposed that a part of the net proceeds will be transferred to the United Nations for development projects throughout the world, and this is expected to yield about US\$6 billion annually. The main problems expected here are in terms of how low-income persons in developed countries may relate to this compared to the higher income individuals who may not show as much interest. There may also be difficulty arising from the competition with national lotteries.

The campaign for the issue of development-focused *Special Drawing Rights* (SDR) by the International Monetary Fund (IMF) has been on the development agenda for many years. This was certainly reflected by the Brandt Commission's report (1970). SDRs are international finance instruments created for the purpose of providing an increase in the world stock of monetary reserves from time to time without making countries run surpluses or deficits. Indeed the idea behind the SDR is that large imbalances force countries to incur costs in earning or borrowing reserves, and this should be contained with the IMF allocation of SDR. Recent attention has focused on how SDR might be used for development finance as new allocations of SDR to developed countries may be donated to the funding of global public goods and to poorer nations directly. It is estimated that an amount of \$25-30 billion could be raised from a new allocation, and this may be repeated regularly (Aryeetey 2004).

The UK *International Finance Facility* proposal is intended to be a long-term but conditional funding guaranteed to the poorest countries by the developed countries. The target is to raise the amount of development aid from just over \$50 billion a year in 2003 to \$100 billion per year in the years up to 2015 so that the MDGs can be achieved. In addition to being a significant increase in annual ODA for a limited period, it represents a pre-commitment to provide aid that allows the promises to be securitized. It also allows a substantial immediate increase in development spending. This facility effectively 'front-loads' long term aid flows. It has the advantage of not requiring universal agreement. It is generally seen as a simple and relatively unproblematic way of providing development finance. Most of the concerns expressed about it are to do with the absorptive capacity of recipient countries and what might happen to their macroeconomic conditions as a result (Mavrotas 2003).

The idea of canvassing for *private donations* for international development has been spurred on recently by such initiatives as the UN Foundation set up by Ted Turner and the Gates Foundation by Bill Gates. While it is acknowledged that donations to charities are a well established practice in the developed world, the use of such donations for long-term development is not that well established. In the U.S. more than 1.5 percent of national income is given to charitable causes. In examining the

potential for expanded private donations for international development, (see Micklewright and Wright 2003), the focus is on more generous tax incentives and various measures to encourage payroll giving, and the channelling of these donations into some global funds.

*Remittances* from migrants rose from US\$15 billion in 1980 to \$80 billion in 2002 worldwide. They are second to only foreign direct investment as a component of external resource flows. Such remittances are used to finance consumption as well as for providing social protection in poor countries. They may also be a source of finance for capital formation helping to provide community infrastructure as well as funds for the finance of new enterprises. It is reckoned that the largest obstacle to further rapid expansion in the flow of remittances is the cost of such transfers. Solimano (2003) has estimated that total charges, including foreign exchange costs, for sending remittances through money transfer operators varies extensively by country of origin and destination and these could go as high as 14% for transfers from the U.S. Bringing such costs down in a more competitive transfer market is expected to yield a lot more remittances.

## **6. Hard and Soft Options for Financing African Growth and Development**

In this discussion of hard and soft options, as indicated earlier, I refer to the mobilization of domestic resources as the hard options in view of the significant structural and policy changes required for meaningful outcomes to be observed. Soft options refer to the additional resources that may come from re-adjusting developed country interests. Their availability does not in any significant way affect the economic structures of the donor countries. It is important to emphasize the point that Africa's future growth and development has a much larger scope than the MDGs require. That's what makes the hard options imperative.

### ***The Hard Option of Generating Financial Resources from Domestic Assets***

There are essentially two things to be considered here, as we leave out the trade expansion discussion. The first is the financialisation of the significant household assets in order to enhance the flow of private resources. The second is a re-orientation of formal financial institutions to support the marginal client. Even though generating public savings is important, it is considered here to be inherent in any sound macroeconomic reform programme.

#### **a) Financialisation of Household Assets**

The composition of household assets reflects the return on different assets, the covariance structure of risks associated with the different assets, liquidity constraints, transaction costs, and production interactions between the different assets. Hence it is possible to draw conclusions about the financial environment

within which households operate by examining the composition of their portfolios. It may be noted that the economic turmoil that has characterised many countries in the last two decades has established the role of macroeconomic phenomena, as well as unstable politics, on household asset choice (Nissanke and Aryeetey 1998). The choice is also affected by the cultural, demographic and other socio-economic characteristics of their communities. The agricultural production cycle and the risky environment within which they live create an urgent need for liquidity. The need for liquidity puts a premium on relatively liquid assets, often dictated by the seasonality of agricultural activity and the associated rural household income.

Is the predominance of non-financial assets in household portfolios a simple consequence of extremely low expected returns to holding financial assets? This brings into focus the role of interest rates and how they are perceived in small African economies in relation to the return on other assets. Various studies of saving in sub-Saharan Africa have come up with inconclusive evidence of how interest rates influence saving (Mwega et.al. 1990, Oshikoya 1992). Obviously pervasive market failure in Africa makes the deposit rate an inappropriate tool for gauging the expected direction of people's preferences. Market failure forces the return on other assets to assume a greater role in asset allocation.

As households weigh the decision to put wealth into particular assets, the alternatives that they confront come with costs that are intrinsic to the transaction. One important source of such costs is incomplete information. Here, it may be noted that the nature of information possessed by depositors and deposit-takers as well as contract enforcement possibilities on the financial markets are crucial. If the transaction cost of holding a financial asset is perceived to be too high because there are no credible institutions, other assets would be given a preference.

What the above explanations suggest, in terms of policies and programmes to assist the process of making households assets financial are as follows:

- Reduce the risks associated with rural production (e.g. seasonality of rainfall) possibly through improved irrigation and other infrastructure, and technology application. This will reduce significantly the higher liquidity preference of households, at the same time that incomes go up in the medium term. Credit is often useful for reducing the idiosyncratic risks of poor households.
- Stabilise the macroeconomic environment that ensures that the returns on financial assets are relatively stable and predictable.
- Reduce the transaction costs of holding financial assets. Developing institutions that are not too far away from rural households and yet are cost-effective is the most sensible thing to do. This is what makes appropriate forms of microfinance essential.

In order, however, for any increases in the financial assets of rural households to benefit the overall development of the larger economy, it is important that institutional developments that take place are linked to the rest of the financial

system in an integrated manner. The microfinance institutions will need to have a link with both the banking institutions and the informal institutions where they exist in order to be effective (Nissanke and Aryeetey 1998).

#### b) Enhancing Microfinance through Greater Linkage to Formal Institutions

In the earlier discussion of decentralization as a way of reaching marginal clients cost-effectively, we placed emphasis on known practices elsewhere that have yielded good outcomes, including the keeping of lean structures, accountability and incentives for increasing operational efficiency, streamlining of operations, and outsourcing and networking (See Wisniwski and Hannig, (1998)).

##### *1. The Use of Lean Structures*

Keeping structures lean, particularly in rural areas, has led to substantial reductions in administrative costs in a number of places. But this cannot be pursued at the risk of neglecting essential aspects of the business of providing financial services. For lean structures, it is essential to have bank staff members that have above-average information to be used for making appropriate decisions, regardless of how far away they are from the centre. The experience of Hatton National Bank (HNB) in Sri Lanka illustrates how this may be achieved. HNB made important adjustments in its general rural operations – in the selection and training of staff and adapting deposit products to the programs' target clientele, in order to build a sustainable microfinance program.

The functional and operational structure of HNB takes advantage of external economies available from existing infrastructure of established branch offices. HNB senior management has shown continuing commitment to its microfinance program and established a clear career-development path for the staff selected to carry out the program. As the general rural credit program is integrated with regular branch operations and HNB takes advantage of external economies from existing infrastructure in its branch offices, a cross-subsidy from other bank operations may exist.

Expansion depends on availability of knowledgeable mainstream bankers from regular operations and the ability to use the physical facilities and infrastructure of an HNB branch as the anchor for operations of other rural units. The latter is based on exploiting external economies in operations and facilitation in communications, reporting, accounting and internal control systems. Additional coverage of rural areas in a regular branch's market area has been achieved by opening more rural units attached to the branch.

The virtual lack of differentiation in the pricing of regular rural loans and deposits raises the issue of whether transactions costs are being adequately covered. This is not an easy issue to address since the rural loans are not isolated from the rest of regular banking operations. In theory, recovery of transaction costs should be managed with a transaction fee, lower interest rate or adjusting minimum deposit

balance to qualify for interest payment. A clear objective and well-defined basis for motivation are core elements of successful microfinance programs. Institutional commitment, operating autonomy and a management environment conducive to responsive business decision is indispensable.

## *2. Accountability and Incentives for Increasing Operational Efficiency:*

The idea behind the creation of profit-centres within existing banks is that those centres will not be over-burdened with the 'excess baggage' of the main organization. By having such centres, it is expected that there will be a transparency of costs and that those involved at the centres will have a higher responsibility to perform. There are several examples in the microfinance literature about these attempts to improve upon operational efficiency, and while the best known are found in Asia, it is worth noting that recent innovations in Ghanaian rural banking offer some useful insights into how these are organized.

The biggest lesson to be drawn from the experience of the Atwima-Kwanwoma Rural Bank in the effort to introduce *susu* operations to its clients is the fact that the institution was willing to learn from the informal sector, adopting from informal savings collectors the practice of making daily collections. The daily contact with clients and potential clients through the *susu* collector facilitates easy marketing of the bank's products to several thousand people on a regular basis. The personal contact between the collector and the client is known to have influenced significantly deposit flows and sizes (Aryeetey 1994).

*Susu* collectors have generally been known to have lower transaction costs per each dollar collected from depositors than regular commercial banks (Aryeetey 1994), and when banks have adopted the practice their client base has expanded considerably. At the Nsoatreman Rural Bank, which also introduced *susu* services to clients using contracted independent collectors, each *susu* collector was able to expand the client base from 150 to 200 in a year. The expansion in total deposits was comparable to what has been achieved at the Atwima-Kwanwoma Rural Bank.

## *3. Streamlining of Operations*

It has been considerably difficult for many banks to introduce new technology into the delivery of financial services to the poor in many developing countries. Aside from the known hardware problems, the difficulties arise from the dearth of critical information to be used in feeding the new technologies about financial transactions. It is interesting, however, that there are a number of initiatives that appear to have substantially overcome some of these known difficulties. A good example of the use of modern technology to reach small depositors is provided by Standard Bank in South Africa. The development of the facility was facilitated by the fact that the high costs of the ATM infrastructure ensure that the product's fees are prohibitive for the poor. Trying to contain the cost enabled Standard Bank to

develop a new electronic product to reach a lower income group than any other banks had previously. Having first set up a "downgraded" service, the bank later brought its E-Bank back into the main organization. The issue of whether or not to integrate services for the poor into regular operations is probably an important one to consider.

#### *4. Outsourcing and Networking*

There is ample evidence that outsourcing and the development of networks has become one of the commonest ways to decentralize the microfinance functions of banks. It often involves handing over key functions to other agents with greater experience and structures that have access to better information. In many countries, the use of self-help groups is a common way of achieving this arrangement. The experience of NABARD in India is insightful for discussions of the use of decentralized and effective institutions. There are a number of lessons to be drawn from the NABARD experience.

On the issue of why a bank should downgrade, it may be noted that formal financial institutions can be motivated to provide financial services to the poor, if they can achieve a cost-effective volume. The formal banking system has the technical expertise in financial services and management of financial resources, branches in rural and remote areas, regulation and supervision to ensure the safety of deposits, and funds to finance an expanding portfolio. What they lack is an orientation towards working with poor and underserved people. Using a lean structure that generates access to others is sensible and cost-effective.

The NABARD experience shows that advocacy alone may not be sufficient to widen the financial services to the poor. Convincing bankers to serve the poor also required a sustainable financial technology that could generate a large volume of deposits at low cost. In many environments, even a banker committed to serving the rural poor would find it difficult to cost-effectively manage large numbers of small deposits. Suitable product design, stream-lined procedures and appropriate delivery technology can drastically reduce transaction costs and default rates.

How important is Government Support in delivering services with a lean structure? Government support is critical. Raising the programme to the level of a national priority and making it highly visible ensures that organizations that are involved are competent. Another chief task is to build the capacity of formal financial institutions to implement the technology. It is obvious that designing and launching such a program is not easy; it is best to start small and test out concepts and models. We learn from the NABARD experience that apart from capacity building and advocacy, banks initially need financial incentives such as refinancing and risk funds until they are assured of the soundness of the proposition. The experience also shows that programs will thrive in a climate of

non-interference from the political establishment. Training groups to understand this can help them remain apolitical.

### *The Soft Option of Attracting Additional Aid*

The literature on aid to Africa suggests that there have been two main constraints to an expansion in aid to the region. These are (a) doubts about the effectiveness of aid to a number of countries, and (b) related to that, 'aid fatigue' which is reflected by the perception in donor governments and countries that Africa may have a bottomless pit for drawing aid.<sup>9</sup> But there are studies that show that different types of aid have varying levels of effectiveness, while different donor institutions are able to make varying impacts in different types of environments. What some of these studies and experiences suggest is that greater specialisation can help improve the effectiveness of aid (Carlsson et.al. 1998). It certainly stops the current situation of many donors running over one another and makes aid co-ordination even easier. Greater effectiveness following specialisation can also help place a lid at the bottom of the pit. This in turn can justify the needed expansion in aid flows. So the ultimate question for strategizing becomes how to achieve the greater specialisation. The following proposals are put forward:

- Multilateral aid agencies, such as the World Bank, the African Development Bank and the European Union need to begin paying greater attention to aid that seeks to transform the infrastructural base supporting intra-regional flows of goods and services. Currently IBRD loans and IDA grants to sub-Saharan Africa amount to some \$37 billion a year; and the amounts have stayed at the same level for close to a decade. These were spread in 16 different sectors, from agriculture to water and sanitation. Some of the largest beneficiary sectors were agriculture and transportation. This is not surprising considering the difficulty that most countries have with financing road construction. If the total IBRD and IDA facilities were raised by an additional \$5 billion annually this would cover some 12.5% of the estimated additional financing requirement of the region.

It is proposed that for the purpose of specialisation and in order to boost growth, an increasing proportion of this amount be devoted to regional projects in the sectors of electric power and other energy, oil and gas, telecommunications and transport. This would improve immensely the effectiveness of World Bank lending to Africa as the specialisation leads to greater efficiency while permitting greater cross-border co-operation and trade. The funding going to countries may be devoted to supporting the

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<sup>9</sup> See Journal of African Economies, Vol.8 No.4, December 1999. This is a special issue based on papers commissioned by the Economic Commission for Africa on aid effectiveness. The papers recognise the fact that the effectiveness of aid is enhanced by the prevailing policy environment as well the appropriateness of the institutional environment in which aid is applied. In an inappropriate environment additional aid is much less useful.

productive sectors of agriculture and industry, and some social sector activity. It is important to emphasise the fact that it is the transformation of economic structures that will make the most impact in the campaign to reduce poverty. The African Development Bank and the European Union should also devote greater resources to promoting regional projects in the area of industry and environment. There is no doubt that such a re-focus of the institutions will require a re-writing of their articles of agreement but that can be arranged with participation of sub-regional bodies.

- Bilateral aid agencies may continue to direct a greater share of their country assistance to social sectors. A number of studies (Carlsson et.al. 1997) show that bilateral assistance in the social sectors have tended to be more effective than multilateral institution interventions. Currently about 50% of DAC support goes into education, health and population, other social infrastructure and economic infrastructure. The rest goes into production, multisector activities, debt relief, programme assistance and emergency aid. Through interaction with various civil society organisations, some bilateral organisations have had a visible impact in social sector interventions. Again many of them have had greater positive impact in some countries than in others.

By common agreement with African countries, it could be organized for various 'link arrangements' to be developed between specific countries to go into 'partnerships for development' after an increase of 50-100% in the total DAC assistance to Africa. A 50% increase will provide another \$14 billion for the pot, which together with the proposed World Bank support will make about 95% of the annual financial requirement. Within the proposed partnerships, focus will be on the social sectors for human capital development mainly and these may draw up to 70% of the partnership budget. The rest may be allocated to domestic infrastructure development, particularly roads, railway systems and other internal communications infrastructure.

### ***The Hard Option of Attracting FDI and Other Private Capital***

Long term growth and development requires long term private capital. Initially the objective in attracting private capital is to make up for the remaining 5% of required external funds. This share should then rise steadily to over 70% of net capital inflows as official assistance is reduced in the long term. While quite a lot has been written about how to attract foreign private capital, with emphasis on country risk minimisation, the development of infrastructure, appropriate macroeconomic policies with particular reference to stable exchange rates, etc. there are also opportunities for African states to do a bit more beyond the standard recommendations. FONDAD (1999) indicates that improving information flows to investors is the first thing that African countries must do. They provide a list of approaches to removing structural barriers to FDI, measures for stabilising

portfolio flows including stable institutions for contract enforcement and the need to improve credit ratings and the macroeconomic situation.

It is worth mentioning a piece of work titled “How can sub-Saharan Africa attract more private capital inflows?” by Bhattacharya et.al. (1997). They suggest that “sub-Saharan Africa has no recourse but to tap private foreign capital to raise productivity levels necessary for sustained increases in living standards”. They expected this to be difficult since many Asian and Latin American countries that were growing rapidly and far ahead of most African countries in terms of financial infrastructure were also targeting the same sources. They suggest that most African countries will have to undertake speedy policy and structural reform to attract private flows. They point out that at the micro level, sub-Saharan countries will need to take concerted action on many fronts:

- improve infrastructure;
- strengthen banking systems;
- develop capital markets by accelerating the pace of privatization and broadening the domestic investor base;
- formulate an appropriate regulatory framework and a more liberal investment regime;
- introduce competitive labour market policies while creating and maintaining institutions for upgrading human capital; and
- reform the judiciary system and contain corruption.

In concluding, they stress the point that “a piecemeal approach, even one including tax holidays and other investment incentives, is unlikely to sway investor decisions and attract international resources on a sustainable basis”. They also point out that “In sub-Saharan Africa, economic characteristics like output growth, openness, relative stability of real effective exchange rates, low external debt, and high investment rates have encouraged private capital flows. The first three of these have been crucial for drawing in FDI and the last two factors, coupled with output growth, have been particularly important for obtaining foreign private loans”.

While it is possible for one to throw one’s arms up in the face of the obviously daunting task, there are also clear indications of the things that need to be done at the minimum. There are three things that are non-negotiable in this regard:

- Countries must have a strategic framework for industrial development and make clear choices about where and how they want foreign participation; these choices can then be reflected in the various incentive packages that countries may offer.
- Countries must have fairly stable macroeconomic regimes, governed in a transparent manner that keeps exchange rates stable. The approach to exchange rate determination must not be dogmatic but based on country capacity and its position in the world market.

- The financial systems in African countries must be made more robust and in tune with global developments; thus there is no question about whether capital accounts should be opened, but more a question of the extent and the conditions under which this should take place.

The following suggestions are about some of the conditions that must prevail in both the banking sector and capital markets in order to facilitate the relaxation of capital account regimes, making such relaxation incremental and based on the day-to-day experience of countries, as well as the experiences of others. China's experience in this regard is very important. It is crucial that governments seek to improve the supervision and regulation of their banking sector by considering the appropriateness of such instruments or combinations of them, including

*a) Asset Regulation:* In regulating assets they should be designed not to homogenise all banks to some common pool of risk since banks are characterised by differential investment opportunity sets (e.g., rural banks versus urban banks).

*b) Capital Regulation:* Capital regulation is a useful scheme in terms of reducing risk shifting incentives. When banks' incentives are regulated through capital requirements, this gives them the freedom to pursue the activities that are unique to their investment opportunity set with the attendant risk (unlike the asset regulation discussed above). However, capital regulation has only limited effectiveness in controlling risk incentives.

*c) Market-Based and Incentivized Regulation:* This may include incentive features of bank management compensation to make up for the deficiencies in the regulatory schemes involving bank capital and assets. Bank regulation can be more efficient if it takes account the incentive features of compensation in pricing deposit insurance and disciplining bank risk behaviour. Market discipline may also be a way to regulate banking systems. Market-based discipline may come from globalisation. The discipline of the global market forces authorities to be more open and transparent. The policy implication is fairly straightforward. Encourage entry by foreign banks into Africa as a mechanism for pressure and market discipline. This is related to the issues of bank deconcentration and privatisation.

In order to enhance the capacity of the fledgling capital markets to attract private capital from outside, it is important that steps are taken to address the following:

*a) Public Confidence and Informational Efficiency:* Public confidence is fostered by an even playing field, with strict enforcement of existing rules. There ought to be an independent judiciary strongly enforcing and protecting rights. The government's role is vital in this regard in ensuring enforceability of private contracts and accounting procedures and legal standards.

*b) Efficient Capital Market Regulation:* At the heart of capital market regulation is investor protection, particularly small participants in the market. Small

investors need to be properly protected through strict enforcement of securities laws and regulations. African stock markets can harmonise laws and regulations toward international standards. Government regulation of securities markets should be more of an oversight function over self-regulatory agencies, such as the stock exchanges and brokerage industry.

*c) Capital Market-Based Privatisation:* Capital markets can be an important avenue for privatisation. Such programmes obviously contribute to the depth of the stock markets through increased supply of listed companies. Capital market-based privatisation provides an improved chance of fair pricing of the enterprises, and hence serves as an important means of de-politicising the privatisation process. In addition, privatisation through local capital markets allows for local investor participation and hence enhanced diversity of ownership of the economy's resources.

*d) Regionalisation of Capital Markets:* One way to address the thinness and illiquidity of African capital markets is for the various countries to pool resources for regional co-operation and capital market development. Regionalisation of African stock markets should enhance mobilisation of both domestic and global financial resources to fund regional companies, while injecting more liquidity into the markets. The francophone example is worth looking at.

*e) Human Capital Development:* Global capital markets have become highly sophisticated in recent years with the advancing information technology. They are increasingly characterised by advanced and exotic securities, including a variety of derivative securities, demanding that market participants stay abreast of recent developments in financial theory and practice. Adequately trained financial manpower should be at the centre of capital market development in Africa.

### ***The Not-So-Hard Option of Making Debt Relief Lead to Increased Resources for Investment***

As seen earlier, the main problems with the enhanced HIPC initiative is that countries will continue to borrow even as they receive relief in order to settle other obligations in the pursuit of poverty reduction goals. If payments on these slow down growth, as is expected, making an exit from the debt overhang becomes extremely difficult. The main question is how can debt relief be made growth-enhancing which should then be made to lead to poverty-reduction?

- Debt-relief must be recognised by creditor countries as additional to new and increased ODA with a focus on enhancing and sustaining both growth and poverty-reduction explicitly. It is important that creditor countries do not take out of ODA funds to offset their commitments to the enhanced HIPC initiative.

- Making debt-relief pro-growth requires that relief must come early rather than later. Noting that interim debt relief is possible with interim PRSPs under the enhanced HIPC, the tension between quick debt relief and comprehensive country-owned poverty-reduction strategies is still quite real as countries divert their attentions and human resources for long periods to producing PRSPs at the expense of comprehensive medium and long term development frameworks. The solution to this problem is to make countries focus on their medium and long term development frameworks, showing the anticipated growth paths and how these provide for poverty reduction. Since many countries have already invested significantly in those medium and long term development frameworks,<sup>10</sup> speeding up the process of qualifying for enhanced HIPC support will simply be a matter of modifying (where necessary) the existing medium and long term development frameworks to make the poverty reduction strategy explicit and credible. The poverty reduction strategy must be embedded in a long term growth and development framework that provides for structural transformation. Indeed that is the only way poverty-reduction is going to be sustained.
- It is important that a part of the freed-up resources from debt relief are channelled to the private sector for job creation purposes. Governments have to exploit such mechanisms as debt-equity swaps in as far as they promote private investment.
- Improved debt management in African countries is very essential. Governments need to monitor closely future borrowing in order to prevent a re-occurrence of the debt problems. Borrowing must be in response to economic developments and based on ability to foster growth while reducing further poverty.

## **7. Summary and Conclusions**

Despite the need for large multilateral support, it is clear that new actions have to be initiated by both African countries and their development partners to fill the identified financing gap. I have suggested here that while it is essential to mobilise all domestic resources or the task of reducing the resource gap, the structure of African economies would make this feasible only in the long term, hence the urgent need to mobilise external resources in the short-medium term.

In order to first reduce the resource gap and then attract the required external resources, have been called upon to improve the generation of financial resources from domestic assets in the medium-long term by taking steps to reduce the risks associated with rural production and stabilising the macroeconomic environment that ensures that the returns on financial assets are relatively stable and

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<sup>10</sup> This view was expressed by Mr James Wolfensohn, President of the World Bank, while launching the Comprehensive Development Framework, Washington, 1999.

predictable. They are also expected to initiate policies that lead to a reduction in the transaction costs of holding financial assets through the development of appropriate institutions, including microfinance institutions.

The urgent need attract additional aid is given considerable attention in this paper. The objective to make aid provide about 95% of the new required external finance after reducing the resource gap through enhanced domestic resource mobilization and trade, while the remainder is drawn from the private sector. By 2015, most inflows should have private origins and aid would be entirely absent.

Beyond increased aid, however, faster longer term growth and development require increasing foreign direct investment and other private capital. While this can immediately make up for the remaining 5% of required external funds, the objective should be to make private capital provide 70% of external finance in the medium term and 100% in the long term. Africa has to tap private foreign capital in order to raise the productivity levels necessary for sustained increases in living standards. For this, countries will need to take concerted action on many fronts including improving infrastructure, strengthening banking systems, developing capital markets by accelerating the pace of privatisation and broadening the domestic investor base, developing an appropriate regulatory framework and a more liberal investment regime, introducing competitive labour market policies while creating and maintaining institutions for upgrading human capital, reforming the judiciary system and containing corruption. It is important that these are carried out in a comprehensive framework and not in a piecemeal manner.

Our final point has been that the development partners should let debt relief enhance growth. I have suggested that the current framework for debt relief (i.e. enhanced HIPC Initiative) will have to be improved to enable it respond adequately to various development issues. The main issue is how to make debt relief growth-enhancing in order to facilitate the achievement of sustained poverty-reduction. I have suggested that debt-relief must be recognised by creditor countries as additional to new and increased ODA with a focus on enhancing and sustaining both growth and poverty-reduction explicitly. It is important that a part of the freed-up resources from debt relief is channelled to the private sector for job creation purposes. Having made the above points, it may be observed that the 100% debt write-off that UNCTAD and others support is not a bad idea. The principle is hardly contested currently.

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